Dubai Islamic Bank PJSC

IBOR Transition:
Customer Communication

June 2021

Introduction

Objectives & Benchmarks

What is IBOR?

Why is LIBOR being replaced?

Introduction

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Objective

The objective of this document is to provide customers and counterparties of DIB, an overview and explain the implications of the Interbank Offered Rates (“IBOR”) discontinuation. This document is provided for information purpose only. Customers are strongly advised to consult their financial advisors to analyse and understand the impact on their respective business.

What are Benchmark Rates and IBOR Reforms?

Benchmark rates are published reference rates used to calculate the amount of profits, rentals, returns, incentives, payments or other rates applicable (the “Applicable Payment”) for transactions with customers and other counterparties. Interbank Offered Rates (“IBOR”) including London Interbank Offered Rate (“LIBOR”) used as Applicable Payment benchmarks (“Benchmark Rates”) are being phased out and shall be replaced by various alternative reference rates (ARRs) across Global Financial Markets. The USD LIBOR for one week tenor (“LIBOR USD 1W”) and for 2 months tenor (“LIBOR USD 2M”) along with LIBORs of other currencies (all tenors) will cease to exist or be representative post 31 December 2021. USD LIBOR rates for other tenors will cease to exist or be representative post 30 June 2023.

Introduction

What is IBOR?

IBOR is a measure of the average interbank rate at which banks are willing to borrow wholesale unsecured funds. It is calculated based on submissions from selected panel banks and is published for a range of currencies and tenors. Used globally, LIBOR is a major benchmark rate which underpins a significant amount of financial contracts including, derivatives, bonds, loans and financings. LIBOR is also used as a gauge of market expectation regarding central bank interest rates, liquidity premiums in the money markets and, during periods of stress, as an indicator of the health of the banking system.

Why LIBOR is getting replaced?

Beginning in June 2012, LIBOR came under public scrutiny due to controversy over individual panel bank submissions during the height of the financial crisis. Banks were alleged to have manipulated the rate to realize gains on LIBOR-based contracts. There are two main concerns with existing LIBOR determination process:

- First, there has been a significant decline in the sample size for calculating LIBOR since the 2008 financial crisis. In its aftermath, fewer panel banks have been reporting, and those that do, report fewer quotes based on market transactions. Instead, LIBOR has increasingly relied on what the Intercontinental Exchange Benchmark Administration calls "market and transaction data-based expert judgment." Therefore, concerns were raised about how well LIBOR reflects market realities since it is not based on actual market transactions.
- Second, LIBOR’s reliance on inputs from panel banks opened it to manipulation.
- As a result, financial regulatory bodies globally have joined in a coordinated effort to develop alternative reference rates (ARRs). At the heart of these deliberations sits the Financial Stability Board (FSB), an international body established in 2009 to oversee global financial system reform.

What are:

Alternative Reference Rates (ARRs)

Key differences between LIBOR and ARR

Alternative Reference Rates (ARRs) that will replace LIBOR?

What are Alternative Reference Rates (ARRs)?

ARRs are overnight rates, based on actual transactions with high volumes so are highly representative of the actual market. This is a significant improvement on LIBOR which was based on expectations/speculations; quotes submitted by panel banks.

Risk Free Rate working groups* in several jurisdictions have identified replacement benchmarks and have begun developing strategies for transition. Select examples of benchmarks which are either being replaced or benchmarks where changes either have or will be made to their methodology (notably the way in which they are determined) are set out in the table below.

The table below is not exhaustive and there may be other benchmarks which are either discontinued or where changes have or will be made to their methodology.

Replacement Rates for 5 LIBOR Rates

Jurisdiction	United Kingdom	United States of America	Eurozone	Switzerland	Japan
IBORs	GBP LIBOR	USD LIBOR	EURIBOR, Euro LIBOR	CHF LIBOR	JPY LIBOR, JPY TIBOR, EUROYENTIBOR
ARR	Reformed Sterling overnight index average (**SONIA**)	Secured overnight financing rate (**SOFR**)	Euro short–term rate (**ESTER**)	Swiss average rate overnight (**SARON**)	Tokyo overnight average rate (**TONA**)
Working Group	Working Group on Sterling Risk–Free Reference Rates	Alternative Reference Rates Committee	Working Group on Euro Risk–Free Rates	National Working Group on Swiss franc Reference Rate	Study Group on Risk–Free Reference Rates
Rate Type	**Unsecured**	**Secured**	**Unsecured**	**Secured**	**Unsecured**
Rate administrator	Bank of England	Federal Reserve Bank of New York	European Central Bank	SIX Swiss Exchange	Bank of Japan

