BNP PARIBAS
CORPORATE & INSTITUTIONAL BANKING

Dear Client,

ISDA 2020 IBOR Fallbacks Protocol (the "Protocol")

We are writing to follow up on the "Notice Concerning Reference Rates and Indices" we previously sent you, in which we drew your attention to the "General risks related to the use of Benchmarks" and the associated "Risks related to the use of benchmarks in Derivatives Transactions". The Notice highlighted the expectation that LIBOR will cease to be available after the end of 2021, and work being done by the International Swaps and Derivatives Association (**ISDA**) to, among other things, introduce a supplement to the 2006 ISDA Definitions (**IBOR Fallbacks Supplement**) revising the Interbank Offered Rates (**IBOR**) floating rate options in those definitions to provide for new triggers and fallbacks to be implemented on rate cessation, and a protocol (**IBOR Fallbacks Protocol**) that parties could use to implement such terms in existing transactions.

ISDA has finalised and published (on 23rd October 2020) the IBOR Fallbacks Supplement and the IBOR Fallbacks Protocol which means that it is now time for participants to derivatives transactions featuring IBORs to consider taking appropriate action. Please ensure that you carefully read this letter and the attached document.

Background: Why should you want to adhere to the Protocol?

Derivative transactions which reference an IBOR typically incorporate the 2006 ISDA Definitions (or earlier iterations) as published by ISDA. This means that if an IBOR were to be unavailable, the rate would generally be determined by reference to quotations from other banks. The 2006 ISDA Definitions do not specifically address the consequences of no quotations being provided. If an IBOR were to be permanently or indefinitely discontinued, it is unlikely that quotations would be provided for some or all of the remaining term of the relevant derivative transactions, meaning that the future status of those transactions would be uncertain.

In 2016, the Financial Stability Board's Official Sector Steering Group requested ISDA to identify robust fallbacks for derivative contracts that reference certain key IBORs. ISDA has subsequently carried out extensive industry consultations to finalise the methodology for fallbacks that take effect following the permanent cessation of certain key IBORs, and in the case of LIBOR only, its non-representativeness as well.

The outcome of the consultations and activities of the various working groups has been a set of new IBOR rate definitions incorporating fallbacks (as further described below) that are based on market consensus, and which were developed with an intent to minimise the economic impact of the fallbacks when applied.

The benefit of the use of the Protocol is that it allows derivatives market participants to apply these fallbacks to existing transactions and agreements on a "multilateral" basis, meaning that you would not have to implement individual agreements with every one of your market counterparts.

The official sector bodies providing market oversight have produced statements in support of the use of the protocol by market participants:

Financial Stability Board –
https://www.fsb.org/2020/10/fsb-encourages-broad-and-timely-adherence-to-the-isda-ibor-fallbacks-protocol/

Alternative Reference Rates Committee - https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Press_Release_ISDA_Protocol.pdf

In addition extensive information on Benchmark Reform and Transition from LIBOR has been made available by ISDA here:
https://www.isda.org/2020/05/11/benchmark-reform-and-transition-from-libor/

What will you need to consider?

When entering into new transactions that reference benchmark rates, you should consider the risks and benefits of using a particular benchmark and ensure that you have an understanding of the consequences if a benchmark is changed or discontinued; and for existing transactions, you should consider whether you have suitable contingency plans in place such as appropriate fallback language in transaction documentation. The revised terms found in the IBOR Fallbacks Supplement and the IBOR Fallbacks Protocol may be valuable tools for this. In addition you should consider your overall strategy to transition your LIBOR referencing activities to appropriate alternative rates due to the projected cessation date for those rates.

What if I do not take any action?

Benchmark reform means that a number of benchmarks, particularly the IBORs, are being reformed and some benchmarks may disappear. If you do not adhere to the IBOR Fallbacks Protocol, or otherwise bilaterally include robust fallbacks in derivatives documentation, fallbacks in existing transactions may not operate to allow parties to identify an alternative rate in the absence of a relevant IBOR.

IBOR Fallbacks Supplement and IBOR Fallbacks Protocol

The IBOR Fallbacks Supplement includes, with respect to certain IBOR rate options[1], new triggers and fallback provisions which apply if:

(i) the IBOR ceases to be provided permanently or indefinitely; and
(ii) in the case of one or more tenors for LIBOR in any of its five currencies, the Financial Conduct Authority announces that it is no longer representative of the underlying market and economic reality that the rate is meant to measure.

Under these fallback provisions, if the relevant IBOR permanently ceases to be available or, in the case of LIBOR only, is no longer representative, the relevant IBOR rate option will first fall back to a term adjusted risk-free rate (RFR) in the same currency plus a spread. The RFR will be adjusted by being compounded in arrears for the relevant term to reflect the fact that the IBOR is a term rate rather than an overnight rate. A fixed spread will also be added to that adjusted RFR given the fact that IBORs include a degree of bank credit risk. More details on how the fallback rate will be calculated for a particular IBOR can be found in the IBOR Fallbacks Fact Sheet available on the ISDA Website.

