LIBOR TRANSITION

Frequently Asked Questions

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*This document is intended to provide an overview of the discontinuation of the London Interbank Offered Rate ("**LIBOR**") to National Bank of Fujairah's (NBF) customers and counterparties. This information is provided for information only and it is not complete or exhaustive. NBF is under no obligation to update this information. NBF is not providing any advice or recommendation in this document. This document does not constitute legal or regulatory advice.*

Alternative reference rates are not direct replacements for LIBOR and may perform differently to LIBOR. The discontinuation or unavailability of LIBOR may therefore have material and adverse consequences (including as to economic value) which may be difficult to predict and for which NBF is not responsible. You should consider obtaining independent professional advice on the potential impact of LIBOR discontinuation and benchmark rate reform on your business and the products that you hold with NBF.

What is LIBOR?

LIBOR (which stands for the London Interbank Offered Rate) is a widely used benchmark for short-term interest rates, providing an indication of the average rates at which certain banks (referred to as LIBOR "panel banks") could fund themselves in the wholesale, unsecured funding market for set periods of time and in particular currencies. The LIBOR calculations are based on data from between 11 and 16 panel banks.

LIBOR is administered by ICE Benchmark Administration Limited. LIBOR is widely used to determine interest rates and payment obligations for a wide range and large volume of financial products including loans, bonds and derivatives.

LIBOR is currently published for five currencies (USD, GBP, EUR, JPY and CHF) and seven tenors or time periods for each currency (Overnight/Spot Next, 1 Week, 1 Month, 2 Months, 3 Months, 6 Months and 12 Months).

What is happening to LIBOR?

The integrity of LIBOR has been questioned due to cases of attempted market manipulation of the rate and the reduced liquidity in the interbank unsecured funding markets that followed the global financial crisis.

In July 2014, the Financial Stability Board ("**FSB**"), the international body monitoring and making recommendations about the global financial system, issued a report on its recommendations on benchmark rates which included, among other recommendations, measures to strengthen interbank offered rates ("**IBORs**") in particular by anchoring them to a greater number of transactions, where possible, and to identify alternative nearly "risk free rates" ("**RFRs**")[1]. The FSB noted in its report that the uncertainty surrounding the integrity of major benchmark rates (including LIBOR) represented a potentially serious source of vulnerability and systemic risk.

The UK Financial Conduct Authority ("**FCA**"), the authority which regulates LIBOR, has also questioned the sustainability of LIBOR. In July 2017, it was announced that the FCA does not intend to compel the panel banks to submit to LIBOR beyond the end of 2021[2]. Although the panel banks have voluntarily agreed to continue submitting to LIBOR until the end of 2021, it is anticipated that LIBOR will be discontinued or declared non-representative after such date.

[1]https://www.fsb.org/wp-content/uploads/r_140722.pdf
[2]https://www.fca.org.uk/news/speeches/the-future-of-libor

Will the Emirates Interbank Offered Rate ("EIBOR") be affected?

At this stage, we are not aware of plans for EIBOR, the benchmark rate administered by the Central Bank of the UAE, to be discontinued. EIBOR is published in respect of the UAE Dirham, which is not a LIBOR currency. Therefore, we do not expect LIBOR discontinuation to have a direct impact on EIBOR or products which reference EIBOR. However, it is possible that the Central Bank of the UAE may in the future adopt reforms that will impact EIBOR.

What is likely to replace LIBOR?

Regulators and public and private sector working groups across various jurisdictions are considering a transition from LIBOR to Risk Free Rates (RFRs).

RFRs are overnight benchmark rates which are calculated in a different way compared to LIBOR. RFRs are intended to be based on liquid overnight markets and can be calculated by reference to a larger number of actual transactions than LIBOR. Therefore, RFRs are considered by regulators to be more robust than LIBOR.

What is happening to other benchmark rates?

