ISDA Fallbacks Protocol and Supplement

Workshop

Sub-working group: Alignment with international legislation and best practices

22 January 2021

Agenda

1. Getting a good understanding of the ISDA Fallbacks Protocol and Supplement
2. How do the ISDA Fallbacks Protocol and Supplement impact Turkish banks?
3. Recommended next steps
4. Q&A

Getting a good understanding of the ISDA Fallbacks Protocol and Supplement

What is the ISDA Fallbacks Protocol & Supplement?

Introduction

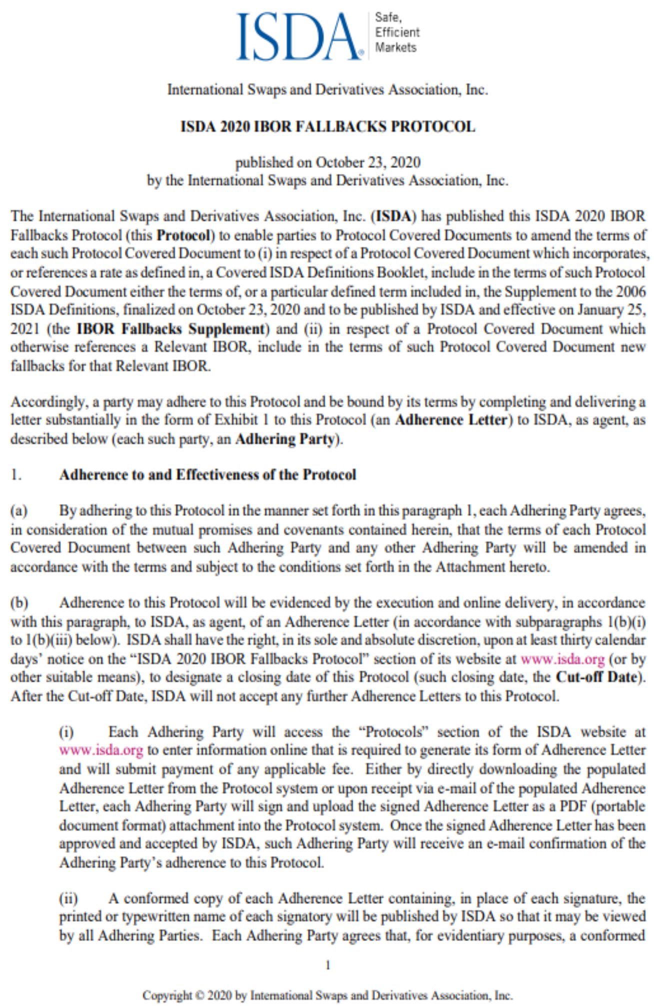
- Since 2017, ISDA has worked on **determining the rate and legal wording** which would be used in contracts when LIBOR, or other key IBORs, permanently cease. Following extensive consultations with financial market infrastructures, corporates, buy-side and sell-side participants, on **23 October 2020** ISDA released amended 2006 ISDA Definitions that incorporate these fallback provisions in **new contracts**. It also published a protocol to ensure **legacy contracts** can rely on these provisions.

What do the ISDA fallbacks achieve?

- ISDA's fallbacks are a **mean to ensure an RFR-linked replacement rate is agreed in contracts** in the event of the discontinuation of an IBOR. This is to ensure that the economics of the contracts **align as closely as possible to the original agreement** after the fallback kicks in, thus minimizing value transfer and any associated **conduct and litigation risk**.

Key takeaways

- The Protocol and the Supplement, which take effect on January 25, 2021, provide robust fallback provisions to be applied upon the **permanent cessation** of a relevant IBOR or a **pre-cessation announcement** made.
- The Protocol provides an efficient amendment mechanism for **mutually adhering counterparties** to incorporate these **fallback provisions into legacy contracts**.
- The Protocol and the Supplement do not themselves modify the terms of underlying floating rate exposures or ensure such exposures transition in the same manner as any interest rate derivatives entered into to hedge those exposures.
- Market participants should work closely with counsel and financial advisors to ensure that they **understand** the role and **impacts** of the Protocol and the Supplement within their overall bank-specific **IBOR transition strategy**.



ISDA Safe, Efficient Markets

International Swaps and Derivatives Association, Inc.

ISDA 2020 IBOR FALLBACKS PROTOCOL

published on October 23, 2020
by the International Swaps and Derivatives Association, Inc.

