NEW REFERENCE RATE

Forging a smooth transition from LIBOR

LIBOR has been in the financial news since July 2017 when the UK's Financial Conduct Authority decided to phase out this reference rate, which over $350 trillion in financial products are based upon. Ralph Waldo Emerson said it best with this quote, "The future belongs to those who prepare for it." If you have not started a plan to address the LIBOR transition, now is the time to begin.

The Federal Reserve has created the Alternative Reference Rates Committee (ARRC) to assess viable alternatives and the secured overnight financing rate (SOFR) was identified as LIBOR's replacement. SOFR is an overnight rate based on the U.S. Treasury repurchase (repo) market, which needs to be developed into a term rate in order to be used as a market index, and it also needs more history in order to make it a reliable index. Additionally, SOFR doesn't include a credit risk component. If the tenor and credit components can be addressed, then market participants could replace LIBOR with SOFR plus a credit spread, that will aid in the phase-out of LIBOR on by the mandated date of December 31, 2021.

To read a more in-depth explanation of the history of the transition from LIBOR, *visit our website*.

The FHLBank System is a primary leader in the financial system's adoption of SOFR. The System is working to help build the SOFR market by participating in SOFR-indexed bond issuances. FHLBank Topeka has been an active participant in these bond issues and is working on a conversion from LIBOR to SOFR in our own contracts.

Similarly, most of you are probably already thinking or planning for this phaseout. LIBOR exposure is found in loans, securities, credit card debt, derivatives, etc. Formulating a plan to show regulators your LIBOR exit strategy and your plan to manage the exposure is key

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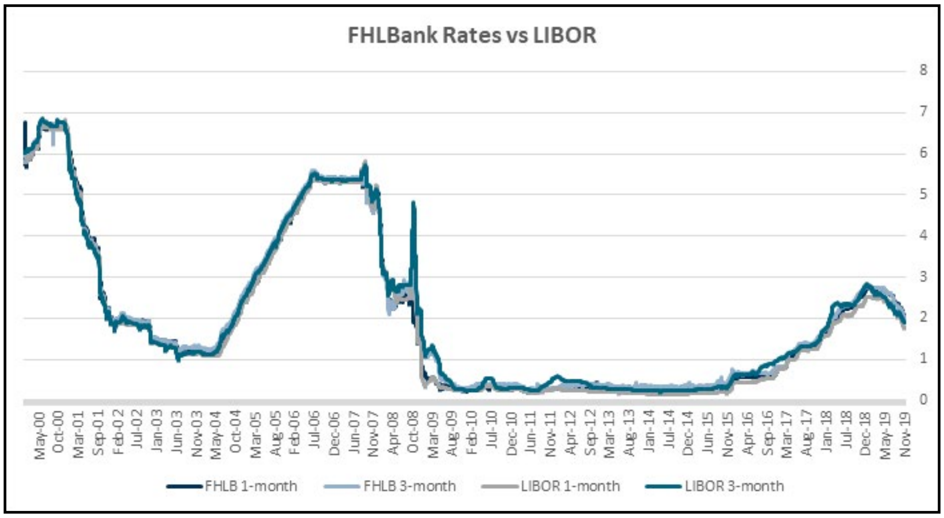
to a successful transition. Institutions that delay may fall behind their proactive rivals. The first step in a plan is to select a transition team with representatives from areas such as senior management, operations, accounting, treasury, IT and risk management.

This committee should create a plan including the following:

- Identify LIBOR exposure
- Estimate the impact of the exposure
- Assess fall back language in contracts with maturities beyond 2021
- Amend contract language if possible
- Develop contracts to incorporate robust fall back language
- Review Implications on systems, taxes, accounting treatment if LIBOR converts to an alternative rate
- Create a communication plan for customers

HOW FHLBANK CAN HELP

FHLBank's short-term advance or RAC (regular adjustable callable) advance may be a good alternative rate when pricing an adjustable rate asset. The graph below is a comparison of 1- and 3-month LIBOR to the 1- and 3- month FHLBank short term advance rates. For at least 20 years, these indices have tracked closely, except for a few weeks in the early part of 2009 when the LIBOR board unsuccessfully tried to force an increase in rates.



If this trend continues, the smart choice may be an FHLBank RAC or short-term advance. Why FHLBank Topeka's short term or RAC advance? Our RAC advance is the perfect liability with a long-term maturity with a rate that adjusts consistent with short-term market rates. The longer maturity provides regulatory certainty in the availability of funding.

Advantages include:

- Provides a low-cost call option in part or in full (up to five-year maturity only 2 bps cost of the call)
- Gives you a reliable, easy to use option with immediate access
- Extends duration of liabilities
- Optimizes deposit pricing
- Matches liability to assets resetting to LIBOR
- Allows you to originate/purchase adjustable rate mortgages, loans, or securities
- Manages exposure to declining interest rates (asset sensitive)
- Tracks with the market

FHLBank's adjustable callable advance can improve your liquidity risk ratio and provide you the benefit of a no-cost call on rate reset dates. The term is four months to 15 years resetting to our 1-week, 1-month or 3-month advance rate. Whichever index you choose ,you may call it away on any reset date with only one business day's notice.

As LIBOR-based instruments expire and SOFR grows in popularity, the exposure to LIBOR will decrease. It is important to FHLBank Topeka to continue to offer an array of products to help our members manage this transition.

We are here for you as a trusted financial partner to meet all your funding needs. Contact the Lending Desk at 800.809.2733 to discuss your options. You can also visit our *LIBOR transition page* for a timeline and more resources to help your institution.