To:	SSW Depository Clients
From:	Chad McKeithen
Re:	LIBOR to SOFR Credit Spread Adjustment
Date	February 27, 2023

In December 2022 the Federal Reserve Board adopted the final rule implementing SOFR as its preferred replacement index for LIBOR, with June 30, 2023, as the LIBOR "cessation" date. ICE Benchmark Administration (IBA) has announced that it will cease publication of USD LIBOR ICE Swap Rate "runs" for all tenors immediately following final publication on June 30, 2023. There may be "synthetic" LIBOR publishments beyond June, but depositories should be preparing for a mid-summer end to LIBOR.

Newly issued contracts are currently being indexed to SOFR, with minimal issues. The outstanding issue relates to legacy LIBOR-indexed contracts, with maturities extending beyond June 30, 2023. Legacy contracts will need to be converted to SOFR and will also require a credit spread adjustment. The spread adjustment is required because SOFR is a Treasury based index whereas LIBOR factors in credit risk from two financial institutions lending to one another. Therefore, LIBOR has an embedded credit premium that SOFR does not.

We are recommending that clients address any contracts, prior to the June 30 cessation date, that may still be indexed to LIBOR. This has primarily involved loans and private debt issues. We recommend following the International Swaps and Derivative Association (ISDA) preferred credit spread adjustment of the 'historical mean approach,'. This requires adjusting the current credit spread on a contract by the 5-year historical mean spread between USD LIBOR and SOFR. Below is a summary of the average historical mean spread for tenors out to 12 months. We have also attached the historical analysis, that corresponds to the summary data below, that can be used as demonstrations.

(click on each below to view chart)	Historical Basis Point Adjustment	Lookback
Overnight LIBOR minus Overnight SOFR	1.9	Since Oct. 2019 due to US $ Repo Market dislocation in Sept 2019
1mo LIBOR minus 1mo SOFR	8.0	5yr
3mo LIBOR minus 3mo SOFR	21.0	5yr
6mo LIBOR minus 6mo SOFR	27.5	Since Jan 3, 2019
12mo LIBOR minus 12mo SOFR	43.2	Since Sep 24, 2021

The 6 and 12 month SOFR tenors do not have five years of liquidt history. We started the overnight rate regression on October, 1 2019 due to the US dollar Repo market liquidity issue that occurred in September 2019. This causedthe SOFR overnight rate spike against global overnight rates.

Example:

- A loan tied to 1m LIBOR + 3.00% would convert to 1m SOFR +3.08%
- A loan tied to 3m LIBOR + 3.00% would convert to 3m SOFR +3.21%