LIBOR is not the only benchmark rate that is being affected. A number of other IBORs and benchmarks are undergoing reform or, in some cases, may be discontinued.

Some jurisdictions are adopting a "multiple rate" approach, meaning that the relevant RFR will exist alongside the relevant IBOR, while in other jurisdictions the relevant IBOR will be discontinued and replaced with the relevant RFR. For some IBORs, the reduction in liquidity in the relevant interbank unsecured funding market means that it is not possible for the relevant IBOR to continue to exist alongside the relevant RFR. The RFRs that have been selected by the relevant working groups for each LIBOR currency are set out below.

LIBOR Currency	Selected RFR
Sterling	**SONIA** (Sterling Overnight Index Average)*
Euro	**€STR** (Euro Short-Term Rate)*
US Dollar	**SOFR** (Secured Overnight Financing Rate)+
Swiss Franc	**SARON** (Swiss Average Rate Overnight)+
Japanese Yen	**TONAR** (Tokyo Overnight Average Rate)*

+ Based on secured transactions
*** Based on unsecured transactions**

The transition to RFRs may occur at different times in different LIBOR currency markets depending on factors such as the liquidity in the relevant RFR and when market participants are ready to adopt the relevant RFR. In the US dollar markets, SOFR will co-exist with US Dollar LIBOR as long as US Dollar LIBOR is published and the Alternative Reference Rates Committee (the "**ARRC**"), the working group leading LIBOR transition in the US Dollar markets, is encouraging a voluntary adoption of SOFR.[3]

The ARRC has noted that although SOFR and other overnight rates are inherently more volatile than term rates on a day-to-day basis, contracts referencing SOFR have been based on averages of these daily rates and the averages of SOFR have been quite smooth.[4]

[3] **https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/ARRC-faq.pdf**
[4] **https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/ARRC-faq.pdf**

Why has preparation for LIBOR discontinuation already commenced if LIBOR is to be discontinued in 2021?

Even though LIBOR will likely remain available until December 2021, because LIBOR is so entrenched in the financial markets and so many instruments are impacted, there is a significant amount of work that needs to be undertaken in order to ensure that a smooth transition to alternative rates occurs upon LIBOR discontinuation. As such, preparatory work has commenced to smooth the path for LIBOR transition from now.

Although the COVID19- pandemic has impacted the timing of certain aspects of LIBOR transition, the FCA has announced that it remains the case that firms cannot rely on the end of 2021 deadline being extended[5]. The FSB has also noted that it maintains its view that efforts should continue to be made for the wider use of RFRs to reduce reliance on IBORs where appropriate and to remove remaining dependencies on LIBOR by the end of 2021.[6]

The ARRC has issued recommendations for preparing for LIBOR discontinuation and included certain milestones that it recommends. For new, renewed or refinanced business loans that mature after 31 December 2021, the ARRC's recommendations include, among others, that:[7]

1. certain specified ARRC-recommended (or substantially similar) US Dollar LIBOR "fallback" language should be included in all new syndicated business loans as soon as possible, but no later than 30 September 2020, and in all new bilateral business loans as soon as possible, but no later than 31 October 2020; and

2. no business loans using US Dollar LIBOR and maturing after 2021 should be originated after 30 June 2021.

ARRC's recommendations in relation to derivatives include, among others, that no new LIBOR derivative trades maturing after 2021 should be initiated unless such trades are for risk or default management of legacy LIBOR positions after 30 June 2021.

Additionally, in October 2020, the FSB published a global transition roadmap for LIBOR setting out steps that financial firms and their clients should be undertaking to prepare for LIBOR transition. This roadmap sets out the deadline for LIBOR transition as the end of 2021.

[5] https://www.fca.org.uk/news/statements/further-statement-rfrwg-impact-coronavirus-timeline-firms-libor-transition-plans

[6] https://www.fsb.org/07/2020/fsb-statement-on-the-impact-of-covid-19-on-global-benchmark-reform/

[7] https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC-Best-Practices.pdf

How do RFRs differ from LIBOR?

