

IBOR TRANSITION - BDO GLOBAL INSIGHTS SERIES: LEGAL AND RISK MANAGEMENT

IBOR Webinar - 2 DEC 2020 - 6:00-7:15 PM (CET)

HOUSE RULES

- Your microphone is automatically muted and your camera is switched off.
- You are invited to submit your questions in the chat room.
- This session will be recorded.
- Materials will be distributed after the webinar together with a feedback e-mail.
- Materials will also be available for download later on bdo.global.

AGENDA

01 PRESENTATION - PAUL HASTINGS

02 BDO PANEL DISCUSSION

03 Q & A

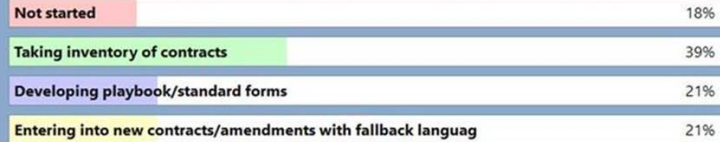
POLLING QUESTION 1

PAUL HASTINGS

- RESULTS -

Which of the following best describes the current stage of your firm's LIBOR transition?

Polling results: Multiple Choice Question /max. one answer allowed





PAUL

HASTINGS

LIBOR TRANSITION

December 2020

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Joyce Sophia Xu is a corporate partner based in the Paul Hastings New York office. Ms. Xu heads up the firm's global Derivatives practice as well as the firm's global Labor Transition Task Force. Her clients range from financial institutions and corporations to hedge funds and private equity funds.

Ms. Xu has been recognized and ranked by Chambers Global and Chambers USA every year since 2011. She was named to Crain's New York Business's 40 Under 40 list in 2011. Ms. Xu has authored a large collection of articles and book chapters on both Labor transition and derivatives products and regulations. For her book chapter titled, "U.S. Corporate and Regulatory Aspects of Equity Derivatives," in *Equity Derivatives: Documenting and Understanding Equity Derivative Products* (Globe Law & Business, Globe Business Publishing Ltd. 2009, pp. 357–384), she received the Burton Award for Achievement in Legal Writing. Ms. Xu also co-authored *Reflections on Dodd-Frank: A Look Back and a Look Forward*, a compendium of articles that review and analyze key rulemaking developments under the Dodd-Frank Act.

Accolades and Recognitions

- Named to Crain's 40 Under 40 list (2011)
- Awarded Asian American Business Development Center's Outstanding 50 Asian Americans Business Award
- Named one of the world's leading lawyers for business by *Chambers Global* (2011–2020) and *Chambers USA* (2011–2020)
- Recognized as a leading lawyer by *IFLR1000*

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Diona N. Park is of counsel in the Securities and Capital Markets practice in the Paul Hastings New York office. Ms. Park is a senior member of the firm's derivatives practice and global Libor Transition Task Force. Her practice focuses on structuring, negotiating, and executing various derivatives transactions and advising on related regulatory issues. Ms. Park has broad experience advising financial institutions, corporations, private equity funds, and other end users on complex equity, currency, and interest rate derivative products as well as on synthetic prime brokerage agreements. She also has considerable experience in structured and customized equity-based financing, hedging and monetization transactions, including variable prepaid forwards, collars, collar-plus-loans, and covered calls.

Ms. Park is a member of the ISDA Americas and Europe Benchmark Working Group.

Prior to joining Paul Hastings, Ms. Park was at JPMorgan, where she was vice president and assistant general counsel in the equity derivatives group of the Corporate & Investment Bank. She also practiced in the derivatives group of another multinational law firm. Ms. Park received her J.D. from Northwestern University Pritzker School of Law and her LL.B. from Seoul National University School of Law.

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- Overview of Libor transition and key industry developments
- ARRC recommended fallbacks for cash products
- Update on Libor transition for derivatives
- LIBOR transition implementation issues



OVERVIEW OF LIBOR TRANSITION AND KEY INDUSTRY DEVELOPMENTS

WHY IS LIBOR ENDING?

