

IBOR Reform - Q&A

Table of Contents

1. IBOR Reform	3
1.1. What does the IBOR reform mean for me as a client of the Bank?	3
1.2. Reasons for the changes in contractual documentation.....	3
2. Contingency procedures	3
2.1. What contingency solution will the Bank use for my contract?	3
2.2. What is an adjustment?	3
3. Status of the WIBOR benchmark rate	4
3.1. What is the current regulatory status of the WIBOR benchmark rate?	4
3.2. What is the foreseeable future of WIBOR?	4
3.3. Do we already know the alternative benchmark that will replace WIBOR?	4
4. Status of the EURIBOR benchmark rate	4
4.1. What is the current state of the EURIBOR benchmark rate?	4
4.2. What is the foreseeable future of EURIBOR?.....	4
4.3. Is there an alternative EURIBOR benchmark?	4
5. Status of the EONIA benchmark rate	4
5.1. What is the EONIA benchmark rate?	4
5.2. What is the foreseeable future of EONIA?	4
6. Status of the LIBOR benchmark rate	5
6.1. What is the current framework of the LIBOR benchmark rate?	5
6.2. Have LIBOR replacing benchmarks already been set?	5
6.3. Should we expect changes in the contractual documentation with the Bank?	5
7. What are RFR rates?	5
7.1. General information on alternative RFR rates.....	5
7.2. What alternative benchmarks/RFRs will the Bank use?	6
7.3. Where can I find information about the level of RFRs?	6
7.4. Since when does the Bank plan to use alternative benchmarks for its products and contracts?.....	6
7.5. What additional issues may concern the Bank's clients in connection with the transition to alternative benchmarks/RFRs?	7
8. Risks associated with benchmarks	7
8.1. What is the overall risk of using benchmarks?	7
8.2. What is the risk of changing a benchmark methodology by an administrator?.....	7
8.3. What is the risk of ceasing to provide a benchmark by an administrator on a permanent or temporary basis?.....	7

1. IBOR Reform

1.1. WHAT DOES THE IBOR REFORM MEAN FOR ME AS A CLIENT OF THE BANK?

Benchmark interest rates have been operating on financial markets in their current form for many years. However, since 2014 there has been a worldwide discussion on their reformation and adaptation to market realities. More and more regulators of the global financial market have drawn attention to the instability and unreliability of such benchmarks as well as their vulnerability to manipulation. This has resulted in, among other things, the issuance of appropriate legal acts regulating the process of providing benchmark rates, providing input data for the benchmarks and using the benchmarks in financial contracts and financial instruments. Finally, it was deemed appropriate to reform some benchmarks, and to gradually abolish LIBOR benchmarks with the aim of replacing them with new, so-called Risk-Free Rate (RFR), benchmarks.

Part of the IBOR (Interbank Offered Rate) reform is to prepare entities that apply the benchmark rates for expected and potential events related to the benchmarks they use. For the Bank's clients, this means the need to introduce appropriate clauses into contracts regarding actions in case of specific events accompanying a given benchmark rate. The changes in contractual documentation proposed by the Bank introduce comprehensive solutions in case of such events. Thanks to the introduced changes, it will still be feasible to continue a contract with the client using an appropriate benchmark. The economic effect of such transition should not affect the client adversely.

1.2. REASONS FOR THE CHANGES IN CONTRACTUAL DOCUMENTATION

For contracts and financial instruments that fall within the definition of "use of a benchmark" in accordance with the BMR Regulation¹ (the Benchmark Regulation), the reason for the introduced changes are the provisions of the Regulation, which, among other things, impose the obligation on banks to prepare contingency measures in case of significant changes or cessation of the provision of a given benchmark. Contingency solutions should be included in contractual relationships with clients. In case of contracts and financial instruments that are not covered by the definition of "use of a benchmark", the need to include contingencies in contractual relationships is aimed to prepare the product and the parties to a contract for potential or expected events relating to the benchmark rates used in the contract.

