U.S. DEPARTMENT OF JUSTICE
Antitrust Division

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October 1, 2020

Abram J. Ellis
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Re: International Swaps and Derivatives Association Business Review Request

Dear Mr. Ellis:

This letter responds to your request, made on behalf of the International Swaps and Derivatives Association, Inc. ("ISDA"), for the issuance of a business review letter from the Department of Justice pursuant to the Department of Justice's Business Review Procedure, 28 C.F.R. § 50.6. Specifically, you have requested a statement of the Department's present enforcement intentions with respect to ISDA's proposal to amend its standardized documentation to account for the potential discontinuation of certain interbank offered rates (collectively referred to as "IBORs").[1] Based on the information and representations you provided, after a thorough review, and for the reasons explained below, the Department does not presently intend to challenge ISDA's proposed amendments to its standardized documentation. In accordance with the Department's usual practice, however, the Department reserves the right to challenge the proposed amendments to ISDA's standardized documentation in the future if the proposed amendments are determined to be anticompetitive in purpose or effect.

[1] *See* Letter from Abram J. Ellis, Esq., Simpson Thacher & Bartlett, to Makan Delrahim, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice (June 4, 2019) [hereinafter June 2019 Letter]; *see also* Letter from Abram J. Ellis, Esq., Simpson Thacher & Bartlett, to Makan Delrahim, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice (Oct. 23, 2019) [hereinafter October 2019 Letter]; Letter from Abram J. Ellis, Esq., Simpson Thacher & Bartlett, to Makan Delrahim, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice (July 10, 2020) [hereinafter July 2020 Letter]; Letter from Abram J. Ellis, Esq., Simpson Thacher & Bartlett, to Makan Delrahim, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice (July 10, 2020); and Letter from Abram J. Ellis, Esq., Simpson Thacher & Bartlett, to Makan Delrahim, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice (Sept. 22, 2020).

I. Background

The facts set out this letter regarding ISDA, the process ISDA used to produce its proposal, and proposal itself are based on ISDA's representations to the Department.

A. ISDA Background

ISDA is an international trade association representing participants in the derivatives industry.[2] Today, ISDA has over 900 member institutions from 71 countries.[3] These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition, ISDA members include exchanges, intermediaries, clearing houses, and repositories, as well as law firms, accounting firms, and other service providers.

ISDA publishes model documents that its members can use for their swaps, forwards, and other derivatives contracts. These documents include the ISDA Master Agreement, a model contract that can be used by parties to govern over-the-counter derivatives transactions, and the 2006 ISDA Definitions, which include standardized definitions for interest rate and currency derivatives contracts. These contracts can reference various rates, including the London Inter-Bank Offered Rate ("LIBOR") and other interbank offered rates ("IBORs"). ISDA's documents also include mechanisms that allow it to publish supplements and protocols to update, add, or adjust the definitions as circumstances warrant.[4]

B. IBOR Background

IBORs are used as reference rates in a wide variety of financial instruments in addition to derivatives contracts, including business loans, securitizations, and consumer loans such as mortgages and credit cards. Using these rates reduces the complexity of financial instruments and facilitates their standardization. Generally, IBORs are meant to reflect the cost at which certain banks can borrow on an unsecured basis for a given period of time. Administrators publish the different IBORs, obtaining quotes from "panel" banks to calculate the rates. U.S. dollar ("USD") LIBOR is the most commonly used IBOR in the United States and the world, with approximately $200 trillion in financial contracts in the

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[2] For purposes of this letter, ISDA is defined to include ISDA, its Board, its Board Committees, and any Board or Board committee member acting in that capacity.

[3] *See* June 2019 Letter at 3.

[4] *See id.* at 4.

derivatives and cash markets referencing the rate.[5] USD LIBOR, along with other LIBOR rates, is regulated by the United Kingdom's Financial Conduct Authority ("FCA").[6]

C. IBOR Reforms

ISDA's proposed amendments are part of a larger effort to identify and implement alternatives to IBORs. After the financial crisis of 2008, U.S. and international regulators uncovered manipulation of different IBORs. Banks manipulated their rate submissions in an attempt to project financial soundness during the financial crisis and to benefit their trading positions. These manipulation cases, along with declining activity in the interbank lending markets underlying banks' rate submissions to IBOR administrators, undermined confidence in the reliability and robustness of the current IBOR system.