The International Swaps and Derivatives Association, Inc. (**ISDA**) has published this ISDA 2020 IBOR Fallbacks Protocol (this **Protocol**) to enable parties to Protocol Covered Documents to amend the terms of each such Protocol Covered Document to (i) in respect of a Protocol Covered Document which incorporates, or references a rate as defined in, a Covered ISDA Definitions Booklet, include in the terms of such Protocol Covered Document either the terms of, or a particular defined term included in, the Supplement to the 2006 ISDA Definitions, finalized on October 23, 2020 and to be published by ISDA and effective on January 25, 2021 (the **IBOR Fallbacks Supplement**) and (ii) in respect of a Protocol Covered Document which otherwise references a Relevant IBOR, include in the terms of such Protocol Covered Document new fallbacks for that Relevant IBOR.

Accordingly, a party may adhere to this Protocol and be bound by its terms by completing and delivering a letter substantially in the form of Exhibit 1 to this Protocol (an **Adherence Letter**) to ISDA, as agent, as described below (each such party, an **Adhering Party**).

1. **Adherence to and Effectiveness of the Protocol**

(a) By adhering to this Protocol in the manner set forth in this paragraph 1, each Adhering Party agrees, in consideration of the mutual promises and covenants contained herein, that the terms of each Protocol Covered Document between such Adhering Party and any other Adhering Party will be amended in accordance with the terms and subject to the conditions set forth in the Attachment hereto.

(b) Adherence to this Protocol will be evidenced by the execution and online delivery, in accordance with this paragraph, to ISDA, as agent, of an Adherence Letter (in accordance with subparagraphs 1(b)(i) to 1(b)(iii) below). ISDA shall have the right, in its sole and absolute discretion, upon at least thirty calendar days' notice on the "ISDA 2020 IBOR Fallbacks Protocol" section of its website at www.isda.org (or by other suitable means), to designate a closing date of this Protocol (such closing date, the **Cut-off Date**). After the Cut-off Date, ISDA will not accept any further Adherence Letters to this Protocol.

(i) Each Adhering Party will access the "Protocols" section of the ISDA website at www.isda.org to enter information online that is required to generate its form of Adherence Letter and will submit payment of any applicable fee. Either by directly downloading the populated Adherence Letter from the Protocol system or upon receipt via e-mail of the populated Adherence Letter, each Adhering Party will sign and upload the signed Adherence Letter as a PDF (portable document format) attachment into the Protocol system. Once the signed Adherence Letter has been approved and accepted by ISDA, such Adhering Party will receive an e-mail confirmation of the Adhering Party's adherence to this Protocol.

(ii) A conformed copy of each Adherence Letter containing, in place of each signature, the printed or typewritten name of each signatory will be published by ISDA so that it may be viewed by all Adhering Parties. Each Adhering Party agrees that, for evidentiary purposes, a conformed

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Which benchmarks and currencies are covered in the Supplement and Protocol?

The fallbacks cover contracts based on:

LIBOR in the five currencies in which it is currently published:

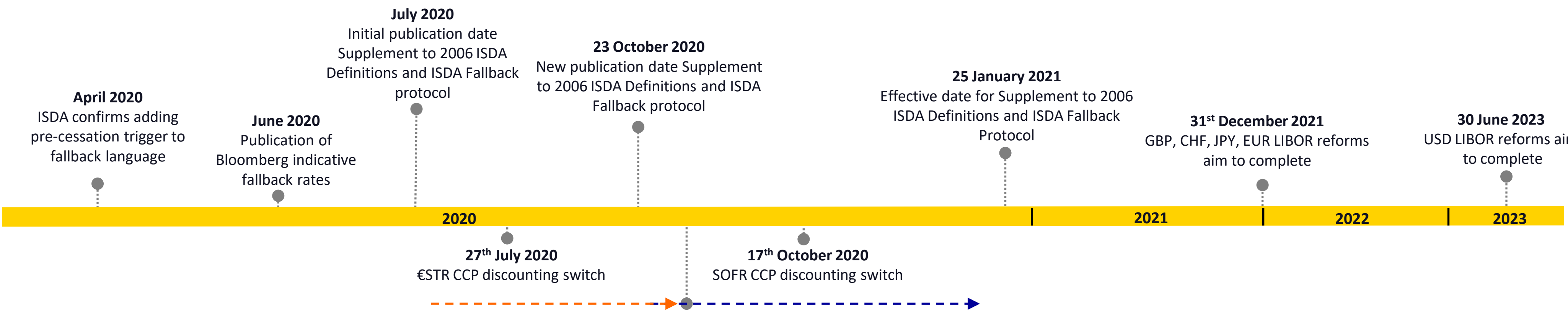
- GBP LIBOR
- USD LIBOR
- Euro LIBOR
- CHF LIBOR
- JPY LIBOR

