

October 30, 2023

ISDA letter to Equity Swap counterparties, regarding the adoption of the 2021 ISDA Interest Rate Derivatives Definitions via the ‘ISDA 2023 Equity Swap – 2021 Definitions Protocol’

You are receiving this letter as part of your dealer’s outreach around an industry initiative to move participants in the equity swap markets onto the 2021 ISDA Interest Rate Derivatives Definitions¹ (the “**2021 Definitions**”) which were published in June 2021 as a replacement for the 2006 ISDA Definitions (the “**2006 Definitions**”). To facilitate this transition, ISDA is publishing the ISDA 2023 Equity Swap – 2021 Definitions Protocol (the “**Equity Swap Protocol**”).

Use of ISDA’s interest rate definitions in equity derivatives transactions.

Equity swaps traded under an ISDA Master Agreement primarily rely on one of ISDA’s equity definitions booklets² as the basis for their standardized provisions. It is common practice, however, to additionally incorporate ISDA’s interest rate definitions to describe the interest rate cashflows. To date, this has usually been the 2006 Definitions but as set out below we believe that the reasons to transition newly executed equity swaps onto the 2021 Definitions are now compelling.

Reasons to transition equity swaps onto the 2021 Definitions

(1) End of Support for the 2006 Definitions

The 2006 Definitions played a pivotal role in interest rate derivatives markets for 15 years. They have also been widely used in derivatives relating to other asset classes such as equity swaps to describe interest rate cashflows.

By 2021 however, they were well past their best. In order to understand the terms of a new trade executed under the 2006 Definitions, market participants had to wade through around 90 Supplements (amounting to over 600 pages of amendments) as well as the main book. That was clearly not a sustainable situation, and even with all those amendments, the 2006 Definitions had fallen behind the times in certain key areas.

Given these issues, ISDA **stopped** supporting the 2006 Definitions following October 4th, 2021. This means that when new amendments, such as new interest rate benchmarks, fallbacks and changes to reflect market practices, have to be initiated,

¹ For more information on the changes in the 2021 Definitions from the 2006 Definitions, please visit <https://www.isda.org/2021/06/24/key-changes-in-the-2021-isda-interest-rate-derivatives-definitions/>

² The 2002 ISDA Equity Definitions or the 2011 ISDA Equity Definitions

ISDA will only update the 2021 Definitions and will **not** produce further Supplements to the 2006 Definitions – we are already on version 9 of the 2021 Definitions.

(2) *Advantages of the 2021 Definitions for participants in the equity derivatives markets*

While the new 2021 Definitions retain a significant amount of what works well in the 2006 Definitions, key changes³ include:

- **No more supplements.** Publication of the 2021 Definitions on the ISDA MyLibrary⁴ platform means they can be amended and restated in their entirety each time they require updating. That means no more juggling Supplements. The platform highlights changes between versions so you can always have a consolidated view of how they have evolved over time.
- **FRO Matrix.** The representation of Floating Rate Options (“FROs”) in a matrix containing the definitions, attributes, and fallbacks of all FROs, including those that are used in equity swaps, makes such information easier to manage and consume. The FRO matrix is regularly updated with the inclusion of new FROs and the corresponding fallback provisions. This means that parties can benefit from updates without having to manually update their equity swap documentation and leverage the latest industry-standard terminology.
- **Alignment with the Interest Rates market.** In recognition of some of the issues set out in this letter, the interest rates derivatives market has now overwhelmingly moved onto the 2021 Definitions. All global CCPs (representing 100% of cleared trades and around 70% of all interest rate trades) have moved onto the 2021 Definitions. For non-cleared interest rate derivatives, around 80% of new dealer-to-client trades confirmed in MarkitSERV now reference the 2021 Definitions. Parties to equity derivatives transactions who are also active in the interest rate derivatives market would benefit from having consistency of terms, provisions and consequences across such equity derivatives transactions and their interest rates derivatives-linked portfolios. For example, transitioning means that lifecycle events will not be treated differently on cleared interest rate swaps compared to the interest rate leg of your equity swap governed by the interest rate definitions.