2. Contingency procedures

2.1. WHAT CONTINGENCY SOLUTION WILL THE BANK USE FOR MY CONTRACT?

Fallback clauses or contingency procedures proposed by the Bank are generally based on the developed market standards, taking into account possible changes to include such aspects as the specificity of the product, the type of documentation, or contingencies adopted by the Bank. The contingency procedure introduced into contractual documentation usually takes the form of a waterfall of successive solutions, where the next one applies in a situation where the preceding solution is not feasible. Where possible and appropriate, the Bank may also indicate one or more alternative benchmarks to be applied where the contingency procedure is being implemented.

2.2. WHAT IS AN ADJUSTMENT

As a result of changing a benchmark rate and replacing it with an alternative benchmark, an adjustment to the value of the alternative benchmark may be required. An adjustment is the value agreed by the parties or determined by the Bank that is applied to the contract or specific financial instrument in order to reduce or eliminate the change in the economic value resulting from the benchmark-related event, and to apply an alternative benchmark in its place. An adjustment may reflect any predicted changes in economic value resulting from the difference relating to the terms / rules of determination, calculation and structure of time periods between the benchmark affected by the event and the alternative benchmark. The value of an adjustment may be positive, negative, or zero. An adjustment determined by the Bank may arise from a recommendation or guideline issued by a specific entity determining the benchmark, or it may result from a provision of law.

¹ Regulation (EU) No. 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No. 596/2014.

3. Status of the WIBOR benchmark rate

3.1. WHAT IS THE CURRENT REGULATORY STATUS OF THE WIBOR BENCHMARK RATE?

The WIBOR benchmark rate is developed and provided by the Polish Administrator: GPW Benchmark which is authorized by the Polish Financial Supervision Authority (KNF).

3.2. WHAT IS THE FORESEEABLE FUTURE OF WIBOR?

The WIBOR development methodology may be subject to appropriate changes. At the moment, it is not known whether the WIBOR benchmark rate will be replaced by another benchmark in the future. Currently, there is no risk that the benchmark will stop being published.

3.3. DO WE ALREADY KNOW THE ALTERNATIVE BENCHMARK THAT WILL REPLACE WIBOR?

Currently, discussions and actions are underway to further reform the WIBOR benchmark rate, including the development of possible alternative solutions to the benchmark. The Polish Financial Supervision Authority expects further changes improving the method of developing this benchmark, however no official decisions have been made to replace the WIBOR benchmark with another benchmark in the future.

4. Status of the EURIBOR benchmark rate

4.1. WHAT IS THE CURRENT STATE OF THE EURIBOR BENCHMARK RATE?

EURIBOR is being developed by a working group at the European Central Bank. EURIBOR has been fundamentally reformed by its Administrator - the European Money Markets Institute (EMMI) and is fully compliant with the BMR Regulation.

4.2. WHAT IS THE FORESEEABLE FUTURE OF EURIBOR?

Further reform of the EURIBOR benchmark rate and the development of optimal contingencies for it are planned to be implemented, however at the moment, there are no plans to discontinue its provision.

4.3. IS THERE AN ALTERNATIVE EURIBOR BENCHMARK?

Yes, there is an RFR (Risk-Free Rate) alternative benchmark that could replace EURIBOR in the future. This benchmark is €STR, developed and published by the European Central Bank based in Frankfurt am Main.

5. Status of the EONIA benchmark rate

5.1. WHAT IS THE EONIA BENCHMARK RATE?

EONIA is a key benchmark rate within the BMR Regulation scope, developed by the European Money Markets Institute (EMMI), based on the authorization granted by the Belgian Financial Services and Markets Authority on 10/12/2019.