- Due to concerns about the reliability and robustness of LIBOR, the Financial Conduct Authority (FCA) announced in 2017 that it will not compel banks to submit LIBOR quotes after 2021.
- Relevant public-private sector working groups are preparing transition plans to encourage adoption of risk-free rates (RFRs) and facilitate transition to the RFRs. These groups also are facilitating the development and use of robust fallback language to reduce the risks of LIBOR cessation.

BENCHMARK REFORMS OCCURRING GLOBALLY



Working Group	Alternative Reference Rates Committee	Working Group on Sterling Risk-Free Reference Rates	Working Group on Euro Risk-Free Rates	National Working Group on Swiss Franc Reference Rates	Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks
Alternative Reference Rate	SOFR (Secured Overnight Financing Rate)	Reformed SONIA (Sterling Overnight Interbank Average Rate)	€STR (Euro-Short term rate)	SARON (Swiss Average Rate Overnight)	TONA (Tokyo Overnight Average Rate)
Underlying Market	Secured overnight funds	Unsecured overnight funds	Unsecured overnight funds	Secured overnight funds	Unsecured overnight funds
Publication Date	Published since 3 April 2018	Reformed since 23 April 2018	Published since 2 October 2019	Published since 2009	Published since 1992
Administrator	Federal Reserve Bank of New York	Bank of England	European Central Bank	SIX Swiss Exchange	Bank of Japan
Tenor	Overnight	Overnight	Overnight	Overnight	Overnight

USD LIBOR VS. SOFR

	USD LIBOR	SOFR
Definition	Unsecured wholesale interbank lending rate	Secured overnight repo rate
Maturity/Term	Various tenors	Currently only overnight
Bank Credit Premium	Yes	No
Methodology	Subjective trimmed mean of panel bank submission rates based on Waterfall Methodology	Objective volume-weighted median for various US Treasury repo datasets
Administrator	ICE Benchmark Administration	Federal Reserve Bank of New York
Underlying Daily Transaction Volume	~\$500 million	More than \$1 Trillion

Source: ICE Benchmark Administration at <https://www.theice.com/iba/libor> and Federal Reserve Bank of New York at <https://apps.newyorkfed.org/markets/autorates/SOFR>

THE ARRC – INITIATIVES, RECOMMENDATIONS, AND BEST PRACTICES

- 2014:
 - The U.S. Federal Reserve Board (FRB) called for development of alternative interest rate benchmarks.
 - The U.S. FRB and the New York Federal Reserve Bank (NYFRB) established the Alternative Reference Rates Committee (ARRC).
- June 2017: ARRC selected the Secured Overnight Financing Rate (SOFR) as the proposed RFR to replace USD LIBOR.
- April 2018: The NYFRB began publishing SOFR.
- 2018 – Present: The ARRC published recommended fallback language for various cash products:
 - Floating rate notes
 - Bilateral business loans
 - Syndicated loans
 - Securitizations
 - Adjustable rate mortgages

THE ARRC'S BEST PRACTICES FOR LIBOR TRANSITION – MAY 2020

Product	Hardwired Fallbacks Incorporated By	Tech/Ops Vendor Readiness By	Target For Cessation Of New Use Of USD LIBOR By	Anticipated Fallback Rates To Be Identified By
Floating Rate Notes	6/30/2020	6/30/2020	12/31/2020	6 months prior to reset after LIBOR's end
Business Loans	Syndicated Loans: 9/30/2020 Bilateral Loans: 10/31/2020	9/30/2020	6/30/2021	6 months prior to reset after LIBOR's end
Consumer Loans	Mortgages: 6/30/2020 Student Loans: 9/30/2020	Mortgages 9/30/2020	Mortgages 9/30/2020	In accordance with relevant consumer regulations
Securitizations	6/30/2020	12/31/2020	CLOs: 9/30/2021 Other: 6/30/2021	6 months prior to reset after LIBOR's end
Derivatives	Not later than 3-4 months after the Amendments to ISDA 2006 Definitions are published	Dealers to take steps to provide liquid SOFR derivatives markets to clients	6/30/2021	

