General Approach of the Two Fallback Proposals

Question 1. If the ARRC were to adopt one or more sets of bilateral business loan fallback language, which one or both of the recommended provisions (i.e., amendment approach and/or hardwired approach), in your view, is an appropriate policy? If you believe the amendment approach is more appropriate at present, what specific information (for instance, existence of term SOFR) would you need in order to get comfortable eventually adopting a hard-wired approach? Why?

Response: This response depends on the type of bilateral loan and the client. While using fallback language that remains flexible until further market infrastructure develops is desirable, banks must also retain the ability to transition large high-volume portfolios (borrowers consisting of both businesses and individuals) in an operationally feasible manner over a short period of time. This causes us to consider using fallback language that uses elements of the hardwired approach. A key gating factor, however, is the development of an acceptable credit risk premium calculation method, and a forward-looking term rate. Further, banks may choose to use the amendment approach on bilateral facilities when the client also has syndicated loans using the amendment approach or the bilateral facilities are of a size or complexity comparable to syndicated loans. Finally, client knowledge and acceptance of SOFR must increase among clients obtaining bilateral loans to ensure end user adoption and satisfaction with the new rate.

Finally, the basis risk between loans based on term SOFR and hedging instruments (e.g., interest rate protection) referencing overnight SOFR represent a potential impediment to SOFR adoption in the bilateral loan market. This is particularly acute in a rising interest rate environment. Ensuring access to interest rate protection on a like basis between loans and derivatives (without the use of additional derivatives) is a repeated subject of discussion with clients.

Question 2. Beyond your response to Question 1, are there product or transaction types, or methods of documenting transactions, for which either of the fallback approaches would be problematic? If so, please explain. What other approach would you suggest?

Response: As discussed in the response to Question 1, application of the amendment approach would be problematic for high-volume portfolios using standardized documentation, where lenders need to transition in a manner that is operationally feasible and where there are regulatory or other reasons to insure that borrowers are treated in a standardized fashion, subject to acceptable parameters. Over time this would be mitigated as market infrastructure develops and SOFR is broadly adopted for use in the origination of new loans.

Triggers

Question 3. (a) Should fallback language for bilateral business loans include any of the pre-cessation triggers (triggers 3, 4 or 5)? If so, which ones?

(b) Please indicate whether any concerns you have about these pre- cessation triggers relate to differences between these triggers and those for standard derivatives or relate specifically to the pre-cessation triggers themselves.

(c) If pre-cessation triggers are not included, what options would be available to market participants to manage the potential risks involved in continuing to reference a Benchmark whose regulator has publicly determined that it is not representative of the underlying market or a Benchmark permanently or indefinitely based on a number of submissions that the Benchmark's administrator acknowledges to be insufficient to allow for production in a standard manner?

Response: *All triggers need to be clearly defined and based on publicly available data so there is no debate on whether a trigger has occurred, and the occurrence of any trigger is recognized consistently by contracts within and across products. We recommend adopting ISDA triggers and selectively adding loan-specific triggers based on type and terms of bilateral agreements.*

(a) *Yes, business loans should include pre-cessation option 5. See further comments below.*

(b) *Pre-cessation triggers 3 and 4 are unnecessary. Trigger #3 doesn't add any benefit that isn't already covered by triggers 1, 2, 5 and the "opt-in" clause. Regarding trigger #4, it is commercially impractical for lenders to monitor how the LIBOR administrator is administering its submissions policy and to hold lenders contractually accountable to have that knowledge.*

(c) *A pre-cessation option should be included which reflects a market move to the replacement rate for newly originated loans. This enables lenders and borrowers to "opt-in", thereby avoiding or reducing any unknown impact to pricing that occurs with LIBOR cessation.*

Question 4. (a) Is an "opt-in" trigger appropriate to include? Why or why not?

(b) Do you believe an "opt-in" trigger should be included in both the hardwired and amendment proposals or only in one (please specify which and explain)?

