



LIBOR Transition for Financial Institutions

March 2021

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DUFF & PHELPS
A **KROLL** BUSINESS

Agenda

Section I Introduction

Section II LIBOR Transition – Recent Updates

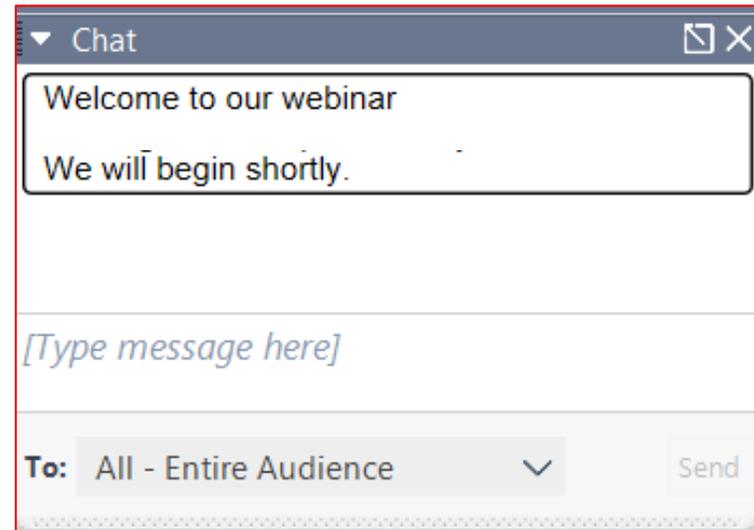
Section III Are you Ready for the Transition?

Section IV Key Takeaways

Appendix I About Duff & Phelps

Notes:

- Ask questions via chat >
- We'll try to answer as many questions as possible
- Handouts included within client



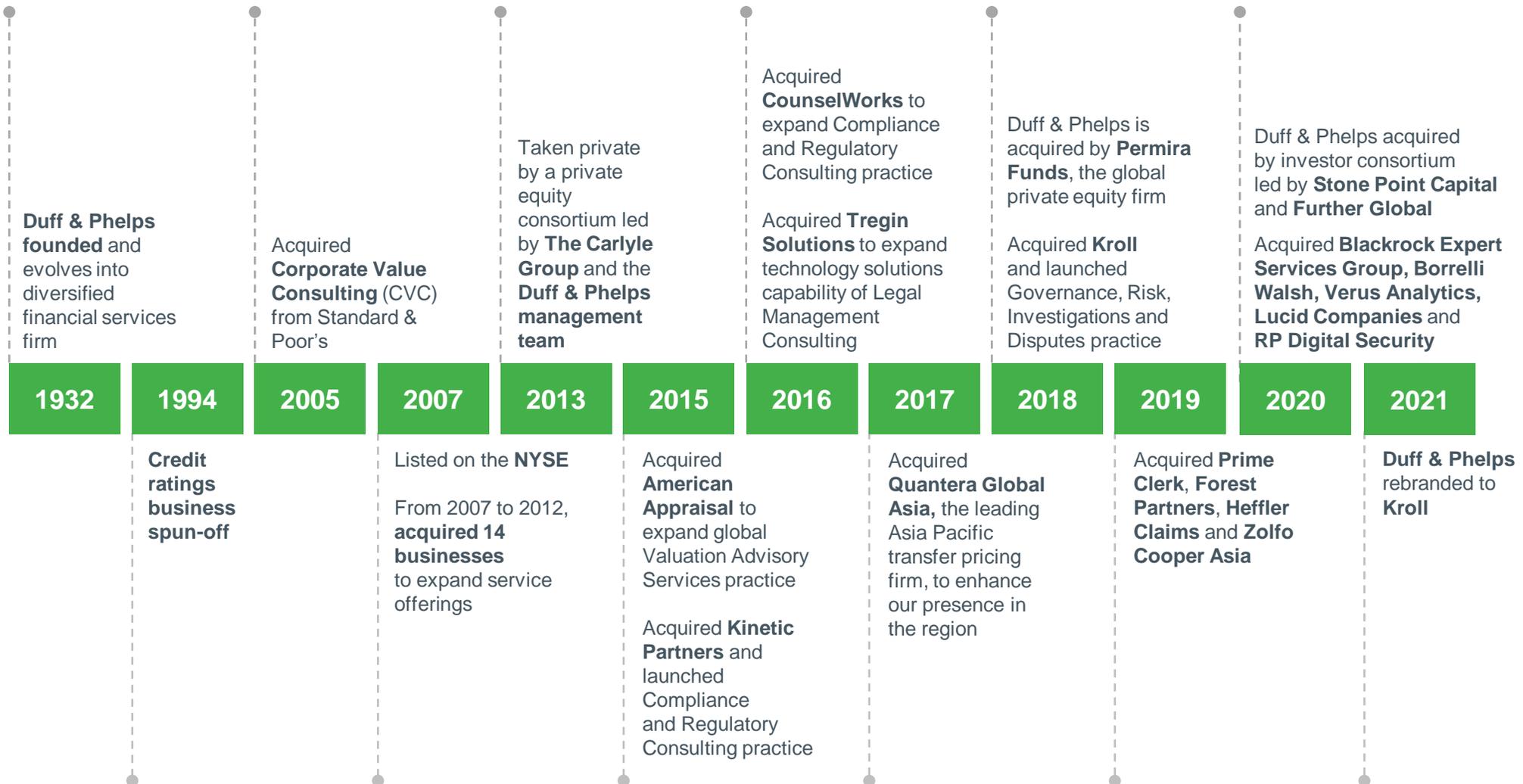
Notes:

- Session is being recorded. You'll receive access to the recording in a couple of days
- CPE Credit: must complete all 4 poll questions. Please message organizers and we will follow up with a certificate after the session
- Please note that this presentation was carefully researched but does not represent legal or financial advice

Introduction

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Panel



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Polling Question 1

Please choose the category that best represents you?

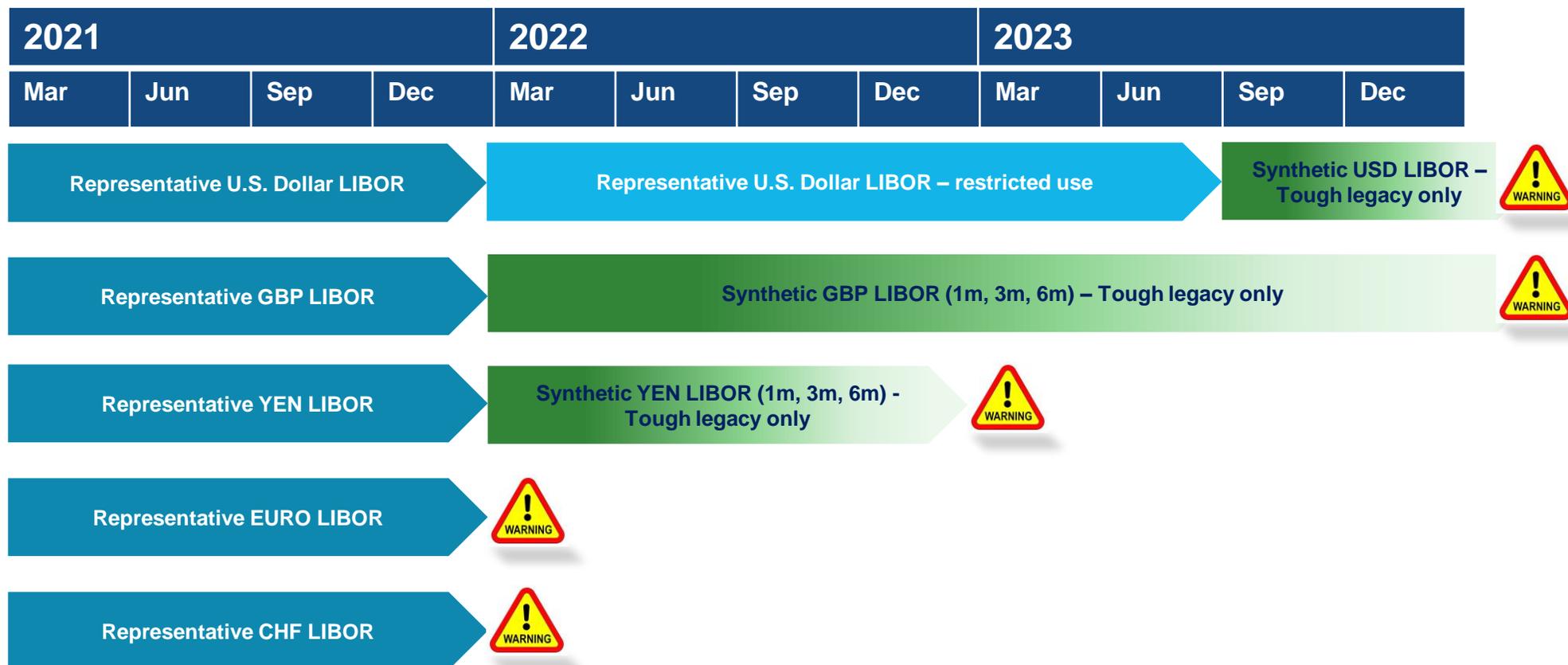
- A. Bank
- B. Hedge Fund
- C. Private Equity Firm
- D. Professional Services Provider
- E. Other