OTHER KEY INITIATIVES – LSTA & ISDA

- The LSTA
 - “Concept credit agreement” for a term loan referencing daily simple SOFR or daily compounded SOFR.
 - “Concept credit agreement” for a term loan referencing compounded SOFR in arrears.
 - LIBOR replacement provisions and accompanying form of supplemental indenture as a template for amending CLOs that do not contain effective fallback/amendment language.
 - Market Advisory: LSTA recommends that amendment on/prior to June 30, 2021 solely intended to incorporate ARRC’s updated hardwired fallback language should not be accompanied by an amendment fee
- ISDA
 - Publication of Supplement to the ISDA 2006 Definitions and related protocol.

REGULATORY / LEGISLATIVE SOLUTIONS

- ARRC's Proposed NY Legislative Solution
- CFTC/Prudential Regulators
 - Rule amendment allowing uncleared swaps to maintain legacy status if amended in connection with LIBOR transition
 - No action relief to facilitate LIBOR transition
- IRS
 - Proposed regulations providing tax relief related to issues that may arise as a result of the modification of debt, derivative, and other financial contracts for LIBOR transition purposes
 - October 2020 – Recent no-action relief providing safe harbor in connection with the utilization of the hardwired approach
- UK Government announced plans to enhance regulatory powers of the FCA
 - Enhanced powers include the creation of “synthetic” LIBOR
 - Will only apply to “tough legacy” contracts



ARRC RECOMMENDED FALLBACKS FOR CASH PRODUCTS

ARRC RECOMMENDED FALLBACKS FOR CASH PRODUCTS



FLOATING RATE NOTES



Debt instruments with a variable interest rate issued in the capital markets.

ARRC's fallback language recommendation finalized: [April 25, 2019](#)



BILATERAL BUSINESS LOANS



Financing provided to a borrower by one lender.

ARRC's updated and current final language recommendation: [August 27, 2020](#)



SYNDICATED LOANS



Financing offered by a group of lenders who work together to provide funds to a company.

ARRC's updated and current final recommendation: [June 30, 2020](#)



SECURITIZATIONS



Pools of various individual assets, typically debt instruments, bundled together where resulting cash flows are structured into asset backed securities issued in the capital markets.

ARRC's fallback language recommendation finalized: [May 31, 2019](#)