Two of the key differences between RFRs and LIBOR are described below.

1. LIBOR is a “forward-looking” term rate that is published for a particular term (such as 1, 3 or 6 months) at the beginning of the relevant period. RFRs are “backward-looking” overnight rates published at the end of the overnight period. When interest is calculated by reference to an RFR, the interest would only be capable of being determined at the end of an interest period. Although work is being undertaken to consider whether forward-looking term RFRs can be developed for certain products for which it may be necessary or desirable for the benchmark rate to be known at the start of the relevant period, it is not certain if such rates will be available before the end of 2021. Therefore, a methodology has been developed to calculate a benchmark rate for the relevant period by compounding the relevant RFR in arrears.

2. LIBOR includes a premium for term or interbank credit risk which is an additional amount to cover the risk that the borrowing bank is unable to repay the lending bank. RFRs, which are overnight rates and, in some cases, secured do not include this premium or include a reduced premium.

   Referencing an RFR instead of LIBOR would therefore likely lead to a reduction in the interest payable unless an “adjustment spread” is added to the RFR rate. Work is being undertaken to determine the calculation methodologies and market conventions for calculating adjustment spreads.

[8] **https://www.fsb.org/wp-content/uploads/P1-161020.pdf**

What is the potential impact on products that you hold?

LIBOR discontinuation may impact products that you currently hold or may hold in the future and such products may perform differently after LIBOR discontinuation. LIBOR discontinuation may also impact your systems and processes as well as tax and accounting treatment. The potential impact of LIBOR discontinuation will depend on the product in question and may include the following:

1. **Changes to payments** – The consequences of LIBOR discontinuation on a product (such as a loan, deposit, bond or derivative) that references LIBOR will depend on the terms of the contract. The contract may not specify the consequences of LIBOR discontinuation or alternatively, may include "fallbacks" or consequences that are not suitable. Fallbacks are the provisions applicable if certain "trigger" events occur, such as the discontinuation or unavailability of LIBOR, and may include a "pre-cessation trigger", which means that the fallbacks take effect if LIBOR is declared non-representative prior to it ceasing to be published. In some contracts, fallbacks may apply which result in the application of a new benchmark instead of LIBOR or the parties may agree to use a new benchmark. The use of a new benchmark may result in payments under the relevant product being more or less than they would have been if LIBOR had continued to apply.

2. **Changes to the product's value** – The value of a product (such as the mark-to-market value of a derivative or the secondary market value of a certificated deposit, loan or bond) may be affected by a transition to a new benchmark instead of LIBOR. The product may be worth more or less than it would have been if LIBOR had continued to apply. This could result in other implications including, but not limited to, tax consequences which you should seek independent professional advice on.

3. **Impact on operations and processes** – As the RFRs are "backward-looking" rather than "forward-looking", interest will be calculated at the end of the interest period. Operations and processes may need to be updated to deal with the change in the method of calculating interest. As LIBOR may also be embedded within systems and infrastructure more generally, the potential wider implications of LIBOR discontinuation on systems and infrastructure will need to be carefully considered.

4. **Impact on hedging arrangements** – A mismatch may arise if a derivative is used to hedge a specific risk under a particular product, such as the interest rate risk under a loan, which does not address LIBOR discontinuation in the same way as the derivative. This may also impact the application of hedge accounting rules to your financial arrangements.

Given that LIBOR is a widely used benchmark, the impact of LIBOR discontinuation is widespread, and the examples provided above are not exhaustive or complete. These examples are provided for information only and are intended to provide an indication of some of potential effects that LIBOR discontinuation may have on your products.

What is the potential impact on loans and loan documentation?

The "fallbacks" that are typically included in loan documentation are generally intended to take effect if LIBOR is temporarily discontinued. These fallbacks have not usually been intended to deal with a permanent discontinuation of LIBOR.

