# Update on LIBOR Transition

Last week, ISDA announced its IBOR Fallbacks Protocol ("Protocol") and updates to the 2006 ISDA Definitions through the IBOR Fallbacks Supplement ("Supplement") to include robust LIBOR fallback language in anticipation of LIBOR discontinuance expected at the end of 2021.

Throughout this piece, we answer various questions that are relevant for financial institutions as they consider their own LIBOR Transition plans for derivatives as well as the lending book.

## What you should know

ISDA has released the following timeline related to the Protocol

| Tentative Timing for Fallback Implementation | |
|---|---|
| Launch of amendments to the 2006 ISDA Definitions and related protocol | **October 23, 2020** |
| Effectiveness of amendments to the 2006 ISDA Definitions and related protocol (between adhering parties) | **January 25, 2021** |

### LIBOR Fallbacks Documentation

**LIBOR Fallbacks Supplement**

http://assets.isda.org/media/3062e7b4/23aa1658-pdf/

**LIBOR Fallbacks Protocol**

http://assets.isda.org/media/3062e7b4/08268161-pdf/

**Protocol Adherence Process**

The Protocol will officially launch for adherence on October 23, 2020.

Once the Protocol launches, parties who wish to adhere to the Protocol can follow these step-by-step instructions to complete the adherence process:

http://assets.isda.org/media/3062e7b4/562d1a52-pdf/

**October 16, 2020**

Update on LIBOR Transition

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# FAQs

*Please note, all answers relate to USD LIBOR*

## What does the Protocol do to amend my legacy LIBOR-based transactions?

For those with existing derivatives contracts referencing LIBOR, the Protocol will enable parties to amend the terms of those transactions to include the amended 2006 ISDA Definitions, thereby incorporating proper LIBOR cessation fallback terms into their legacy LIBOR-based derivatives with other adhering parties to prepare for the discontinuance of LIBOR.

## Will adherence to the Protocol mean that the All-In Fallback Rate is immediately applicable?

No. The All-In Fallback Rate will not take effect until a LIBOR cessation event occurs.

## What is the fallback?

ISDA is updating its LIBOR definitions to replace the reference to the current ineffective fallback of polling reference banks with fallbacks that consist of converting to SOFR plus a spread as recommended by the Alternative Rate Reference Committee (ARRC). These new fallback rates will be calculated by adding the SOFR rate compounded in arrears observed during the relevant interest period, along with a spread adjustment, based on a five-year historical median of the differences between USD LIBOR and SOFR (the "All-In Fallback Rate") at the time of LIBOR cessation. Bloomberg will publish the All-In Fallback Rate.

## What are the USD LIBOR cessation events listed in the Protocol/Supplement?

The Supplement includes both permanent and pre-cessation events. A 'permanent cessation' event occurs when LIBOR will permanently cease to be published following a public statement or published announcement of such discontinuance. A 'pre-cessation' event is a public statement or publication of information by the regulatory supervisor for the administrator of LIBOR (currently, the Financial Conduct Authority) announcing that (i) the regulatory supervisor has determined that LIBOR in the relevant currency is no longer, or as of a specified future date will no longer be, representative of the underlying market and economic reality that LIBOR in the relevant currency is intended to measure and that representativeness will not be restored and (ii) it is being made in the awareness that the statement or publication will engage certain contractual triggers for fallbacks activated by pre-cessation announcements by such supervisor (howsoever described) in contracts.

## Will the Protocol amend all of my LIBOR based transactions?

For a Protocol amendment to be effective, both parties to the transaction need to adhere to the Protocol via ISDA's website. If one of the parties to the transaction chooses not to adhere to the Protocol, you will need to bilaterally amend the transaction to incorporate the amended LIBOR definitions or another benchmark.

## Is there a fee to adhere to the Protocol?

Most adhering parties in the regional and community bank space are not required to submit a fee to ISDA if it submits its Adherence Letter prior to the Protocol Effective Date, i.e. January 25, 2021. If an Adhering Party submits its Adherence

Letter on or after the Protocol Effective Date, it must submit a one-time fee of U.S. $500 to ISDA on or before submission of its Adherence Letter.

## Do we need to adhere to the Protocol by January 25, 2021?

Parties wishing to adhere to the Protocol should aim to adhere by January 25, 2021. Adherence after that date will result in a $500 fee due. Additionally, parties who have not incorporated proper LIBOR fallback terms into their agreements with Swap Dealers, whether through the Protocol or a bilateral amendment, by January 25, 2021, run the risk of impairing their ability to execute additional trades with those Swap Dealers until proper fallback terms are incorporated into legacy transactions.