EONIA is determined using a method independently developed by the EMMI under the supervision of the Belgian Financial Services and Markets Authority. The details of EONIA, including a description of key elements of its methodology, the Benchmark Statement (a Document published by the administrator pursuant to Article 27 of the BMR Regulation) and the procedures for receiving and handling complaints regarding the process of determining the EONIA benchmark have been published by the EMMI on its website at: www.emmi-benchmarks.eu/euribor-eonia-org/governance-framework.html.

5.2. WHAT IS THE FORESEEABLE FUTURE OF EONIA?

The publication of the EONIA benchmark rate will end on 03/01/2022. It will be replaced by the €STR benchmark rate.

6. Status of the LIBOR benchmark rate

6.1. WHAT IS THE CURRENT FRAMEWORK OF THE LIBOR BENCHMARK RATE?

The situation of the LIBOR benchmark is determined. The Financial Conduct Authority (FCA), the supervisor of the benchmark administrator, has announced that effective from 31 December 2021, LIBOR will cease to be published in the existing form for: GBP, EUR, CHF, JPY and USD, but USD only for 1W and 2M tenors. USD LIBOR for other tenors will be withdrawn on 30 June 2023.

However, it is not certain that the LIBOR benchmark will completely disappear after the set date. The FCA allows for the possibility of further publication of selected tenors for some currencies given that the benchmarks developed and published on the basis of this exception would be reflecting a different methodology than traditional LIBOR. For the sake of simplicity, they are called “synthetic LIBORs”. Such an exception may be provided for the following currencies:

- GBP LIBOR 1M, 3M and 6M,
- JPY LIBOR 1M, 3M and 6M,
- USD LIBOR 1M, 3M and 6M,

However, for the time being there is no certainty as to further processes regarding these benchmarks after the announced withdrawal date. Financial market participants are being consulted on this subject. It is likely that not all entities using these benchmarks will be able to implement contingency solutions in all contracts before the date of their withdrawal, so such a solution would to some extent facilitate the transition to the new benchmarks.

6.2. HAVE LIBOR REPLACING BENCHMARKS ALREADY BEEN SET?

The Bank has decided to use the following alternative benchmarks in place of LIBOR:

- USD LIBOR → SOFR
- CHF LIBOR → SARON
- GBP LIBOR → SONIA
- JPY LIBOR → TONAR
- EUR LIBOR → EURIBOR for credit products
- EUR LIBOR → €STR for deposits

6.3. SHOULD WE EXPECT CHANGES IN THE CONTRACTUAL DOCUMENTATION WITH THE BANK?

In the standard part of the contractual documentation, in particular where we are dealing with the “use of a benchmark” within the meaning of the BMR Regulation, changes containing contingency procedures have already been introduced. In the case of contracts concluded before the introduced changes or as part of the remaining standard documentation, the changes are introduced gradually, e.g. by means of signed annexes or under another procedure applicable to a given client relationship. With the specific situation of LIBOR, of which benchmarks for multiple currencies will cease to be provided at the end of 2021, appropriate contingency procedures should be introduced in case of certain regulatory triggering events for the benchmark, or a specific alternative benchmark/benchmarks should be introduced, with an indication of the appropriate adjustment and methodology for calculating interest where it is necessary due to the used benchmark and in the manner applicable to a given contractual relationship (e.g. by signing an annex). The above changes should be introduced by the end of 2021 at the latest.

7. What are RFR rates?

7.1. GENERAL INFORMATION ON ALTERNATIVE RFR RATES.

RFRs are calculated under the supervision of national regulatory authorities on the basis of real interbank market transactions. They are overnight rates, calculated daily and then adapted to specific tenors (periods such as 3M, 6M, etc.) by using an appropriate method. Therefore, they are not identical in their construction and application to the existing benchmark rates. First of all, they are determined at or before the beginning of the period to which they apply, which gives assurance as to the amounts due accrued at the end of that period. Below are illustrated

examples of differences in the construction of both solutions - RFRs and term benchmark rates (on the example of the LIBOR benchmark):