The Financial Stability Board ("FSB") was tasked by the G20 to review major interest rate benchmarks and ensure that these types of benchmarks are robust and used appropriately, and different working groups were created to identify, and develop if necessary, alternative or "fallback" rates to be used if existing IBORs are discontinued.[7] In the United States, the responsible working group is the Alternative Reference Rates Committee ("ARRC").[8]

In 2016, the FSB asked ISDA to develop fallback arrangements for derivatives contracts in the event that an IBOR referenced in a derivatives contract is permanently discontinued, which prompted ISDA's work on developing fallback rates and procedures.[9] The prospect of an IBOR becoming permanently discontinued became more likely when the FCA announced in 2017 that it could not guarantee that LIBOR rates would be available after 2021,[10] and reiterated this deadline earlier this year.[11]

D. Development of ISDA's Proposal

ISDA conducted six public consultations between July 2018 and February 2020 to educate the public and market participants about the proposed amendments to ISDA's standard documentation, to solicit feedback on how the fallback rates should be structured and

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[5] *See* Alt. Reference Rates Comm., *Frequently Asked Questions* (July 16, 2020) at 2, https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/ARRC-faq.pdf [hereinafter *ARRC FAQs*].
[6] LIBOR rates are calculated for the U.S. dollar, British pound sterling, Swiss Franc, Japanese Yen, and Euro. For each currency, rates are calculated for seven maturities ranging from overnight to twelve months. *Id.*
[7] Fin. Stability Bd., *Reforming Major Interest Rate Benchmarks* (July 22, 2014), https://www.fsb.org/wp-content/uploads/r_140722.pdf [hereinafter *FSB Report*].
[8] The ARRC is chartered and administered by the Board of Governors of the Federal Reserve System in cooperation with the Federal Reserve Bank of New York. *See ARRC FAQs* at 1.
[9] *See* June 2019 Letter at 6.
[10] Andrew Bailey, *The Future of LIBOR*, July 27, 2017, https://www.fca.org.uk/news/speeches/the-future-of-libor.
[11] Edward Latter, *LIBOR Transition – The Critical Tasks Ahead of Us in the Second Half of 2020* (July 14, 2020), https://www.fca.org.uk/news/speeches/libor-transition-critical-tasks-ahead-us-second-half-2020.

calculated, and whether to include a "pre-cessation trigger" for certain rates.[12] The consultations were announced on ISDA's website, and responses were open to the public. Based on the feedback received from these consultations and discussions with regulators and other stakeholders, ISDA prepared the proposal that is the subject of this letter.[13]

II. ISDA's Proposal

ISDA proposes to issue (1) a supplement that amends the 2006 ISDA Definitions to incorporate designated fallback rates for certain IBORs (the "Proposed Supplement"), and (2) a protocol that ISDA members can use to apply these designated fallback rates to legacy contracts (the "Proposed Protocol"). ISDA's proposal is designed to replace the current fallback mechanisms in the 2006 ISDA Definitions with new fallback rates and details about when those new fallback rates will take effect.

If an IBOR is not available, the current procedure in the 2006 ISDA Definitions is for the derivative contract's calculation agent to calculate an *ad hoc* fallback rate by obtaining quotations from dealers in the relevant interbank market.[14] This solution is not practical, however, if an IBOR is permanently discontinued or if there are an insufficient number of banks willing or able to provide quotations for an *ad hoc* fallback rate.[15] To take into account these scenarios, ISDA's model documents need to be amended to incorporate new fallback rates and calculation methods so that market participants can, if they so choose, refer to these new rates in derivatives contracts going forward and efficiently amend legacy contracts to incorporate the new rates when needed.

ISDA's Proposed Supplement and the Proposed Protocol redefine certain IBORs that can serve as "rate options" by adding provisions that incorporate the proposed fallback rates and terms necessary to implement them.[16] Transactions that use the 2006 ISDA Definitions and are entered into after the Proposed Supplement's effective date will include the Proposed Supplement's definitions for certain IBORs, which include the proposed fallback rates.

These fallback rates are based on replacing a given IBOR with an adjusted "risk-free rate" ("RFR"). RFRs are interest rates where there is zero or nearly zero risk of default or loss. As part of the FSB's work in transitioning the financial community away from using IBORs, public-private working groups reviewed IBORs related to their relevant

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[12] *See* July 2020 Letter at 3-5.

[13] The Department does not express any position regarding the consultation process ISDA used to receive input in drafting its proposal.

[14] *See* June 2019 Letter at 5.

