PROACTIVELY MANAGING THE LIBOR TRANSITION

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Webcast objectives

By the end of this webcast you will be able to:

- Explain the impacts of the LIBOR transition to the financial institution industry
- Identify the key challenges related to the cessation of LIBOR
- Determine how to proactively manage the transition from LIBOR at your institution

Agenda

Topic	Minutes
Background / impact	20
Transition process	30
Accounting considerations	10

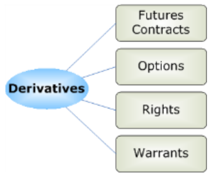
BACKGROUND / IMPACT

LIBOR will cease to exist beyond 2021

- The London Interbank Offered Rate (LIBOR) is the average interest-rate calculated from estimates of the rate a bank would be charged to borrow from other banks (i.e., its cost of funds in the inter-bank market)
  - Updated daily based on a survey of major banks in five currencies (US dollar, Euro, British pound sterling, Japanese yen, and Swiss franc)
  - Forward-looking rate, with implied credit component, over seven borrowing periods ranging from overnight to one year (1 day, 1 week, 1 month, 2 months, 3 months, 6 months, and 12 months)
  - One of the most commonly used reference rates in the global financial markets
- LIBOR is being decommissioned as of the end of 2021
  - Reports of abuse as part of 2008 Financial Crisis resulted in fines, lawsuits, and in LIBOR coming under UK regulatory authority by the Financial Conduct Authority (FCA)
  - Concerns over sustainability as the inter-bank market is no longer sufficiently active and was being maintained by the use of expert judgment by the survey banks
  - Banks also requested relief from submission responsibilities due to increased cost and risk of maintaining governance and controls over the LIBOR survey process

Instruments referencing LIBOR

It is estimated that there is over $200 trillion in contract notional amount tied to LIBOR in the U.S.



Money Market Instruments

- Time Deposits
- Money Market Accounts
- Demand Deposits
- Checking Accounts
- CDs
- Commercial Paper
- Medium-term Notes
- Securities Lending

Loan Products

- Commercial Loans
- Syndicated Loans
- Floating Rate Bank Notes
- Leveraged Loan Facilities
- Intercompany Loans
- Agricultural Loans
- Mortgage Loans
- Home Equity Loans
- Student Loans
- Credit Card Loans
- FHLB Advances

Derivative Securities

- Interest Rate Swaps
- Cross-currency Swaps
- Caps and Floors
- Swaptions
- Mortgage Derivatives
- Exotic Derivatives

Structured Products

- Asset-backed Securities (ABS)
- Mortgage-backed Securities (MBS)
- Commercial Mortgage-backed Securities (CMBS)
- Collateralized Mortgage Obligations (CMOs)
- Collateralized Loan Obligations (CLOs)
- Hybrids and Synthetics

Broad impact across organization

Departments across the organization must be aligned on readiness status in order to be successful (for example, the front office should not modify contracts with clients if operations cannot handle the trades).

Treasury

ALM considerations

Changes to funding and hedging strategies

Business lines

Changes to product design and yield curves

Renegotiate existing contracts

Operations

Collateral management, settlements and confirmation

Legal

Amend legacy contracts and agreements

Review and add of fallback language

Accounting & reporting

Hedge accounting & effectiveness

Accounting for modifications

Discounting and valuations

Market risk

Valuation and sensitivity analysis

Changes to market data and models

IT

Technology & spreadsheet enhancements

Data management and feeds

Compliance

Regulatory compliance and reporting

Supervisory expectations

- Banking regulators have indicated that preparedness for the cessation of LIBOR is a focus area in upcoming exams and that each financial institution will have:
  - Identified and quantified its LIBOR exposure across product and business lines;
  - Conducted a risk assessment of such exposure;
  - Developed and are implementing transition plans with milestones and specific completion dates for such tasks as identifying the need to revise certain contracts and to communicate with customers;
  - Assessed the need for revisions in the bank’s own policies, procedures and internal controls due to the LIBOR transition;
  - Identified those persons at the bank who are responsible for oversight of the transition; and
  - Regularly updates its board of directors on the bank’s LIBOR transition efforts.
- SEC’s OCIE have indicated that upcoming exams will review how company’s have assessed the impact of the LIBOR transition on their business activities, operations, services, customers and investors.