Response: *(a) (b) Yes, as discussed above, an opt-in clause is appropriate and should be included in most bilateral loan products, assuming agreement of the borrower and lender. The inclusion of an "opt-in" clause solves some issues related to #4 trigger, while preserving the flexibility for lenders and borrowers that is unique to the loan product. Of course, the "opt-in" clause is an option and does not lead to an automatic conversion.*

Question 5. Are there any other trigger events that you believe should be included for consideration? If yes, please explain.

Response: *No. We believe it is counter-productive to include other triggers attempting to cover circumstances which may not arise and / or are challenging to document in a contract.*

The Replacement Benchmark

Question 6. If the ARRC has recommended a forward-looking term rate, should that rate be the primary fallback for bilateral business loans referencing LIBOR even though derivatives are expected to reference overnight versions of SOFR? Please explain.

Response: *Yes, term SOFR should be the primary fallback rate to ease the process of transitioning off term LIBOR and reduce the number of adjustments required to enable such transition. Further, derivatives which hedge interest rate risk should also be permitted to reference term SOFR to enable hedging of those risks without requiring the use of another derivative. As described previously, use of term SOFR improves the ability of clients to manage interest payments and lenders or loan investors to trade loans in the secondary market. It is also important to note that derivatives are permitted to match the product being hedged in other jurisdictions, and not allowing derivatives to match introduces a complexity in the US market that will not be present in others.*

Question 7. Should the Lender be able to eliminate certain interest period options if there are no equivalent SOFR terms available? If so, consider the following options: (i) the Lender may remove all interest periods for which there is not a published term rate or (ii) the Lender may remove only the interest periods for which there is not a published term rate and a term rate cannot be interpolated. Which of the options do you support? Why?

Response: Yes, lenders should be able to eliminate any interest periods for which term rates are not published. Lenders should not have the burden or responsibility of creating (via interpolation or otherwise) the rate for periods not available from the benchmark administrator. Standard published term SOFR periods should include 1-month, 3-month, 6-month and 12-month periods.

Question 8. Should "Compounded SOFR" be included as the second step in the waterfall? Why or why not? Would this preference be influenced by whether ISDA implements fallbacks referencing compounded SOFR or overnight SOFR?

Response: No. Term SOFR should replace LIBOR as the primary reference rate applicable for loans. Similar to current practice in many bilateral loans, if term SOFR for the applicable interest period becomes temporarily unavailable, the rate could fall back to a definition of Base Rate that could include overnight SOFR as one of the "higher of" choices (Prime, Fed Funds plus 50bps, and O/N SOFR+spread adjustment). This would greatly simplify the transition by generally leaving in place the current approach to fallbacks in most of the bilateral loan market[1], as opposed to requiring a waterfall of complex calculations that impact both borrowers' and lenders' ability to predict payments. Additionally, the use of Compounded SOFR may be unacceptable to clients, who typically reconcile interest invoices prior to paying them. The burden will be particularly heavy for smaller clients with limited financial staffing.

The Replacement Benchmark, continued

Question 9. If you believe that Compounded SOFR should be included, which compounding period is preferable ("in arrears" or "in advance")? Would this preference be influenced by whether ISDA implements fallbacks referencing compounded SOFR "in arrears" or "in advance"?

Response: Term SOFR should be the primary reference rate applicable for loans. See response to Question 8. Compounding in advance or arrears does not reduce the burden.

Question 10. As noted, this consultation does not include Overnight SOFR as a final step in the waterfall. Do you believe that Overnight SOFR is an appropriate fallback reference rate for bilateral business loans or should the final step in the replacement rate waterfall be Compounded SOFR (after which the hardwired approach defaults to a streamlined amendment process)?

Response: No. Term SOFR should be the reference rate applicable for loans. However, if term SOFR is temporarily unavailable, an appropriate fallback would be to Base Rate, revised as described in the response to Question 8.

Question 11. Is there any other replacement rate that should be added to the hardwired approach waterfall before parties move to the streamlined amendment process? If so, what is the appropriate rate or rates and at which stage in the waterfall should they be applied? Please explain.

[1] Some products use a simplified base rate definition

<u>Response</u>: No. Term SOFR should be the only reference rate applicable for loans, with a standard fallback to Base Rate in the case of temporary unavailability, revised as described in the response to Question 8.

