APS Portfolio Strategy call

Full speed ahead from LIBOR to SOFR

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LIBOR TRANSITION – LEGAL ISSUES

"LIBOR" applies to a transaction through the operative legal documents. As a contractual provision that directly affects payments, it is considered one of the key provisions in a contract.

Broadly speaking, three cohorts of transactions sorted by time:

- SOFR – indexed at inception – no problem
- LIBOR with "modern" fallback – should be no problem
- LIBOR with "legacy fallback" – problem

Three cohorts also sorted by type of product:

- Loans – should not be a problem
- Derivatives should be okay via ISDA Protocols
- Securities – problem if "legacy fallback"

Biggest problem are securities with "legacy fallback" provisions – these provisions often default to "last LIBOR ever quoted".

- Unanimous consent issues
- Trust Indenture Act
- Biggest problem of all – securitizations (including Agencies) with legacy fallback provisions

ARRC – Proposed New York State Legislation

Issue	**Response**
Rationale	• It will be very difficult to amend legacy securities offerings without legislative relief. Maintain New York as a center of finance. Don't clog up New York courts with people trying to get out of contracts or fighting over damages. Earlier New York legislation addressed the introduction of the euro.
Override of Legacy Contract Fallback Provisions	• **Override**: a *Libor-based rate* (such as last quoted Libor) and *polling for Libor or other interbank funding rate*. • **No Override**: where the legacy language is *silent* as to fallbacks or gives a party the right to exercise *judgment or discretion* regarding the fallback. • **No Override**: if legacy language falls back to an express *non-Libor based rate* (such as Prime).
Recommended Fallback	• ARRC/Fed recommended benchmark is considered substantial performance and receives legal safe harbor. Existing credit spreads carry forward
Mutual "Opt-Out"	• Parties would be permitted to mutually opt-out of the application of the statute, in writing, at any time *before or after* the occurrence of the trigger event.
"All Products"	• **No Exclusions**: No product would be categorically excluded from the statute. Parties can opt-out as described above.
Is it legal?	• Arguments under the US and New York State Constitutions: Impairment of Contracts, Takings, Due Process, Impermissible Delegation.

IBOR Fallback coverage

The complete data set will cover approximately 154,000 active securities with an IBOR as underlying index that mature post 2021.

- **Completed:**
  - 250 Preferred Securities
  - 550 Municipal Securities
  - 5,000 USD Syndicated Loans
  - 7,700 Corporates for LIBOR linked instruments for USD, GBP, EUR, CHF and JPY
- **In development:**
  - 114,000 Securitized products – Q2/3 2020
    - 47,600 Agency RMBS
    - 33,000 CLO
    - 15,500 ABS
    - 13,000 Non Agency RMBS
    - 5,000 CMBS
  - 8,000 Structured Notes - Available Q3/4 2020
  - All other floating rate benchmarks including Euribor - ongoing 2020
- **Data is available per security or via a bulk file.**

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Fallback Totals for Corporate Securities

	Total	Fallback Defined		No Documentation	"Silent" Fallback
		Yes	No		
GBP Libor	311	195	39	77	37
Euro Libor	2	1	-	1	-
JPY Libor	326	190	40	96	37
CHF Libor	110	11	2	97	2
USD Libor	6,945	3,337	2,584	1,024	1,231
Total	7,694	3,734	2,665	1,295	1,307

17% of population reviewed is Silent on fallback.

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ARRC HAS RECOMMENDED LIBOR CONTRACTS SWITCH TO SOFR + A FIXED SPREAD

ARRC reviewed a range of possibilities

Which SOFR rate to use?	How to measure the LIBOR-SOFR difference?	How far back to look?	How to transition to the new coupon?
Forward looking SOFR	**Median**	**5 years**	**On next reset**
SOFR in arrears	Average	10-years	Linearly over a year
SOFR in advance	Trimmed mean		

The swap market and other considerations weighed heavily

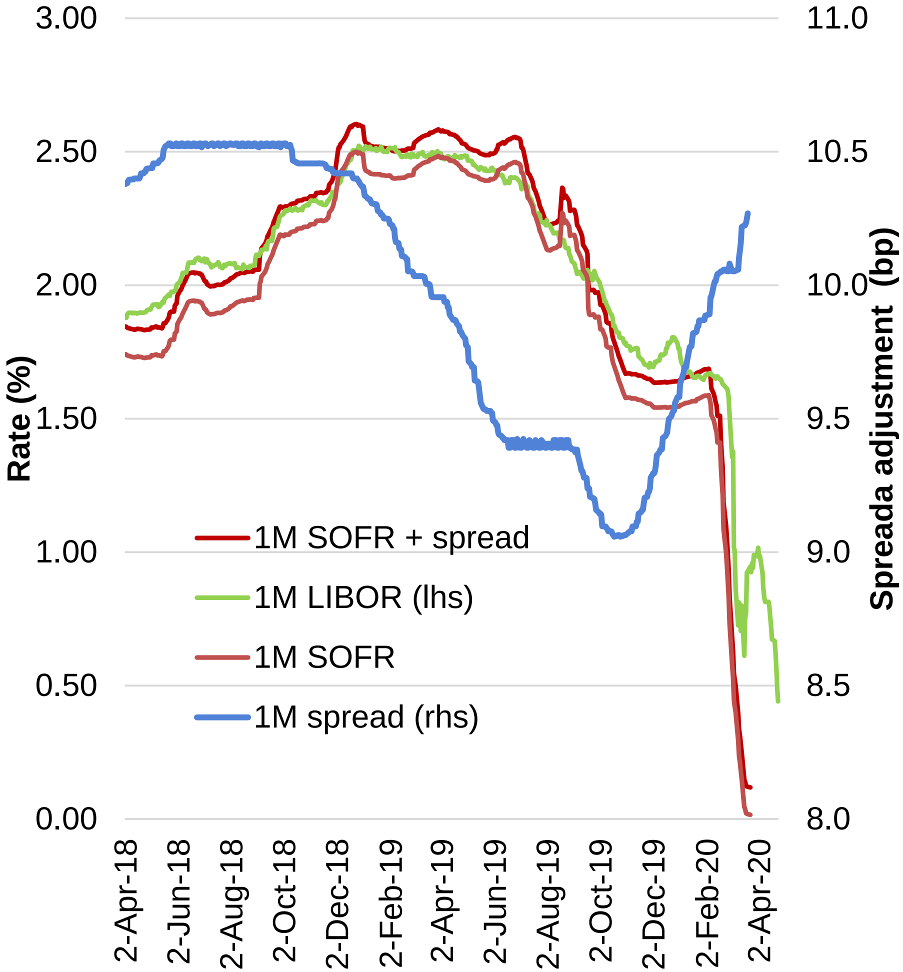
- Consistency with the ISDA approach
- Minimize basis with hedges
- Easiest path for operations, accounting, tax and legal