ADJUSTABLE RATE MORTGAGES

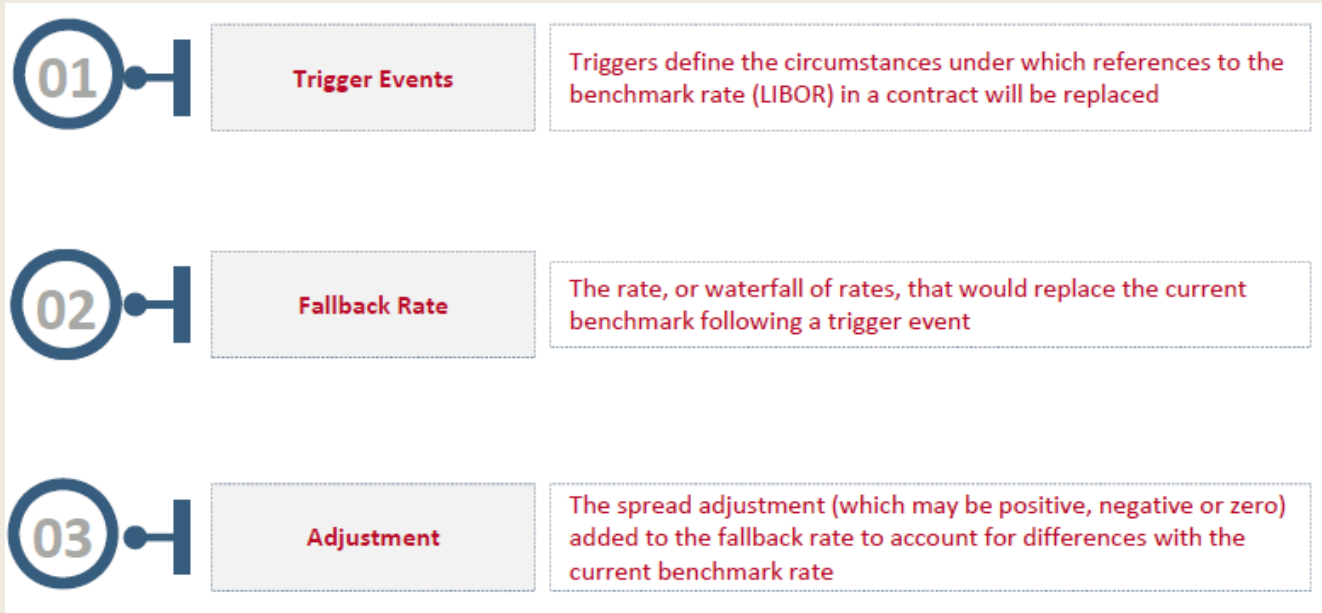


A type of mortgage in which the interest rate applied on the outstanding balance varies after an initial fixed-rate period ends.

ARRC's fallback language recommendation finalized: [November 15, 2019](#)

ARRC FALLBACKS FOR USD LIBOR CASH PRODUCTS

The ARRC recommended triggers, fallback rates, and spread adjustments for certain products. The following slides include definitions of each and their applicability to each product.





UPDATE ON LIBOR TRANSITION FOR DERIVATIVES

IBOR FALLBACKS: ISDA'S WORK

Relevant IBOR and corresponding floating rate options in 2006 ISDA Definitions		Fallback rate
GBP LIBOR	GBP-LIBOR-BBA GBP-LIBOR-BBA-Bloomberg	SONIA
CHF LIBOR	CHF-LIBOR-BBA CHF-LIBOR-BBA-Bloomberg	SARON
JPY LIBOR	JPY-LIBOR-FRASETT JPY-LIBOR-BBA JPY-LIBOR-BBA-Bloomberg	TONA
TIBOR	JPY-TIBOR-TIBM JPY-TIBOR-17096 JPY-TIBOR-17097 JPY-TIBOR-TIBM (All Banks)-Bloomberg	TONA
Euroyen TIBOR	JPY-TIBOR-ZTIBOR	TONA
BBSW	AUD-BBR-AUBBSW AUD-BBR-BBSW AUD-BBR-BBSW-Bloomberg	RBA Cash Rate
USD LIBOR	USD-LIBOR-BBA USD-LIBOR-BBA-Bloomberg	SOFR
HIBOR	HKD-HIBOR-HKAB HKD-HIBOR-HKAB-Bloomberg	HONIA
CDOR	CAD-BA-CDOR CAD-BA-CDOR-Bloomberg	CORRA
EUR LIBOR	EUR-LIBOR-BBA EUR-LIBOR-BBA-Bloomberg	€STR
EURIBOR	EUR-EURIBOR-Reuters	€STR

ISDA'S WORK ON FALLBACK LANGUAGE

- The **Compounded Setting in Arrears Rate** is the relevant RFR observed over the relevant IBOR tenor and compounded daily during that period
- The **Five-Year Historical Median Approach to the spread adjustment**
 - Based on the median spread between the IBOR in the relevant tenor and the adjusted RFR over each corresponding tenor (so the spread will differ across different IBOR tenors).
 - Calculated over the five-year period prior to the relevant announcement or publication triggering the fallback provisions (but will not take effect until fallback rates actually apply, if a later date).
 - Spread will remain constant upon trigger.
- Upon a **Trigger Event**, transactions referencing the new IBOR definitions will fall back to the compounded in arrears RFRs with a spread adjustment