- EURIBOR
- TIBOR
- Euroyen TIBOR
- BBSW
- HIBOR
- CDOR

They are based on the RFRs available for each key currency in the scope of the fallbacks:

- A$ ▶ AONIA (Australian dollar)
- C$ ▶ CORRA (Canadian dollar)
- € ▶ €STR (euro)
- HK$ ▶ HONIA (Hong Kong dollar)
- ₣ ▶ SARON (Swiss franc)
- $ ▶ SOFR (US dollar)
- £ ▶ SONIA (sterling)
- ¥ ▶ TONA (yen)

What have been key milestones in respect of the ISDA Fallbacks Protocol & Supplement?



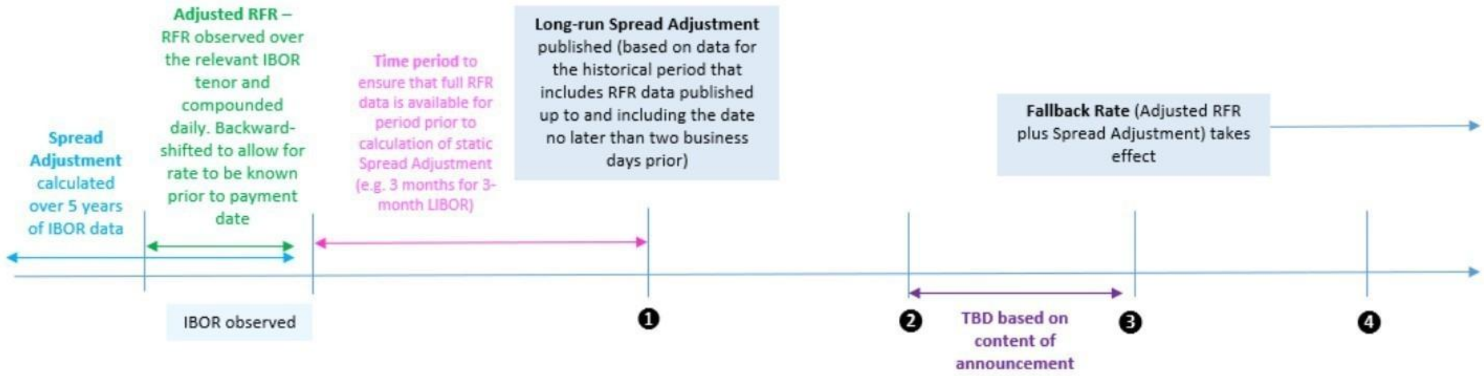
- As of 28th of September 2020 ISDA published a comprehensive document for interest rate derivatives - a product table on RFR conventions and IBOR fallbacks. The document is to assist market participants to understand how the fallbacks would function in their legacy and new derivatives that reference IBORs.
- On the 1st of October 2020 the US Department of Justice **(DoJ) confirmed it sees no immediate competition issues** with the fallback protocol, now finalizing with other competition authorities in other jurisdictions.
- As of **25 January 2021, the supplement and protocol take effect**. Market participants have been strongly advised to avoid an effective date at the end of the year.
- From 25 January 2021 onward, **all new derivatives referencing the 2006 ISDA Definitions will automatically include the updated fallbacks for covered IBORs**. The changes will **apply to legacy derivatives** as well if **both counterparties have adhered to the protocol** or have agreed similar bilateral amendments.
- When the regulators make an announcement on the cessation and/or non-representativeness of LIBOR, then the **spread adjustments** set out under the fallback methodology would be **calculated and frozen from that point according to Bloomberg's rulebook**.

What are index cessation trigger events?