[15] *See id.*

[16] Specifically, the Proposed Supplement's new definitions that incorporate fallback rates are to certain terms defined in Section 7.1 of the 2006 ISDA Definitions. *See* June 2019 Letter at 10; ISDA, *Amendments to the 2006 ISDA Definitions to include new IBOR fallbacks, Supplement number [70] to the 2006 ISDA Definitions* (pre-publication version) at 1 [hereinafter *Proposed Supplement*].

jurisdictions and recommended the RFR that should serve as replacements.[17] ISDA selected the RFRs recommended by the working groups to serve as the basis for the proposal's fallback rates.[18]

Since the RFRs selected by ISDA are overnight, risk-free rates, the RFRs need two different types of adjustments to function as fallbacks for their corresponding IBORs: (1) a "term" adjustment that accounts for the different maturities used for IBOR rates (*e.g.*, three months or twelve months); and (2) a "spread" adjustment that accounts for the risk premium reflected in IBORs but not RFRs. The fallback rates in the Proposed Supplement incorporate these adjustments, as calculated by ISDA's designated calculation and distribution vendor for the fallback rates.[19]

Derivatives contracts already in place will be able to incorporate the proposed fallback rates through ISDA's Proposed Protocol. If all of the parties to a particular contract are signatories to the Proposed Protocol, then the contract will incorporate the new fallback rates.[20] By using the Proposed Protocol, there is no need to go back and individually re-negotiate contracts to incorporate the new fallback rates, unless the parties to the contract wish to negotiate and use a different rate. The Proposed Protocol is voluntary and "without prejudice to any amendment modification or waiver in respect of a Protocol Covered Document [*i.e.*, individual derivatives contract] that the parties may otherwise effect in accordance with the terms of that [contract]."[21]

The fallback rates in the Proposed Supplement and Proposed Protocol come into effect when an IBOR's administrator or the administrator's regulator announces that the administrator has ceased providing, or will cease providing, the rate and that there is no successor administrator.[22] There is also a "pre-cessation trigger" in the Proposed Supplement and Proposed Protocol for the LIBOR rates, which are currently regulated by the FCA. The trigger implements the appropriate fallback rate if there is a statement by the rate's regulator that the rate is no longer "representative of the underlying market and economic reality that such [rate] is intended to measure and that representativeness will not be restored."[23] This could happen if, for example, the number of panel banks submitting rates used to calculate a particular LIBOR rate shrinks significantly.[24]

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[17] For a list of the public-private working groups with whom ISDA has consulted to identify the appropriate risk-free-rates, *see* June 2019 Letter at 7, Table 1. The Department does not take any position regarding the process the working groups used to select their recommended RFRs.

[18] June 2019 Letter at 7. The Department does not take any position regarding the process ISDA used to select these RFRs.

[19] The Department does not take any position regarding the process ISDA used to select its calculation and distribution vendor, Bloomberg Index Services Limited.

[20] *See* ISDA, *ISDA 2020 IBOR Fallbacks Protocol* (pre-publication version) at 2 [hereinafter *Proposed Protocol*].

[21] *Id.* at 2.

[22] *See Proposed Supplement* at 90; *Proposed Protocol* at 50.

[23] *Id.*

[24] *See* October 2019 Letter at 6.

ISDA has represented that market participants are not required to use the Proposed Supplement's fallback rates or the Proposed Protocol, and may use different fallback rates if they think that the current fallback procedure or an alternative fallback rate is more appropriate for a particular contract.[25]

III. Analysis

The first step in the Department's analysis is to decide whether ISDA's proposal should be evaluated under the *per se* rule or the rule of reason.[26] The Department reviews agreements among competitors, like ISDA's proposal to adopt the Proposed Supplement and Proposed Protocol, under the *per se* rule only if the agreements are of a type "that would always or almost always tend to restrict competition and decrease output."[27] The types of changes to model documents that are the subject of ISDA's proposal are not the type of agreements that the Department has historically viewed as always or almost always likely to raise price or reduce output, so evaluating ISDA's proposal under the *per se* rule is inappropriate.[28] The Department analyzes agreements that fall outside of the *per se* rule under the rule of reason, and believes that the rule of reason analysis is appropriate for ISDA's proposal.

A. Potential Anticompetitive Effects of ISDA's Proposal

The Department's analysis begins by assessing whether the conduct under review has the potential to harm competition. For example, ISDA's proposed fallback rates for IBORs could result in one group of derivatives users benefiting at the expense of another. Based on ISDA's representations and the Department's investigation, however, anticompetitive effects arising from ISDA's Proposed Supplement and Proposed Protocol do not appear to be likely.

