The Alternate Reference Rate Committee (ARRC)
Federal Reserve Bank of New York
United States of America

November 26, 2018

Credit Suisse Group (Credit Suisse or CS) hereby submits our response to the Syndicated Business Loans consultation paper published by the ARRC on September 24, 2018. We welcome the consultation and believe it to be a vital prerequisite for a market-wide transition to the new alternate reference rates.

In accordance with existing business practice, CS will seek to utilize the fallback standards that are eventually adopted by global loan industry associations (LSTA, LMA, APLMA) in their respective markets. This letter is intended to highlight our general recommendations for a safe transition to all proposed alternate reference rates, as well as to present a view on topics outlined within the ARRC paper.

CS believes that in principle, an optimal adoption of fallbacks for new Syndicated Business Loan contracts must:

a. Minimize the potential for market manipulation by any group of market participants, regardless of the timing of the trigger event.
b. Minimize interpretation risk, by using transparent data and simple and deterministic terms. This should allow both lenders and borrowers to independently derive the fallback terms without the need for additional validation.
c. Be synchronized, or at least compatible, with developing fallbacks in other related markets (e.g. Derivatives, CLOs and Floating Rate Notes).
d. Minimize the possibility of value transfer at the point of transition, or perceived economic harm on parties, so as to reduce risk of litigation and other disputes.
e. Minimize event risk by limiting impacts from global monetary policy decisions on or around the day of the fallback being triggered.
f. Be practical to implement across systems, entailing reasonable implementation overhead and complexity.

We think the availability of published forward-looking term rates will be critical to a safe market-wide transition to alternate reference rates (ARRs). Term rates are used in determining interest payments for the vast majority of Syndicated Loan contracts globally today, and are intuitive and transparent to even unsophisticated borrowers. Not only would term rates be a superior solution to the other waterfall steps proposed in the consultation paper, they would also provide for consistency if adopted in coordination with other markets (e.g. Derivatives). Further, while larger lenders could build the mechanisms necessary to calculate a compounded rate, we think borrowers will highly prefer using simple term rates instead. These term rates could be derived from the developing futures markets in respective ARRs (e.g. SOFR futures), and ideally should be made available across the range of primary loan contract currencies (USD, GBP, CHF, EUR and JPY).

While the fallback terms proposed in your paper are specific to the SOFR rate alone, we believe it essential to align such provisions across all the globally identified ARRs (i.e. across currencies). This will minimize the disruption of business practices at large global lenders like CS, which commonly offer multi-currency credit facilities and often deal with borrowers across multiple global loan markets (e.g. across the US, European and Swiss Credit markets). Standardization of approaches will also serve to minimize cross-currency basis risk, thus saving potential hedging costs. A simplified approach across currencies would also reduce implementation costs and complexity for all parties.

Similarly, the alignment or compatibility of fallbacks agreed for Loans with those of Derivatives and Floating Rate Note markets is important. This is because at CS and other large lenders, loan activities are often

hedged using Derivatives, and internal cost of funding measurements help determine prices for our lending activities to clients.

Finally, within the ‘Hardwired Approach Replacement Benchmark Waterfall’ proposed in the consultation, CS is opposed to using the ‘Overnight/Spot SOFR rate’ as an adjustment. Such a provision, if invoked, would materially expose contract parties to monetary policy developments on or around the actual day of fallback (e.g., a steep interest rate hike). In our opinion, this presents a high risk of market manipulation or allegations thereof and may lead to disputes between lenders and borrowers. We also believe that the Overnight SOFR rate may be inappropriate for loan transactions with longer term maturities.

Here are some additional views on the detailed sections within the consultation paper:

General approach of the two fallback proposals (question 1)

While the ‘Amendment approach’ is ideal in theory, it may be difficult to practically implement market-wide in its current definition and could create a perception of winning or losing in different market cycles as the paper rightly identifies. For this reason, we believe the ‘Hardwired approach’ would be preferable for an orderly transition given it provides greater visibility on terms upfront, which we believe will be important to borrowers and investors alike.

However we note that the Hardwired approach as defined uses term SOFR rates with its suggested waterfall, which are not currently available. Similarly the methodology for compounding SOFR, whether in arrears or in advance, has not been agreed. It would thus be difficult for market participants to agree to move to a rate without the necessary conventions for that rate already developed. Regardless of the approach eventually recommended by the ARRC, we think consistency of adoption across lenders and borrowers of all degrees of sophistication to be the most important objective.

Triggers (questions 2 through 4)

We believe the inclusion of pre-cessation trigger 5 is helpful, as its determination is made by a regulatory authority, and as such a situation could not give rise to market manipulation or allegations thereof. Our concern with trigger 3 is that a failure to publish LIBOR for some days should result in permanent LIBOR discontinuation, not a temporary one, to prevent untimely contractual resets and operational issues. If such a trigger is chosen, we recommend arriving at the ‘number of days LIBOR fails to publish’ through future industry consultation. Our suggestion for trigger 4 is that such a determination would be best made by a regulatory body that the market recognizes, so its definition could be aligned to trigger 5.

In general, any and all pre-cessation triggers should be simple, deterministic and widely known to all market participants. With borrowers and investors differing in their sophistication and capabilities, disagreements on fallback terms would increase litigation risks. Separately, we are concerned that the recent ISDA consultation for Derivative fallbacks did not propose any pre-cessation trigger events, which would present an apparent departure from ARRC papers for FRNs and Loans.