<u>Spread adjustments</u>

<u>Question 12.</u> Do you believe that the ARRC should consider recommending a spread adjustment that could apply to cash products, including bilateral business loans?

<u>Response</u>: We strongly prefer for the ARRC to publicly recommend spread adjustments (for the applicable terms) to term SOFR for loans which minimize value transfer as a result of transition. Endorsement by the ARRC will support end user adoption of the spread adjustments, particularly given the broad range of end users across cash products (and also derivatives).

<u>Question 13.</u> Is a spread adjustment applicable to fallbacks for derivatives under the ISDA definitions appropriate as the second priority in the hardwired approach spread waterfall even if bilateral business loans may fall back at a different time or to a different rate from derivatives? Please explain.

<u>Response</u>: It remains to be seen whether the adjustment method adopted by the derivatives market is applicable for use with loans. The spread adjustment defined by ISDA only relates to overnight SOFR, and loans will need a spread adjustment that uses term SOFR. Additionally, loans may have other adjustment needs beyond what derivatives require.

<u>Question 14.</u> Is there any other spread adjustment that should be added to the hardwired approach spread waterfall before parties move to the streamlined amendment process? If so, what is the appropriate spread and at which stage in the waterfall should it be applied?

<u>Response</u>: No. The same spread adjustment method should apply to either the hardwired or the amendment approach.

<u>The role of the Lender</u>

<u>Question 15.</u> For respondents that act as Lenders in the bilateral business loan market, would your institution be willing to (i) work with the Borrower to identify a new reference rate or spread adjustment, (ii) determine whether triggers have occurred, (iii) select screen rates where reference rates are to be found, (iv) interpolate LIBOR or term SOFR if there is a missing middle maturity, and (v) execute one-time or periodic technical or operational amendments to appropriately administer the replacement benchmark? Please respond to each and explain.

<u>Response</u>: Our institution would be willing to work with borrowers to identify a new reference rate and screen location, applicable spread adjustment and technical/operational amendments in the event there is no prevailing successor to LIBOR. <u>However</u>, undertaking individual negotiations would be enormously burdensome and complicated for lenders, and confusing for clients. We strongly prefer for an industrywide solution to enable a transition away from LIBOR.

We do not support the use of interpolated rates, per response to Question 7.

<u>Question 16.</u> In any of these situations, should the Lender have the right to take the relevant action, for example to designate loan terms unilaterally within the framework of either Appendix I or Appendix II, simply by notice to the Borrower? Alternatively, should the lender have the right to take such action,

subject only to the Borrower's right to withhold consent? Please explain which approach, or what alternative approach, you think would be better.

Response: Yes, there should be a language option that provides the Lender the right to take unilateral action by one-way notice to the Borrower including but not limited to the provisions in Appendix I and Appendix II. For high-volume bilateral portfolios it may not be feasible to include consent rights in the same manner as amendment language for syndicated loans, as it would be operationally burdensome to track consent over thousands of bilateral loans.

Question 17. Is it necessary that any replacement rate and/or applicable spread adjustment be published on a screen by a third party? Why or why not?

Response: Yes. Sourcing the replacement rate and spread adjustment from a third party screen eases operational feasibility and prevents disagreement on determination of the all-in rate.

Question 18. Given that market practices and conventions may change over time, should the Lender's limited ability to make conforming changes be available only at the point of transition or on a periodic, ongoing basis? Why or why not?

Response: The lender must maintain the right to make conforming changes on an ongoing basis as market infrastructure matures around SOFR. After a period of stability (for example, in the calculation method, production and publication of forward term rates) as well as strong market adoption of common standards, we would expect the need to make conforming changes to ease and eventually end. This assumes any issues around definition of the new benchmark rate, triggers and spread adjustment have been resolved, the market is consistently using the same contractual definitions and there is not confusion or litigation in the market as to how to apply these definitions.

Operational considerations

Question 19. Are there operational concerns about having the ability to convert many loans over a very short period of time? Please explain.