*Regulators in different jurisdictions set up specific working groups to develop robust alternatives to LIBOR. To name a few examples, the Alternative Reference Rates Committee (ARRC) was set up under the Federal Reserve Bank of New York and the Working Group on Sterling Risk-Free Reference Rates was set up under the Bank of England (UK RFR WG)

What are the key differences between LIBOR and ARR

LIBOR	ARR
Forward looking rate with the defined **term structure** (7 tenors)	Overnight only (at this stage), backward looking rates with limited forward term structure
Based on **expectations/speculations**; quotes submitted by panel banks	Based on actual transactions from the previous day; calculated volume-weighted median.
Includes a built-in credit risk and liquidity spread across the tenors	Nearly risk free rate that closely tracks the central bank rate
Centrally calculated in the London Interbank market	Each country has its own rate calculation mechanism
Responsive to risk free rate, liquidity and credit pricing (specially in the event of stress)	Only responsive to change in risk free rates

What are the key differences between LIBOR and ARR (contd.)

Timing for Calculating Applicable Payments for ARR Facilities (for example, Ijara, Murabaha, Musharaka, Wakala, etc.)

- LIBOR is a forward-looking, unsecured term rate published in 7 tenors. This setup allows the parties to calculate the Applicable Payment payable for the applicable period under the facility (the Applicable Period) using the relevant rate (the Relevant Rate) at the start of that Applicable Period itself.
- On the other hand, ARRs are backward-looking overnight rates. Hence, for ARR-linked facilities, Banks will not be able to determine the Applicable Payment until the end of the Applicable Period.
- To allow the banks to calculate the payable amount and generate notices prior to the due date, a lag period has been introduced between the Applicable Period and the cashflow period. The expected market convention in line with the Bank of England recommendation for this lag is a 5 RFR Banking Day (5 BD) lookback.

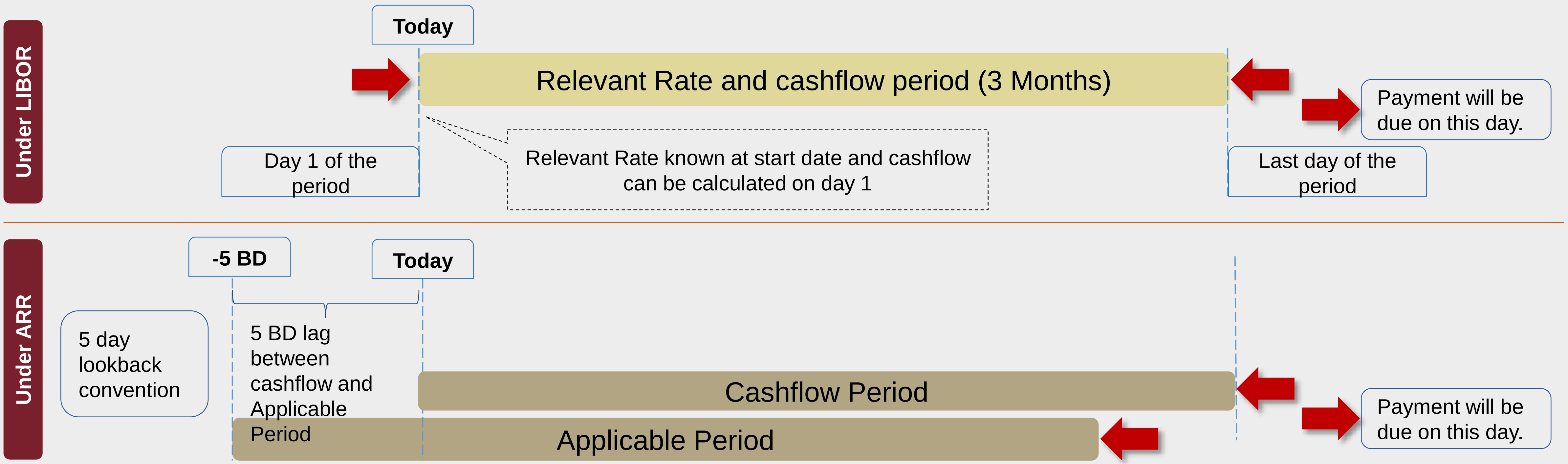

Illustration of the difference in the Relevant Rate calculation timelines and method for RFRs as compared to LIBOR

