ARRC Bilateral Business Loans Consultation Response – The Huntington National Bank

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?

We do not favor a hardwired approach at this time due to the uncertainty surrounding the development and adoption of term SOFR, Compounded SOFR or other versions of SOFR in the bilateral business loan market.

The amendment approach, as currently drafted, raises significant operational concerns for bilateral business loans. Providing the Borrower the right to withhold consent in all cases will create substantial risks of operational error and confusion across the bilateral loan market. Such an approach would require lenders to monitor and implement responses on thousands of loans simultaneously, while at the same time demanding prompt responses from a wide range of borrowers. This would be particularly problematic in the context of a sudden LIBOR discontinuance. The fallback language should seek to minimize the likelihood of an outcome that requires borrower-by-borrower consent in this market.

We believe the ARRC should adopt an approach that allows the Lender greater flexibility to select a replacement index rate in a process that is fair to the Borrower. For instance, rather than a hardwired approach specifying specific versions of SOFR in a specific order, the fallback language could provide that the Lender will select a replacement index rate from a menu of SOFR-based options or in accordance with an objective standard. If the Lender selected a rate outside of these parameters, then a negative consent process could apply.

Likewise, a flexible approach should apply to the determination of the spread adjustment. The Lender could be provided the ability to select a spread adjustment promulgated by the ARRC, ISDA or a similar third-party without locking in a specific waterfall. If the Lender selected a spread adjustment outside of these parameters, then a negative consent process could apply. The need for this flexibility on the selection of the spread adjustment factor is discussed in our response to Question 12 below.

We note that the bilateral business loan market differs from other markets in which fallback language is being considered because of the nature of the relationship between Borrower and Lender. In many cases, the Lender has an ongoing relationship with the Borrower of which the loan is only one piece, and Lenders will seek to treat customers fairly and consistently in order to maintain their relationships with Borrowers and their reputation in the marketplace. In these circumstances, Borrowers are more comfortable with their Lender operating with appropriate discretion.

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?

See response to Question 1 above.

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?

Yes, we believe each of these triggers is appropriate to include.

(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.

See response to Question 22 below.

(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?

As noted in our response to Question 3(a), we believe pre-cessation triggers should be included.

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

Yes, an "opt-in" trigger is appropriate to include. The ability for Lenders to proactively move loans to SOFR on agreed-upon terms would allow Lenders and the market generally to reduce the risks of a LIBOR cessation. Borrower concerns could be reduced by the inclusion of a Borrower right to withhold consent, which would not present the same operational risks in an opt-in scenario given the Lender's ability to convert its portfolio in stages rather than all at once.

In addition, the "opt-in" trigger could be a useful tool for Lenders to manage the risk of a "zombie" or non-representative LIBOR that does not trigger a Benchmark Discontinuance Event. In order to serve that purpose, however, the Borrower's negative consent right should have an outside date (either a certain period of time after the Lender's initial opt-in notice or a specified date) after which the negative consent right falls away.

(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)?

The "opt-in" trigger should be included in whatever proposal is adopted by the ARRC.

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

No.

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.

As discussed in Question 1, we do not believe the fallback language should provide this level of specificity on a replacement rate at this time. In the more flexible approach that we describe, a forward-looking term rate could be included as a SOFR-based option available for selection by the Lender.

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?

> We would prefer that the Lender be able to eliminate all interest periods for which no published term rate is available. There is no need to introduce the complexity of clause (ii) through the fallback provisions.

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?

> As discussed in Question 1, we do not believe the fallback language should provide this level of specificity on a replacement rate at this time. In the more flexible approach that we describe, Compounded SOFR could be included as a SOFR-based option available for selection by the Lender.

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"?

> As discussed in Question 1, we do not believe the fallback language should provide this level of specificity on a replacement rate at this time. In the more flexible approach that we describe, both Compounded SOFR in arrears and Compounded SOFR in advance could be included as SOFR-based options available for selection by the Lender.

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)?

> Overnight SOFR is not an appropriate fallback reference rate for bilateral loans and should not be included in a waterfall or as a SOFR-based option available for selection by the Lender.

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.

> No.

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

> Yes, it would be beneficial for both Borrowers and Lenders and promote a smooth transition in the bilateral loan market. Such a spread adjustment would provide confidence to Borrowers that they are being treated fairly and in a manner consistent with other Borrowers using an adjustment determined with objective criteria, while reducing the risk of disputes and errors for Lenders across the bilateral loan market.

Given the importance of interest rate hedges in the bilateral loan market, however, a recommendation by the ARCC of a spread adjustment that is different from the ISDA spread adjustment could create inconsistency for Lenders and Borrowers that would complicate the transition process. If a Lender uses the ISDA spread adjustment only for hedged loans, for example, a Borrower that has both hedged and unhedged loans could find that a different spread adjustment applies to its various loans, despite using the same or a similar SOFR-based reference rate. We expect such a Borrower would react negatively to this result. Determining the best way to address these types of issues is difficult at this stage of the transition process.