## Can we complete bilateral agreements with parties who potentially will not understand or not want to adhere to the Protocol?

Yes. Derivative Path will issue guidance for entering into bilateral agreements with parties, such as end users with swaps, in a later communication.

## Will new LIBOR-based derivatives transactions automatically incorporate the new ISDA definitions that incorporate proper fallback terms?

New swap transactions entered into after January 25, 2021 will incorporate the new ISDA definitions automatically. Therefore, any LIBOR-based derivatives transaction entered into after January 25, 2021 will not need to be amended to incorporate fallback terms. The new ISDA definitions will not automatically be incorporated into new transactions executed before January 25, 2021 without adherence to the protocol or bilateral agreement.

## What should we do if a party wishes to replace LIBOR with an index other than SOFR?

If a party wishes to replace LIBOR with an index other than SOFR, you should negotiate an amendment to the swap transaction (and any related loan documents) to incorporate the alternate benchmark prior to LIBOR cessation.

## For banks with customer swap programs, what should we be communicating to our existing swap customers?

Engaging in early client communication is helpful to bring awareness of these important market changes to your customers. While you are performing your LIBOR transition analysis on your customer-facing transactions, we would consider some form of communication to educate your customers on the upcoming transition as a best practice.

Here is a sample communication you could consider sharing with end-user clients who have LIBOR-based swaps and loans currently outstanding and expected to be outstanding after 2021:

*Dear Client,*

*As you may know, the financial industry is planning for the discontinuance of the London Interbank Offered Rate (LIBOR) by the end of 2021 as a result of recent pronouncements from global regulators. The U.K. Financial Conduct Authority, which regulates LIBOR as a benchmark rate, along with U.S. regulators have announced that financial institutions and their counterparties should not expect LIBOR to continue beyond 2021. [BANK], along with other financial institutions, is in the process of preparing for the discontinuance of LIBOR and transition to the use of alternate reference rates (ARRs).*

*Our preparations have included a review of client agreements that may contain LIBOR terms. As part of this review we have identified 1 or more LIBOR-linked financial instruments between [BANK] and you, such as loans and/or interest rate swaps. We are contacting you to bring this to your attention and to inform you that we are taking steps to facilitate a transition away from LIBOR, which may include amending our agreements with you to address LIBOR's discontinuance.*

*No action is required of you at this time. In the coming months, we will contact you again with additional information about your loan, swap and/or other impacted financial instruments. In the meantime, we encourage you to familiarize yourself with the terms and conditions of your existing LIBOR based financial instruments that mature after the end of 2021, as well as the materials published by the various working groups convened by global regulators to inform market participants about LIBOR's discontinuance. This website (https://www.derivativepath.com/resources/libor-transition-resources) contains links to several working groups including the Alternative Reference Rate Committee (ARRC), the group convened by the Federal Reserve Bank of New York and tasked with selecting the benchmark interest rate to replace USD LIBOR, to help you begin to understand the impact of LIBOR discontinuance.*

*For more information, please contact your relationship manager or e-mail [BANK CONTACT].*

*Sincerely,*

*[BANK]*

## How do I ensure that I mitigate basis risk upon a LIBOR cessation event in my customer swap program?

If your bank runs a customer swap program, it is highly recommended that your loan, customer facing swap, and dealer facing swap all have compatible LIBOR fallback terms. You should review your underlying loan to be sure it contains LIBOR fallback language that allows for the same LIBOR cessation terms as the swap. Key terms you need to look for in loan language include: both pre-cessation and permanent cessation triggers; either reference to SOFR or flexible language that allows the bank to select the new benchmark; and a provision that allows for a spread adjustment to be applied to the new benchmark rate.

## Are there any updates for Hedge Accounting related to LIBOR transition?

Loan and swap customers may be inquiring on the accounting impact due to LIBOR transition. The FASB released ASC 848 Reference Rate Reform in March 2020 to address potential concerns on this topic. This guidance is applicable immediately and offers optional relief for users around loan modifications, continuation of hedge accounting despite changes to economic terms, and other points related to LIBOR. Although LIBOR fallback is not expected until the end of 2021, ASC 848 was written to allow constituents to proactively address their existing LIBOR exposure in loans, hedges, and other financial instruments through the use of a relief period available now expiring at end of 2022. To help in your discussions with your customers on this topic, please reach out to your DPI contact for further insight on this guidance.

# Questions?

Please contact our LIBOR Transition Team at **415-992-8200** or LIBORTransition@derivativepath.com.

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