LIBOR Transition – Recent Updates

LIBOR Transition Key Updates

- On March 5, 2021, the FCA announced that **all Sterling, Euro, Swiss Franc, Japanese Yen LIBOR settings, and the 1-week and 2-month US dollar LIBOR setting** to cease publication after December 31, 2021
 - The FCA will likely **mandate the continued publication of 1m, 3m and 6m for GBP and Yen LIBOR as synthetic rates**, meaning they will be based on overnight rates plus a spread adjustment rather than panel bank submissions.
- On November 30, 2020, ICE announced the extension of the publication of **overnight and one-, three-, six- and 12-month USD LIBOR** interest periods, to **June 30, 2023**, subject to market consultation
- ISDA confirmed that the FCA's statement constitutes a cessation event under its protocol governing much of the global OTC derivatives referencing LIBOR. As a consequence, the **fallback spread adjustment published by Bloomberg was fixed as of March 5, 2021**.
- On March 17, 2021, ARRC announced that it has selected **Refinitiv to publish its recommended spread adjustments and spread-adjusted rates for USD cash products**. Refinitiv will publish ARRC-recommended spread adjustments to SOFR-based rates and spread-adjusted SOFR-based rates for cash products that transition away from USD LIBOR.
- Forward Term SONIA rates have begun publication and SOFR rates are expected to be published by **June 30**
- The Federal Reserve is **intensifying its scrutiny** of banks' efforts to shed their reliance on USD LIBOR, and has begun compiling more detailed evidence on their progress

LIBOR Transition Timelines

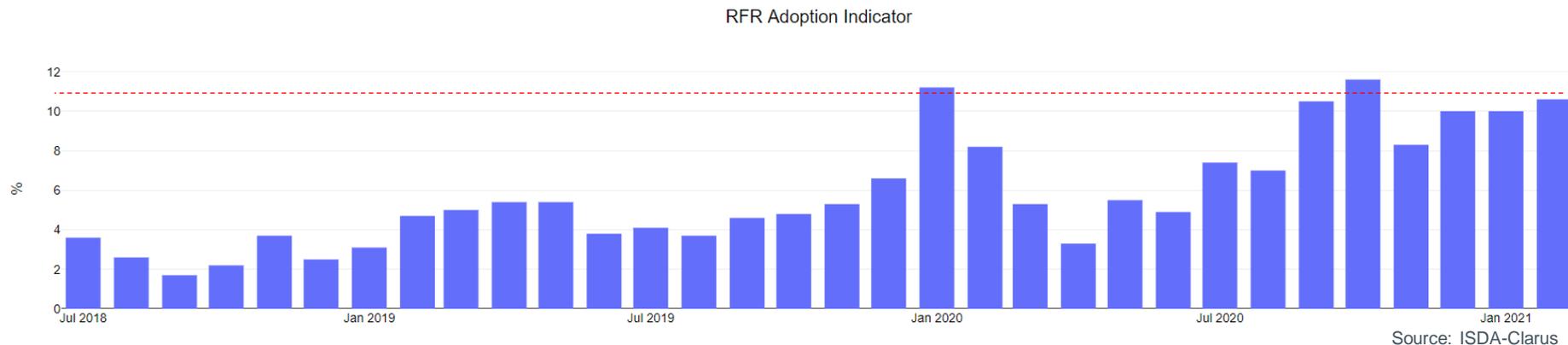


Key Takeaways

- Market participants must **understand their exposures**, in particular the contractual provisions regarding alternative reference rates, fallbacks, governing jurisdiction, and amendments
- Existing credit agreements with an expiry date after December 31, 2021 or June 30, 2023 depending on the LIBOR setting **should be amended as soon as practicable** to include the appropriate LIBOR fallback language
- **All new issuance of LIBOR products to cease** before December 31, 2021

Where Are We With Risk Free Rate (RFR) Adoption Rate?

ISDA-Clarus RFR Adoption Indicator



In February 2021, the indicator stood at 11% of risk-weighted DV01 activity across all interest rate derivatives and LIBOR currencies plus AUD.