The benefits to be gained from using the new definitions combined with the rapidity with which the 2006 Definitions are becoming outdated means the time for equity swap markets to engage with this process is now.

³ Detailed descriptions of these improvements can be found here: <https://www.isda.org/2021/06/24/key-changes-in-the-2021-isda-interest-rate-derivatives-definitions/>

⁴ <https://isda.mylibrary.org>

Features of the Equity Swap Protocol

Over the years ISDA has published many protocols which have successfully facilitated industry-wide amendment to ISDA documentation. The benefits of using an ISDA Protocol to effect amendments is that it eliminates costly and time-consuming bilateral negotiations and allows the market to transition in a synchronized manner. ISDA is now publishing the Equity Swap Protocol that adherents can use to transition newly executed equity derivatives transactions onto the 2021 Definitions. Key features include:

- updating references to a 2006 Definitions FRO to the equivalent 2021 Definitions FRO referencing the same underlying benchmark⁵;
- updating terms that are used in the 2006 Definitions to corresponding terms in the 2021 Definitions; and
- inserting certain supplementary fields into each covered template equity swap transaction supplement, such as those relating to compounding, averaging and other features of a FRO.

The Equity Swap Protocol will not amend any legacy trades executed before the protocol becomes effective between the parties and any hard-wired elections or bespoke amendments shall continue to apply mutatis mutandis to the equivalent provisions in the 2021 Definitions.

Reasons to adhere to the Equity Swap Protocol

We understand that transitioning to the 2021 Definitions for equity swaps may be burdensome. However, adopting the 2021 Definitions, will avoid continuing to reference a set of definitions which is rapidly becoming stale.

Adhering to the Equity Swap Protocol is the most efficient way for parties to update their equity swap documentation so that new trades incorporate the 2021 Definitions rather than the 2006 Definitions. For parties that adhere to the Equity Swap Protocol, all in-scope documentation will be updated on one date, in a synchronized fashion with the other adhering parties.

ISDA opened the Equity Swap Protocol for general adherence on **Monday October 30th, 2023**, ahead of a Protocol Effective Date currently expected to be **Monday March 18th, 2024**. This five-month period will provide time for adherents to perform any internal systems' updates as required (e.g., paper and electronic confirmation systems updates) and allow a greater number of adhering parties to synchronize their alignment with the 2021 Definitions on the same date.

Institutions who adhere to the Protocol on behalf of some of its clients or on behalf of all clients except for identified excluded clients will need to disclose such client list on the

⁵ As set out in version 7 of the 2021 Definitions FRO Mapping Tables available here: <https://www.isda.org/a/KNogE/2006-FRO-Mapping-to-2021-FROs-Version-7.pdf>

Agency Adherence Module within ISDA Amend. Such functionality is expected to be available from the middle of February 2024.

More information on the Agency Adherence Module is contained in the Equity Swap Protocol FAQs, available on the following webpage <https://www.isda.org/2023/05/31/isda-equity-swap-protocol-2021-definitions>.

The Equity Swap Protocol text and information on how to adhere to the Equity Swap Protocol are also available on the same website.

The creation of the new definitional booklet was significantly driven by a desire to provide buy-side and corporate end users with a better outcome in the derivatives market. We were very grateful to our buy-side members and the buy-side associations who dedicated significant time and resources into ensuring that was achieved. We believe it is now in all market participants' interests to ensure they take steps today that will allow them to enjoy the benefits of all that endeavor.

ISDA would welcome the opportunity to discuss these topics with you. If you have any questions about the Equity Swap Protocol or the 2021 Definitions, please do not hesitate to contact ISDA.

ISDA Contacts:

Michelangelo de Marzio (mdemarzio@isda.org)

Monica Chiu (mchiu@isda.org)