The Loan Market Association ("**LMA**"), an industry body that focuses on loans, has published "replacement of screen rate" wording to facilitate amendments in syndicated loan documentation to introduce a replacement benchmark rate upon the occurrence of certain trigger events with a lower lender consent threshold than would otherwise be the case. The trigger events include a permanent discontinuation of LIBOR, the designation of a replacement rate and/or a determination that a successor rate has generally been accepted in the international or any relevant domestic market.

Additionally, the LMA has published two "exposure drafts" of a syndicated Sterling facility with compounding SONIA as the benchmark rate and a syndicated US dollar facility with compounding SOFR as the benchmark rate, in each case, instead of LIBOR. The LMA has also published an "exposure draft" of a rate switch agreement which includes provisions to facilitate the switch from the existing benchmark rate to the relevant RFR. The LMA "exposure drafts" are working drafts that may change and are expected to be finalised in due course.

It is expected that an increasing number of new loans will include the relevant RFR compounded in arrears instead of LIBOR as the benchmark rate. It is also expected that existing loans maturing after the end of 2021 will be amended to replace LIBOR as the benchmark rate with the relevant RFR. In each case, using the relevant RFR instead of LIBOR as the benchmark rate may change the amounts payable under loan documentation. In addition, unless a forward-looking term version of the relevant RFRs are developed and adopted, the interest rate for a loan may only be determined at (or near) the end of an interest period based on a series of compounded overnight rates, rather than at the start of an interest period as is currently the case in respect of loans that use forward-looking LIBOR as the benchmark rate.

What is the potential impact on derivatives and derivative documentation?

Derivative transactions which reference interest rate benchmarks typically incorporate the 2006 ISDA Definitions (or, for older transactions, earlier iterations thereof), as published by the International Swaps and Derivatives Association, Inc. ("**ISDA**"). For a number of the IBORs, including LIBOR, this means that if the IBOR were to be unavailable, the rate would be determined by reference to quotations from reference banks, with no alternative methodology provided. The 2006 ISDA Definitions generally do not address the consequences of no quotations being provided by reference banks. If an IBOR were to be permanently or indefinitely discontinued, it is unlikely that quotations would be provided for some or all of the remaining term of the relevant derivative transaction. In these circumstances, if those provisions are not updated, the value and continued existence of, and payments due under, the relevant derivative transaction would be uncertain.

ISDA has undertaken a number of industry consultations to address this issue and has recently finalised Supplement 70 to the 2006 ISDA Definitions addressing IBOR fallbacks ("**IBOR Fallbacks Supplement**"), among other things, and launched the ISDA 2020 IBOR Fallbacks Protocol ("**IBOR Fallbacks Protocol**"). The IBOR Fallbacks Supplement among other things introduces fallback provisions which would apply if the relevant IBOR ceases to be provided permanently or indefinitely, and, in the case only of LIBOR, after a determination and announcement by the FCA that LIBOR is no longer representative. In these circumstances, the applicable rate for the relevant IBOR rate option will first fall back to a term adjusted (RFR) in the same currency plus a spread. The RFR will be adjusted by being compounded in arrears for the relevant term to reflect the fact that the IBOR is a term rate rather than an overnight rate. A spread will also be added to that adjusted RFR to account for the fact that the IBORs include a degree of bank credit risk. Under the 2006 ISDA Definitions, the fallbacks for the IBORs specified in the IBOR Fallbacks Supplement and used in transactions that refer to the 2006 ISDA Definitions entered into on or after 25 January 2021 (which is when the IBOR Fallbacks Supplement will be published) ("**Effective Date**") will automatically include the new fallback provisions without any further action needed.