97%

**OF GBP INTEREST
RATE DERIVATIVES
COVERED BY
FALLBACKS***

*Source: FCA estimate

98%

**OF FRNS
REFERENCING USD
LIBOR HAD
MATURITIES BEFORE
JUNE 30 2023^**

^Source: ICMA

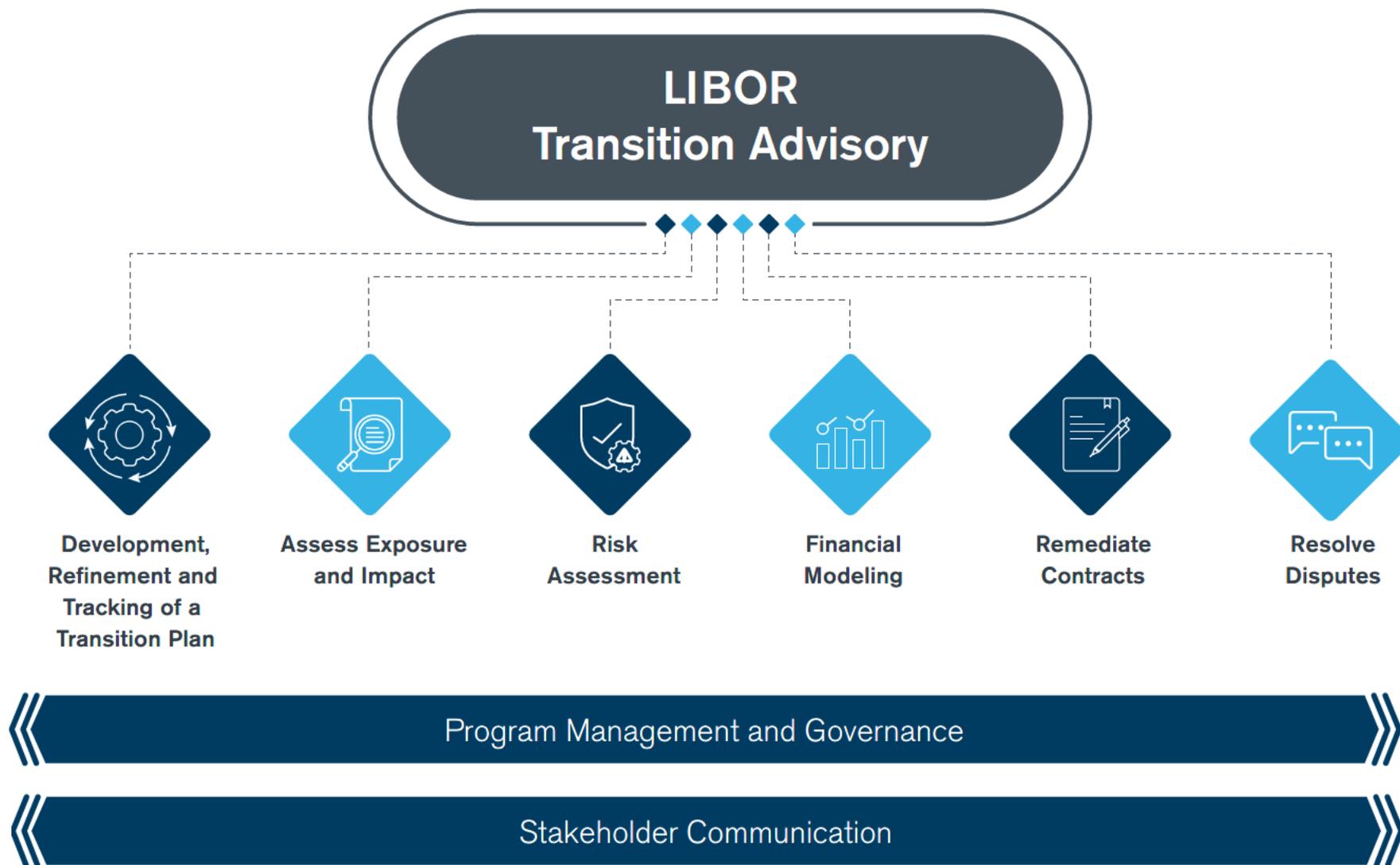
Are you Ready for the Transition?

Polling Question 2

Where are you in your LIBOR transition process?

- A. We haven't started yet
- B. Just started thinking about it
- C. On track to be ready by mid 2021
- D. On track to be ready by Dec 2021
- E. Not on track to be ready before at least Q1 2022

Various Phases of LIBOR Decommissioning



Development, Refinement and Tracking of your LIBOR Transition Plan

Program Governance

- **Implement a robust governance framework** with accountable senior executives to oversee the delivery and coordination of your LIBOR transition plan
- **Determine approach for rollout of program governance and management framework** to all impacted business lines and enterprise functions
- Define and prioritize program objectives, success criteria and internal milestones in line with the **ARRC's Checklist**

Transition Management

- Conduct a **comprehensive impact assessment** across key focus areas including, but not limited to, financial products, contracts, business process (including systems and models)
- Confirm **resource and budget needs** to deliver the activities in the implementation roadmap
- **Proactively monitor and adjust the implementation plan** based on evolving and/or shifting external industry and/or regulatory developments

Communication Strategy

- **Confirm internal and external impacted groups** (clients, regulators, etc.), prioritizing and segmenting as appropriate
- **Educate internal stakeholders** (including business leadership) on LIBOR transition program objectives, industry developments and relevant business impacts
- **Provide clear and consistent messaging on transition impacts to external stakeholders** including clients and investors

Contract Discovery

Approach



Do You Know What is in Your Contracts?

