State of play interest rate benchmarks reform:
Adaptation of derivative contracts

June 2021

ISDA Safe, Efficient Markets

ISDA IBOR Fallbacks

Introduction to Benchmark Fallbacks Video:

http://assets.isda.org/media/bb017c50/3a79d84b-mp4/ (may also be viewed at https://www.isda.org/2020/10/23/video-introduction-to-benchmark-fallbacks/)

ISDA IBOR Fallbacks

- ISDA published the IBOR Fallbacks Protocol and finalized the IBOR Fallbacks Supplement (Supplement 70 to the 2006 ISDA Definitions) on October 23, 2020
- The Protocol was effective three months later on January 25, 2021 and the Supplement was 'deemed published' and effective on the same date
- All new derivative transactions that incorporate the 2006 ISDA Definitions and that are (or were)
  entered on or after January 25, 2021 include the new triggers and fallbacks set out in the 2006 ISDA Definitions as amended by the Supplement
  - Parties will not need to take any additional steps to include the new fallbacks when entering into new derivative transactions that incorporate the 2006 ISDA Definitions after 25 January 2021
- The Protocol allows parties to include the terms of the Supplement in their existing Protocol Covered Documents, thereby applying the new triggers and fallbacks to derivative transactions entered into prior to January 25, 2021

ISDA IBOR Fallbacks

How the IBOR fallbacks work in practice:

- The RFRs for each currency are adjusted (1) to reflect the fact that the IBOR is a term rate and (2) to factor in the bank credit risk premia and other factors embedded in the IBOR
  - The RFRs are term-adjusted using the compounded setting in arrears rate approach and the spread adjustment
    is calculated using the five-year historical median approach
  - The compounded setting in arrears rate is the RFR observed over a period (generally equivalent to the relevant IBOR tenor) and compounded daily. The period over which the RFR is observed is backward-shifted to allow for the rate to generally be known prior to the relevant payment date

The five-year historical median approach to the spread adjustment is based on the median of the differences between the IBOR and the compounded RFR for that tenor calculated over a static lookback period of five years prior to the Index Cessation Event. The spread adjustment will be added to the compounded setting in arrears rate (but will not be compounded itself)

Bloomberg is producing and publishing the compounded setting in arrears rate, the spread adjustment and the “all in” fallback rate (i.e. the compounded setting in arrears rate plus the spread adjustment) for all relevant IBORs

More information about the calculation of the fallback rates is available in the ISDA/Bloomberg/Linklaters Fact Sheet at http://assets.isda.org/media/d3cb1711/42ca5ad8-pdf/

Fallback Terminology

- ISDA's fallbacks for derivatives took effect on January 25th. As a result of the IBOR Fallbacks Supplement to the ISDA Definitions, any new transactions referencing LIBOR or another covered IBOR contain the fallbacks to the adjusted RFRs plus the spread, as published by Bloomberg. Counterparties who have adhered to the IBOR Fallbacks Protocol also have these fallbacks in their legacy transactions with each other
- The announcement on March 5th constituted an Index Cessation Event under the IBOR Fallbacks Supplement and the ISDA 2020 IBOR Fallbacks Protocol for all 35 LIBOR settings. Some have referred to this as triggering the fallbacks
- However, the fallback rates do not apply as the floating rate in derivatives contracts until the actual dates of cessation or non-representativeness (as applicable), or, in the case of 1 week and 2-month US dollar LIBOR, the date when shorter and longer tenors cease or become non-representative

  - The first London Banking Day on or after January 1, 2022 for GBP, CHF, EUR, JPY (expected to be January 4, 2022)
  - The first London Banking Day on or after July 1, 2023 for USD (expected to be July 3, 2023)

IBOR Fallbacks Protocol

- Over 14,100 adherents
  - Most in the US, followed by the UK but adherents represent over 100 jurisdictions globally
  - Over 75% of adherents had never adhered to an ISDA protocol before
  - Over 85% of adherents are not ISDA members
  - View list of adherents at https://www.isda.org/protocol/isda-2020-ibor-fallbacks-protocol/adhering-parties
- Based on US CFTC staff analysis of information from ISDA and data from swap data repositories, legal entities that account for close to 95% of gross notional outstanding cleared and non-cleared interest rate swaps have adhered to the Protocol. About 69% of notional outstanding of non-cleared interest rate swaps now have the updated ISDA fallback language. See https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement022321#_ftn4
- The UK FCA estimates just over 85% of non-cleared sterling LIBOR-referencing swaps now have effective fallbacks in place because of dual-sided adherence to the Protocol. 99.7% have at least one-sided adherence. Adding that 85% coverage to cleared swaps and futures means 97% of sterling interest rate derivatives are covered by fallbacks. See https://www.fca.org.uk/news/speeches/libor-are-you-ready-life-without-libor-end-2021

Bilateral Templates

ISDA has prepared the following templates relating to the application of the IBOR Fallbacks Protocol. These templates allow parties to:

- Bilaterally adopt the IBOR Fallbacks Protocol (short form and long form)
- Amend the terms of the IBOR Fallbacks Protocol in existing agreements
- Exclude documents from the scope of the IBOR Fallbacks Protocol
  - E.g., to ensure the triggers and fallbacks in the relevant contract match those in a related hedge product
- Include additional documents within the scope of the IBOR Fallbacks Protocol
- Disapply the ‘pre-cessation’ trigger set out in the IBOR Fallbacks Protocol in existing agreements
- Apply the terms of the IBOR Fallbacks Protocol to new agreements that do not incorporate the 2006 ISDA Definitions (and disapply the ‘pre-cessation’ if they choose to do so)
- Disapply the ‘pre-cessation’ trigger set out in the IBOR Fallbacks Supplement in new confirmations that incorporate the 2006 ISDA Definitions

Additional Information

For additional information from ISDA relating to financial benchmark reform, visit the ISDA website at:
https://www.isda.org/2020/05/11/benchmark-reform-and-transition-from-libor/

For additional information about the IBOR Fallbacks Protocol and related documentation, including information about how to adhere to the Protocol, visit the ISDA website at:
https://www.isda.org/protocol/isda-2020-ibor-fallbacks-protocol/