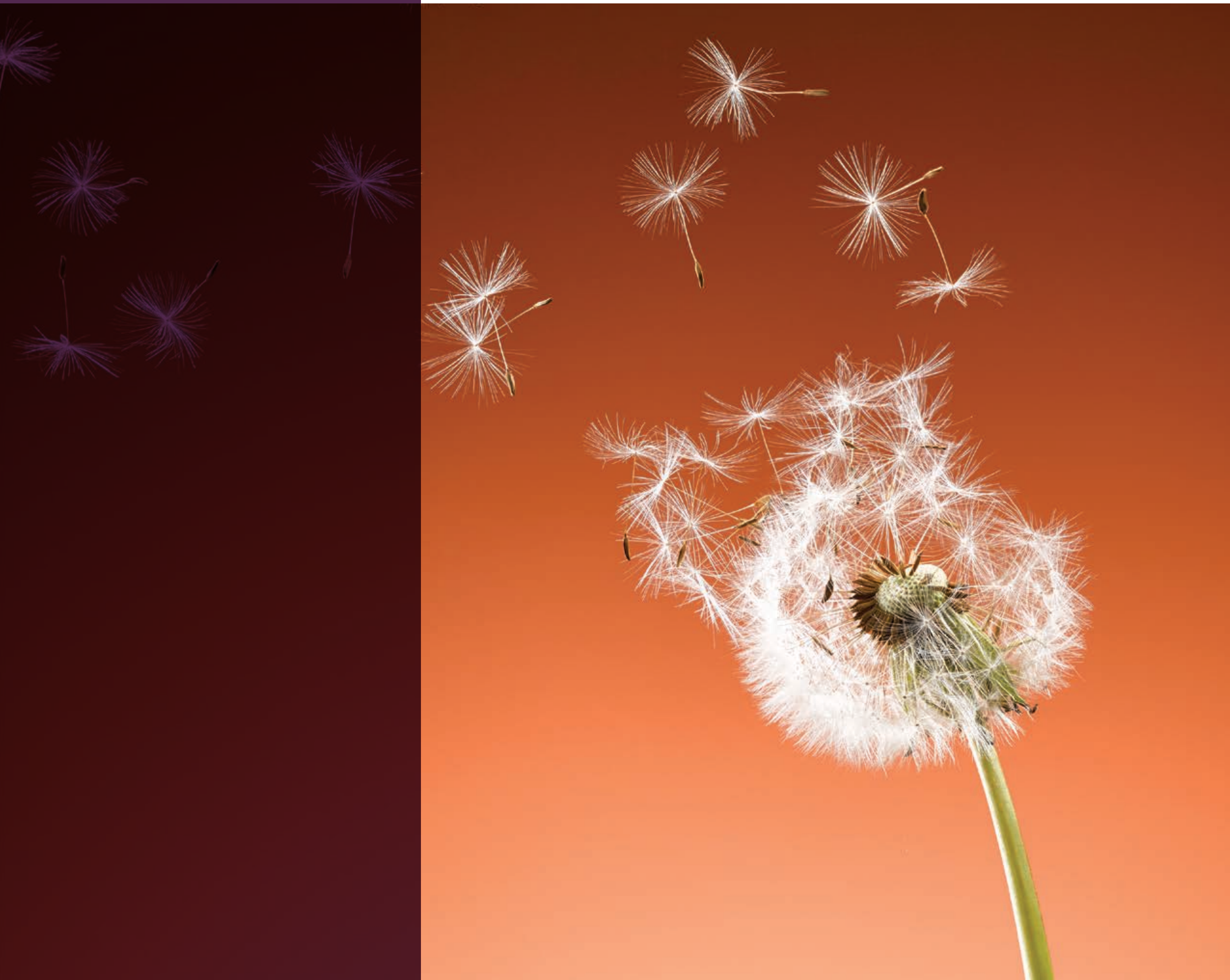
May 2021

The Transition Away from Libor

Preparing for the Deadline



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Report Highlights

- Since our last report, various events and announcements from regulatory entities have reinforced the process of transitioning away from Libor to a SOFR-based market.
- The industrywide adoption of SOFR is expected later in 2021, once liquidity has developed sufficiently to produce a robust rate.
- The Treasury's issuance of SOFR-indexed FRNs will help transition the cash market away from Libor, improve the liquidity of the broader market for SOFR FRNs, and demonstrate government support for SOFR.
- We remain focused on our Libor transition efforts and are committed to providing our clients with updates on our progress toward a post-Libor world.

