ARRC CONSULTATION
REGARDING MORE ROBUST LIBOR FALLBACK CONTRACT LANGUAGE FOR
NEW ORIGINATIONS OF LIBOR SYNDICATED BUSINESS LOANS
(dated September 24, 2018)

Question 1. *If the ARRC were to adopt one or more sets of 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 support fallback language which engenders as much transparency as possible in order to create trust in the new benchmark(s) and the broader process as a whole. As such, we favor the hardwired approach which allows borrowers and lenders to understand at the outset the triggers and the replacement dynamics. From the experience of the recent tax law change, most tax-exempt loans contained Change in Law provisions. While most of these were bilateral facilities, the effort required to notify clients and change billing was a significant undertaking. The Change in Law provisions functioned similarly to the hardwired approach provisions. In the event of a trigger as set forth below, the scale of implementation for syndicated loans would be larger by magnitudes and potentially under a more compressed timeframe. The additional administrative requirements as provided in the amendment approach would only serve to complicate and delay a process which is expected to involve an abrupt change.

Moreover, the amendment approach involves a greater degree of subjectivity than the hardwired approach in that under the former approach the Administrative Agent is granted a degree of discretion in subparagraph (a) to apply the Replacement Benchmark in a manner it reasonably determines. We support processes which eliminate subjectivity and discretion by the lending community so as to foster a degree of transparency and trust in this broader process. We should be cognizant that the syndication language will heavily influence if not become the language used in bi-lateral facilities.

We do recognize, however, that certain borrowers may push back on the hardwired approach until more information is available about term SOFR and a consensus develops about the best transition spread adjustment methodology. At the point when such information becomes available, we would expect the hardwired approach to be broadly acceptable to those borrowers who were previously reluctant to adopt the hardwired approach in the absence of this information.

Question 2. *(a) Should fallback language for 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?

We broadly support the inclusion of these pre-cessation triggers as a means to manage potential frustration of contract claims by syndicated loan parties. We would prefer to see alignment between the triggers applicable to standard derivatives under ISDA and the loan market as the rate risk associated with such syndicated loans are frequently hedged with standard derivatives.

Question 3. *(a) Is an "opt-in" trigger appropriate to include? Why or why not? (b) If you do believe an "opt-in" trigger should be included, do you prefer the approach in the hardwired proposal or the amendment proposal? Please explain.*

No, because the process by which the industry transitions from LIBOR needs to be above reproach and certain market participants may perceive that they may be "dragged along" by the required vote of the other loan parties. For example, under the hardwired approach, given the required level of consent, larger lenders may be able to opt-in and "drag along" smaller lenders and borrowers with only two transactions required to trigger such a process. We believe that two public transactions is too low of a bar and a substantially larger population of loans should be considered.

The use of LIBOR has evolved such that there are a variety of different market forces creating equilibrium in a general rate for the key tenors. Forward Rate Agreements, various money market instruments and the interest rate derivative market (generic swaps) are trading in such volume that it is efficient and therefore transparent and trusted. We should be cautious about opting in to a new benchmark framework until such time that there is liquidity in the short-end tenors and general market acceptance of the new benchmarks.

Finally, loan parties would still be free to amend their syndicated loans to opt-in to a new benchmark at any time; albeit it would be a cumbersome process given the standard voting requirements.

Question 4. *Are there any other trigger events that you believe should be included for consideration? If yes, please explain.*

No comment.

Question 5. *If the ARRC has recommended a forward-looking term rate, should that rate be the primary fallback for syndicated loans referencing LIBOR even though derivatives are expected to reference overnight versions of SOFR? Please explain.*

The potential mismatch of loans transitioning to a forward-looking term rate and derivatives referencing overnight SOFR is a concern. Borrowers are going to continue to push to try to be perfectly hedged. It is possible that once the derivative market becomes more liquid, basis hedges between tenor rates and overnight rates could develop which may facilitate the use of term rates in syndicated loans hedged by overnight rates in derivatives. However, this may still present issues from an operational and/or a hedge accounting perspective (i.e., ASC-815).

Question 6. *Should the administrative agent (by itself or with some other party) be able to eliminate certain interest period options if there are no equivalent SOFR terms available? If so, consider the following options: (i) the administrative agent (and/or some other party) may remove all interest periods for which there is not a published term rate or (ii) the administrative agent (and/or some other party) 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?*

Yes, because the purpose of having a reference rate is to have a market recognized rate underlying the interest costs. If an equivalent benchmark is unavailable for a given tenor, then it does not comply with the primary requisite in establishing a new benchmark and should not be allowable as an interest period option. Likewise, unless a recognized interpolated benchmark rate is published or otherwise easily derived via a standard market convention, it should not be considered as an available option.