New transactions that reference the 2006 ISDA Definitions and are implemented following the effective date of the IBOR Fallbacks Supplement (25th January 2021) will automatically include the new fallbacks without the need for any further action, however derivative transactions incorporating the 2006 ISDA Definitions entered into prior to that effective date will not automatically include the new fallback provisions. ISDA has published the IBOR Fallbacks Protocol to enable parties to amend those existing derivative transactions, as well as other specified documents which reference certain IBORs, to include the updated rates and fallbacks.

[1] The IBOR rate options are Sterling LIBOR, Swiss Franc LIBOR, US Dollar LIBOR, Euro LIBOR, EURIBOR, Yen LIBOR, Yen TIBOR, Euroyen TIBOR, the Bank Bill Swap Rate, the Canadian Dollar Offered Rate, the Hong Kong Interbank Offered Rate, the Singapore Dollar Swap Offer Rate and the Thai Baht Interest Rate Fixing.

More information on the IBOR Fallbacks Supplement and IBOR Fallbacks Protocol can be found in the appendix here. Extensive information on the IBOR Fallbacks Supplement and IBOR Fallbacks Protocol, including FAQs, has been made available by ISDA here.

BNP Paribas' approach

After careful consideration of its own position, BNP Paribas has adhered to the IBOR Fallbacks Protocol. We find the wide acceptance of the fallback methodology set out in the ISDA IBORs Supplement, the need for a coherent market approach in implementing solutions, and the practicality of the protocol approach compelling reasons for using it.

Therefore, if you do decide to adhere to the IBOR Fallbacks Protocol, Protocol Covered Documents (as defined in the protocol) between you and BNP Paribas entities also adhering to the protocol will be amended to include the revised rate references set out in the IBOR Fallbacks Supplement, and will thereby benefit from the updated cessation triggers and fallbacks.

Next steps

You will need to make your own assessment as to the impact of adhering to the IBOR Fallbacks Protocol and the steps you should take in advance of adhering or otherwise adopting the terms of the IBOR Fallbacks Supplement.

In particular, if you have IBOR referencing transactions which you consider would not be suitable to be amended by way of the IBOR Fallbacks Protocol, and would like to discuss another type of amendment to the current fallback provisions, you would need to identify such transactions to us and we will be happy to engage into a discussion with you concerning available solutions.

Once you have fully considered the effect of adhering to the IBOR Fallbacks Protocol taking appropriate legal and other professional advice, could you please let us know:

- whether you intend to adhere to the IBOR Fallbacks Protocol;
- whether you intend to adhere to the IBOR Fallbacks Protocol but would like to enter into a bilateral agreement to vary the terms of the IBOR Fallbacks Protocol, for example by expanding or reducing the scope of the transactions covered;
- whether you do not intend to adhere to the IBOR Fallbacks Protocol but would prefer to enter into a bilateral agreement to incorporate the updated fallbacks; or
- whether you do not intend to adopt any of the above options together with your reasons for not doing so.

Step by step instructions on how to adhere to protocol can be found on the ISDA site through this link.

Please note that you may receive further communications, including in relation to this documentation, as well as additional documentation from BNP Paribas CIB.

Should you like to discuss this letter, or any of the information or documents referenced in this communication, please do not hesitate to contact gmibor@uk.bnpparibas.com or your usual BNP Paribas CIB contact.

Yours faithfully,

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APPENDIX

Further information on the IBOR Fallbacks Supplement and IBOR Fallbacks Protocol:

What are some key points you should consider?

It is important that you familiarise yourself with the way in which the IBOR Fallbacks Supplement and IBOR Fallbacks Protocol work and, in particular take professional advice. Contained in this communication is a non-exhaustive list of points that may be worth considering and discussing with your advisers when assessing the impact of these documents.

What documents are covered by the IBOR Fallbacks Protocol?

The range of documents within scope of the IBOR Fallbacks Protocol is broad. It covers documents beyond those that incorporate or reference a rate defined in the 2006 ISDA Definitions. For example, it covers transactions that incorporate or reference a rate in one of the predecessors to the 2006 ISDA Definitions, such as the 2000 ISDA Definitions. It also covers a range of ISDA published master agreements and credit support documents. It is also important to note that the scope also extends to agreements not published by ISDA, such as the Global Master Securities Lending Agreement.

It is important that you familiarise yourself with the range of documents covered by the IBOR Fallbacks Protocol and the conditions that apply in order for the amendments contemplated by the IBOR Fallbacks Protocol to take effect.

Does the IBOR Fallbacks Protocol apply to documentation governing cleared transactions?