Introduction

“Guggenheim Investments continues to review and prepare our clients’ portfolios for a market that no longer relies on Libor.

The last fifteen months have been an unprecedented period for markets, but that does not mean the financial services industry—which was rightly focused on the pandemic, the election, and the shifting tides of monetary and fiscal policy—can allow itself to be distracted from the looming end of the London Interbank Offer Rate (Libor).

Since our last report on the topic, regulators and market participants have continued preparations for the transition to a post-Libor world. For our part, Guggenheim Investments continues to review and prepare our clients’ portfolios for a market that no longer relies on Libor. Our clients have entrusted us with the responsibility of safeguarding and growing their assets, and we consider our work to prepare for this transition to be as important as security selection and asset allocation in our portfolios. In this report, we provide an overview and update on recent market and industry developments in transitioning from Libor, and our work to ensure that transition occurs smoothly for our clients.

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The Transition Away from Libor

Pieces Are Falling into Place

The Alternative Reference Rates Committee (ARRC), a group of market participants convened by the Federal Reserve, has led the transition away from U.S. dollar Libor in favor of an alternative reference rate. ARRC's membership is comprised of a broad set of private-market participants—including banks, asset managers, insurers, and industry trade organizations—and official sector ex-officio members. In June 2017, ARRC selected the Secured Overnight Financing Rate (SOFR) as its preferred U.S. dollar Libor alternative. SOFR is an overnight Treasury repo rate published daily by the Federal Reserve Bank of New York that represents the general cost of secured lending and borrowing for the wide range of market participants involved in the repurchase market, including banks, broker-dealers, money market funds, asset managers, and insurance companies.

Since our last report, various events and announcements from regulatory entities have reinforced the process of transitioning away from Libor to a SOFR-based market. For example, in a major milestone in the transition process, the so-called "Big Bang" occurred over the weekend of Oct. 16-18, 2020, when the clearing services providers CME Group Inc. and LCH Ltd switched the reference rate for discounting the value of interest rate swaps from Fed Funds OIS to SOFR.

Most recently, March 2021 was an eventful month in the Libor transition process, with three important developments. On March 5, regulators on both sides of the Atlantic established final cessation dates for different tenor Libor rates. The one-day, one-month, six-month and one-year U.S. dollar Libor rates will cease publication on June 30, 2023, while one- and two-week U.S. dollar Libor rates will cease publication on Dec. 31, 2021. The March 5 announcement also prompted corresponding fixed spread adjustments for all Libor tenors across all currencies. On March 24, the New York State legislature passed a bill that Governor Andrew Cuomo subsequently signed into law that provides for a statutory replacement benchmark rate for outstanding Libor-linked contracts that contain no fallback provisions or contain inadequate fallback provisions that are based on Libor. On March 29, the Alternative Reference Rates Committee (ARRC) published a white paper that outlined how the 30-day average SOFR could be used in new ABS, MBS, and CMBS products, with a monthly reset, set in advance of the interest accrual period, an option ARRC's working group views as superior to other alternatives.

“ARRC has helped facilitate the industrywide adoption of SOFR, although the creation of a term reference rate based on SOFR derivatives markets is still to come.

Market Adoption of SOFR Is Slowly Expanding

SOFR fixings incorporate a broad set of repo market activity, with underlying daily transaction volumes averaging more than $1 trillion over the last two years.

SOFR References Nearly $1 Trillion in Daily Repo Market Activity

Volume of Daily Secured Overnight Financing Rate Transactions

Source: Guggenheim Investments, Haver Analytics, New York Fed. Data as of 5.21.2021.

While there is much work to be done to implement widespread replacement of U.S. dollar Libor with the risk-free SOFR rate, progress was made throughout 2020 and into 2021. In March 2020, the New York Fed, in cooperation with the Treasury Department’s Office of Financial Research (OFR), began publishing 30-, 90-, and 180-day SOFR Averages and a SOFR Index in order to support a successful transition away from U.S. dollar Libor. In July, the New York Fed updated its Statement of Compliance with the International Organization of Securities Commissions Principles for Financial Benchmarks. The statement is updated each year to reflect any changes that may have occurred, and this year includes the 30-, 90- and 180- day SOFR Averages and the SOFR Index. In August, Fannie Mae began accepting deliveries of single-family SOFR ARM loans.