- The LIBOR benchmark is determined by reference to future and uncertain interest rates on deposits, while the RFRs are determined on the basis of values embedded in the past;
- The LIBOR benchmark is a term interest rate for multiple periods (tenors) such as: O/N, 1W, 1M, 2M, 3M, 6M, 12M, while RFRs are only O/N (overnight) rates with no element of timeliness;
- The LIBOR benchmark incorporates a premium for the Bank's credit risk and the risk of term liquidity. On the other hand, the RFR contain a very little additional premium or do not contain it at all due to the construction of the overnight interest rate and the fact that they may be secured;
- The LIBOR benchmark for each currency is developed and calculated by a single administrator. The RFR benchmarks for each currency are developed and calculated by different administrators in different countries, leading to the emergence of distinctiveness and unique characteristics for each of the RFR benchmarks.

It may be necessary to adapt the RFR benchmarks to contracts and instruments in which the tenor (period rate) was used, e.g. 3M or 6M, due to the way they are constructed (they are calculated on a daily basis). For this reason, also RFR Term Rates, the so-called "compounded rates" are developed, which allow for setting interest rates for longer interest periods (**RFR Term Rate**) by using the RFR benchmarks.

These RFR Term Rates, such as "SONIA 3-month Compounded Rate", are calculated on the basis of the daily values of the underlying RFR benchmark - in this example, the SONIA benchmark. The administrator that calculates such a RFR Term Rate takes into account a certain period of publication of the RFR benchmark (e.g. SONIA), which corresponds to the interest period (for the "SONIA 3-month Compounded Rate" it will be three months), and then determines the period of observation of that RFR benchmark. The period of observation does not have to coincide with the interest period for which the RFR Term Rate is going to be used - therefore, the final value of the RFR Term Rate might be known even before the end of the interest period. The period of observation of the underlying rate may begin, for example, a few days before the commencement of the interest period for which it will apply. Given the above, the value of the RFR Term Rate, "*the compounded rate*", which will apply to this interest period, will be known the same number of days earlier.

The administrators use various models and mathematical formulas to calculate the RFR Term Rates. The aim of such an operation is to ensure a comprehensive replacement of term rates with RFR benchmarks. Thanks to the adjustment applied, the economic effect of using such an operation should not differ from the effect obtained by using term benchmarks.

7.2. WHAT ALTERNATIVE BENCHMARKS/RFRS WILL THE BANK USE?

The contingency procedures proposed by the Bank in the contractual documentation are to a large extent based on the developed market standards, taking into account possible changes to include, among other aspects, the specificity of the product or the type of documentation. The contingency procedure usually takes the form of a waterfall of successive solutions, where the next one applies in a situation where the preceding solution is not feasible. In the case of determining alternative benchmarks, subject to the provisions of a specific contingency procedure and generally applicable regulations, the Bank has the possibility, or the obligation resulting from the legal provisions, to take into account alternative benchmarks proposed by the competent industry organizations, supervisory authorities, public administration bodies or other third parties entitled to make such indications. In addition, we refer to the answer given in point 6.2. of this document.

7.3. WHERE CAN I FIND INFORMATION ABOUT THE LEVEL OF RFRS?

Exhaustive information on this subject can be found on the website of each alternative benchmark (RFR) administrator. The Bank provides the client with the information on the competent administrator in the appropriate information package, indicating at the same time the address of this administrator's website.

7.4. SINCE WHEN DOES THE BANK PLAN TO USE ALTERNATIVE BENCHMARKS FOR ITS PRODUCTS AND CONTRACTS?

The Bank is preparing for the comprehensive use of RFRs for products and, where necessary, as part of the implementation of contingency procedures incorporated in the contracts with clients in connection with the occurrence of a specific triggering event for the benchmark. Such an event may be a consequence of, for example, the announcement of cessation of benchmark provision.

7.5. WHAT ADDITIONAL ISSUES MAY CONCERN THE BANK'S CLIENTS IN CONNECTION WITH THE TRANSITION TO ALTERNATIVE BENCHMARKS/RFRS?

