

IBOR Transition and the ISDA Fallbacks Protocol FAQs

1) What is the Fallback language?

Fallback language refers to the contractual provisions that outline the process by which a replacement rate can be implemented if a benchmark, such as LIBOR, is no longer available. Updated fallback language needs to be included in legal agreements because the current IBOR fallback language does not contemplate a scenario where IBOR is permanently unavailable.

2) What are the ISDA and the ARRC?

The International Swaps and Derivatives Association (ISDA) is a professional association that promotes and improves the trading of swaps and derivatives.

The Alternative Reference Rates Committee (ARRC) is a group of private-market participants convened by the Federal Reserve Board and the New York Fed to help ensure a successful transition from USD LIBOR to their recommended alternative, the Secured Overnight Financing Rate (SOFR).

3) Is there a difference between the fallback language used in derivatives products and cash products?

Yes, the fallback language will differ between derivatives and cash products in addition to differences between cash products themselves. Industry bodies are working to develop robust fallback provisions for IBOR-referencing transactions. For derivatives, ISDA has amended the ISDA 2006 Definitions. For cash products, national working groups, such as the ARRC have published proposed fallback language to implement in new transactions referencing IBOR.

4) When is LIBOR going away?

On Friday March 5th, the FCA made an official statement on the end of LIBOR. The FCA has confirmed that all LIBOR settings will either cease to be provided by any administrator or no longer be representative:

- immediately after 31 December 2021, in the case of all sterling, euro, Swiss franc and Japanese yen settings, and the 1-week and 2-month US dollar settings; and
- immediately after 30 June 2023, in the case of the remaining US dollar settings

5) What is the ISDA Protocol?

The ISDA 2020 IBOR Fallbacks Protocol (Protocol) enables parties to amend certain Master Agreements; allowing an Alternative Reference Rate (ARR) to replace an IBOR and permit existing agreements to remain in place. The Protocol allows parties to amend ISDA Master Agreements and Non-ISDA Master Agreements – including Global Master Repurchase Agreements (GMRAs) and Global Master Securities Lending Agreements (GMSLAs).

6) Why does the ISDA Protocol impact loans?

Many commercial and corporate banking clients purchase derivatives products in order to hedge certain risks. A common over-the-counter (OTC) derivative transaction for these clients is to enter into an interest rate swap in order to hedge their interest rate risk. Both the loan documents and the interest rate swap may need to be amended to include updated fallback language. One way to update the swap agreement is through the ISDA Protocol.

IBOR Transition and the ISDA Fallbacks Protocol FAQs

7) What is being done to ensure that new OTC derivatives agreements are ready for the IBOR transition?

ISDA has published a supplement to the 2006 ISDA Definitions (the Supplement) that has incorporated new fallbacks for derivatives that reference IBORs. All new derivatives transactions entered into after January 25, 2021 and reference the 2006 ISDA Definitions reference the new alternative reference rates.

8) What about BMO clients that have legacy derivatives transactions?

The Protocol allows market participants to choose to incorporate the revisions to the 2006 ISDA Definitions into their legacy derivatives trades (trades entered into before January 25, 2021).

9) How does the Protocol work?

By adhering to the Protocol, parties adopt the updated benchmark fallback language contained in the Supplement for all their OTC derivative agreements unless the parties choose to exclude certain agreements from being amended by the Protocol.

10) When were the Protocol and Supplement published?

The Supplement and Protocol were published and launched on **October 23, 2020. Both took effect on January 25, 2021.** The Protocol will remain open for parties to adhere to for the duration of the transition.

11) Has BMO adhered to the Protocol?

Yes, BMO adhered to the Protocol in advance of its publication (in escrow), along with 237 other market participants in order to demonstrate our support for this mechanism to remediate legacy derivative trades. BMO chose to adhere because of the efficiency advantages of amending many bilateral agreements all at once.

12) Do all clients have to adhere to the Protocol?