Pre-cessation trigger event	Permanent-cessation trigger event
▸ **Triggered by a Pre-cessation event**: this is a public statement or publication of information by the **regulatory supervisor for the administrator of LIBOR** (currently FCA), announcing that: ▸ The regulatory supervisor has determined that LIBOR in the relevant currency **is no longer 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 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 (a Pre-cessation Index Cessation Event).	▸ **Triggered by a Permanent cessation event:** this is a **public statement** or publication of information by or on behalf of the **administrator of the relevant IBOR** (Relevant Administrator) announcing that: ▸ Relevant Administrator has ceased, or will cease, to provide the relevant IBOR permanently or indefinitely, provided that, at that time, there is **no successor administrator** that will continue to provide the relevant IBOR ▸ **A public statement or publication of information by**: (i) the regulatory supervisor for the Relevant Administrator; (ii) the central bank for the currency of the relevant IBOR; (iii) an insolvency official with jurisdiction over the Relevant Administrator; (iv) a resolution authority with jurisdiction over the Relevant Administrator; (v) a court or an entity with similar insolvency or resolution authority over the Relevant Administrator, ▸ In case a Relevant Administrator has ceased or will cease to provide the relevant IBOR permanently or indefinitely, **no successor administrator** is supposed to continue to provide the relevant IBOR

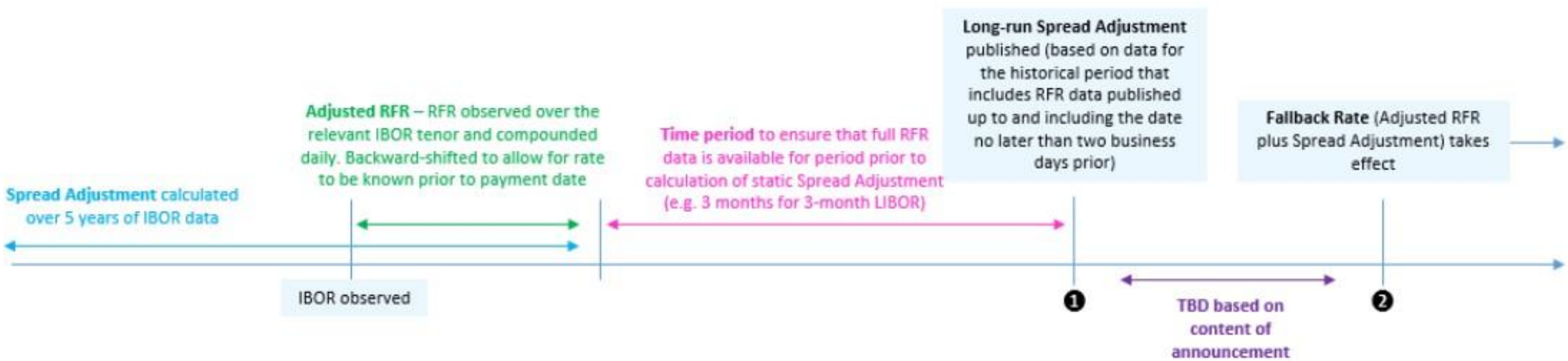
Trigger events scenarios

When the spread would be fixed or 'set' and when the fallbacks would apply **if both a permanent cessation Index Cessation Event and a Precessation Index Cessation Event** occur with respect to a Relevant IBOR:



❶: permanent cessation Index Cessation Event, i.e. announcement that IBOR will permanently cease to be available as of ❹
❷: pre-cessation Index Cessation Event, i.e. public statement or publication of information by the regulatory supervisor that IBOR will be Non-Representative as of ❸ (which may either coincide with ❷ or be after ❷)
❸: IBOR actually becomes Non-Representative
❹: IBOR permanently ceases to be available

When the spread would be fixed or 'set' and when the fallbacks would apply **if only a permanent cessation Index Cessation Event** occurs with respect to a Relevant IBOR:



❶: permanent cessation Index Cessation Event, i.e. announcement that IBOR will permanently cease to be available (and therefore will permanently cease to be available as of ❷ (which may either coincide with ❶ or be after ❶))
❷: permanent cessation Index Cessation Effective Date, i.e. IBOR actually permanently ceases to be available

How are the fallback rates calculated and when do they kick in?