Note: DIB will adopt a Relevant Rate calculation methodology that is approved by its Internal Sharia Supervisory Committee of DIB and the Higher Sharia Authority of CBUAE

Pricing structure & Credit Adjustment Spread Methodology(CAS)

Pricing structure under LIBOR and ARR regimes

LIBOR Financing	**LIBOR**			+	**Margin**
LIBOR Financing transitioned to ARR	1 **ARR**	+	2 **CAS**	+	3 **Margin**
New Financing under ARR	1 **ARR**	+	2 **Margin**		

ARR: DIB will replace LIBOR with the benchmark rate designated, nominated or recommended by the administrator of LIBOR or Applicable Regulatory Body. In case the administrator or Applicable Regulatory Body does not recommend a replacement rate then the benchmark replacement for LIBOR shall be the arithmetic mean of the rate as supplied by the Replacement Benchmark Reference Bank to DIB on its request. The options for profit rate calculation methodology that are under consideration have been discussed later

Credit Adjustment Spread (CAS): As LIBOR and ARR are economically different (as explained earlier), a Credit Adjustment Spread may be added when transitioning a LIBOR reference product to ARR to reduce or remove any transfer of value between the Bank and customer. DIB will determine the appropriate level of CAS by using commercially acceptable methods.

Margin: The margin applied in the transitioned ARR product will be the same as the LIBOR referenced product. Margin for products priced using ARR directly will be determined on an exposure by exposure basis.

Fallback language

The transition from LIBOR to ARR will come into effect through the fallback language provisions of the financing contracts. Fallback language states the entire mechanism of transition from LIBOR to ARR including, but not limited to, definition of a cessation trigger event (for example the date on the rate administrator stops publishing the LIBOR or a similar benchmark rate), cessation trigger event (for example date of announcement by rate administrator that LIBOR or a similar benchmark rate will become unrepresentative on a certain date), method to identify a successor or a substitute rate upon occurrence of trigger event, etc. Such fallback language is contingent upon cessation trigger event and/or the pre-cessation trigger that will initiate the switch to the ARR. Various regulatory working groups have come out with recommendations on fallbacks language. Such recommendation can be found on the website URLs provided later. DIB will adopt a fallback language which provides for a methodology of determining the Relevant Rate in accordance with the principles of Sharia (as approved by the Internal Sharia Supervisory Committee of DIB and the Higher Sharia Authority of CBUAE).

Credit Adjustment Spread Methodology(CAS)

ISDA 5-year historical median is one of the approaches recommended by different regulatory and industry bodies (such as ARRC, UK RFR WG and ISDA) to calculate CAS.
Under this approach, CAS is equivalent to the median between the LIBOR and the relevant RFR over a period of 5 years, historically.

5Y ISDA Median Spread
(Expected to be the industry standard)

5-year historical median of LIBOR - RFR

Relatively lower risk due to fixed spread and not sensitive to the changes in the financial markets

Consistent with derivatives markets as defined in the ISDA fallback protocol

Recommended by BoE as a fallback and market precedent set by some of the syndicated financing

Currency	LIBOR Tenor	5Y ISDA Median spread (bps)*
GBP	3M	11.93
	6M	27.66
	12M	46.44
USD	3M	26.161
	6M	42.826
	12M	71.513

**** Fixed as of 05 March 2021***

Timelines

Timelines for LIBOR Cessation

Regulatory bodies such as ARRC (a body Convened by Federal Reserve Board and New York Fed), Bank of England, Financial Conduct Authority (FCA) amongst others have prepared a high level transition timelines and are encouraging the market participants to follow these timelines.

