FREQUENTLY ASKED QUESTIONS

Background of the transition

1. When is LIBOR expected to be discontinued?

⇨ LIBOR is expected to be discontinued from 31st December 2021, as the UK Financial Conduct Authority (FCA) made an agreement with LIBOR panel banks to submit LIBOR only until the end of 2021. The continuation of the publication of LIBOR thereafter is therefore not guaranteed.

2. How was LIBOR was being manipulated in the past?

⇨ LIBOR determination is based on submissions from selected panel banks. These submissions are supposed to reflect the real interest rate that banks are paying for borrowing in the interbank market. The LIBOR scandal of 2012 arose when it was revealed that several panel banks were deliberately inflating or deflating their submitted rates in order to make profit on their trade positions, or to give the impression by artificially lowering their rates of being more creditworthy than what the market would indicate based on an objective assessment.

SOFR

3. Is SOFR (Secured Overnight Financing Rate) the mandatory replacement rate for LIBOR USD?

⇨ As of today, SOFR is recommended as alternative reference rate (ARR) for LIBOR by the ARRC (Alternative Reference Rates Committee). The ARRC is the working group established by the FED of private-market participants in the US to support a successful transition. The ARRC supports the launch and widespread usage of SOFR-based financial products in the market. SOFR is already used in the capital and derivatives markets as ARR for USD LIBOR. The Loan Market Association (LMA) has also included SOFR as ARR in its recent exposure drafts.

4. What are the current levels of LIBOR USD and SOFR?

⇨ As per 3 November 2020:

SOFR (overnight) 0.10%

ICE LIBOR levels:

$LIBOR 3-mth 0.22%

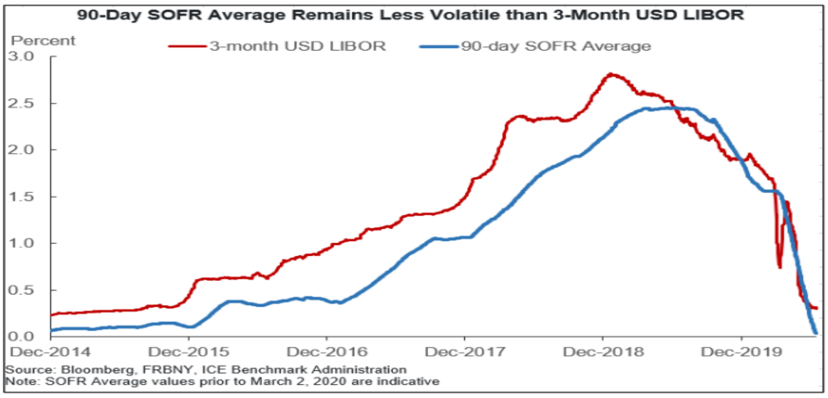
$LIBOR 6-mth 0.24%

5. Are there other risk-free rate alternatives than SOFR available to replace USD LIBOR?

⇨ At the time being, there is no risk-free reference rate available for USD other than the overnight SOFR published by the Fed.

6. How does the volatility of SOFR compare to USD LIBOR?

⇨ Back tests performed by ARRC show that in the past five years, the 90-day average of SOFR (carrying a US-Treasury risk) has been less volatile than 3-month LIBOR (carrying a bank risk). Please see chart below :



7. How will the overnight SOFR be used to determine interest for a 3 or 6-month interest period?

⇨ Several methodologies are under analysis by sponsored working groups and market participants. The more common methodology is SOFR compounded in arrears, where the daily SOFR rate is compounded during the interest period and payable quarterly or semi-annually. Dependent on the number of lag days, the rate would be set several days in advance of the payment due date.

8. How will a backward-looking interest rate affect the timing of interests notice to borrowers?

⇨ It is expected that the rate will be determined several days in advance of the payment date, in order to allow sufficient time to notify the borrower.

Adjustment Spread

9. What factors are captured in the adjustment spread?

⇨ The adjustment spread captures the difference of credit and term risk between LIBOR (term rate, bank risk) and SOFR (overnight rate, risk-free).