LIBOR Language?



PROBLEM: Review of current rights and restrictions within specific contracts affected by the regulation to identify key attributes and biased terms

Key discovery fields for your LIBOR exposure “Catalogue”

Deal Overview

- Agent(s) / Trustee(s)
- Issuer / Co-Issuer
- Borrowers
- Collateral Manager
- Currency
- Governing Law
- Term
- Maturity Date
- Renewal Period

Collateral

- Collateral Asset Type
- Collateral Rate Type
- LIBOR Relevant (Collateral)

LIBOR

- LIBOR Relevant (Security/Loan)
- Determining Party
- Fallback (LIBOR)
- Fallback Details
- Alternative Reference Rate(s)
- Amending Agreement
- Amendment Jurisdiction

Polling Question 3

Where are you exactly in your transition planning?

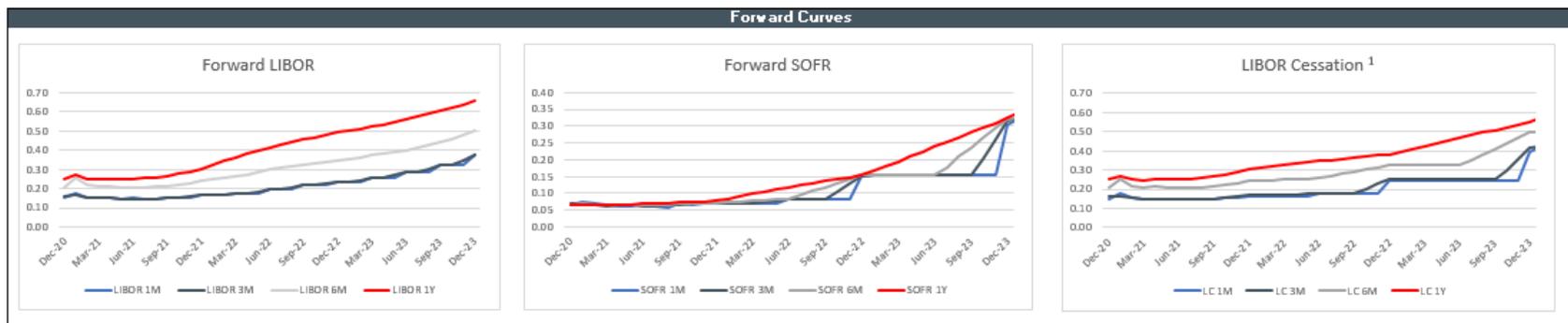
- A. Haven't started yet
- B. Believe no LIBOR exposure, not conducted formal process
- C. Found LIBOR exposures, not catalogued transition provisions
- D. Catalogued LIBOR exposures but unsure what to do next
- E. Comprehensive LIBOR transition plan in place

Scenario Construction

Key Scenario Considerations: LIBOR transition provisions, coupons, transition timing, alternative rate, product and currency liquidity, current and stress market conditions, as well as other risk management parameters

Loan and Private Credit Scenarios											
Description	Name	Amendment %		Hardwire %		Amendment Timing		Hardwire Timing		Last Available Fixation %	
		Liabilities	Underlying	Liabilities	Underlying	Liabilities	Underlying	Liabilities	Underlying	Liabilities	Underlying
Amendment in 6 months	AMEND6	NA	100%	NA	0%	NA	6 Months	NA	NA	NA	0%
Amendment in 12 months	AMEND12	NA	100%	NA	0%	NA	12 Months	NA	NA	NA	0%
"Hardwire" in 6 months	HW6	NA	0%	NA	100%	NA	NA	NA	6 Months	NA	0%
"Hardwire" in 12 months	HW12	NA	0%	NA	100%	NA	NA	NA	12 Months	NA	0%
Last Available LIBOR Fixation	FIX	NA	0%	NA	0%	NA	NA	NA	NA	NA	100%