LIBOR Rate	Tenor	Cessation Date (As per regulatory guidance)	Action for new floating contracts (As per regulatory guidance)
USD LIBOR	One week and two months	31 December 2021	The regulators encourage banks to cease entering into new contracts that use USD LIBOR as a reference rate as soon as practicable and in any event by December 31, 2021. New contracts entered into before December 31, 2021 should either utilize a reference rate other than LIBOR or have robust fallback language that includes a clearly defined alternative reference rate after LIBOR's discontinuation. The FCA and the US Federal Reserve have recommended that, as soon as possible but no later than 31 December 2021, new USD floating rate financing arrangements expiring after 30 June 2023 be documented by reference to ARRs and not IBORs.
	All remaining tenors	30 June 2023	
GBP LIBOR	All tenors	31 December 2021	The FCA and the Bank of England have recommended that, from 1 April 2021, any new floating rate GBP financing and linear derivatives expiring after 31 December 2021 be documented by reference to SONIA and not to GBP LIBOR.
EUR LIBOR	All tenors	31 December 2021	The European Union (EU) in respect of Euro, the Bank of Japan in respect of Japanese yen, and the Swiss National Bank in respect of Swiss Francs, have each recommended that, from 1 July 2021, any new floating rate financing and linear derivatives denominated in those currencies, respectively, and expiring after 31 December 2021 be documented by reference to the relevant ARRs and not to LIBOR.
CHF LIBOR	All tenors	31 December 2021	
JPY LIBOR	All tenors	31 December 2021	

Transition approach for existing LIBOR Referenced Products

Transition approach would be dependent upon the maturity date of the LIBOR referenced products, as explained below:

Financing	Maturity	Transition Approach
Existing LIBOR referencing financing	**Prior to 31 Dec 2021**	▸ No action required as the contracts will be allowed to expire upon maturity
Existing LIBOR referencing financing	Post 31 Dec 2021	▸ **Active transitioning**: LIBOR facilities shall be re-contracted as per adopted methodology, which is consistent with the principles of Sharia (as approved by the Internal Sharia Supervisory Committee of DIB) and the Higher Sharia Authority of CBUAE. ▸ **Allowing fallback to be triggered**: appropriate fallback language and transition methodology for switch to ARRs on the cessation date in accordance with a Sharia compliant mechanism as approved by the Internal Sharia Supervisory Committee of DIB and the Higher Sharia Authority of CBUAE.

Note: CAS shall be fixed once for all existing LIBOR referenced products maturing post the cessation date.

ARRC Recommended Timeline

USD LIBOR, SOFR

Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021
▪ *No new LIBOR mortgages* ▪ *Hardwired fallbacks in business loans*	▪ *No new LIBOR FRN* ▪ *Hardwired fallback language in derivatives*		▪ *No new LIBOR loans & derivatives* ▪ *CCPs to not accept EFFR*	▪ *No new LIBOR CLOs*	▪ *Forward looking SOFR term rate publish (May or may not be available)*

Characteristics and Considerations

Characteristics and Considerations for entering into new LIBOR financing contracts

Pricing mechanism	LIBOR Financing + Switch to Recommended Rate*
Description of pricing mechanism	► The financing will initially be priced using relevant USD LIBOR plus a margin ► Subsequent to the transition trigger event, the financing will automatically convert to recommended rate plus CAS plus margin as per the terms of the facility
Benefits (compared to deals without the switch mechanism)	► Financing continues to operate on LIBOR while LIBOR remains available and representative ► Methodology and approach for transition is agreed in advance
Additional considerations for customer	► Customer should understand the mechanism of the recommended rate conventions ► The IBOR transition environment is still evolving and customers should keep themselves updated about the developments. DIB will endeavor to communicate major developments to our customers ► Hedging needs of the customers will have an implication on the products. Customers should contact DIB for specific hedging requirements and DIB will endeavor to meet the objectives of their needs.

*Currently, ARRC has recommended SOFR as a replacement benchmark for USD LIBOR. If there are changes to ARRC recommendations in this regard then DIB will inform the customer about the implications of the same.

FAQs

Frequently Asked Questions (FAQs)

Potential impact on agreements between you and DIB

The use of the benchmark rate may result in products or agreements performing differently than if the original benchmark rate had continued to apply. This could include variation or amendment to the calculation of profit, income, rental, return or incentive amounts (being the Applicable Payment). Please contact your relationship manager for more details.

Is there any impact or change in Emirates Interbank Offered Rate ("EIBOR")?

We are not aware of any forthcoming changes to the EIBOR administered by the Central Bank of the United Arab Emirates, however, in future, EIBOR may also be reformed.

What is the fallback Language?