Members of an association that help develop a product standard "implicitly [may enter into] an agreement not to manufacture, distribute, or purchase certain types of products" that fall outside that standard.[29] Here, the Department does not believe that ISDA's proposal indicates an agreement among its members to limit their choice of fallback rates to only the proposed fallback rates in the Proposed Supplement and Proposed Protocol. If a user of ISDA's model documents does not wish to use the proposed fallback rates, nothing in the Proposed Supplement or Proposed Protocol prevents the user from entering

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[25] *See id.* at 4.

[26] Notwithstanding the involvement of government officials at different points in ISDA's preparation of its Proposed Supplement and Proposed Protocol, this letter's analysis does not rely on an application of antitrust immunity to ISDA based on a claim that ISDA's proposal was done at the federal government's direction. *See* Letter from Makan Delrahim, Assistant Att'y Gen., U.S. Dep't of Justice, to Lori A. Schechter, McKesson Corp., at 7 (April 4, 2020), https://www.justice.gov/atr/page/file/1266511/download.

[27] *Broadcast Music, Inc. v. Columbia Broadcasting Sys.*, 441 U.S. 1, 19-20 (1979); *see also* U.S. Dep't of Justice and Fed. Trade Comm'n, *Antitrust Guidelines for Collaborations Among Competitors* §§ 1.2, 3.2 (2000), https://www.justice.gov/atr/page/file/1098461/download.

[28] *See Leegin Creative Leather Prod., Inc. v. PSKS, Inc.*, 551 U.S. 877, 886-887 (2007).

[29] *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492, 500 (1988).

into a derivatives contract (or amending one currently in place) that uses an alternative rate, including rates not included in the 2006 ISDA Definitions.[30]

Choosing a particular rate as the basis for an IBOR's fallback rate could have the potential for anticompetitive effects by preventing other rates from being used instead.[31] Here, the Department has no reason to believe that anticompetitive effects are likely to arise from ISDA's proposal to use the RFRs it has chosen to use as the starting point for its proposed fallback rates. The RFRs were chosen by public-private working groups tasked by the FSB to identify suitable RFRs to replace their corresponding IBORs.[32] For this reason, the Department does not believe that using these RFRs is likely to have anticompetitive effects. The Department also does not believe that the adjustments to these RFRs are likely to have anticompetitive effects. One reason for this belief is the breadth of support ISDA received for the proposed adjustments during its consultation process soliciting input from the industry regarding possible adjustment approaches.[33] In addition, the fallback rates defined in the Proposed Supplement and Proposed Protocol are non-exclusive and voluntary, so if users of ISDA's model documents would rather use an alternative fallback rate, they are free to do so.

With respect to ISDA's Proposed Protocol, the Department does not consider the Proposed Protocol likely to have anticompetitive effects. The Proposed Protocol is voluntary; if holders of derivatives contracts wish to use different fallback procedures than those in the Proposed Protocol, they can decide not to sign the Proposed Protocol and to individually amend their contracts instead. In addition, the Proposed Protocol permits users to further amend derivatives contracts covered by the Proposed Protocol. As a result, if a firm has a number of derivatives contracts that use IBORs, that firm may use the Proposed Protocol and still retain the option to negotiate different fallback rates for specific contracts. For these reasons, the Department has no current reason to believe that the Proposed Protocol is likely to have anticompetitive effects.

With respect to ISDA's decision to include a pre-cessation trigger for the LIBOR rates, the Department does not see the potential for anticompetitive harm arising from this aspect of ISDA's Proposed Supplement and Proposed Protocol. The pre-cessation trigger is structured as a default provision, so if parties to a particular derivatives contract wish to use a different type of pre-cessation trigger, or not use one at all, they are free to do so.

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[30] *See* June 2019 Letter at 3.

[31] *See, e.g.*, U.S. Dep't of Justice & Fed. Trade Comm'n, *Antitrust Guidelines for the Licensing of Intellectual Property* § 4.1.2 (Jan. 12, 2017) ("Such restraints may anticompetitively foreclose access to, or increase competitors' costs of obtaining, important inputs, or facilitate coordination to raise price or reduce output.").

[32] *See FSB Report* at 59. The Department does not take any position regarding the process used to select the RFRs by the public-private working groups.

[33] The Department does not take any position regarding the methodology underlying the spread and term adjustments in the Proposed Supplement and Proposed Protocol or the consultation process ISDA used to obtain feedback regarding these adjustments.