No, clients do not have to adhere to the Protocol. If a client does not choose to adhere to the Protocol, then bilateral negotiations may be necessary to amend the transaction and implement a new rate.

13) Are the new ARR the same as IBORs?

No. The rates replacing IBORs, which are referred to as Alternative Reference Rates (ARRs), are fundamentally different in nature. ARRs, such as SOFR, tend to be overnight rates instead of term rates like LIBOR. In addition, ARRs tend to be secured, whereas LIBOR is unsecured and therefore incorporates an element of bank credit risk into the benchmark.

In order to make the transition possible for legacy agreements, when the market switches from LIBOR to SOFR, for example, a term adjustment and a credit spread will need to be added to SOFR to make the rates fungible for their use in derivatives and cash products.

14) Will the spread adjustment be the same for SOFR in cash and derivatives products?

The ARRC has recommended a spread adjustment methodology for cash products on a historical median over a five-year lookback period, calculating the difference between USD LIBOR and SOFR. This methodology aligns with ISDA's methodology for derivatives, and when applied, will make SOFR fungible with USD LIBOR.

IBOR Transition and the ISDA Fallbacks Protocol FAQs

15) What are the Spread Adjustments for LIBOR/SOFR?

Spread adjustments have been fixed as a result of the March 5th FCA announcement. The following chart outlines the LIBOR/SOFR spreads that are intended for use with fallback provisions should LIBOR be deemed unrepresentative:

LIBOR / SOFR Spreads		
Tenors	Bloomberg Ticker	Spread
Overnight	SUS000N Index	0.00644
1 Week	SUS0001W Index	0.03839
1-Month	SUS0001M Index	0.11448
2-Month	SUS0002M Index	0.18456
3-Month	SUS0003M Index	0.26161
6-Month	SUS0006M Index	0.42826
12-Month	SUS0012M Index	0.71513

16) Does the March 5th FCA announcement constitute a “Benchmark Transition Event” under ARRC recommended fallback language?

Yes. The announcement does constitute a “Benchmark Transition Event” with respect to all USD LIBOR settings under the ARRC-recommended fallback language.

17) If there were terms within the ISDA Supplement or Annex that were customized, would these revert to “standard” language by accepting this protocol?

If clients have included customized floating rate options, adhering to the ISDA protocol would override those.

18) My swap is remediated and now has appropriate fallback language; is there anything else I should do?

After having adhered to the Protocol or bi-laterally remediated their agreements, BMO expects many of its counterparties to proactively renegotiate their trades to new rates, especially those that are used to hedge loans as the fallback language is slightly different. Once your swaps (and loans) include fallback language there is no drop dead date for renegotiation.

19) Are there any anticipated challenges associated with fallback language?

The industry continues to work through issues as they arise. For example, during 2020 the loan industry realized that there would be significant operational issues using compounded-in-arrears SOFR for syndicated loans, and as a result, the ARRC updated its recommended fallbacks for those products to prioritize a simple average computation. However, there still remains the challenge of not knowing the cashflow until the end of the term. The market preference is for Term SOFR, which could reduce the anticipated conversion challenges. The ARRC released a Request for Proposal (RFP) for a Term SOFR provider and anticipates publication by mid-2021, depending on liquidity. As a result, BMO continues to expect the landscape of the LIBOR transition to change and we will continue to advise our clients as it does.

IBOR Transition and the ISDA Fallbacks Protocol FAQs

20) If a client chooses to proceed with bilateral negotiations and not sign the Protocol, are there any requirements to file with ISDA?

No, if clients choose to engage in bilateral negotiations to amend their ISDA, there are no requirements to file with ISDA and also no ISDA fees.

21) Can I incorporate the fallbacks without adhering to the Protocol?

Yes. ISDA has produced template bilateral amendment agreements (short form and long form versions) that allow parties to apply the terms of the Protocol to transactions without the need to adhere to the Protocol. In certain instances, it may be advisable to bilaterally amend transactions. Parties should consider their particular circumstances in determining whether to adhere to the Protocol, bilaterally amend transactions, or use a combination of both.