CLO Scenarios											
Description	Name	Amendment %		Hardwire %		Amendment Timing		Hardwire Timing		Last Available Fixation %	
		Liabilities	Underlying	Liabilities	Underlying	Liabilities	Underlying	Liabilities	Underlying	Liabilities	Underlying
Liability Amendment in 6 Months, Underlying Loan Amendment in 6 months	AA6.6	100%	100%	NA	NA	6 Months	6 Months	NA	NA	NA	0%
Liability Amendment in 6 Months, Underlying Loan Hardwire in 6 months	AH6.6	100%	0%	0%	100%	6 Months	NA	NA	6 Months	NA	0%
Liability Amendment in 6 Months, Underlying Loans Amendment in 12 months	AA6.12	100%	100%	NA	NA	6 Months	12 Months	NA	NA	NA	0%
Liability Amendment in 6 Months, Underlying Loans Hardwire in 12 months	AH6.12	100%	0%	0%	100%	6 Months	NA	NA	12 Months	NA	0%
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Last Available LIBOR Fixation	FIX	NA	0%	NA	0%	NA	NA	NA	NA	100%	100%



Quantitative and Qualitative Impact Assessment

Sensitivities Relative To Pre-Cessation Base Case																		
	Currency	Carry Value	Pre-Cessation Base Case					Scenario 1 - Amendment in 12 months					Scenario 2 - "Hardwire" in 12 months					
			Discount Rate	Discount Margin	WAL	DV01	Cumulative Cash Flow	Carry Value	Discount Margin	WAL	DV01	Cumulative Cash Flow	Estimated P&L Impact	Carry Value	Discount Margin	WAL	DV01	Cumulative Cash Flow
USD																		
RMBS	USD																	
CMBS	USD																	
ABS	USD																	
CLOs	USD																	
Private Credit	USD																	
Broadly Syndicated Loans	USD																	
GBP																		
RMBS	GBP																	
CMBS	GBP																	
ABS	GBP																	
CLOs	GBP																	
Private Credit	GBP																	
Broadly Syndicated Loans	GBP																	
Total	USD																	

Valuation Challenges / Considerations

Term Structure

- **Market Observation**
 - The alternative reference rates (ARR) developed to-date are **overnight rates**. There are ongoing efforts to develop forward looking term structures for the ARR, the most advanced of these is in SONIA where there is sufficient depth in the ARR derivatives market. It is also expected that a SOFR term rate will be available for use by mid-2021
- **Valuation Challenge**
 - Without published forward curves, market participants carry out certain **approximation approaches** through the use of indicative forward-looking term rates as published by the Federal Reserve, and a combination of bootstrapping and extrapolation techniques.

Credit Risk

- **Market Observation**
 - Among other factors, such a **spread differential** primarily highlights the difference in market expectations driven by the perceived credit risk associated with each of the underlying ARR.
- **Valuation Challenge**
 - This challenge will need to be tackled with a **focus on the expected cash flows** associated with the underlying instruments
 - Market participants will need to **re-examine the estimation process of the discount rate** to account for the different risk profile upon transitioning from a legacy LIBOR instrument to a new ARR instrument

Selecting an Alternative Reference Rate (USD)

- While SOFR has been identified as the presumptive USD LIBOR alternative reference rate, other indices market participants are choosing to consider in their transition plans include Ameribor and the Prime Rate

Possible Hurdles

- **Structure of the rate themselves**
 - SOFR a daily rate market without an active and observable derivatives market with no objectively observable forward term rates (set to be published June 30, 2020 per ARRC)
- **SOFR “in arrears” methodology**
 - Simple calculation methodology (ARRC recommended)
 - Compounded daily methodology (ISDA recommended)
- Challenge for market participants with loan portfolios hedged with interest rate derivatives

Technical Considerations

- **Appropriate spread adjustment**
 - Regulating bodies are currently leaning towards spread adjustments based on historical differences between SOFR and the respective LIBOR indices over a five-year lookback period
 - ARRC set to publish the recommended spread adjustments to the forward SOFR term by June 30, 2021

Contract Remediation

Using Technology to Remediate/Repaper



Interviews

- Enable data analytics and stakeholder surveys to scope out specific affected third parties



Contract Extraction

- Leveraging NLP and text analytics, large numbers of contracts can be searched and key clauses, data points, party names, etc. can be extracted, indexed and reviewed.



Contract Review

- Related to contract extraction is the review of the information gleaned from NLP.
- Was the information extracted properly?
- Are there issues with the clauses?



Negotiate

- Leverage a technology framework to negotiate with pre-approved legal clauses

Key Benefits

Establishing a framework that can govern the entire life cycle of a contract, from identifying insufficient agreements to repapering and signing

Regulatory Considerations

What the Regulators have said....