Question 7. *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 stated elsewhere herein, there is a strong preference to pursue Term SOFR in order to facilitate the transition away from Term LIBOR rates in order to minimize the potential transfer of value and avoid undue operational risks. While not preferable, Compounded SOFR has some redeeming qualities in helping to bridge the gap from Spot SOFR and, if used "in arrears", would have the likely benefit of consistency with the derivatives market. Beyond the differences in accrual methodology, using Compounded SOFR would likely alter the way payments are exchanged so the industry should be mindful of the operational and system impacts. Additionally, there are some administrative issues that should be considered as draw frequencies have historically mirrored interest resets which will likely impact the operational burden of tracking and billing for frequent draws under a given facility.

Question 8. *If you believe that Compounded SOFR should be included, would a Compounded SOFR in advance* or *Compounded SOFR in arrears be preferable for syndicated loans? Please explain.*

See response to Question 7 above.

Question 9. *Is Overnight SOFR an appropriate fallback reference rate for syndicated 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)? Would this preference be influenced by whether ISDA implements fallbacks referencing compounded SOFR or overnight SOFR? Please explain.*

As presented, Overnight SOFR for a term borrowing is not practical, even for terms of one month. During times of expected FOMC activity, this rate would not capture the implied marginal costs of lenders. While it should be influenced by ISDA implementation for compounding SOFR, doing so as proposed would create significant basis risk between derivatives and would not add credibility to the benchmark for the term.

Question 10. *Is it acceptable to fix one observation of Overnight SOFR as the reference rate for a loan lasting three months (or longer)? Would lenders refuse to offer longer-duration loans if they were priced over one Overnight SOFR observation? Please explain.*

No, see response to Question 9 above.

Question 11. *Is there any another 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?*

As SOFR represents a rate which is generally collateralized by U.S. Treasuries, using T-Bills should be considered. The H15 report is issued daily for the prior day and references 4 week, 3 month and 6 month terms. Government securities are referenced regularly in indicative spreads for pricing on corporate bonds. Additionally, while its' derivatives market is somewhat less tailored than the broader swaps market, the U.S. Treasury curve is already an acknowledged benchmark under ASC 815. A fallback reference rate does not need to be the final paradigm; it only needs to work sufficiently to allow the continued flow of capital without interruption until a new paradigm is established. The use of T-Bills would seem a prudent means to help bridge any such gap.

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

Yes. Ideally, it should help to minimize any transfer of value and be comparable to any adjustments and/or spread methodology as recommended by ISDA.

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

While the actual adjustment may differ, the fallbacks for derivatives and loans should employ similar methodologies in order to minimize any transfer of value. To the extent that the underlying benchmark or related transition timing may differ, using a similar spread adjustment methodology as opposed to applying a single spread adjustment, should minimize the potential for value transfer.

Question 14. *Is there any another 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 comment.

Question 15. *(a) Under the amendment approach proposal, if parties are selecting a replacement rate through the amendment process, should the objection of the Required Lenders be by class (if applicable) (see clause (b) of the section titled "Effect of Benchmark Discontinuance Event" in Appendix I)? Why or why not?*

No, not by class. Required Lender objection should be sufficient as this is negative consent only. With a class requirement , the Required Lenders could object and the rate would still become effective unless each class objected. This seems unnecessary and disruptive as (i) such an objection would likely be an extraordinary event as presumably the rate adopted by the Agent and Borrower would be the accepted market replacement and (ii) historically LIBOR has been defined consistently across loans in a single credit agreement and it would seem that this approach should continue in the event of any replacement benchmark.

(b) Under the amendment approach proposal, if parties choose to select a replacement rate through the "opt-in" amendment process, should the affirmative consent of the Required Lenders be by class (if applicable) (see clause (b) of the section titled "Effect of Benchmark Discontinuance Event" in Appendix I)? Is affirmative consent appropriate or should negative consent be considered instead? Please explain.

Affirmative consent is appropriate here as the amendment would occur when no Benchmark Discontinuance Event has occurred and based only on the fact that other credit agreements are being amended. A class vote would be appropriate here to avoid a drag along, especially of a small revolver by a larger Term Loan B.

Question 16. *(a) Under the hardwired approach proposal, if parties must fallback to selecting a replacement rate through the amendment process because none of the options in the replacement rate waterfall are available, is the objection of the Required Lenders by a class appropriate (if applicable) (see clause (d) of the section titled "Effect of Benchmark Discontinuance Event" in Appendix II)? Why or why not?*

Required Lender objection should be sufficient for the same reasons set forth in our response to Question 15(a) above.

(b) The hardwired approach proposal provides two bracketed options for a successful declaration of the "opt-in" amendment process - Required Lenders (typically a majority) vs. supermajority (2/3) of lenders (see clause (B) of the definition of "Benchmark Transition Determination" in Appendix II). What should be the standard affirmative lender voting threshold for consenting to the "opt-in"? Please explain.