22) Do I need to wait until LIBOR is permanently discontinued in order to replace LIBOR with an ARR?

Some market participants may choose to voluntarily amend LIBOR-linked transactions to reference an ARR without waiting for any cessation of LIBOR publication. In some cases, it may be more efficient for market participants to execute new transactions to transition a contract or portfolio from LIBOR to an ARR. Alternatively, some market participants may choose to undertake various bilateral or multilateral portfolio compression exercises to reduce the number of transactions on their books.

23) What will happen to any cleared swaps?

For cleared derivatives, LCH and CME have indicated the intent to align with ISDA to include fallback provisions into their rulebooks. The new fallbacks would apply to both legacy and new cleared derivatives transactions and would become effective concurrently with the effective date of the Protocol. We anticipate no changes to clearing legal agreements to support this transition. Any inclusion of fallback provisions will be applied to cleared transactions through CCP rule-book changes.

24) Is there going to be a Term SOFR available?

The ARRC has stated that it is not in a position to recommend a forward-looking SOFR term rate by the intended mid-2021 timeframe, and cannot commit to one being recommended by year-end. The ARRC is encouraging market participants to not wait for a forward-looking term rate for new contracts, but to instead prepare to transition from LIBOR using the tools available now.

25) How will credit spread sensitivity impact the IBOR Transition?

SOFR does not have sensitivity to bank funding costs built into it like LIBOR does. This could result in result in disparities arising between the lending costs of banks and the borrowing cost of borrowers throughout the lifetime of a loan, especially during liquidity events. In order to ensure that unintended value transfer does not occur in this type of event, lenders require benchmark rates, or spreads added to them, to have credit sensitivity. IN response to this need, several private market solutions are currently being brought to market. BMO is paying close attention to these developments in order to see whether the market accepts one or more as standard.

Disclaimer

This material has been prepared with the assistance of employees of Bank of Montreal (“BMO”) who are involved in derivatives sales and marketing efforts.

We are not soliciting any specific action based on this material. It is for the general information of our clients. It does not constitute a recommendation or a suggestion that any investment or strategy referenced herein may be suitable for you. It does not take into account the particular investment objectives, financial conditions, or needs of individual clients.

Nothing in this material constitutes investment, legal, accounting or tax advice, or a representation that any investment or strategy is suitable or appropriate to your unique circumstances, or otherwise constitutes an opinion or a recommendation to you. BMO is not providing advice regarding the value or advisability of trading in commodity interests, including futures contracts and commodity options or any other activity which would cause BMO or any of its affiliates to be considered a commodity trading advisor under the U.S. Commodity Exchange Act. BMO is not undertaking to act as a swap advisor to you or in your best interests and you, to the extent applicable, will rely solely on advice from your qualified independent representative in making hedging or trading decisions. This material is not to be relied upon in substitution for the exercise of independent judgment. Any recipient of these materials should conduct its own independent analysis of the matters referred to herein, together with its qualified independent representative, if applicable. Any discussion of tax matters in these materials (i) is not intended to be used, and cannot be used or relied upon, for the purposes of avoiding any tax penalties and (ii) may have been written in connection with the “promotion or marketing” of the transaction or matter described herein. Accordingly, the recipient should seek advice based on its particular circumstances from its own independent financial, tax, legal, accounting and other professional advisors (including, without limitation, its qualified independent representative, if applicable).

These materials are confidential and proprietary to, and may not be reproduced, disseminated or referred to, in whole or in part without the prior consent of BMO. Information presented in this material has been obtained or derived from sources believed by BMO to be reliable, but BMO does not guarantee their accuracy or completeness. BMO assumes no responsibility for verification of the information in these materials, no representation or warranty is made as to the accuracy or completeness of such information and BMO accepts no liability whatsoever for any loss arising from any use of, or reliance on, these materials. BMO assumes no obligation to correct or update these materials. These materials do not contain all information that may be required to evaluate any transaction or matter and information may be available to BMO and/or its affiliates that is not reflected herein.

