# LIBOR (London Interbank Offered Rate)

## What is LIBOR?

- Provides an indication of the average rate at which 16 panel banks estimate they could obtain wholesale, unsecured funding
- Created to better represent true cost of bank borrowings versus other benchmarks
- Widely used to price financial contracts for over 30 years
- Currently serves as the benchmark for roughly $200 trillion of USD-denominated financial contracts
  - Derivatives (roughly 95% of total exposure)
  - Business & Consumer Loans
  - Bonds
  - Securitizations

## The Problem with LIBOR

- Significant decline in interbank unsecured lending after financial crisis
- Relatively small volume of actual underlying transactions
  - Approximately $500 million daily transaction volume supporting $200 trillion of financial contracts
- High reliance on “expert judgment” of panel banks resulted in manipulation of the rate, discovered in 2012

## Global Transition Plan

- In 2014, the Fed convened the Alternative Reference Rates Committee (ARRC) in order to identify best practices for alternative reference rates
  - Asked to identify best practices for contract robustness, develop an adoption plan, and create an implementation plan with metrics of success and a timeline
- In June 2017, the ARRC recommended the Secured Overnight Financing Rate (SOFR) as its choice to replace LIBOR
- In July 2017, the U.K. Financial Conduct Authority (FCA) announced that it would no longer compel panel banks to provide LIBOR submissions past 2021
- On July 29, 2021, ARRC formally recommended CME Group’s Term SOFR

## KEY TAKEAWAYS: Active Deal Impact

- LIBOR will be quoted through **June 2023**
- Deals currently priced with LIBOR will be quoted through June 2023, allowing time for transition and are expected to function normally until then
- Loans currently on LIBOR can transition to alternative reference rates Term SOFR, Daily Simple SOFR, or BSBY
- Loans not transitioned off LIBOR by June 2023 risk more expensive borrowing costs than those offered by the new reference rates
SOFR and Credit Spread Adjustments (“CSA”)

Reason for CSAs

• While SOFR broadly measures the cost of borrowing cash overnight secured by Treasury securities, LIBOR indicates the average rates at which large banks could fund themselves on the wholesale unsecured funding market.

• As a result of the security differential (i.e., SOFR being essentially risk-free borrowing secured by Treasuries, vs. LIBOR borrowings reflecting higher risk as unsecured obligations), LIBOR is generally higher than SOFR, particularly for longer-dated tenors.

• To capture the difference between the rates over different interest periods (e.g., 1-month, 3-month, 6-month), both the ARRC and ISDA recommended the use of a five-year median spread adjustment, which compares the median LIBOR and Compounded SOFR figures over the five-year period from March 2016 to March 2021.

• In existing loan documents, borrowing costs are determined by LIBOR and a credit spread. To create comparable borrowing costs that are better than the fallback, but that mirrors borrowers’ current rate but using SOFR, Texas Capital Bank is providing an alternate (and better) credit spread adjustment than the industry recommended.

CSAs in Credit Agreements

• CSAs will be added in all Texas Capital Bank credit agreements that quote Term SOFR or Daily Simple SOFR.

<table>
<thead>
<tr>
<th>Interest Period</th>
<th>ARRC &amp; ISDA Recommended</th>
<th>Texas Capital Bank Preference</th>
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<tbody>
<tr>
<td>One-month</td>
<td>0.11448%</td>
<td>0.10%</td>
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<tr>
<td>Three-month</td>
<td>0.26161%</td>
<td>0.15%</td>
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<tr>
<td>Six-month</td>
<td>0.42826%</td>
<td>0.25%</td>
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General Benchmark Rate Stability – Last 1 Year

1-Month LIBOR vs. 1-Month BSBY vs. 1-Month Term SOFR vs. Daily Simple SOFR

Source: Bloomberg as of 8/24/2022
Key Takeaways

- For Texas Capital Bank-led loans, Term SOFR margins will be used as the primary replacement rate effective immediately, with the Texas Capital Bank-approved LIBOR benchmark replacement order as follows:
  1. Term SOFR + Credit Spread Adjustment
  2. Daily Simple SOFR + Credit Spread Adjustment
  3. BSBY Rate

- BSBY-based loans do not need to be transitioned to Term SOFR, as BSBY is expected to remain a viable benchmark rate

- Texas Capital Bank advises that existing LIBOR loans be transitioned off LIBOR by year-end given LIBOR’s cessation in June 2023
## Appendix: Universe of Replacement Alternatives

<table>
<thead>
<tr>
<th>Description</th>
<th>Pros / Cons</th>
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<tbody>
<tr>
<td><strong>Term SOFR (forward looking)</strong></td>
<td>✓ ARRC supported &lt;br&gt; ✓ Full suite of hedging options/contracts available &lt;br&gt; ✗ No credit component</td>
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<td>- Term, secured rate derived from SOFR derivatives</td>
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<tr>
<td><strong>Daily Simple SOFR (Secured Overnight Financing Rate)</strong></td>
<td>✓ Robust volume &lt;br&gt; ✓ ARRC selection &lt;br&gt; ✗ No credit component &lt;br&gt; ✗ Backward looking</td>
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<td>- Overnight, secured rate based on ~$1 trillion in repo transactions &lt;br&gt; - Volume-weighted median &lt;br&gt; - International Organization of Securities Commissions (IOSCO) compliant</td>
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<tr>
<td><strong>Bloomberg’s BSBY (Short-Term Bank Yield Index)</strong></td>
<td>✓ Offers credit-sensitive rate &lt;br&gt; ✓ Forward looking rates across several tenors &lt;br&gt; ✓ Full suite of hedging options/contracts available &lt;br&gt; ✗ Moderate volume</td>
</tr>
<tr>
<td>- Unsecured overnight, 1m, 3m, 6m, 12m rates based on unsecured transaction-related and executable data from large international banks &lt;br&gt; - Derived from curve fitted to data</td>
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<tr>
<td><strong>Ameribor (American Interbank Offered Rate)</strong></td>
<td>✓ Offers credit-sensitive rate reflecting bank borrowing costs &lt;br&gt; ✓ &gt;150 banks / market participants on AFX &lt;br&gt; ✗ Low volume &lt;br&gt; ✗ Backward looking</td>
</tr>
<tr>
<td>- Overnight, unsecured rate based on &gt;$2 billion in loan transactions on AFX (small and mid-sized bank with &lt;$150 billion in assets) &lt;br&gt; - Volume-weighted average &lt;br&gt; - IOSCO compliant</td>
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