A vote of lenders holding a supermajority of the aggregate commitments is the preferable standard since it is likely to reduce litigation risk amongst the bank group on an impacted syndicated loan. If a replacement rate is being selected via the amendment process, this by definition means none of the preceding options in the waterfall for establishing a replacement rate are available. This likely would be an indication that there is material uncertainty in the market with respect to the appropriate replacement rate. A supermajority requirement would ensure that lenders holding a higher percentage of the aggregate commitments are on board with any proposed replacement rate which should theoretically reduce the risk of claims by dissenting lenders. Reducing this risk outweighs the administrative burden associated with (i) including a supermajority concept in credit agreements that don't otherwise include such a concept and (ii) requesting and obtaining the necessary lender consents to establish a supermajority.

Question 17. *For respondents that act as administrative agents in the syndicated 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 term SOFR if there is a missing middle maturity and, (v) execute one-time or periodic technical or operational amendments to allow the administrative agent to appropriately administer the replacement benchmark? Please respond to each and explain.*

i. Our preference is to leverage industry/official sector recognized fallback standards in order to provide for an efficient transition and minimize potential borrower disputes.
ii. Our preference would be to do so based on industry/official sector triggers rather than on a deal-by-deal basis.
iii. Yes, once defined and published.
iv. Yes, assuming a recognized benchmark rate is published/available and interpolation is a generally accepted market practice.
v. Yes.

Question 18. *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?*

Generally speaking, yes. This would seem warranted as part of the effort to instill confidence in the transition and support consistency and transparency for all stakeholders.

Question 19. *Given that market practices and conventions may change over time, should the administrative agent'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 administrative agent's ability to make conforming changes should be available on a periodic or ongoing basis. Particularly in the early stages of the transition to a new benchmark rate, operational challenges in administering the new reference rate may arise. Limiting the agent's ability to make conforming changes to only the point of transition might impact potential lenders willingness to join loan syndicates.

Question 20. *How important is it for the fallback rate to be available prior to making a borrowing/advancing funds? For instance, if the rate was a compounded three-month rate calculated at the* ***end*** *of the interest period, would that be problematic? Please explain.*

Our preference is to have the rate be available prior to advancing funds. Generally speaking, lenders and borrowers have systems and processes designed to accommodate rates being available in advance. It would likely require significant changes to those systems and processes to transition to a methodology where accruals and payments are handled "in arrears".

Question 21. *Are there operational concerns about having the ability to convert many loans over a very short period of time? Please explain.*

Yes. This will involve changes to lenders' loan systems and legal and administrative resources to process the required amendments. We estimate the process could take between several months to beyond one year to complete such a conversion.

Question 22. *Do you see other operational challenges that fallback language should acknowledge or of which the ARRC should be aware? Please explain.*

Currently with LIBOR, when a given tenor is selected, it is expected that the borrower will retain the loan through its intended maturity date. Any early repayment is potentially subject to breakfunding compensation to the impacted lenders. Term SOFR would approximate the same certainty and consistency within the marketplace while an overnight rate would seemingly allow the borrower to repay their loans without penalty, much like an ABR loan. This leads to a few questions:

- Why would anyone borrow at ABR if the same flexibility were available to them at a lower rate?
    - ABR is supposed to allow for more flexible terms while providing better compensation to the lenders.
- How would the lack of certainty and predictability impact a bank's ability to forecast income and/or repayment terms and the amount of cash they need to keep on hand?

Question 23. *What modifications to the syndicated loan consultative language may be helpful to market participants as they consider more robust fallback language in a bilateral or single-bank business loan context, if any? Please explain. Specifically, what modifications to the language may be appropriate in instances in which the bilateral loan is fully or partially hedged? Please explain.*

We will wait for the pending Bilateral Business Loan consultation.

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

No comment.

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

Specific Questions on Hardwired Approach Language:

- **Replacement Benchmark Spread definition**:

    It's not clear if this is intended to a one-time adjustment made only at the time of <u>initial</u> transition to the replacement benchmark or if the adjustment is made afresh for <u>each</u> interest period (this is also discussed in the first paragraph of Section D on page 12). Appears to be the latter?

    Also in this definition, the spread adjustment that will be made is described as intended "to account for the effects of the transition to the Replacement Benchmark". Borrowers are likely push for this to be further defined to clarify that adjustments are to be made so that the Replacement Benchmark is “substantially equivalent/similar to LIBOR” or similar language.

- **Compounded SOFR definition**:

  It’s not clear over what period of time this is calculated. We believe the intent is that it’s calculated in advance for a length of time equal to the relevant Interest Period.