B. Procompetitive Benefits of ISDA's Proposal

The Department also considered the procompetitive aspects of ISDA's proposal. The Department believes that ISDA's proposal is likely to have substantial procompetitive benefits and that these benefits outweigh the possible anticompetitive effects.

The Department first notes that there are benefits from increasing the efficiency and certainty in calculating the value of fallback rates should an IBOR be discontinued. As noted above, the current 2006 ISDA Definitions have a cumbersome, contract-by-contract process that must be used if an IBOR is unavailable.[34] By establishing a standard and widely available rate that can serve as the fallback for an IBOR in case the rate is discontinued (or found unrepresentative), time and effort needed to obtain quotes and calculate rates on a contract-by-contract basis can be avoided. Similarly, the Proposed Protocol allows users of derivatives contracts to save time and effort by easily incorporating the proposed fallback rates into existing derivatives contracts without having to individually re-negotiate the contracts.

In addition, the proposed fallback rates in ISDA's proposal increase the predictability and certainty of rate calculations for derivatives contracts that use the Proposed Supplement's definitions going forward and contracts currently in place that are amended via the Proposed Protocol. The added certainty provided by the Proposed Supplement and Proposed Protocol should substantially reduce the number of disputes surrounding the calculation of fallback rates should their IBORs be discontinued.

Basing the designated fallback rates on the RFRs identified by public-private working groups is likely to have procompetitive benefits. Since firms often use derivatives contracts to hedge loans and other obligations, and working groups like the ARRC have developed fallback language to incorporate these RFRs into non-derivative products, using the same RFRs for ISDA's proposed fallback rates lowers the risk of mismatched hedges and helps improve the stability of the financial system.[35]

The pre-cessation triggers included in the Proposed Supplement and Proposed Protocol are also likely to have procompetitive effects. The triggers are intended to address a scenario where an IBOR is considered no longer representative, but is still in effect. Including such a trigger will help ensure a more predictable transition process from IBORs to the proposed fallback rates, including a consistent transition process as between derivatives contracts using ISDA's model definitions and other products that reference the same IBORs and use a similar pre-cessation trigger.

More generally, ISDA's proposal, made in cooperation with government regulators and industry participants, has the potential to benefit the financial services industry by helping

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[34] *See* note 15 and accompanying text, *supra*.

[35] *See* Alt. Reference Rates Comm., *Second Report* (March 2018) at 25-26, 28, https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-Second-report.

foster a smooth transition away from IBORs to other reference rates. By working with regulators and public-private working groups like the ARRC, ISDA's use of working-group-endorsed RFRs as the basis for its fallback rates encourages standardization and adoption of those RFRs for other uses, such as for business and consumer loans.[36] In addition, ISDA's proposal to adopt certain adjustments to RFRs for its proposed fallback rates has encouraged others to adopt similar adjustments for their fallback rates, facilitating standardization of contract language across financial products.[37]

IV. Conclusion

Based on our investigation and ISDA's representations regarding its proposal to amend its standardized documentation to include the Proposed Supplement and Proposed Protocol, the Department has concluded that ISDA's proposal is unlikely to produce anticompetitive effects, and ISDA's proposal has the potential to offer substantial benefits to the financial services industry. Accordingly, the Department has no present intention to challenge ISDA's proposal to amend its standardized documentation.

This letter expresses the Department's current enforcement intention and is predicated on the accuracy of the information and assertions that you have presented to us, as well as the additional qualifications set forth in this letter. In accordance with our normal practices, the Department reserves the right to bring an enforcement action in the future if the actual operation of the proposed conduct proves to be anticompetitive in purpose or effect.

This statement is made in accordance with the Department's Business Review Procedure, 28 C.F.R. § 50.6. Pursuant to its terms, your business review request and this letter will be made publicly available immediately, and any supporting data you submitted will be made publicly available within 30 days of the date of this letter, unless you request that part of the material be withheld in accordance with paragraph 10(c) of the Business Review Procedure.

Sincerely,

Makan Delrahim

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[36] *See, e.g.*, *ARRC FAQs* at 6 (describing SOFR as "suitable to be used across a broad range of financial products, including but not limited to, derivatives (listed, cleared, and bilateral-OTC), and many variable rate cash products that have historically referenced LIBOR").

[37] *See, e.g.*, Alt. Reference Rates Comm., *ARRC Announces Further Details Regarding its Recommendation of Spread Adjustments for Cash Products* (June 30, 2020), https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Recommendation_Spread_Adjustments_Cash_Products_Press_Release.pdf.