TRANSITION PROCESS

Key considerations in LIBOR transition

- Assess the impact and develop a transition strategy, which includes:
  - Identify project team, governance and timeline
  - Develop process for identifying LIBOR exposures by asset classes and contract types
  - Evaluate alternative reference rate or rates
  - Review fallback language in existing contracts to identify key risk areas
  - Update systems and go forward contract language
  - Analysis of accounting, tax, reporting and controls
- Although the ARRC recommended SOFR as the preferred alternative, other alternatives are available and may be more suitable for certain products based on the organization’s facts and circumstances.
- Engage counterparties and vendors to understand their transition readiness, education, and timelines; set renegotiation plan for historical contracts and agreements
- Engage key stakeholders across the organization early and communicate often as departments across organization will be impacted by the LIBOR transition.

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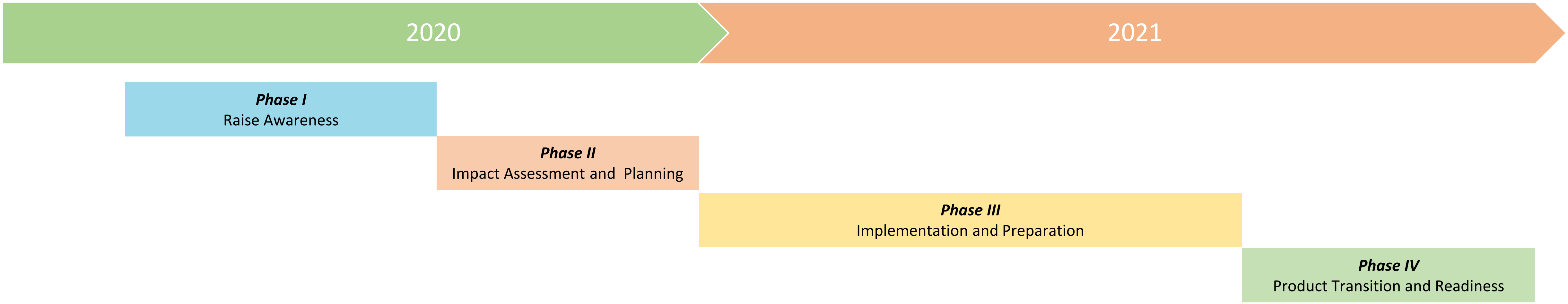
LIBOR transition timeline



I	*II*	*III*	*III*	*III*	*IV*
Raise Awareness	Perform Impact Assessment, Develop Transition Plan and Implementation Office	Identify Affected Products/Contracts	Client Outreach/Education	Adopt Alternative Rate	Post Transition Activities
Obtain an in-depth understanding of the key aspects as well as potential impacts and raise awareness within the institution to lay the foundation for a smooth transition.	Mobilize and organize firm for successful project completion, perform impact assessment along the value chain and set up the project plan.	Collect and analyze products/contracts that are related to LIBOR and identify approach for use of alternative rate for each product type.	Identify timeline and begin client negotiation and outreach.	Assess implications of the new rate across the organization, including risk, tax and accounting impact.	Update books and records to reflect the impact of the new rate and perform post transition validation across the organization.

Potential alternatives to LIBOR[1]

Although the ARRC recommended SOFR as the preferred alternative to LIBOR, other alternatives are available and may be more suitable for certain products based on the organization's facts and circumstances.

Rate	Description
H.15 Commercial Paper (CP)	Overnight unsecured rate based on issuance of short-term debt by AA-rated financial and non-financial institutions. Published in the Federal Reserve H.15 Statistical Release.
Fed Funds / OIS	Overnight unsecured rate set by the Federal Open Market Committee (FOMC) and represents the target lending rate between the Fed and major financial institutions.
Prime Rate	Overnight unsecured rate used in loans granted to credit worthy customers (individuals and corporations) by banks and other lenders.
AMERIBOR	Overnight unsecured lending, mainly between smaller, regional US banks.
U.S. Dollar ICE Bank Yield Index	Unsecured rate that is meant to be a measure of yields paid by banks to its investors. There is potential for it to be combined with SOFR, but it does not exist yet.
"Zombie LIBOR"	Submissions by fewer panel banks after 2021.
SOFR	Overnight secured rate based on the U.S. Government securities repo market.