We support the concept of the ‘early opt-in trigger’ in theory as it can provide an orderly transition of the market standard for a number of issuers, and as it provides flexibility to convert to SOFR prior to LIBOR cessation which borrowers may seek. However, such a trigger needs to have inherent safety provisions to prevent giving too much power to an administrative agent or borrower. Depending on market conditions, lenders may or may not provide the necessary consent, which could results in a bifurcated market. CS stands ready to adopt such a trigger, in as much as it is carefully deliberated in industry associations like the LSTA and LMA.

The replacement benchmark (questions 5 through 11)

As stated earlier, CS highly prefers published term rates to any other derivations noted in the waterfall.

Within the hardwired approach, in the absence of a published term rate, a 'compounded in advance' rate is preferred over any overnight/spot rate (which we oppose), as it limits exposure to monetary policy developments on or near the day of the fallback event. While fallback terms for Loans should ideally align with those of Derivatives, choosing an overnight/spot rate in any step of the waterfall could bring economic consequences for contract parties, based on fallback timing, thereby increasing litigation risk. The Overnight rate observed at the time of fallback may differ materially from that prevalent during coupon payments, particularly in a sharp interest rate hiking or lowering cycle. Therefore this recommendation for Loans stands regardless of what ISDA chooses for Derivatives.

The 'compounded in advance' method is operationally the most practical for the loans industry, and reflects current loan market practices and borrower preferences. Importantly, in the event that ISDA chooses a 'compounded in arrears' approach for Derivative contracts, we suggest the ARRC coordinate with ISDA to ensure that interest rate hedges reflecting the difference in market approaches are available to borrowers and lenders. The selection of a 'compounded in arrears' approach for the loan market would require strong industry-wide consensus as it would be a significant departure from how loan contracts are structured today.

Spread adjustments (questions 12 through 14)

We believe the ARRC (or another regulatory body) should consider calculating and reporting a spread adjustment that could apply to cash products, including Syndicated Business Loans. This will provide for consistency between markets and provide transparency to lenders, borrowers and investors and reduce litigation risk.

Of the spread adjustments proposed by ISDA for Derivatives, CS has expressed support for the 'Historical Mean/Median Approach'. While not without its own limitations, this approach allows the least scope for market manipulation, uses readily accessible historical data, and is relatively simple to implement in firm systems. However, the Historical Mean/Median Approach as proposed suggests a simple mean or median on a fixed lookback period. CS has suggested an enhancement where more weight could be given to more recent observation periods by applying a time decay function (e.g. exponential weighing). This would ensure that any extreme market events from the distant past would wield only limited influence on current fallback parameters. Similarly any material moves from the recent past would be appropriately emphasized.

Lender vote (questions 15 and 16)

We defer to the LSTA and LMA to provide a more representative view of lender preferences on these proposals.

Role of the administrative agent (questions 17 through 19)

As administrative agent, CS would prefer to work with, but not act on behalf of syndicates. With regards to the ARRC's questions related to the role of the administrative agent:

i. We would be willing to work with the borrower to identify a new reference rate or spread adjustment, but only to the extent endorsed by relevant regulators and only when uniformly adopted across the loan market. We would look to avoid exercising discretion or choice among options.
ii. We would be willing to determine whether triggers have occurred, but only to the extent endorsed by relevant regulators and only when uniformly adopted across the loan market. We would look to avoid exercising discretion or choice among options.

iii. We would be willing to select screen rates where reference rates are to be found. However, ideally issuers should adopt market standards and announce screens widely so these may be transparently available to investors and borrowers.
iv. We would be willing to interpolate term SOFR if there is a missing middle maturity, but only if such a term SOFR rate is not already available and is required, and as long as the loans industry can agree an interpolation methodology.
v. Our willingness to execute one-time or periodic technical or operational amendments to allow for better administration of the replacement benchmark will depend upon the nature of the replacement rate and the number and extent of changes required.

CS would highly prefer replacement rates and spread adjustment be published on a third-party screen that is accessible widely to all market participants. This will allow all parties to have independent access and verifiability, without assertions of manipulation by either side. Operationally, lenders would also require a systematic feed from such a third-party source, and not just a keyed-in number.

Operational considerations (questions 20 through 22)

Knowledge of the fallback rate prior to making a borrowing reflects current loan market practices and borrower preferences. The selection of a 'compounded in arrears' approach for the loan market would require strong industry-wide consensus as it would be a significant departure from how loan contracts are structured today. This would entail a number of operational changes, as well as changes to hedging strategies for financing portfolios at lenders. In the event that ISDA chooses a 'compounded in arrears' approach for Derivative contracts, we suggest the ARRC coordinate with ISDA to ensure that interest rate hedges reflecting the difference in market approaches are available to borrowers and lenders.

To minimize operational concerns, a transition point to alternate reference rates must be clearly defined and communicated sufficiently in advance. This would allow for better market-wide cooperation on both new contracts and historical amendments.

Please direct any questions or feedback to Nomita Singh (Managing Director – Head of US Regulatory Affairs) at nomita.singh@credit-suisse.com

Thank you.