10. How will the adjustment spread be determined?

⇨ ARRC recommends an adjustment spread based on an historical median between USD LIBOR and SOFR over a five-year lookback period. : Bloomberg has begun to publish calculation showing the spread between LIBOR and SOFR, please link below for further info: https://www.bloomberg.com/company/press/bloomberg-begins-publishing-calculations-related-to-ibor-fallbacks/

11. How do borrowers avoid value transfer unwinding LIBOR swaps tied to the switch to SOFR?

⇨ The International Swaps and Derivatives Association (ISDA) has released the ISDA IBOR protocol as per 23 October 2020, being effective from 25 January 2021 onwards. The transition from LIBOR to SOFR is expected to be market value neutral.

12. Will the adjustment spread be set once or will it be set for each interest period?

⇨ For each loan, the adjustment spread will be set at the transition date from LIBOR to SOFR and remains static until the maturity date of the loan.

13. Will the margin part of the interest rate payment will remain unchanged in existing contracts?

⇨ For existing contracts, the credit margin will remain unchanged. Only the USD LIBOR will be replaced by the replacement rate (SOFR) plus the adjustment spread to account for the differences between the two rates.

14. Is it possible that the adjustment spread will be included into interest/credit margin, instead of separate adjustment?

⇨ For existing loans where LIBOR is replaced by SOFR, the adjustment spread should not be integrated in the interest margin and should be considered as an addition to SOFR to compensate for differences in value with LIBOR. For new SOFR loans, the adjustment spread will not be required: SOFR and the interest/credit margin will reflect the total loan interest.

15. How will the adjustment spread be presented to borrowers?

⇨ Borrowers will be informed on the adjustment spread as part of the contractual amendments to be made for the purposes of replacing LIBOR. The adjustment spread is expected to objectively reflect the differences in value between LIBOR and SOFR. Note that the adjustment spread is published on Bloomberg (see question 10).

16. Will the transition result in a higher or lower interest rate for existing loans?

⇨ The expectation is to maintain the economic balance between the parties as the adjustment spread only accounts for the differences between LIBOR and SOFR and the interest margin will remain unchanged.

17. Regarding the legal aspect of the adjustment spread, should it be considered in fallback wording or is it allowed per international legal framework?

⇨ In principle the adjustment spread is being contemplated as part of the fallback wording to be implemented in the amendments to contracts. However, it is possible that regulators will impose a sort of adjustment spread for those contracts not explicitly including any mechanism for adjustment at the time discontinuation occurs.

Alternatives

18. If a borrower asks for a conversion of its floating rate loan to fixed rate before the discontinuation of LIBOR, how will the lender fix the rate?

⇨ The borrower should contact the investment manager to discuss the conversion from floating to fixed rate. In principle, the fixed interest rate is set two business days before an interest payment date at the then prevailing swap market conditions for the remaining repayment schedule profile of the loan.

19. When do you expect SOFR term rates?

⇨ Not before the second half of 2021. The ARRC launched one month ago a RFP for the publication of forward-looking SOFR term rates from 30 June 2021 (1-month and 3-month, possibly 6-month). But there is no guarantee that the ARRC will endorse Term SOFR or the appointment of its administrator and in any case there is no guarantee that participants will adopt such rates as reference rates to replace LIBOR for the loan market.

Transition process and timeline

20. Should the national regulator be directly involved in transition process to increase the awareness of the transition to market and provide guidelines/fallback wording templates to banks? Or should banks develop their individual fallbacks for the floating loan agreements?

⇨ Regulators in Europe and the US are concerned about the readiness of supervised entities in the market, therefore encouraging the adoption of fallback provisions in their contracts to avoid disruption once LIBOR is being discontinued. However the development of templates is being promoted mainly by the ARRC together with the Loan Syndications and Trading Association (LSTA) in the US, and the LMA in Europe, which are still based on recommendations being developed in consultation with market participants. Banks are expected to take the initiative to develop their own templates considering the recommendations of LMA and LSTA.

21. When shall lenders make formal communication to their borrowers?

⇨ Lenders should attentively follow the market and regulatory developments to be ready for the transition and proactively communicate with their clients to ensure that steps are taken in sync with these developments. We will continue to communicate with our clients on these developments via mail, websites, calls and webinar to support a smooth transition process.

22. What is the tentative timeline for amendment in facility agreements in order to adopt SOFR by 2021?

⇨ The process of adopting amendments to transition to SOFR should be initiated as soon as possible and in any case should be completed before the end of 2021, considering the continuity of LIBOR as a reliable index is not guaranteed beyond this date and might run into 2022 dependent on the last LIBOR interest period duration in accordance with respective contract. However, at this stage (before initiating this process) further consensus in the market is needed around the methodology for calculation of the new rate.