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Alert

LIBOR Transition: ISDA 2020 IBOR Fallbacks Protocol

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In order to assist market participants in mitigating systemic risks associated with the cessation of key interbank offered rates ("IBORs"), including the upcoming cessation after December 2021 of the London Interbank Offered Rate ("LIBOR"), the International Swaps and Derivatives Association Inc. ("ISDA") published on Oct. 23, 2020 a supplement[1] to its 2006 ISDA Definitions ("IBOR Fallbacks Supplement" or "Supplement") and a protocol[2] allowing adherence and incorporation of the Supplement by market participants into existing covered agreements ("ISDA 2020 IBOR Fallbacks Protocol" or "Protocol").

Beginning Oct. 23, 2020, market participants may adhere to the Protocol in escrow (in a binding but nonpublic manner) so that the Supplement and Protocol will come into effect immediately on their effective date, which is Jan. 25, 2021 ("Effective Date"). All cleared over-the-counter and non-cleared derivatives entered into on or after the Effective Date that incorporate the 2006 ISDA Definitions and reference a covered IBOR will contain new fallbacks without further action by the parties thereto. While ISDA has expressed its support for broad adherence, the Protocol, like all ISDA protocols, is voluntary and firms may alternatively choose to make changes to their legacy contracts on a bilateral basis, or opt to keep their outstanding trades unchanged.

The Protocol allows market participants (whether or not they are ISDA members themselves) who are party to a non-cleared "Protocol Covered Document" (generally, ISDA Master Agreements, confirmations and credit support documents) to (1) incorporate all or some of the defined terms included in the Supplement and (2) include new fallbacks for a relevant IBOR (including for LIBOR) into the terms of any existing Protocol Covered Document. If a party adheres, the Protocol will only apply to Protocol Covered Documents entered into with other adhering parties.

From the Effective Date, the Supplement will provide robust fallbacks for all new cleared and non-cleared derivatives linked to IBORs that reference the 2006 ISDA Definitions, which include new fallbacks in the event of a permanent cessation of a relevant IBOR in respect of which there is a public statement or publication of information by certain specified entities that the relevant IBOR has or will cease to be published. The Supplement also contains new fallbacks for "LIBOR Rate Options" following a pre-cessation event. The Supplement generally provides that the IBOR will "fallback" to a term-adjusted risk-free rate for the relevant currency plus a spread published by *Bloomberg*[3] on the date of the first public statement or publication of information which constitutes a permanent or pre-cessation event. The Supplement also covers situations where a permanent cessation event and pre-cessation event occur simultaneously. In the case of U.S. dollar-denominated LIBOR, the Supplement uses the Secured

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[1] The Supplement may be found here.

[2] The Protocol may be found here.

[3] The *Bloomberg* Rulebook may be found here.

Overnight Financing Rate ("SOFR") administered by the Federal Reserve Bank of New York as its general fallback rate, which is the risk-free rate favored by the Alternative Reference Rates Committee ("ARRC") as a replacement to U.S. dollar-denominated LIBOR.

A party may adhere to the Protocol (either directly or through an agent) by completing and delivering a letter ("Adherence Letter") to ISDA which is substantially in the form provided by ISDA in the Protocol.[4] The Adherence Letter must be submitted to ISDA by a cut-off date which ISDA will set.[5] Between two adhering parties, the agreement to make the amendments contemplated by the Protocol will be effective on the date of acceptance of the later of the two Adherence Letters delivered, after which such agreement will form part of the mutual Protocol Covered Documents of both adhering parties. The Protocol is intended for use without negotiation, but shall not prejudice the adhering parties from amendments, modifications or waivers to any part of the Protocol Covered Document that the parties may otherwise effect in accordance with its terms.

As the market begins to move toward adherence of the Protocol and incorporation of the terms of the Supplement, investment managers may, particularly as the expected date for LIBOR cessation comes nearer, begin to see requests from their swap counterparties, banks and prime brokers either requesting mutual adoption of the Protocol or else incorporation of the new Supplement definitions in some other bilateral manner.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[4] You can find the form of Adherence Letter under Exhibit I to the Protocol here.

[5] ISDA will provide at least 30-days' notice of the cut-off date on its website (on the "ISDA 2020 IBOR Fallbacks Protocol" section) or by other suitable means. ISDA won't accept Adherence Letters after the cut-off date.