The availability of the ISDA spread adjustment at the time of a trigger event is an additional concern. If a loan is triggered prior to the occurrence of an ISDA trigger event, the ISDA spread adjustment will not be available.

For these reasons, while we are in favor of the ARRC recommending a spread adjustment, we would recommend that the fallback language provide the Lender with flexibility to select a spread adjustment determined in a process promulgated by the ARRC, ISDA or a similar third party.

Question 13. 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.

As discussed in Question 12, we do not believe the fallback language should provide a hardwired waterfall for the spread adjustment at this time. In the more flexible approach that we describe, the ISDA spread adjustment could be included an option available for selection by the Lender. Despite the potential for use of a different version of SOFR, we expect the ISDA definitions will provide an effective spread adjustment.

Question 14. 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?

No.

Question 15. 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.

On item (i), as discussed in our response to Question 1 above, we believe the fallback language should seek to minimize the likelihood of an outcome that requires borrower-by-borrower consent in this market. On item (iv), as discussed in our response to Question 7, we would prefer that the Lender be permitted to remove interest periods for which a term rate is not available. We would be prepared to take the other steps described in this Question 15.

Question 16. 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.

See our response to Question 1 above.

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?

Yes, we believe both the rate and spread adjustment should be published on a screen by a third party to the extent available. Allowing both Lenders and Borrowers to see the source of the rate and spread adjustment will promote a smooth transition, create confidence in the process and minimize the potential for disputes, error or confusion.

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?

The Lender should have this ability on an ongoing basis. As market practice for SOFR develops and as Lenders develop their loan servicing mechanics for SOFR, it may become apparent that further updates to loan documents are necessary to permit a smooth functioning of the servicing process and allow consistent handling of loans across a Lender's loan portfolio. Information to determine the optimal set of conforming changes may not be available on the date a fallback occurs, depending on the timing and circumstances of such an event. Having loans converted or originated at different times subject to different processes, or requiring Lenders to seek consent from each Borrower in their loan portfolio for these types of amendments in order to correct or improve a process, could result in substantial operational risk for Lenders.

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

Yes. This will be a complex operational process, potentially requiring the conversion of a large number of loans to a new rate over a short period of time. Fallback language should be drafted in a manner that creates a process that is as simple as possible while treating both the Borrower and Lender fairly.

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.

See responses to Questions 1 and 18 above.

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?

As a regional bank, our interest rate hedging products offered to customers are focused on hedging the interest rate risk of their loans with us. Our customers enter into these swap transactions in order to effectively lock in a certain fixed rate of interest for the relevant portion of their loan, and they reasonably will expect their loan and swap to fall back to the same rate so that the fixed rate continues in effect following a LIBOR discontinuance. We would not expect swaps to be terminated and replaced. Rather, we believe customers will look to their Lenders to address this issue through the fallback provisions, and Lenders should be best placed to assume the risks inherent in doing so.

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.

Yes, we would prefer that hedged loans fall back to the same rate and spread that becomes operative under the ISDA Definitions even if a term SOFR is available. As described in our response to Question 21, we believe this is the result that our customers will expect in order to maintain the effectiveness of their hedge and avoid additional interest rate or basis risk.

We believe the proposal set forth in Appendix VI is an effective way to implement this approach. Additional language could be included to allow the Lender to implement a fallback rate under the standard fallback language if certain pre-cessation triggers not included in the ISDA Definitions are triggered. In addition, we urge the ARRC and ISDA to resolve any inconsistences and develop consistent trigger events across cash products and derivatives to simplify the LIBOR transition across markets.

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?

Yes, a trigger event should result in the entire loan balance converting to the fallback rate and spread that matches the ISDA Definitions. It would not be operationally practical to align only the hedged portion to the ISDA rate and spread. This is true for a single loan, which would have to be tracked as two separate tranches during the full life of the loan, but the complication is increased when a single hedge is used to manage the interest rate risk across multiple obligations (as is the case for some of our customers). If a Borrower has specific concerns about this issue and the treatment of the unhedged portion, those concerns could be addressed by structuring the loan and swap differently at the time the loan is originated or amended, rather than through the fallback language.

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.

No.

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

The bilateral loan market covers a wide range of transactions in terms of size and complexity. This range of complexity extends to the related loan documentation, which can vary from simple notes to long, complex loan agreements. For this reason, we believe it would be useful for the ARRC to acknowledge that Lenders, in addition to determining whether to implement the substance of the ARRC language, may choose to adapt it to fit the specific circumstances of the documentation process for a particular transaction.

We would like to thank the ARRC and the Business Loans Working Group for their efforts in preparing this Consultation, and we appreciate the opportunity to provide comments.