Terms and conditions of financial products typically contain fallback provisions, which identify how a successor or substitute rate will be selected if LIBOR, EURIBOR, EONIA or a similar benchmark is not published. There is a risk that fallback terms do not adequately cater for the circumstances in which they need to be used. Fallback language in the context of LIBOR is the contractual language contingent on the cessation trigger and/or the pre-cessation trigger that will initiate the switch to the ARR. Furthermore, DIB will adopt a Sharia compliant mechanism under the Fallback language which is in accordance with principles of Sharia, as approved by the Internal Sharia Supervisory Committee of DIB and the HSA of CBUAE.

Is there any guidance for Islamic financing and Islamic derivatives?

Concrete regulatory guidance, and corresponding industry consensus, on IBOR referencing Islamic financing and derivative products are yet to emerge.

More Information

Where can you find more information on ARRs / RFRs?

As part of efforts to develop ARRs authorities in line with Financial Stability Board's recommendations various Central Banks have set up national working groups to make recommendations on the transition to ARRs. All the Working Groups provide market participants with information regarding key transition topics, working group's recommendations, progress updates, market consultations, feedback on market consultations, and other relevant data through respective Central Bank's websites or through other channels. Following, including but not limited to, is a list of sources that customers may use to get the latest updates on the IBOR transition:

#	Relevant Currency	Website URL for Working Group
1	GBP	https://www.bankofengland.co.uk/markets/transition-to-sterling-risk-free-rates-from-libor
2	EUR	https://www.ecb.europa.eu/paym/initiatives/interest_rate_benchmarks/WG_euro_risk-free_ rates/html/index.en.html
3	USD	https://www.newyorkfed.org/arrc
4	JPY	https://www.boj.or.jp/en/paym/market/jpy_cmte/index.htm/
5	CHF	https://www.snb.ch/en/ifor/finmkt/fnmkt_benchm/id/finmkt_reformrates
6	SGD	https://www.abs.org.sg/benchmark-rates/about-sora
7	HKD	https://www.hkma.gov.hk/eng/news-and-media/insight/2019/05/20190502/

Where can you find more information about IBOR Reforms?

There are some other independent organizations such as ISDA, IIFM, LMA, LSTA, ACT, etc. which also publish guidance IBOR transition. The information published by these organizations have a wide reach in terms of regulators, market participants, customers, etc. Following, including but not limited to, is a list of sources that customers may use to get the latest updates on the IBOR transition from such organizations:

#	Organization	Website URL
1	International Swaps and Derivatives Association	https://www.isda.org/ https://www.isda.org/category/legal/benchmarks/
2	International Islamic Financial Market	IIFM-White-Paper-on-Global-Benchmark-Rate-Reforms-and-Implications-of-IBOR-Transition-for-Islamic-Finance.pdf
3	ICMA - International Capital Market Association	https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/benchmark-reform/
4	LMA - Loan Market Association	https://www.lma.eu.com/libor
5	LSTA - Loan Syndications and Trading Association	https://www.lsta.org/
6	APLMA - Asia Pacific Loan Market Association	https://www.aplma.com/
7	ACT - Association of Corporate Treasurers	https://www.treasurers.org/

Disclaimer

This document is provided for customers of Dubai Islamic Bank PJSC and each of its subsidiaries (collectively, 'DIB') who may have Islamic products or agreements (investments, financing products, Sharia compliant Wa'ad and agreements relating to hedging and derivative products) which uses the London Interbank Offered Rate ('LIBOR') or another inter-bank offered rate (together with LIBOR, the 'IBORs') as a benchmark rate. Information relating to IBOR discontinuation may change at any time, and by providing you with this explanation and general risk warning, DIB does not imply that the information contained herein is correct at any time subsequent to the date set out above, or that any other information provided to you in relation to IBOR discontinuation is correct at any time subsequent to the date of the relevant communication containing such information. Since DIB is an Islamic bank, the mechanism for adoption of the ARR will be in accordance with a Sharia compliant methodology as approved by the Internal Sharia Supervisory Committee of DIB and the and the Higher Sharia Authority of CBUAE. Resultantly the Sharia compliant methodology may be different from the methodology applied by conventional banks in the UAE.

This overview is not complete or exhaustive and does not constitute any form of advice or recommendation. We recommend that you keep up to date with the latest developments in relation to the changes and the potential alternative benchmark rates that may be relevant to you. Clients should contact their professional advisors on the possible implications of the changes such as financial, legal, accounting or other economic consequences.

If you wish to discuss this further with us, please contact your DIB Relationship Manager or you can also write to us on the email ID dedicated to handle IBOR transition requests. You can also visit our website for further updates.