Additionally, ARRC continues to facilitate the industrywide adoption of SOFR, although the creation of a term reference rate based on SOFR derivatives markets is still to come. This is expected in the first half of 2021, once liquidity has developed sufficiently to produce a robust rate.

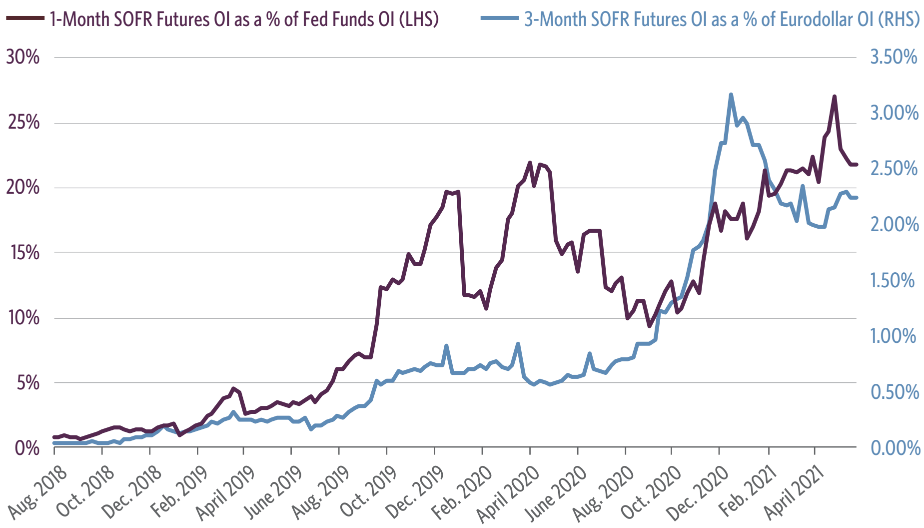
> The amount of debt issuance referencing SOFR continues to rise, with cumulative bond issuance over 8x more than the end of 2019.

ARRC has also indicated that new Libor loan originations should end later in 2021, that loans should start using hardwired fallbacks by Sept. 30, 2020, and that new contracts entered into before Dec. 31, 2021, should use a reference rate other than Libor or have robust fallback language.

Finally, in November 2020, ARRC released conventions for using SOFR in arrears, an important step for business loans that will use SOFR.

As this work progresses, the volume of instruments that use SOFR as a reference rate is growing slowly. The open interest in one-month and three-month SOFR futures markets is rising, but it remains a small fraction of the corresponding federal funds and Eurodollar futures markets.

SOFR Futures Open Interest Has Grown, But Remains Relatively Small

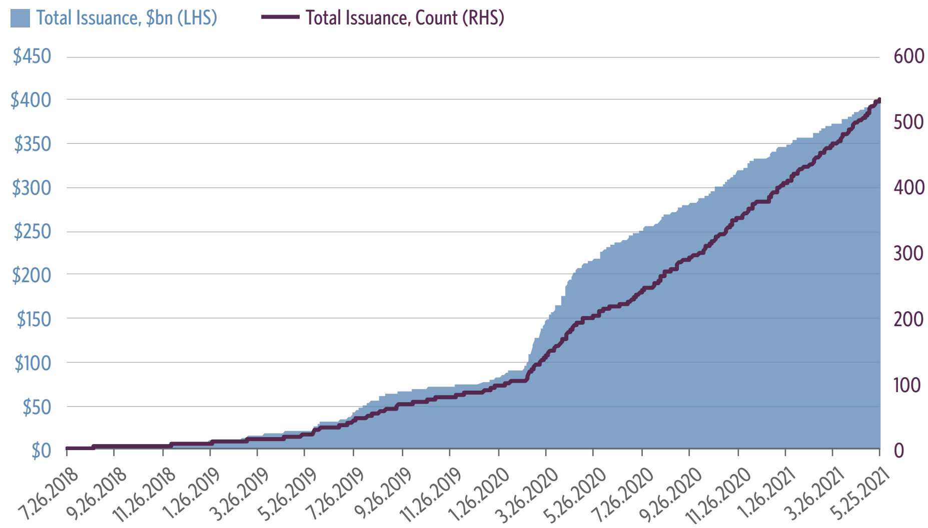


Source: Guggenheim, Bloomberg, CFTC. Data as of 5.25.2021. Note: Includes combined futures and options open interest.