The agencies encourage banks to cease entering into new contracts that use USD LIBOR as a reference rate as soon as practicable and in any event by December 31, 2021, in order to facilitate an orderly—and safe and sound—LIBOR transition.

Board of Governors of the Fed, FDIC, OCC – Statement on LIBOR Transition

"When transitioning their existing contracts, firms receiving LIBOR-linked interest are not expected to give up the difference between LIBOR and SONIA"

FCA, Conduct Risk during LIBOR transition

"Has management identified appropriate replacement rates and adjustment methodologies that do not result in customer harm or expose the bank to unwarranted compliance and reputation risks?"

OCC, LIBOR self-assessment tool

The SEC "encourages [...] entities to analyze how this change [discontinuation of LIBOR] will impact them – their business, systems, models, processes, risk management frameworks, and clients – and to respond accordingly."

SEC, Staff Statement on LIBOR transition

Regulatory Considerations

Key areas

Governance and oversight



- Dependent on size and complexity – committee or senior manager
- **In UK:** Identify the Senior Manager responsible for oversight (SMCR)
- Considerations:
 - Impacts on firm (e.g. financial, business model)
 - Impacts on clients and their fair treatment
- Record-keeping of discussions and decisions

Treatment of customers



- Legacy contracts need to be migrated to alternative RFRs; the outcome must be fair; not an opportunity to charge customers more
- Depending on the complexity of the business, a framework might be advisable to ensure consistent approach to different clients
- Product governance frameworks must be able to consider customer needs and potential conflicts of interest of RFR-linked offering

Communication with customers



- Communications with customers to be clear, fair and consistent
- Must adapt to the sophistication and financial literacy of the individual customer
- Should be transparent and fairly presented regarding benefits, costs and risks of transition outcomes and potential options (e.g. compounded vs term rates)

Conflicts and market abuse



- LIBOR transition poses the risk of conflicts of interest (e.g. remuneration driving choice of transition options; customer choices result in a negative outcome for the firm) or certain market abuse behaviors (front running customer intentions)
- Conflict policies and registers might have to be updated
- Surveillance and monitoring activities might need to be increased for teams whose products are transitioning

Training staff about changes, firm approach, risks and staff responsibilities

Polling Question 4

If applicable, when do you plan to cease issuance of new LIBOR instruments?

- A. Already transitioned new issuances to an ARR
- B. Plan to cease issuance by end of Q2
- C. Plan to cease issuance by end of Q3
- D. Do not have a date set yet
- E. Not applicable

Key Takeaways

Key Takeaways

- Now that the cessation announcement has been made any possible extension unlikely and regulators are pushing for new LIBOR issuance to cease
- The best place to start the transition is to understand what and where are LIBOR exposures within each company as soon as possible
- Regulators are intensifying their scrutiny on the transition so having a clear plan and communication strategy is vital
- There are multiple ways to transition – fallbacks are not the only or the best solution – so careful scenario analysis is needed to identify the best course of action in each case
- A lot of focus is on the transition of the legacy portfolios but equally a firm must be operationally ready to value, risk manage and report in the new rates environment for new business



Jennifer Press



Rich Vestuto



Mark Turner



Marcus Morton

For more, visit duffandphelps.com/libor

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1. Source: Thomson Reuters' cumulative data 2011-2020
2. Source: Thomson Financial Securities Data (U.S. deals \$10M < \$150M, including deals without a disclosed value). Full years 2011 through 2020
3. Who's Who Legal 2018-2020: Forensic and Litigation Consulting.
4. HedgeWeek 2018

5. HFM European Quant Awards 2019
6. 2020 Corporate INTL Global Awards
7. Who's Who Legal 2019
8. 11th Annual HFM European Hedge Fund Services Awards in 2019

9. America's Best Management Consulting Firms – Forbes
10. Compliance Week's 2020 Excellence in Compliance Awards
11. IAM Patent 1000 2020

