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LIBOR IS COMING TO AN END
WILL YOU BE READY!

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Managing The Risks Associated With The End of Libor

- Libor is the "London Interbank Offered Rate"
  - Set Daily By a "Panel" of Large Banks in London
- Quoting on Interest Rates Banks Would Have to Pay If They Borrowed From Other Banks On An *Unsecured* Basis
  - Quoted in Five Different Currency Denominations
  - And Seven Different Maturities

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Managing The Risks Associated With The End of Libor (cont.)

- Massive Population of Contracts Pegged to Libor
- $370 Trillion Worldwide for All Denominations
- $200 Trillion U.S. Dollar Libor, Including
  - $81 Trillion in Interest Rate Swap Contracts
  - $1.2 Trillion in Retail Mortgages
    - Fannie/Freddie Created Robust Secondary Market
  - $800 Billion in Non-Syndicated Business Loans
  - $1.1 Trillion in Non-Syndicated CRE/Commercial Mortgages

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Managing The Risks Associated With The End of Libor (cont.)

- In 2005, Regulators Discovered That Panel Banks Were "Rigging" The Quotes to Their Own Advantage
  - Paid Billions in Fines
  - Reforms Were Implemented
- In the Aftermath, Many of the Banks Wanted to Exit the Panel
  - Due to Very Thin Markets in Unsecured Borrowing
  - Litigation Risks for "Educated Guesses"
- In 2017, British Regulators Announced That After the End of 2021, They Would Stop Compelling Banks to Submit Quotes

Managing The Risks Associated With The End of Libor (cont.)

- Could Libor Cease to Exist <u>Before</u> the End of 2021?
  - Fear of A So-Called "Zombie Index"
- Could Libor Continue to Exist <u>Beyond</u> 2021?
- In U.S., Fed Convenes the Alternative Reference Rate Committee ("ARRC")
  - To Identify Alternative Reference Rates
  - Create an "Adoption Plan"
  - To Promote a "Smooth and Orderly Transition"

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Managing The Risks Associated With The End of Libor (cont.)

- In 2017, ARRC Introduces a New Index Called "Secured Overnight Financing Rate" ("SOFR")
  - Based on Cost of Repurchase Agreements
  - Overnight Loans Secured by U.S. Government Debt
  - Over $650 Billion in Daily Transactions
- SOFR is Not a Perfect Substitute for Libor
  - No Credit Risk in Rate
  - Only Daily Maturities (No Term Risk in Rate)

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Managing The Risks Associated With The End of Libor (cont.)

- Estimated that SOFR Will Track Lower Than Libor
- According to Urban Institute, If Used As a Substitute in Outstanding Residential Mortgage Contracts (Roughly $1.2 Trillion)
  - Estimated Windfall to Borrowers Would Be $2.5 to $5 Billion Per Year
- ARRC Expected to Develop Alternative "Term" Rates Based on SOFR
  - Also Introduce an "Add-On Adjustment Margin"
  - Unclear When That Will Happen

Managing The Risks Associated With The End of Libor (cont.)

- We Know Libor Will Come to an End!
- What Can You Do To Manage the Risks?
  - Existing Contracts
  - New Contracts
- Perform Inventory Across Institution to Identify Contracts Tied to Libor
  - When Do They Mature?
  - When Does it Reprice?
  - Which Index (i.e., Term and Denomination)?
  - Does It Provide For a Substitute Index?
  - What if Your Contract is Silent?

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Managing The Risks Associated With The End of Libor (cont.)

- If Contract Provides For A Substitute Index
  - What is the Triggering Event?
    - E.G., When the Index Becomes "Unavailable"
    - When is that?
    - What Happens If There Is A Zombie Index?
  - Are You Substituting a "Comparable" Index
    - What is That?
    - Libor is Based on Unsecured Interbank Lending

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Managing The Risks Associated With The End of Libor (cont.)

- Is SOFR "Comparable"?
  - No Credit Risk
  - Overnight Term
  - Libor – 2.03%
  - SOFR – 1.85% (18 Basis Points Lower)
- What Else is There?

One-Year Treasury Securities Rate	- 1.77% (26 Basis Points Lower)
Ameribore Rate	- 1.92% (11 Basis Points Lower)
Fed Funds	- 2.19% (16 Basis Points Higher)

- There Will Likely be A Winner and A Loser
  - Can You Adjust the Margins
- Consider TILA Rate Adjustment Disclosure Requirements

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Managing The Risks Associated With The End of Libor (cont.)

- Should you Change Indexes For New Contracts?

- Consider Comments From Fed Vice Chairman Quarles

  "At this moment, many seem to take comfort in continuing to use Libor … it is familiar; and it remains liquid. But history may not view that decision kindly; after Libor stops, it may be fairly difficult to explain to those who may ask exactly why it made sense to continue using a rate that you had been clearly informed had such significant risks attached to it."

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Managing The Risks Associated With The End of Libor (cont.)

- What Should You Change To?
- On the Consumer Side, We Expect Fannie and Freddie to Designate Comparable Substitutes
  - But When?
  - Servicer vs. Portfolio
  - In the Meantime, Should You Look to Other Marketable Reference Rate Products?
- On the Commercial Side, ARRC Has Been Working On Models and Publishing "Consultations"
  - Still Rely on Libor
  - But Have "Fallback" Provisions With Different Options
  - "Amendment Approach"
  - Versus The "Hardwired Approach"

- Closing Remarks
- Questions & Answers
- Thanks for Coming

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