Derivative transactions incorporating the 2006 ISDA Definitions entered into prior to the Effective Date will not automatically include the new fallback provisions. ISDA has launched the IBOR Fallbacks Protocol to enable parties to amend those existing derivative transactions as well as other specified documents which reference certain IBORs to include the updated rates and fallbacks. These amendments apply to covered documents between parties that have adhered to the IBOR Fallbacks Protocol by completing and delivering a letter in a specified format to ISDA (each, an "Adhering Party"). After careful consideration of its own position, NBF and NBF Markets Cayman Limited have adhered to the IBOR Fallbacks Protocol and are therefore Adhering Parties. If you do decide to adhere to the IBOR Fallbacks Protocol after familiarising yourself with its terms, reading the related documents on the ISDA website and taking appropriate professional advice, please note that covered documents between either of these NBF entities and yourselves will be amended from the later of: (i) 25 January 2021; and (ii) the date of your adherence (although special rules apply to covered documents that have been entered into by an agent on behalf of its clients).

Adopting the terms of the IBOR Fallbacks Protocol is effectively an amendment to a covered document. The IBOR Fallbacks Protocol also contains a representation to the effect that relevant consents have been obtained. If there are any consents required to amend any of your derivative transactions, you will need to have obtained those consents before you adhere to the IBOR Fallbacks Protocol.

As the RFRs are not direct replacements for LIBOR and may operate in a different way compared to LIBOR, falling back to a rate based on the relevant RFR may cause the value of the derivative transaction to change. The extent of any such value change may not be known until the relevant spread is calculated, which may limit the parties' ability to prepare for the related economic effect.

Generally, there are risks associated with using a derivative transaction to hedge underlying exposure under a different product, such as a loan or a bond, which typically contain, in the case of a loan, a specific waterfall of fallback methods with a final fallback referencing the lender's cost of funding, the alternative base rate and/or PRIME, and in the case of a bond, may contain a fallback to the rate for the previous interest period (which effectively converts the product into a fixed rate note).

The time at which and the way in which the fallback operates under the derivative transaction may cause the derivative transaction to hedge any underlying exposure less effectively. Examples of differences in operation include differences in fallback rate (such as a difference in the way in which the RFR is adjusted or the spread is calculated), differences in interest accrual periods or payment dates resulting from varying accrual or payment conventions and a difference in triggers (such as the inclusion of a pre-cessation or non-representativeness trigger in one instrument but not the other).

Any mismatches may also impact the accounting treatment (such as hedge accounting) and tax treatment. Parties to derivative transactions need to familiarise themselves with how the IBORs are defined within their documentation and how the related fallbacks apply and interact with related arrangements such as a cash product for which the derivative transaction is intended to serve as a hedge and take professional advice as to the potential impact and risks associated with the discontinuation of these IBORs. This should include assessing the effect of the triggers and fallbacks set out in the IBOR Fallbacks Supplement and the IBOR Fallbacks Protocol.

It is unclear whether the fallbacks set out in the IBOR Fallbacks Supplement and the IBOR Fallbacks Protocol would be suitable for certain non-linear derivative transactions that parties may have entered into such as in-arrear swaps, interest rate caps and floors and range accrual products.

If the ISDA published provisions are not appropriate for a particular transaction, whether for a new or existing derivative transaction, parties will need to bilaterally negotiate and agree to adjust the basis on which they adopt those provisions.

For derivative transactions that are traded under documentation not published by ISDA, parties need to understand and take advice on the potential legal, regulatory and financial impact on those transactions of possible changes in, disruption to, or discontinuance of, LIBOR. The scope of ISDA's work on IBOR fallbacks may not extend to all such derivative transactions and parties may be required to enter into bilateral negotiations and/or amendments to moderate the impact of changes in, disruption to, or discontinuance of, LIBOR.

What is the potential impact on bonds, notes, commercial paper and certificates of deposit and the associated documentation?