A trigger will start the process

- ICE announces it has or will stop publishing LIBOR or the UK Financial Conduct Authority announces LIBOR is no longer representative
- The fixed spread is measured on the prior day
- The spread is applied at the next reset

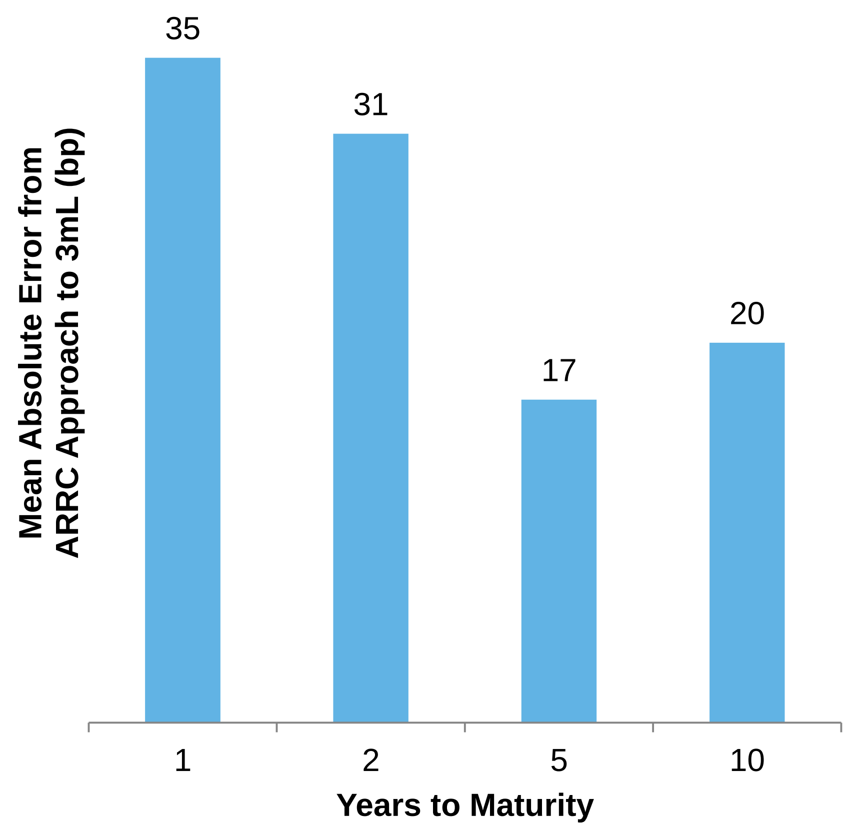
THE PROPOSED TRANSITION COMES WITH MARKET RISK

A switch to the median can create sudden change in coupons



Source: Amherst Pierpont Securities

Absolute differences between 3mL and the ARRC approach vary with maturity



Source: ARRC Spread Adjustment Consultation, Jan 2020. Data shows basis points based on a hypothetical security with quarterly resets to the given maturity at the time of transition Jan 1999-May 2019.

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RECENT DIFFERENCES IN LIBOR EXPECTATIONS AND THE REALIZED PATH OF SOFR WOULD HAVE LED TO DIFFERENT COUPONS

Hypothetical: differences in cost of funds for a floating security paying 4/24/20:

	If LIBOR		If SOFR implemented on reset date			LIBOR Cpn - SOFR Realized Cpn (bp)
Term	Rate reset on	Rate on reset date (%)	SOFR (%)	Spread Adjust (bp)	Rate due 4/24/20	
O/N	4/23/2020	0.057	0.010	1.3	0.023	-3.4
1M	3/24/2020	0.925	0.016	10.6	0.122	-80.3
3M	1/24/2020	1.795	0.878	25.0	1.128	-66.8
6M	10/24/2019	1.932	1.236	35.7	1.593	-33.9
12M	4/24/2019	2.725	1.768	52.9	2.297	-42.8

Source: Amherst Pierpont Securities

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