BMO and/or its affiliates may make a market or deal as principal in the products (including, without limitation, any commodities, securities or other financial instruments) referenced herein. BMO, its affiliates, and/or their respective shareholders, directors, officers and/or employees may from time to time have long or short positions in any such products (including, without limitation, commodities, securities or other financial instruments).

BMO Capital Markets is a trade name used by BMO Financial Group for the wholesale banking businesses of Bank of Montreal, BMO Harris Bank N.A. and Bank of Montreal Ireland p.l.c., and the institutional broker dealer businesses of BMO Capital Markets Corp., BMO Nesbitt Burns Trading Corp. S.A., BMO Nesbitt Burns Securities Limited in the U.S., BMO Nesbitt Burns Inc. in Canada and Asia, BMO Nesbitt Burns Ltée/Ltd. in Canada, BMO Capital Markets Limited in Europe and Australia, BMO Advisors Private Limited in India and Bank of Montreal (China) Co. Ltd. in China.

® Registered trademark of Bank of Montreal in the United States, Canada and elsewhere.

TO U.K./E.U. RESIDENTS: In the UK, Bank of Montreal London branch is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority (“FCA”) and the Prudential Regulation Authority and BMO Capital Markets Limited is authorized and regulated by the FCA. The contents hereof are intended solely for the use of, and may only be issued or passed on to, persons who have professional experience in matters relating to investments falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 or to investors in any E.U. Member State, other than persons meeting the criteria for classification as professional client or eligible counterparty under the Markets in Financial Instruments Directive 2004/39/EC (and relevant implementing legislation in such E.U. Member State). Any U.K. person wishing to effect transactions in any security discussed herein should do so through Bank of Montreal, London Branch or BMO Capital Markets Limited; any person in the E.U. wishing to effect transactions in any security discussed herein should do so through BMO Capital Markets Limited.

TO PRC RESIDENTS: This material does not constitute an offer to sell or the solicitation of an offer to buy any financial products in the People’s Republic of China (excluding Hong Kong, Macau and Taiwan, the “PRC”). BMO and its affiliates do not represent that this material may be lawfully distributed, or that any financial products may be lawfully offered, in compliance with any applicable registration or other requirements in the PRC, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. This material may not be distributed or published in the PRC, except under circumstances that will result in compliance with any applicable laws and regulations.

TO HONG KONG RESIDENTS: This material has not been reviewed or approved by any regulatory authority in Hong Kong. Accordingly the material must not be issued, circulated or distributed in Hong Kong other than (1) except for “structured products” as defined in the Securities and Futures Ordinance, in circumstances which do not constitute it as a “Prospectus” as defined in the Companies Ordinance or which do not constitute an offer to the public within the meaning of that Ordinance, or (2) to professional investors as defined in the Securities and Futures Ordinance and the Securities and Futures (Professional Investor) Rules made thereunder. Unless permitted by the securities laws of Hong Kong, no person may issue in Hong Kong, or have in its possession for issue in Hong Kong this material or any other advertisement, invitation or document relating to the products other than to a professional investor as defined the Securities and Futures Ordinance and the Securities and Futures (Professional Investor) Rules.

TO SINGAPORE RESIDENTS: This document has not been registered as a prospectus with the Monetary Authority of Singapore and the material does not constitute an offer or sale, solicitation or invitation for subscription or purchase of any shares or financial products in Singapore. Accordingly, BMO and its affiliates do not represent that this document and any other materials produced in connection therewith may lawfully be circulated or distributed, whether directly or indirectly, to persons in Singapore. This document and the material do not and are not intended to constitute the provision of financial advisory services, whether directly or indirectly, to persons in Singapore.