Response: Yes, converting legacy bilateral facilities will require manual coordination to facilitate the transition over thousands of facilities and greatly increase fulfillment duties. Staffing considerations would need to reflect the sudden increase in operational demands. The burden is amplified if challenges to adoption have not been resolved, such as delivery of forward term rates, a satisfactory spread adjustment and availability of interest rate hedges using a like basis as the loan being hedged.

Question 20. Do you see other operational challenges that fallback language should acknowledge or of which the ARRC should be aware? For example, both approaches to fallback language involve various notices from the Lender – do these requirements and the resulting communications between parties impose undue operational burdens? Please explain.

Response: The ARRC should be aware that any SOFR mechanics left to be calculated by banks, as opposed to obtained from a third party (i.e., spread adjustment or interest rates for each available forward period) will negatively impact the operational mechanics of implementing of SOFR. It is likely internal systems will need technical enhancements. It also increases the likelihood of disputes among parties. Due to the wide variety of bilateral loan products and types of clients, banks need the ability to simplify language and approach from the suggested appendix language.

Hedged loans

Question 21. If bilateral business loans fall back to a different rate from derivatives, how do market participants expect to handle the interplay of loans and their hedges? Would market participants expect that current swaps would be terminated and a new swaps entered into once the loan has transitioned?

Response: Loans falling back to different rates or at a different time is not desirable. Allowing loans to diverge from the instrument used to hedge introduces basis risk to the client, and adversely affects clients who have chosen hedge accounting treatment. Specific to terminating the swap, termination of the existing swap may not be in the best financial interest of the client (clients would unwind a derivative if it made financial sense and to unwind otherwise could harm the client). To ensure a smooth transition, a coordinated change in the loan and derivative at the same time and to the same rate (including tenor and any market agreed spread adjustment) is necessary.

Question 22. Would market participants that execute interest rate hedges prefer to fall back to the same rate and spread that becomes operative under the ISDA Definitions even if a term SOFR is available? If so, please provide comments on the proposal for hedged loans set forth in Appendix VI, including a discussion of any operational concerns. Please provide comments on any other approaches you think could be useful in addressing fallbacks in loans and related hedges.

Response: Loans need to fall back to the same rate as the derivative including the same market agreed upon spread adjustment.

Appendix VI blurs the distinction between the loan and swap as separate transactions. It works best if both the loan and derivative move to term SOFR. Even if both the loan and the swap move to term SOFR, it could result in a mismatch with the lender's cost of funds if the derivative uses a spread adjustment which is different from what is used in loans.

Appendix VI appears to imply that both the borrower and lender are waiving the ability to invoke close-out netting with multiple trades under the same ISDA master agreement. Instead, in Appendix VI, the hedging swap trade will be only netted and offset against the bilateral loan. Appendix VI should specify whether both parties are waiving and giving up the right to reduce "out of the money" termination amounts by "in the money" trades under the same ISDA master agreement.

Question 23. When a loan is only partially hedged, either by a swap that is not coterminous with the loan's maturity or a swap the notional amount of which is less than the loan amount (or the portion of the loan accruing interest based on LIBOR), should a trigger event result in the entire loan balance converting to the fallback benchmark? Would it be operationally practical to align only the hedged portion's terms with the terms of the swap? What other concerns would market participants anticipate in operationalizing dynamic tranching of a partially hedged loan?

Response: Loans and derivatives used to hedge, should transition at the same time for the entire loan balance. Mismatch concerns involve both the loan and derivative using the same rate including tenor and market agreed spread adjustment and are less related to differing term or notional amounts. Still, any divergence will be operationally burdensome and lead to increased risks to the lender.

General feedback

Question 24. Are there any provisions in the fallback language proposals that would significantly impede bilateral business loan originations? If so, please provide a specific and detailed explanation.

Response: Compound pricing that cannot be forecasted (i.e., through forward looking term rates) will complicate the reconciliation of interest invoices by borrowers.

Question 25. Please provide any additional feedback on any aspect of the proposals.

Response: While the proposed provisions may be appropriate for syndicated loans, for a large segment of the bilateral loan market, they are unnecessarily complex for use in highly standardized, two-party contracts that tend to have relatively straightforward provisions for transition or other changes in terms.