SOFR Transition Discussion

October 2022

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

© 2022 Texas Capital Bank Member FDIC

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

	Credit Spread Adjustment (%)	
Interest Period	**ARRC & ISDA Recommended**	**Texas Capital Bank Preference**
One-month	0.11448%	0.10%
Three-month	0.26161%	0.15%
Six-month	0.42826%	0.25%

© 2022 Texas Capital Bank Member FDIC

General Benchmark Rate Stability – Last 1 Year

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

3.0%
2.5%
2.0%
1.5%
1.0%
0.5%
0.0%

Aug-21 Oct-21 Dec-21 Feb-22 Apr-22 Jun-22 Aug-22

LIBOR 1M BSBY 1M Term SOFR 1M Daily Simple SOFR

Texas Capital Bank

Source: Bloomberg as of 8/24/2022

© 2022 Texas Capital Bank Member FDIC

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

© 2022 Texas Capital Bank Member FDIC

Appendix: Universe of Replacement Alternatives

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

© 2022 Texas Capital Bank Member FDIC

Disclosure

DISCLAIMER

Deposit, loan, and treasury management products and services are provided by Texas Capital Bank, a subsidiary of Texas Capital Bancshares, Inc. Loan and leasing products and services, including treasury management, risk management and capital solutions services, as well as certain other banking products and services, require prior credit approval. Foreign exchange and derivative and capital solutions products are obligations of Texas Capital Bank.

This presentation has been prepared by TCBI Securities, Inc., doing business as Texas Capital Securities (together with its affiliates, “TCS”), for the exclusive use of the intended recipient using information provided to TCS and other publicly available information. TCS has not independently verified the information contained herein, nor does TCS make any representation or warranty, either expressed or implied, as to the accuracy, completeness or reliability of the information contained in this presentation. Any estimates or projections as to transactions or events that may occur in the future (including expected transaction terms, market information or projections of revenue, expense, net income and stock performance) are based upon the best judgment of TCS from the information provided by the company other publicly available information as to the date of this presentation. There is no guarantee that any of these estimates or projections will be achieved. Actual results will vary from the projections and such variations may be material. Nothing contained herein is or shall be relied upon as a promise or representation as to the past or future. TCS expressly disclaims any and all liability relating or resulting from the use of this presentation.

The contents of this presentation are provided for information purposes only and do not constitute a solicitation to buy or an offer to sell any securities under the Securities Act of 1933 or under any other U.S. federal or state securities law, rule or regulation. Trading in securities and financial instruments, strategic advisory, and other investment banking activities are performed by TCBI Securities, Inc., doing business as Texas Capital Securities. TCBI Securities, Inc. is a member of FINRA and SIPC and has registered with the SEC and other state securities regulators as a broker dealer. TCBI Securities, Inc. is a subsidiary of Texas Capital Bancshares, Inc., the parent company of Texas Capital Bank. All investing involves risks, including the loss of principal. Past performance does not guarantee future results. Securities and other investment products offered by TCBI Securities, Inc. are not FDIC insured, may lose value and are not bank guaranteed.

TCS does not provide legal, tax or accounting advice, and you should not construe the contents of this presentation as legal, tax, accounting or investment advice or a recommendation regarding the same. You should consult its own counsel, tax and financial advisors as to legal and related matters concerning any transaction described herein. This presentation does not purport to be all-inclusive or to contain all of the information which the Company may require. No investment, divestment or other financial decisions or actions should be based solely on the information in this presentation.

This presentation has been prepared on a confidential basis for the sole use and benefit of the intended recipient. Distribution of this presentation to any other person is unauthorized. This material must not be copied, reproduced, distributed or passed to others at any time without the prior written consent of TCS.

© 2022 Texas Capital Bank Member FDIC