TO THAI RESIDENTS: The contents hereof are intended solely for the use of persons qualified as Institutional Investors according to Notification of the Securities and Exchange Commission No. GorKor. 11/2547 Re: Characteristics of Advice which are not deemed as Conducting Derivatives Advisory Services dated 23 January 2004 (as amended). BMO and its affiliates do not represent that the material may be lawfully distributed, or that any financial products may be lawfully offered, in compliance with any regulatory requirements in Thailand, or pursuant to an exemption available under any applicable laws and regulations.

TO MALAYSIAN RESIDENTS: The Information contained herein is information which is publicly available. This report and the Information contained herein do not constitute nor should they be construed as an offer to sell or buy, or an inducement or solicitation of an offer to sell or buy, or a proposal in respect of, or a dealing in, any securities, currencies, derivatives or any other financial products (“financial products”) in Malaysia. Bank of Montreal and its affiliates do not

represent that the Information may be lawfully distributed, or that any financial products may be lawfully offered or dealt with, in compliance with any applicable registration or other requirements in Malaysia, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution, offering or dealing in such financial instruments.

TO KOREAN RESIDENTS: This material is not provided to make a recommendation for specific Korean residents to enter into a contract for trading financial investment instruments, for investment advising, for discretionary investment, or for a trust, nor does it constitute advertisement of any financial business or financial investment instruments towards Korean residents. The material is not provided as advice on the value of financial investment instruments or any investment decision for specific Korean residents. The provision of the material does not constitute engaging in the foreign exchange business or foreign exchange brokerage business regulated under the Foreign Exchange Transactions Act of Korea.

TO INDONESIAN RESIDENTS: No registration statement has been filed with the Financial Services Authority (Otoritas Jasa Keuangan - OJK) and no information contained herein should be considered as an offer to sell or the solicitation of an offer to buy any financial products in a manner which constitutes a public offering under the Indonesian capital market laws and regulations. BMO and its affiliates do not represent that the Information may be lawfully distributed, or that any financial products may be lawfully offered, in compliance with any applicable registration or other requirements in Indonesia, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. You are advised to exercise caution in relation to the Information contained herein. If you are in doubt about any of the content of these documents, you should obtain independent professional advice.

TO PHILIPPINE RESIDENTS: This Information is intended for distribution only to “qualified buyers” as defined under in Section 10 (l) of the Securities Regulation Code of the Philippines. The contents hereof are not intended for the use of and may not be issued or passed on to retail clients.

TO VIETNAMESE RESIDENTS: This document is not a securities offering document and is not required to be registered with any relevant authorities of Vietnam. The contents hereof are intended solely for the use of, and may only be passed on to, persons with whom BMO has had agreement on provision of the Information. The Information is not provided as advice on the value of financial investment instruments, to make a recommendation for specific Vietnamese residents to enter into a contract for trading financial investment instruments, for money broking, for asset management, for settlement and clearing services or for a trust, nor does it constitute advertisement of any financial business or financial investment instruments towards Vietnamese residents. BMO and its affiliates do not represent that the Information may be lawfully imported, distributed, or that any financial products may be lawfully offered, in Vietnam, in compliance with applicable laws of Vietnam, and do not assume any responsibility for facilitating any import, distribution or offering thereof. The Information is only for private use of recipients and may not be reproduced, distributed or published in Vietnam in any form, except under circumstances that will result in compliance with applicable laws of Vietnam.

In Asia, Bank of Montreal is licensed to conduct banking and financial services in Hong Kong and Singapore. Certain products and services referred to in this document are designed specifically for certain categories of investors in a number of different countries and regions. Such products and services would only be offered to these investors in those countries and regions in accordance with applicable laws and regulations. The Information is directed only at persons in jurisdictions where access to and use of such information is lawful.

™ - “BMO (M-bar roundel symbol) Capital Markets” is a trade-mark of Bank of Montreal, used under licence.