The documentation for bonds, notes, commercial paper and certificates of deposit referencing LIBOR typically (although not always) includes "fallbacks" which apply if LIBOR is *temporarily unavailable* but, as with loans and derivatives, such fallback provisions have in the past generally not been intended to deal with a *permanent* discontinuation of LIBOR. For example, some floating rate notes provide that, in this scenario, the rate for the previous interest period applies which would effectively convert the floating rate note into a fixed rate note. More recently, the terms of floating rate notes have incorporated additional fallbacks with the purpose of providing a solution to the permanent discontinuation of an IBOR, pursuant to which upon the occurrence of certain trigger events, a successor or alternative rate may be selected and other necessary amendments to the terms of floating rate notes made, such as adding an adjustment spread to the replacement rate.

There is typically no mechanism in the documentation for these types of products that would specify, after the issue date, an alternative interest rate. Therefore, to deal with a permanent discontinuation of LIBOR, the terms of each such product would require amendment, usually by obtaining consent from a specified percentage of holders. However, amendments to include a different basis of calculating interest may be difficult where the products are broadly held (and there are difficulties in reaching a quorum or approval threshold) or narrowly held (and investors with material stakes are not receptive to any amendments) and/or have high consent thresholds once a quorum is achieved.

The operation of any existing fallback arrangements could result in a different return for the holder of the relevant product (which may include payment of a lower rate of interest or a fixed rate of interest until maturity) than they might receive under similar products which contain different or no fallback arrangements.

NBF does not set the terms of secondary market products that it offers as it is not the issuer of such products. You should bear in mind that such products may (i) not include any fallbacks, (ii) include fallbacks that differ from those included in a product issued by NBF and/or (iii) be subject to a change of the benchmark and/or repricing as a result of the discontinuation of LIBOR.

How is NBF preparing for LIBOR discontinuation and what are the next steps?

NBF is preparing for LIBOR discontinuation and is continuing to monitor developments from the regulators and the industry on benchmark rate reform. NBF is communicating with its customers and counterparties to raise awareness of LIBOR discontinuation.

NBF is also reviewing the impact that LIBOR discontinuation will have on the products that it offers and assessing a transition to RFRs for relevant products. A transition to RFRs may require amendments to the terms of products that you hold with NBF which may differ from the approaches to amendment described in this document.

Customers and counterparties should consider seeking independent professional advice on LIBOR discontinuation and benchmark rate reform including the potential impact on their businesses and the products that they hold. Nothing in this document should be construed as a recommendation or advice by NBF to its customers or counterparties regarding which RFRs they should transition to or the risks or exposure resulting from LIBOR transition. Given that benchmark rate reform is continuously developing, customers and counterparties should seek to monitor new developments.

Further information

Please contact your relationship team at NBF, in case you have any questions regarding this communication or would like to receive further information relating to LIBOR discontinuation.

Further background information can also be found on the following websites:

Association of Corporate Treasurers website: https://www.treasurers.org/liborreform

Bank of England website:
https://www.bankofengland.co.uk/markets/transition-to-sterling-risk-free-rates-from-libor and https://www.bankofengland.co.uk/markets/sonia-benchmark

Bank of Japan website: https://www.boj.or.jp/en/paym/market/sg/index.htm/ and https://www.boj.or.jp/en/paym/market/jpy_cmte/index.htm/

European Central Bank website: https://www.ecb.europa.eu/paym/initiatives/interest_rate_benchmarks/WG_euro_risk-free_rates/html/index.en.html

FCA website: https://www.fca.org.uk/

Federal Reserve Bank of New York website: https://www.newyorkfed.org/ and https://www.newyorkfed.org/arrc

Financial Stability Board website: https://www.fsb.org/

ICMA website: https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/benchmark-reform/

Intercontinental Exchange website: https://www.theice.com/iba/libor

ISDA website: https://www.isda.org/category/legal/benchmarks/

LMA website: https://www.lma.eu.com/libor

LSTA website: https://www.lsta.org

Swiss National Bank website: https://www.snb.ch

U.S. Commodity Futures and Trading Commission website: https://www.cftc.gov/