A change in the basis for calculating the variable interest rate to which the contracts relate may require an appropriate verification from the client's accounting and valuation of contracts and financial instruments, as well as hedge accounting (e.g. a significant reconstruction of discount curves used for the valuation and determination of fair value). Due to the nature of the changes in the variable interest rate, the Bank recommends that the client, independently with its advisors, conduct an analysis of the impact of the above-mentioned changes on its business.

8. Risks associated with benchmarks

8.1. WHAT IS THE OVERALL RISK OF USING BENCHMARKS?

- Certain benchmarks, including their methodology, may be subject to change by their administrators for regulatory or business reasons;
- The administrator of a particular benchmark may decide to cease to provide the benchmark, or the competent authority may withdraw the administrator's authorization for benchmark provision;
- Benchmarks may cease to be representative of a given market or economic reality due to the cessation of the contribution of relevant input data by contributors necessary to provide a given benchmark, or benchmarks may lose their reliability adequate to measure a given underlying market as a result of a decision of the competent supervisory authority;
- Benchmarks may cease to be published or developed in their entirety (e.g. LIBOR as a benchmark ceases to exist) or in relation to a specific tenor (e.g. WIBOR as a benchmark will still exist, but the cessation of its provision will only apply to 6M WIBOR) or a specific currency (in the case of LIBOR, GBP LIBOR disappears), and relevant alternative benchmarks may not be designated;
- There may be a legitimate need to amend financial contracts or financial instruments by referencing to risk-free rates.

8.2. WHAT IS THE RISK OF CHANGING A BENCHMARK METHODOLOGY BY AN ADMINISTRATOR?

A benchmark provider acting on the basis of its authorization as part of its professional activity is entitled to make a change to the benchmark development methodology in accordance with the procedure set out in the benchmark documentation published by the administrator on its website. In accordance with the general information published by the administrator regarding the process of changing the benchmark development methodology, the administrator's change in accordance with the provisions of the BMR Regulation precedes the public consultation process, where the administrator will determine the scope of the proposed change and provide justification. A justification for making a change in the benchmark development methodology may be, for example, the need to adapt the benchmark development methodology to the requirements of the BMR Regulation, the guidelines of the supervisory authority or recommendations of the supervisory entity. The change made by the administrator in the benchmark development methodology may result in a change in the benchmark's value. An increase or decrease in the benchmark's value as a result of the change in the development method made by the administrator may affect the value of mutual considerations between the client and the Bank in connection with the concluded contract, or the valuation of the financial instrument/financial product held by the client.

8.3. WHAT IS THE RISK OF CEASING TO PROVIDE A BENCHMARK BY AN ADMINISTRATOR ON A PERMANENT OR TEMPORARY BASIS

The entity that provides a given benchmark in the course of its professional activity is entitled to cease to provide the benchmark permanently using the procedure described in the benchmark documentation published by the administrator on its website, subject to authorizations of supervisory authorities in that scope, which arise from Articles 21 and 23 of the BMR Regulation. An administrator may decide to cease to provide a benchmark, in particular for business reasons (a non-economic factor) or because it considers that the data used to provide the benchmark is not representative of the market or economic reality that the benchmark is intended to measure. The cessation of provision of the benchmark is preceded by a public consultation process which usually lasts several months, during which the administrator sets the date from which it intends to cease to provide the benchmark.

In addition, the benchmark development methodology specifies the circumstances in which an administrator may not be able to determine a benchmark value on a given date, for example if the administrator does not receive sufficient data to determine the benchmark value on a given date.

The consequence of the administrator's permanent or temporary cessation of provision of a benchmark may be the inability to use the benchmark by the Bank to determine the value of mutual considerations resulting from the contract concluded between the Bank and the client. In such a situation, the provisions of the binding contract between the client and the Bank will apply.

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