	Description	Commentary
Trigger Events	<ul style="list-style-type: none"> • Permanent Cessation Triggers: <ol style="list-style-type: none"> 1) The administrator of IBOR (IBA for LIBOR) issues a public statement announcing that they have ceased or will cease to provide IBOR, and there is no successor administrator 2) The regulator of the administrator of IBOR (FCA for LIBOR), the central bank for IBOR, or an entity with insolvency or resolution authority over the administrator of IBOR states that IBOR has ceased or will cease to be provided, and there is no successor administrator • Pre-Cessation Trigger: The regulator with authority over the administrator of the benchmark announces that the benchmark is no longer representative. 	
Benchmark Replacement	<ul style="list-style-type: none"> • Compounded SOFR in Arrears + Adjustment 	<ul style="list-style-type: none"> • RFRs will be compounded over an Observation Period. The Observation Period will be backward-shifted two Banking Days so that payments are known before they become due.
Adjustment	<ul style="list-style-type: none"> • Adjustment to be calculated based on historical difference between LIBOR and SOFR over a significant, static lookback period prior to the trigger event 	<ul style="list-style-type: none"> • The Adjustment will be based on the historical median between LIBOR and compounded SOFR calculated over a 5-year lookback period.

Additional information is available on ISDA's website: <https://www.isda.org/category/legal/benchmarks/>

ISDA IBOR FALLBACKS: IMPLEMENTATION IN ISDA DOCUMENTATION

2006 ISDA Definitions Supplement

- Amendments to relevant floating rate options in Section 7.1 of the 2006 ISDA Definitions
 - Amended and restated floating rate options will generally include:
 - The existing price source information;
 - A statement identifying the objective triggers for a ‘permanent cessation’ that would activate the selected fallbacks; and
 - A description of the fallback that would apply upon the occurrence of that trigger, which will be the adjusted RFR plus the spread adjustment
- Amendments will be implemented via a ‘Supplement’ to the 2006 ISDA Definitions (as Supplement number 70 to the 2006 ISDA Definitions)
- Upon the effective date of the Supplement (January 25, 2021) amending the relevant floating rate option, all *new* derivative transactions that incorporate the 2006 ISDA Definitions will include the fallbacks (counterparties will not have to take any additional steps)

ISDA IBOR FALLBACKS: IMPLEMENTATION IN ISDA DOCUMENTATION (CONT'D)

IBOR Fallbacks Protocol

- ISDA Protocol (published October 23, 2020)
 - Facilitates inclusion of the amended definitions (i.e. the definitions with fallbacks) into *existing* derivative transactions that were entered into prior to the effective date of the relevant Supplement
- Adherents to the Protocol agree that derivatives transactions entered into *with other adherents* prior to effectiveness of the relevant Supplement (i.e., January 25, 2021) will be based on the relevant amended floating rate options in the 2006 ISDA Definitions
- Existing derivatives transactions entered into prior to the date of the relevant Supplement amending the 2006 ISDA Definitions between counterparties that do not *both* adhere to the protocol, or otherwise (e.g. bilaterally) agree to include the amended definitions in their transactions, will not include the fallbacks



LIBOR TRANSITION IMPLEMENTATION ISSUES

LIBOR TRANSITION IMPLEMENTATION ISSUES

- Review legacy/existing contract language
- New contract language
- Avoid mismatched economics

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Century City
Chicago
Houston
Los Angeles
New York

Orange County
Palo Alto
San Diego
San Francisco
São Paulo
Washington, D.C.

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Frankfurt
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1 LEGAL TEAM

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BDO PANEL DISCUSSION



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MODERATOR



TOPIC AREAS IN FOCUS

VALUATION

- Value to Value Transfer
- MTM and Recurring Valuations
- Settlements

ACCOUNTING

- U.S. GAAP - Accounting Standards Updates
- IFRS Updates - Phase I and Phase II

RISK MANAGEMENT

- Asset Liability Management
- Basis Risk
- Liquidity Risk / Contingency Plans

POLLING QUESTION 2

BDO PANEL

- RESULTS -

What area do you perceive to be the most challenging thus far regarding your LIBOR transition efforts?

Polling results: Multiple Choice Question /max. one answer allowed

Valuation elements of the existing portfolio	41%
Accounting and financial reporting elements	22%
Compliance and governance aspects	19%
Legal considerations	19%





Q & A

THANK YOU

FOR MORE INFORMATION

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