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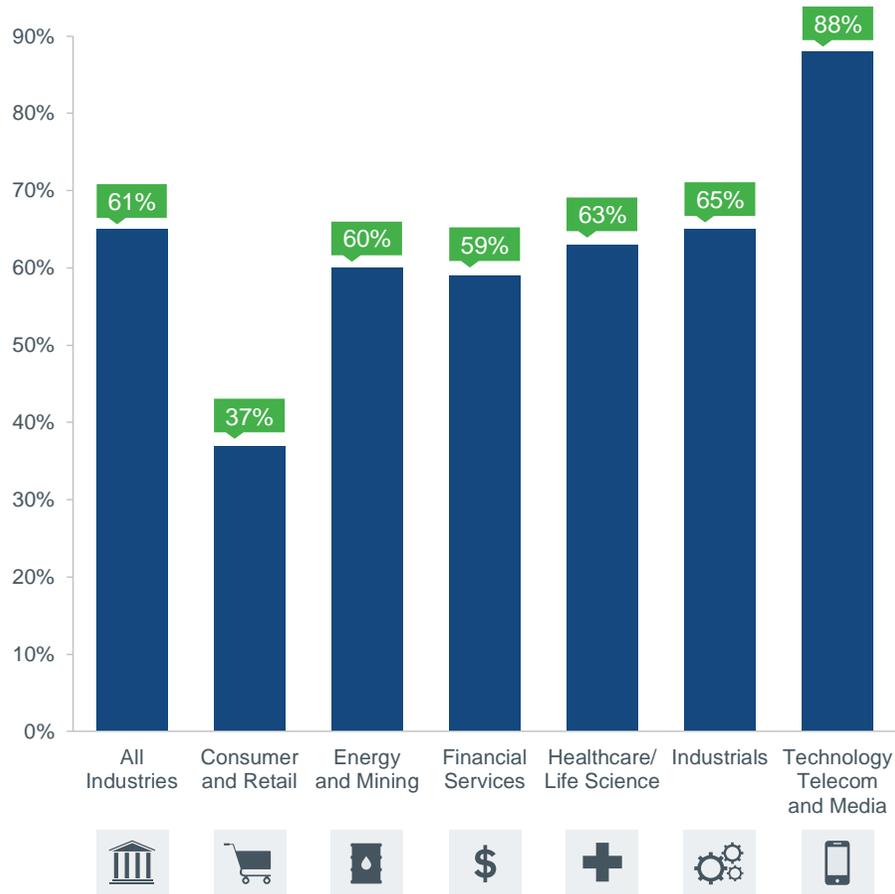
IPEV

International Private Equity
and Venture Capital
Valuation Guidelines

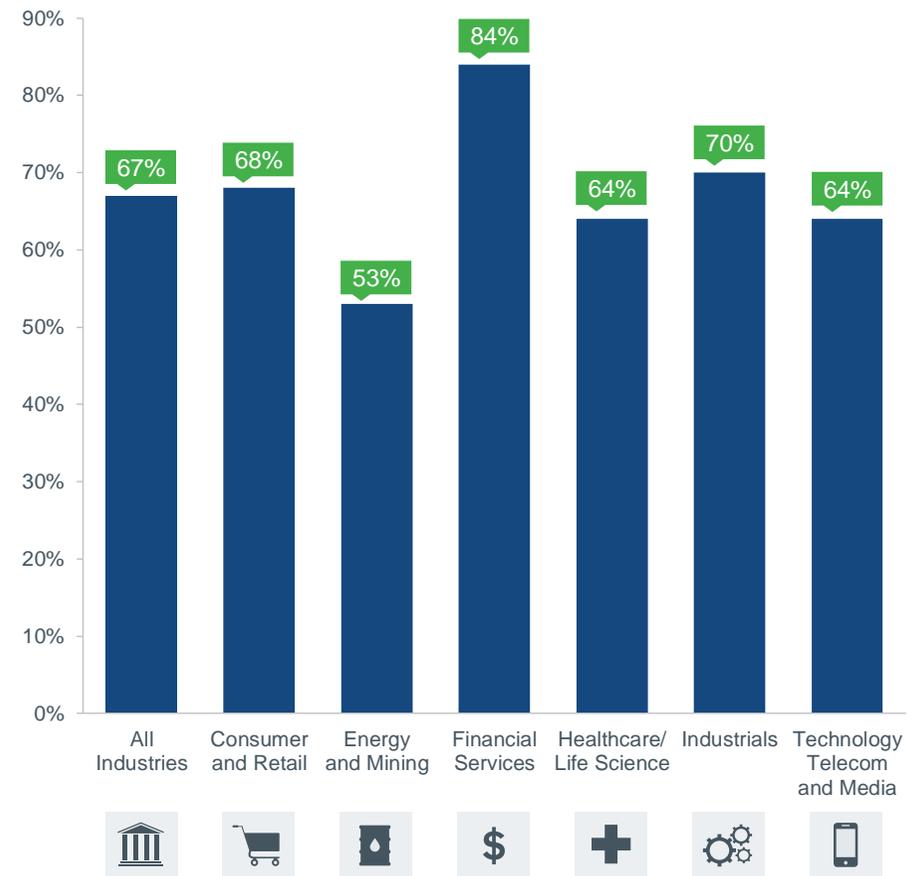


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