1. Alternative reference rate information based on data obtained from Market Alpha Advisors

Why is fallback language important?

- Fallback language are the provisions that define how a replacement rate will be identified if the reference rate benchmark is not available.
- Inadequate fallback language may have negative financial impacts
- Common fallback issues include:
  - Language is non-standard and varies widely depending on the originator/issuer
  - Many documents either have no fallback language or inadequate fallback language
  - Language in many documents were written to address a temporary disruption in LIBOR, not a permanent cessation
  - There is no guarantee that documents with inadequate fallback language will be remediated to the satisfaction of the affected party
  - Fallback language in cash instruments will likely not match fallback language in hedge instruments, creating a temporary or permanent mismatch in terms

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Identifying fallback risk

- Legacy business processes are burdened with unsearchable and unstructured documents that impede the enterprise and are costly to store and maintain.
- Accessing and acting on information in unsearchable and unstructured documents is cumbersome, time-consuming and error-prone.
- This unstructured data problem has become painfully apparent to organizations that are preparing for the cessation of LIBOR.
- The only way to understand the cessation risk in LIBOR-linked instruments is to analyze the LIBOR fallback language within deal documents.
- Many contracts did not properly anticipate a permanent cessation of LIBOR so the language in a large percentage of these documents is inadequate.

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ACCOUNTING CONSIDERATIONS

Reference rate reform

Scope

- Applies to all entities
- Applies to contracts that reference LIBOR or an interest rate that has been discontinued or is anticipated to be discontinued
  - Guidance is elective

Main provisions

- Optional expedients and exceptions for applying GAAP to contracts, hedging relationships, and other transactions affected by reference rate reform if certain criteria are met
- Continued application of hedge accounting for hedge relationships that are impacted by reference rate reform yet remain highly effective
- One-time election to transfer or sell HTM securities

Effective period

- From issuance, on March 12, 2020, until Dec. 31, 2022

ASU 2020-04

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Replacing a reference rate

Key issue – modification must relate to replacing a reference rate

Relates to replacing a reference rate (select examples)

- Changes to the referenced interest rate index
- Addition of or changes to a spread adjustment
- Changes to the reset period, reset dates, day-count conventions, etc.
- Addition of fallback terms that are consistent with fallback terms developed by a regulator or by a private-sector working group convened by a regulator

Does not relate to replacing a reference rate (select examples)

- Changes to the notional amount
- Changes to the maturity date
- Changes from a referenced interest rate index to a stated fixed rate
- Changes to the loan structure (for example, changing a term loan to a revolver loan)

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Practical optional expedients for hedge accounting

Amending the hedging relationship	Fair value hedges	Cash flow hedges
• Critical terms • Changing method of assessing effectiveness for cash flow hedges • Rebalancing • Excluded components	• Shortcut method • Changing the designated benchmark rate	• Probability of forecasted transaction occurring • Changing the hedged risk • Initial and subsequent assessment of effectiveness (including shortcut method and simplified approach) • Groups of forecasted transactions

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QUESTIONS AND CLOSING REMARKS

RSM LIBOR solutions

RSM utilizes a three phase approach designed to efficiently produce results for your organization and its stakeholders. Each phase will provide your organization with continual communication and progress towards achieving reference rate reform.

Rapid Assessment

- Engage with the organization's stakeholders to kick off project
- Review and identify impacted contracts efficiently with the latest technology
- Create a roadmap to transition plan that envisions future state

Roadmap Execution

- Provide project management and communication resources
- Assist in the various stages of the execution of the LIBOR transition roadmap
- Assist with documentation of changes to future state

Accounting & Reporting

- Assist with ASU 2020-04 supporting documentation of accounting conclusions made
- Provide support and guidance for when exemptions cannot or are not met
- Assist with updating and enhancing policy, process and controls documentation

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RSM thought leadership (cont.)

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