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.

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 derivate 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 ARRs 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.

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	SUS00ON 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.

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) 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.

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