

IBOR TRANSITION: DERIVATIVES

ISDA was mandated in 2016 by the Financial Stability Board to spearhead the market-led transition from IBORs to alternative RFRs.

The derivatives market is therefore some distance further ahead in the IBOR transition process than other financial products which reference IBORs, such as bonds and loans. In particular, efforts by ISDA over the last few years have culminated in the publication of the ISDA 2020 IBOR Fallbacks Protocol (the Protocol) and a supplement to the 2006 ISDA Definitions, which is the market standard interest rate derivative documentation (the “Supplement”). Publication of the Protocol and the Supplement are key milestones in the transition journey from IBORs to RFRs, and amount to the starting gun being fired on what is expected to be a mass market wide repapering and amendment exercise as the market says goodbye to the old world of IBORs and welcomes the new world of RFRs.

The Protocol is intended to deal with legacy transactions which require amendment to transition from IBORs to the new adjusted RFRs. The Protocol is an efficient tool commonly used by ISDA to achieve mass market wide amendment of derivative contracts, often driven by regulatory change. The Protocol operates as a multi-lateral amendment tool. Thus, by signing up (or adhering) to the Protocol, a party agrees to incorporate certain changes specified in the Protocol to its relevant agreements entered into with other market participants who have adhered to the Protocol. The universe of documents covered by the Protocol is very wide. It includes most ISDA published documents, and also (in a welcome move for the market), a broad range of non-ISDA (and non-derivative) master agreements.

For new transactions, ISDA has released the Supplement. The Supplement is a supplement and amendment to the 2006 ISDA Definitions, which is the market standard definitional booklet for interest rate derivatives. It will be included in all transactions executed on standard market terms.

The benefits which the Protocol and Supplement bring are clear and unambiguous. The Protocol is an efficient and effective amendment tool which allows for the bulk amendment of in scope contracts on standard terms, without the cost and resources of bilateral amendments on a mass scale. Similarly, the Supplement is an effective and clear way of bringing about transition from IBORs to RFRs for new transactions, and presents a robust and secure route map as the market adjusts to the new world of RFRs. However, there are important considerations which the Protocol and Supplement raise, which should be considered carefully by clients. These include the economic consequences of converting from an IBOR to RFR, potentially problematic products which are not well suited to RFRs and the risk of a mismatch to hedged cash products.

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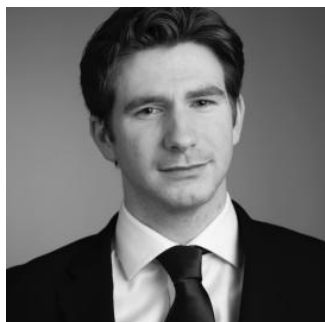
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