How are fallback rates calculated?	When do fallback rates 'kick in'?
▶ Due to structural differences between IBORs and RFRs, key adjustments are necessary if fallbacks to RFRs are to take effect in existing contracts referencing IBORs. ▶ IBORs are forward-looking rates, while RFRs are overnight rates and hence backward-looking when compounded. To adjust the RFR for the term structure, a compounded setting in arrears rate will be calculated, by compounding daily values of the overnight RFR, for the relevant tenor. The interest rate would be set a few days (two to five) in advance of the payment due date to allow for payment calculation and settlement. ▶ IBORs also include a credit risk premium whereas an RFR does not. To address this difference, a spread adjustment based on the median spot spread between the IBOR and the adjusted RFR will be calculated over a static lookback period of five years, prior to an announcement triggering a fallback. ▶ A fallback rate is calculated for each tenor. Counterparties are able to access the fallback rates on a screen in the same way they access the IBORs today (although the fallback rates will be available at the end of each period instead of the beginning). These rates are published by Bloomberg.	▶ For derivatives that reference any IBOR, the event that would trigger the application of the fallback is when the IBOR ceases to be published permanently. This is commonly referred to as a "cessation trigger". ▶ For derivatives that reference LIBOR only, the adjusted rate would also apply as a fallback following a determination by the FCA that LIBOR in that currency is no longer representative of its underlying market, even if it continues to be published. That is what market participants commonly call a "pre-cessation trigger". ▶ In June 2020, Edwin Schooling Latter, Head of Markets and Wholesale Policy at the FCA, said that an announcement on the cessation of LIBOR could come as soon as November or December 2020. Speaking on 7 October 2020, Schooling Latter again signaled to market participants that they should prepare for announcements later in 2020 setting out what would happen at the end of 2021. ▶ An announcement prior to the protocol coming into effect could encourage some institutions to sign the protocol as it would trigger the calculation and locking of the spread adjustment intended to address the lack of a credit risk component in the RFRs serving as fallback to LIBOR. **Having a known spread adjustment value at the time of signing up to the protocol provides certainty on the potential outcomes and valuation impacts at the time of LIBOR's cessation.** ▶ However, that announcement hasn't happened. Nonetheless the ISDA protocol and supplement have achieved broad adherence in over 70 jurisdictions.

ISDA Protocol – Conventions & methodology

- Historical median spread is calculated till the announcement (pre-Cessation). It is calculated for 5 years back + tenor + 2 BD payment lag.
- The Adjusted RFR (compounded calculation in arrears + the spread = Fallback Rate).
- Fallback Rate becomes effective from cessation effective date.
- If your Payment date is June 30, 2 BD earlier you will observe the published Fallback Rate on BBG. You will not observe the rate for that day, but for the original Libor rate day of that period, which is the rest day minus 2 at the beginning of the tenor period.
- In absence of no fallback rate being observed for the original Libor reset date, use the most recent fallback rate observed close to that day.
- ISDA protocol is two business days lookback with shift, and payment date is same as the period end date. However, amendments are possible.

Linear Interpolation

The amended ISDA documentation will direct counterparties to firstly apply linear interpolation if the relevant IBOR is available for the next longer and next shorter tenor. If linear interpolation is not available, counterparties are directed to use the published fallback rate that corresponds to the date on which they were to reference the relevant IBOR, provided that this fallback rate appears on the relevant screen at least two Business Days prior to the relevant Payment Date. Counterparties can define the relevant Business Days in the contract so as to ensure that the Fallback Rate will be known two days in advance of the payment being due based on the Business Day calendar in relevant jurisdictions.

Payment Dates

For certain products, counterparties may want to consider whether to amend the Business Days or Payment Dates and/or agree to use a fallback rate for a date other than the referenced IBOR's original fixing date. In some cases, such amendments may better align the outcomes with the counterparties' original intentions and/or with the desired outcomes for hedged instruments. Any such amendments would be strictly based on agreements between the relevant counterparties but counterparties could consider using the fallback language with any modifications necessary to reflect the terms of the relevant derivative contracts and review by legal counsel and other advisors.

How do the ISDA Fallbacks Protocol and Supplement impact Turkish banks?

How can firms use fallbacks in their uncleared trade contracts?

New uncleared trades	Legacy uncleared trades
► For new uncleared derivatives, ISDA will incorporate the new fallbacks in its 2006 ISDA Definitions (through a supplement). Those fallbacks will automatically apply to any trades referencing the 2006 ISDA Definitions, executed on or after the date the Supplement comes into effect.	► For legacy uncleared trades (those entered into before the effective date of the amended 2006 ISDA Definitions), the protocol incorporates the supplement to the 2006 ISDA Definitions into existing trade documentation. ► Provided that each counterparty to a trade has adhered to the protocol. Once both sides adhere to the protocol, legacy trades between them will incorporate the new triggers and fallback language. The protocol offers the convenience of implementing industry standard contractual changes to legacy trades with a large number of counterparties. It avoids the need to bilaterally negotiate the same amendments with each party, thus reducing costs and time.