The IBOR Fallbacks Protocol does not apply to documentation governing cleared transactions. You should refer to the relevant central counterparty for more information as to how the updates to the ISDA documentation will affect transactions cleared with that central clearing house. CME has indicated that it intends to align with the ISDA documentation when including revised fallback language in its rules[2] and LCH set out its position in respect of ISDA's recommended benchmark fallback approaches in December 2018[3] which has been followed by consultations on rulebook changes with its members.

Will my derivative be the same after a fallback rate is applied?

Through a series of market-wide consultations conducted by ISDA the industry has selected a fallback methodology based on the relevant RFRs with a term and credit spread adjustment, with an expressed intent of minimising any transfer of value to the extent possible. However a fallback rate will not necessarily be a like for like replacement rate for the corresponding relevant IBOR.

[2] https://www.cmegroup.com/trading/interest-rates/sofr-sonia-and-other-alternative-reference-rates.html

[3] https://www.lch.com/membership/ltd-membership/ltd-member-updates/lchs-position-respect-isdas-recommended-benchmark

This means that adopting the updated fallbacks in an existing derivative transaction or triggering the fallbacks may cause the value of the derivative transaction to change.

Will the spread be a dynamic one?

The spread that is added to the adjusted RFR that is used as a fallback will be a fixed spread. It will be based on historic data and so will not reflect the "point in time" difference between the Relevant IBOR and the adjusted RFR when the fallback rate applies. You should familiarise yourself with the methodology used for calculation of the spread and the circumstances in which the spread is fixed.

What might happen if I am using a derivative to hedge another product?

Mismatches may arise if a derivative transaction is used to hedge a product (e.g. a loan or a bond) which does not deal with the discontinuation of the relevant IBOR and the non-representativeness of LIBOR in the same way as the derivative transaction. These mismatches could arise if you adopt the terms of the IBOR Fallbacks Protocol and equally if you do not. That is to say fallbacks in existing derivative documentation may not currently match the hedged loan or bond. Mismatches could also affect the tax and accounting treatment of a product.

Will I require any consents to adopt the terms of the IBOR Fallbacks Protocol?

Adopting the terms of the IBOR Fallbacks Protocol has the effect of an amendment to affected transactions and the IBOR Fallbacks Protocol also contains a representation to the effect that relevant consents have been obtained. If there are any consents required to amend any of your derivative transactions, you will need to have obtained those consents before you adopt the terms of the IBOR Fallbacks Protocol.

Will any security be required to be retaken or re-registered?

If a security document is amended by the IBOR Fallbacks Protocol, you will need to consider whether security will need to be retaken or re-registered as a result of adoption of the terms of the IBOR Fallbacks Protocol.

How does the IBOR Fallbacks Protocol apply to non-linear derivative transactions?

It is also unclear whether the fallbacks set out in the IBOR Fallbacks Protocol would be suitable for certain non-linear derivative transactions into which parties may have entered. These include, for example, in-arrears swaps, interest rate caps and floors and range accrual products. Further information on products covered can be found on the ISDA website.

Can parties agree to include the amendments contemplated by the IBOR Fallbacks Protocol without adhering to it?

ISDA has published forms of amendment agreement which enable parties to introduce the amendments contemplated by the IBOR Fallbacks Protocol without adhering to it.

Can parties agree to bilaterally amend the terms or scope of the IBOR Fallbacks Protocol?

The IBOR Fallbacks Protocol is intended for use without negotiation and a party will not be able to specify additional provisions, conditions or limitations while adhering. Parties will however be able to bilaterally amend its terms or scope. ISDA has also published template language that enables parties to alter the scope of the IBOR Fallbacks Protocol.

Why might I want to exclude certain transactions from scope of the IBOR Fallbacks Protocol?

Examples of situations where parties may want to exclude transactions from the scope of the protocol might include (inter alia): in order to coordinate the amendment of specific transactions with the liabilities to which they operate as a hedge; because special approvals would be required to be obtained in order to effect an amendment of a transaction; or due to the nature of the transaction (such as non-linear transactions) meaning a fallback to a rate fixed in arrears would be viewed as not being suitable. In such cases it would be possible to arrange to handle such transactions outside of the protocol approach, however such transactions would need to be identified to us for this purpose. In relation to the latter category of transactions for which the IBORs Supplement fallback solution is not felt to be ideal, it will of course be possible to agree further amendments to address relevant issues after the protocol has been applied.

Other publicly available resources:

BNP Paribas' risk warning statement on loan, security and derivative products:
https://cib.bnpparibas.com/documents/risk-disclosure-on-notice-concerning-reference-rates-and-indices.pdf

International Swaps and Derivatives Association Benchmark Reform and Transition from LIBOR online resource:
https://www.isda.org/2020/05/11/benchmark-reform-and-transition-from-libor/?_zs=p6q2P1&_zl=lvcl5

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As the topic discussed herein is a complex one, we would encourage you to read the documents published by ISDA thoroughly and obtain any necessary professional advice on the action appropriate for your specific circumstances.