

Alternative Reference Rates Committee
Federal Reserve Bank of New York
New York
United States of America

Email: arrc@ny.frb.org

November 23, 2018

Re: ARRC Consultation regarding more robust LIBOR fallback contract language for new issuances of US\$ LIBOR Syndicated Business Loans

Dear Sirs,

We applaud the efforts of the Alternative Reference Rates Committee (the “ARRC”) to develop recommended contract language to address the transition from US\$ LIBOR to SOFR for syndicated business loans. We think that the Consultation Paper is constructive and provides welcome visibility. We have the following thoughts on the proposals and certain questions posed in the Paper.

Amendment vs. Hardwired Approach

Currently, we support the adoption of the “amendment approach” as the more appropriate policy. The “hardwired approach” would be appropriate once a robust, liquid SOFR term rate is published and available and also, once market participants have built out appropriate operational infrastructure to support overnight rates and/or compounded SOFR rates. The amendment approach, together with current market disruption clauses, should continue to be used to avoid operational risk associated with agents and lenders not being able to support the rates proposed under the hardwired approach. The amendment approach also provides the parties with flexibility to consider the appropriate changes to the loan documentation to implement the prevailing alternative benchmark rate being utilized at the time trigger events occur, whereas adopting the hardwired approach now may lead to redundant or outmoded clauses which may then need to be further amended. Once there is greater certainty around the publication of a robust, liquid SOFR term rate, we would be more comfortable adopting a hardwired approach.

Triggers

We support the inclusion of all three pre-cessation triggers, (i.e., “an unannounced stop to LIBOR (trigger 3), a material change in LIBOR (trigger 4), or a shift in the regulatory judgment of the quality of LIBOR that would likely have a significant negative impact on its liquidity and usefulness to market participants (trigger 5)”). While we would prefer to have consistency in the triggers with over-the-counter (“OTC”) derivatives, we think that the benefits of including these triggers outweigh the benefits of broad-based consistency, particularly since OTC derivative terms can be negotiated on a bilateral basis, if need be. Including the pre-cessation triggers as well as the opt-in triggers will provide market

participants with greater flexibility to transition the large volume of syndicated business loans in a more orderly fashion.

Primary Fallback Rate

To the extent the hardwired approach is adopted, we support the use of a forward-looking term SOFR rate as the primary fallback rate. We believe this would reassure market participants as it (i) reflects current practice with regard to LIBOR and (ii) benefits both borrowers and lenders who require knowing the interest rate in effect before the commencement of the interest period. Again, to the extent possible, it would be preferable to have consistency with OTC derivatives.

We would encourage the ARRC to move quickly towards the publication of a robust, liquid forward-looking term SOFR rate in order to aid the transition from LIBOR. We note the Financial Stability Board acknowledged in its July 2018 white paper that use of term rates for certain segments of the cash markets would be compatible with financial stability.

Secondary Fallback Rate

We believe Compounded SOFR should be the second step in the waterfall but suggest it would be preferable to have the SOFR rate calculated in advance as a fallback (to follow the preferred practice of having the interest rate available in advance through the term SOFR rate) to allow both borrowers and lenders greater certainty in knowing the interest rate at the beginning of a given interest period.

Both a forward-looking term SOFR rate and compounded SOFR rate calculated in advance will also benefit participants in the secondary market who need to know interest rates in advance to calculate delayed compensation. In addition, many leveraged credit facilities contain complex mandatory prepayment provisions which permit lenders to decline prepayments; declined amounts are then distributed to the other lenders who did accept or to lenders under other tranches. This process only works because the interest rate is known in advance, allowing the agent to calculate payment amounts several days in advance of the prepayment date. Use of a backward-looking rate would require significant changes to current secondary market trading documentation.

Final Fallback Rate

We generally support the remaining proposed step in the waterfall as overnight SOFR is the only rate that is currently available to date. To the extent an overnight SOFR rate is used, only one-month interest periods should be available in light of the potentially unrepresentative interest rates resulting from using overnight SOFR.

Spread Adjustment

We strongly encourage the ARRC to consider recommending a spread adjustment to apply to cash products (including business loans and FRNs), and we support the proposed spread adjustment waterfall. We believe an ARRC published spread adjustment would promote transparency and credibility and encourage transition for cash market participants, especially given the varying degrees of sophistication in certain segments of the syndicated loan market.

Administrative Agent Discretion

Discretion can be a sensitive topic with market participants, and we therefore believe any such use should be transparent and well-governed to promote credibility. We note that both the amendment and the hardwired approaches are only feasible to the extent that the administrative agent is willing to exercise certain levels of discretion in order to transition to the new rates; however, such discretion should be minimized. In particular, replacement rates and spread adjustments should be publicly quoted and available in order to provide market participants with transparency and objectivity, and the ARRC should work to achieve this result. In addition, to the extent term SOFR is being quoted, we would expect that rates would be quoted for interest periods equivalent to the most commonly used LIBOR interest periods currently (e.g., 1M and 3M LIBOR). Finally, loan documentation should provide administrative agents with appropriate indemnity and limitations of liability provisions in exercising such roles to induce them to do so.

The Consultation Paper also poses the question whether there is any provision in the proposal that would impede syndicated loan originations, and we are not aware of any provision that would have such an impact. We would expect the market to start to follow the ARRC proposals once they become final recommendations and the SOFR cash and derivatives markets develop their own common financial conventions (e.g., day count, business day convention and like terms). It will help considerably when ISDA completes its derivatives work and the ARRC publishes its recommendations for other cash products. Finally, we encourage the ARRC to coordinate its efforts and final recommendations regarding contract fallback language with relevant governmental authorities and/or industry bodies in other jurisdictions in order to promote a consistent transition approach even though international convergence may not be possible.