Type of transaction	Method to include fallback	Entry into force of amendments
New uncleared OTC derivative	Supplement to the ISDA 2006 definitions	25 January 2021
Legacy uncleared OTC derivative	ISDA Protocol	25 January 2021

While the protocol has standard recommended conventions, it can be bilaterally amended or excluded using certain templates that have been published by ISDA. This might be useful where parties want to negotiate only aspects of the protocol, such as dispute resolutions processes around calculation agents.

What happens to cleared trades?

Major CCPs have indicated they will use the powers in their rulebooks to implement the fallbacks in all of their legacy cleared derivatives transactions as of the effective date of the updates. This means that firms do not have to take action for their cleared trades, but there could be systems, commercial, hedging issues which they will need to consider and address next to operational aspects in order to comply with amendments to the CCP rulebooks as triggered by IBOR transition.

Type of transaction	Method to include fallback
New cleared OTC derivative	CCP rulebooks
Legacy cleared OTC derivative	CCP rulebooks

Bilateral Templates for Exclusion &Amendments

- The ISDA Fallback Protocol has an implicit convention of two business days lookback with observation shift and payment delay. However, flexibility is provided in amending or excluding parameters of the conventions:
  - Changing the spread
  - Amending any text of the protocol
  - Including non-ISDA documents in scope of the protocol
  - De-scoping documents from the scope of the ISDA to align terms with hedges linked to cash loans
  - Disapplying the pre-cessation trigger
  - Modifying CSA rates to RFRs
- The templates are listed in the link and summarized below: Link for bilateral templates: http://assets.isda.org/media/3062e7b4/bf8c96ca-pdf/

ISDA Protocol: Process for Adherence

ISDA Process for Adherence

1. Each market participant that intends to adhere to the IBOR Fallbacks Protocol should **access the "Protocols" section of the ISDA website** at www.isda.org to enter the information that is required to **generate its form of Adherence Letter**.

2. Either by directly downloading the populated Adherence Letter from the Protocol system or upon receipt via e-mail of the populated Adherence Letter, each **Adhering Party should sign the populated Adherence Letter** (a "wet-ink" signature is not required) and **upload it as a PDF** (portable document format) attachment into the Protocol system.

3. Once the signed Adherence Letter has been approved and accepted by ISDA, such Adhering Party will **receive an e-mail confirmation of adherence to the IBOR Fallbacks Protocol**.

Adherence is free to non-ISDA Primary Members until January 25, 2021.. For a step-by-step guide to adherence, please see the following guide:assets.isda.org/media/3062e7b4/562d1a52-pdf/

Recommended next steps

What have international banks been initiating in 2020?

23 October 2020 marked the beginning of a three-month period during which firms can adhere to the protocol, although regulators encourage and expect firms to do so early. Firms will need to monitor ISDA's website to determine whether the counterparties they trade with have also decided to sign up. We also encourage firms to check with their key counterparties bilaterally as soon as possible to get certainty early on, and start negotiations with non-signatories where applicable.

1. Create a repository and dashboard of your derivative trades across books, product types, currencies, IBOR's and other relevant aspects
2. Identify contracts maturing post likely cessation dates
3. Identify (bilateral) derivative trades with interbank counterparties, corporates, and linked hedges
4. Detailed (financial) impact assessment on adherence to ISDA protocol, also considering cost of bilateral negotiations. Over 6500 counterparties have already done so globally including major investment banks
5. Communicate with respective counterparties to verify the requirements for amendments and exclusions
6. Prepare and internally agree legal documents and repaper strategy for bilateral negotiations, where required
7. Prepare systems for new RFRs, their respective calculations, and new confirmations