The amount of debt issuance referencing SOFR continues to rise, with cumulative bond issuance over 8x more than the end of 2019. In February 2021, Enbridge, Inc., a Canadian energy firm, became the world's first non-financial issuer to sell debt linked to SOFR, a significant advancement in market adoption of the new financial benchmark.

> "The Treasury's issuance of SOFR-indexed FRNs will help transition the cash market away from Libor.

SOFR Bonds Cumulative Issuance Grows



Source: Guggenheim Investments, Bloomberg. Data as of 5.25.2021.

One of the most positive developments in advancing market adoption of SOFR was the U.S. Treasury's announcement, in May 2020, that it is considering issuing its own SOFR floating rate note (FRN). We believe such a development would enhance the Treasury funding market and provide new investment opportunities for investors. Moreover, the Treasury's issuance of SOFR-indexed FRNs will help transition the cash market away from Libor, improve the liquidity of the broader market for SOFR FRNs, and demonstrate government support for SOFR as the replacement rate for U.S. dollar Libor.

Guggenheim's Libor Transition Teamwork Update

Guggenheim Investments has been preparing the firm and our clients for the transition away from Libor. The firm's senior leadership recognized the magnitude of this challenge early on and established the Libor Transition Core Team (Core Team) in early 2019 to lead the transition effort. The Core Team, which consists of senior representatives from portfolio management, sector teams, risk, operations, accounting, and legal, has organized the work of the firm into four primary areas of focus:

- **Industry/Regulatory Engagement**
  Our involvement in regulatory and industry trade groups allows us to assess the impact of anticipated and planned changes to transition schedules, evaluate reporting and disclosure requirements, and align our transition schedule to reflect market best practices.

“We remain focused on our Libor transition efforts and are committed to providing our clients with updates on our progress toward a post-Libor world.

- **Client Communications**
  We have implemented a plan to provide the results of portfolio reviews and respond to client inquiries regarding the transition progress, and intend to update our communication plan as key dates and milestones approach.

- **Operational Development**
  We are conducting a thorough review of all aspects of our operations including business processes, systems and models, and actively monitoring the progress of third-party systems and data providers to ensure a smooth transition.

- **Risk Assessment**
  Teams across the firm continue to review and assess impacts to our Libor-based securities, investment strategies, and portfolios, and to actively monitor the broader Libor transition and project risks.

The Transition Is Moving Forward

The Libor transition deadline of Dec. 31, 2021 is fast approaching. Asset managers and their clients, service providers, intermediaries, and regulators still have a lot of work to do before that date, but we believe that the pieces are falling into place as the deadline approaches. We remain focused on our Libor transition efforts and are committed to providing our clients with updates on our progress toward a post-Libor world.

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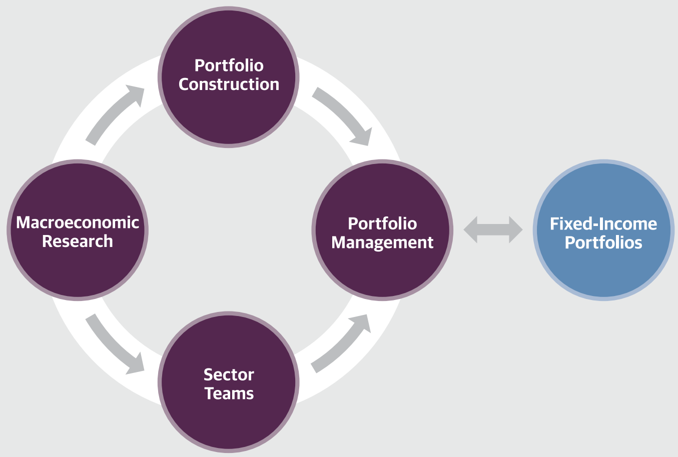

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