Newsletter | LIBOR Transition – Issue 7

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Welcome to Greenberg Traurig's LIBOR Transition Newsletter, where we provide updates, analysis, and occasional commentary on the latest developments relating to the highly anticipated phasing-out of LIBOR at the end of 2021 or *perhaps sooner*.

LIBOR Fallback Imminent: ISDA Protocol and Supplement Published

On Friday, Oct. 23, ISDA published the long-awaited ISDA IBOR Supplement and Protocol detailing the fallback procedures for LIBOR-based derivatives. As we previously noted in our last newsletter, the UK Financial Conduct Authority (FCA), the regulatory authority with jurisdiction over the LIBOR administrator, has stated that a LIBOR pre-cessation or cessation announcement would be forthcoming prior to year-end 2020.[1] However, the FCA was waiting for the publication of the ISDA IBOR Supplement and Protocol prior to making such an announcement to minimize its impact on the derivatives market. With the publication of the IBOR Supplement and Protocol on Oct. 23, it is expected that the FCA announcement will be forthcoming by year-end, thus beginning the transitional process to fallback rates for LIBOR and other IBORs. The FCA announcement will cause the fallback provisions under newer loan agreements that have adopted industry-standard cessation events to be triggered.

The publication of this long-anticipated Protocol and Supplement was delayed because ISDA sought antitrust clearance from the Department of Justice. The Department of Justice issued its business review letter on Oct. 1, 2020. The Supplement provides the fallback rates and procedures that will apply to derivative transactions once cessation or pre-cessation events are triggered. When made, the FCA

[1] Edwin Schooling Latter, Director of Markets and Wholesale Policy, Financial Conduct Authority, ISDA Webinar Conference, The Path Forward for LIBOR Transition (July 14, 2020).

announcement will cause at least one of these events to be triggered, depending on the exact nature of the announcement.

The Supplement amends the ISDA 2006 Definitions and will be incorporated into all derivative transactions incorporating the 2006 Definitions commencing Jan. 25, 2021.

The Supplement will be incorporated into existing derivatives contracts through the Protocol process. The Protocol process has been successfully utilized in the past to amend derivative contracts for regulatory purposes without engaging in contract-by-contract amendments. In particular, the Protocol process was efficient in modifying derivative contracts for Dodd-Frank and EMIR regulatory purposes after the financial crisis.

Under the Protocol process, adhering parties have their derivative contracts automatically amended without having to individually amend the contracts. The adherence can be electronic through the IHS Markit process by which derivative counterparties adhere to the Protocol electronically on Markit. All swap dealers are expected to adhere to the Protocol through Markit. End-users will be encouraged to similarly adhere through the Markit electronic process. End-users adhering on Markit will then be matched with adhering swap dealers, and all derivative contracts between the parties will be automatically amended to incorporate the Supplement.

ISDA and the FCA have stated that the derivatives clearinghouses have already accepted the provisions of the Supplement and are expected to immediately adhere to the Protocol. Accordingly, all cleared derivatives will be subject to these new ISDA fallback provisions set forth in the Supplement. Uncleared or over-the-counter (**OTC**) derivatives, however, are not subject to the Supplement unless both parties adhere to the Protocol or the parties agree to a bilateral amendment incorporating the Supplement in their derivative contracts. For OTC derivatives, the consent of both parties will be required to implement the provisions of the Supplement.

The Supplement provides that upon an "Index Cessation Event" SOFR will be the fallback rate in relation to USD (and SONIA will be the fallback rate in relation to GBP). An Index Cessation Event is the permanent cessation of LIBOR or announcements by the LIBOR administrator or the administrator's regulator (the FCA) that an IBOR has ceased or will cease to provide an IBOR permanently or indefinitely. Accordingly, the anticipated FCA announcement by the end of 2020 should constitute an Index Cessation Event for LIBOR (and presumably other IBORs) that will cause SOFR to become the fallback rate in relation to USD (and SONIA to become the fallback rate in relation to GBP) in derivative contracts subject to the Supplement.

The definitions in the Supplement include the spread adjustment that is needed for SOFR to approximate USD LIBOR and for SONIA to approximate GBP LIBOR. The spread adjustment is determined by reference to the spread adjustments published by Bloomberg Index Services Limited, which has been selected as the provider of term SOFR / SONIA and the spread adjustment. The Supplement also provides a fallback hierarchy if SOFR / SONIA or any other fallback is no longer permanently published. In relation to SOFR, the fallback rates are (i) any Federal Reserve Bank recommended rate; (ii) the Overnight Bank Funding Rate (**OBFR**) published by the Federal Reserve; and finally, (iii) the short-term interest rate target set by the Federal Open Market Committee and published on the Federal Reserve's website. Similarly, in relation to SONIA, the fallback rates to SONIA (published by Bloomberg) are (i) SONIA (published by the Bank of England rather than Bloomberg); (ii) the rate recommended as the replacement for SONIA by the administrator of SONIA (**GBP Recommended Rate**); and finally, (iii) the official bank rate as determined by the Monetary Policy Committee of the Bank of England and published by the Bank of England (**UK Bank Rate**).

The publication of the Supplement and Protocol were the long-awaited events that the FCA indicated would start the countdown to its public announcement of a LIBOR cessation or pre-cessation event before year-end. Whether the market is ready or not, the FCA's anticipated announcement will start the mandatory LIBOR transition for both the cash and derivatives market.

Read previous editions of GT's LIBOR Transition Newsletter.

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