Q&A

Q&A

Questions	Answers
For transactions made prior to the Fallback Protocol's signature date, how will the interest rates be affected? Will we have to adapt the existing transactions immediately within the scope of the regulations accepted in the Fallback Protocol? Or as long as the IBOR continues to be published, existing transactions will continue in the same way, without any interest rate conversion?	The transactions will continue as is until the IBOR continues to be published and is representative of the underlying market. However, in the case of the pre-cessation trigger, the spread will be locked even if the IBOR continues to be published until its cessation date.
How will interest rates be determined for transactions to be made after the Fallback Protocol's signature date? Do we have to determine RFR as the floating interest rate of these transactions? Or can we continue with IBOR as long as it continues to be published?	ISDA will amend the 2006 ISDA Definitions by publishing a 'Supplement' to the 2006 ISDA Definitions on January 25, 2021. Upon publication of the Supplement for the relevant IBOR, transactions incorporating the 2006 ISDA Definitions that are entered into on or after the date of the Supplement (i.e., January 25, 2021) will include the amended floating rate option (i.e., the floating rate option with the fallback). The fallback kicks in at the permanent cessation event, however, there is guidance from regulators to cease issuance of new GBP LIBOR linear derivatives by start of Q2 2021 and non-linear derivatives by start of Q3 2021. For USD LIBOR, FED has recommended all new issuances to cease by end-2021.
If both banks (counterparties) have recently signed the ISDA protocol. Do you then call each other that for this particular derivative you do not want to use the protocol but agree bilaterally?	Yes, parties can bilaterally agree to preserve bespoke provisions. Parties should carefully consider whether the IBOR Fallbacks Protocol will override or otherwise amend bespoke provisions in their Protocol Covered Documents and seek advice from professional advisors as required. ISDA has published template language that Adhering Parties may use to exclude and/or amend one or more aspects of the IBOR Fallbacks Protocol.
What if one of the parties rejects a bespoke proposal and wants to stick to the ISDA protocol?	In principle the IBOR Fallbacks Protocol provides that the terms and conditions of each Protocol Covered Document, that apply to that Protocol Covered Document immediately before it is amended by the IBOR Fallbacks Protocol will continue to apply. Bespoke provisions can only be maintained if bilaterally agreed to.

ISDA Fallbacks Protocol and Supplement documentation

Relevant documents on the ISDA Fallbacks Protocol link

- View adhering parties link
- ISDA 2020 IBOR Fallbacks Protocol link
- IBOR Fallback Supplement link
- FAQs to ISDA IBOR Fallbacks Protocol link
- Bilateral Documents related to IBOR Fallbacks link
- Outline of Bilateral Documents with Descriptions link
- How to Adhere to 2020 IBOR Fallbacks Protocol link
- List of Counsel/Trade Associations for Non-ISDA Documents link

Webinars

- IBOR Fallbacks Supplement and IBOR Fallbacks Protocol webinar link (& slides link)
- Methodology and Bloomberg Publication webinar link (& slides link)
- Bilateral Templates, ISDA Create and HIS Markit Outreach360 webinar slides link (& slides link)

Yasal Uyarı

Resmi mercilerin yönlendirme ve talimatlarıyla oluşturulan TBB Ulusal Çalışma Grubu ("UÇG") ve alt çalışma gruplarının toplantıları sonucunda, TBB'ye ve UÇG'na danışmanlık hizmeti veren bağımsız firma tarafından, herhangi bir yönlendirme, öneri ve taahhüt içermeksizin, sadece üye bankalarımıza ve kamuoyuna, UÇG'nun konu hakkındaki faaliyetlerine ilişkin genel nitelikte bilgiler verilmesi ve bunların gerektiğinde resmi mercilerle paylaşılması amacıyla hazırlanmış olan sunumlardaki bilgi ve açıklamalar, konunun tamamını içermediği gibi, içerdikleri konularla ilgili danışmanlık veya tavsiye amacı da taşımamaktadır. Sunumlar sadece bilgilendirme amaçlı olarak yayınlanmakta olup, içeriklerine dair Birliğimizin ve danışmanlık hizmeti veren firmanın hiçbir sorumluluğu bulunmamaktadır. Birliğimizce, sunumlar içeriğindeki konulara ilişkin genel ya da özel nitelikte herhangi bir görüş beyan edilmemektedir. Sunumlarda yer alan bilgi ve açıklamalar Birliğimizin resmi görüşünü veya bu konularda alınmış ya da alınabilecek bir kararını yansıtmamaktadır. Yürürlükte olan rekabet hukuku kuralları çerçevesinde bütün teşebbüslerin ticari strateji ve kararlarını bağımsız bir şekilde belirlemeleri gerekmektedir. Sunumlarda yer alan hiçbir husus, bahse konu düzenlemelere aykırı şekilde yorumlanamaz. Birliğimizin bu metinlerde yer alan bilgileri güncelleme veya düzeltme yükümlülüğü bulunmamaktadır.