Loan
Market
Association

the authoritative voice
of the EMEA market

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Alternative Reference Rates Committee
Federal Reserve Bank of New York
33 Liberty Street
New York, NY 10045
United States of America

Email: arrc@ny.frb.org

Dear Sirs,

ARRC consultation regarding more robust LIBOR contract language for new originations of LIBOR syndicated business loans (the "Consultation Paper")

The Loan Market Association (**LMA**) welcomes the opportunity to provide feedback on the above Consultation Paper published in September 2018.

The Loan Market Association

The LMA is the trade body for European, Middle Eastern and African syndicated loan markets. Its aim is to encourage liquidity in both the primary and secondary loan markets by promoting efficiency and transparency, as well as by developing standards of documentation and codes of market practice, which are widely used and adopted. Membership of the LMA currently stands at over 700 organisations across EMEA and consists of banks, non-bank investors, law firms and service providers.

There are many loan transactions in EMEA which are denominated in U.S dollars. The LMA recommended forms of loan documentation contain drafting for U.S. dollar facilities which reference LIBOR.

Scope of LMA feedback

As the LMA is concerned with the EMEA syndicated loan markets, we have not replied to each individual question in the Consultation Paper but set out our thoughts on some aspects of the proposals set out in the Consultation Paper. Our particular focus is on elements of the proposals that we feel would not be workable in EMEA and which, given the international nature of many transactions, the ARRC may wish to consider.

Our member institutions are likely to have other thoughts on the proposals and we have encouraged them to submit their own feedback on the Consultation Paper.

The LMA welcomes the Consultation Paper as an important step towards facilitating transition away from LIBOR and towards alternative reference rate(s) in the syndicated loan markets and hopes that these comments are helpful.

Terms not otherwise defined in this letter have the meanings given to them in the Consultation Paper.

The "amendment" approach

Since 2014 the LMA recommended forms of documentation have included an optional "replacement of screen rate" clause. This clause provides that if a benchmark rate is unavailable, amendments to replace that rate that would otherwise require all lender consent may be made with the consent of the majority lenders and the borrower. In May 2018, this clause was revised to permit amendments to be made to documents with a lower consent threshold than would otherwise be required in a wider range of circumstances than the 2014 version. The clause was published in October 2018 by the Bank of England's Working Group on Sterling Risk Free Rates in order for it to be available to a wider audience.[1]

This approach is most similar to the "amendment" approach set out in the Consultation Paper. Pending the development of appropriate term risk-free reference rate(s) or other risk-free rate based market conventions and related operational infrastructure, this approach is generally being adopted in the EMEA syndicated loan markets at present.

The "hardwired" approach

Although it is important to consider the options available to market participants, the LMA is of the view that it is premature to "hardwire" fallback rates into documentation where such rates do not currently exist. The proposals in the Consultation Paper reference a forward-looking SOFR rate selected, endorsed or recommended as the replacement by the Relevant Government Body, which it is hoped will be developed in due course, as well as other potential fallback rates (such as Compounded SOFR). It would be difficult for EMEA market participants to agree to move to a rate at a time where there is uncertainty as to the methodology for the calculation of that rate as well as the need to develop infrastructure and conventions (both operational and documentary) for such a rate. In our opinion, it would be more appropriate to "hardwire" fallbacks into documentation at a time when there is much more clarity on these matters.

One of the proposed "hardwired" fallbacks in the Consultation Paper is SOFR (an overnight rate). If SOFR is not available, the next fallback would be to a streamlined amendment approach. However, given SOFR is a currently published rate, it would seem unlikely that there would ever be a fallback to an amendment approach unless a significant SOFR-related market disruption were to occur. This could be problematic in that SOFR, as an overnight rate, is unlikely to be appropriate other than on a short-term basis in loan transactions. There may be further implications for the use of SOFR in the secondary markets. Loans with "hardwired" language may be left with SOFR when the market may have moved to a better alternative.

[1] The clause can be found here: https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/risk-free-reference-rates-replacement-of-screen-rate-clause.pdf?la=en&hash=69D8106F9D8FC4BE97F67A214B456D4DEC5A893E.

Further, the "hardwired" approach details a spread adjustment waterfall, the Replacement Benchmark Spread. As the ARRC itself recognises, it is important to ensure minimisation of any value transfer on transition from LIBOR to an alternative fallback rate. However, the first limb of this waterfall is a spread recommended by a Relevant Governmental Body. At this stage, it is not certain that a spread will be recommended by a Relevant Governmental Body or, depending on how the method for calculating any such spread is developed, that market participants will be comfortable using such a spread. The second priority in the waterfall is the spread that ISDA anticipates implementing in its definitions for derivatives transactions. As the Consultation Paper notes, this spread adjustment will be intended for use in derivatives transactions and for SOFR derived rates other than a forward-looking term SOFR. As such it may not be suitable for use in loan transactions. Indeed, at this stage, it is unclear whether there will be a different Replacement Benchmark Spread for each of Term SOFR, Compounded SOFR and SOFR – it will not necessarily be appropriate for the same spread to apply to each rate. Therefore, it may be premature to include these limbs into a hardwired spread waterfall at this stage pending further clarity on any recommendations for the calculation methodology for a spread adjustment that would be applicable for the replacement reference rate which is determined as being appropriate for the syndicated loan markets.

The Consultation Paper makes the assumption that the "amendment" approach could create winners and losers in different market cycles. This assumption could also apply to the "hardwired" approach at the time that fallbacks are triggered given any potential difference between the fallback rates.

The role of the administrative agent

The proposals set out in the Consultation Paper involve the administrative agent in the selection and administration of the replacement rate. They also provide for the administrative agent's ability to execute certain technical or conforming changes in order to appropriately administer the replacement rate (for example, in the definition of "Replacement Benchmark Conforming Changes"). However, any such changes could be significant given the operational differences between the proposed fallbacks i.e. moving from Term SOFR (a forward-looking rate) to Compounded SOFR (a backwards-looking rate) to SOFR (an overnight rate). Pending clarity on the infrastructure and market conventions for any replacement benchmark rate, it may be premature to give this level of discretion to the administrative agent.

In any event, at least in the context of the way in which EMEA syndicated loan transactions normally operate, we consider that the levels of agent discretion proposed may go beyond what an administrative agent would be willing to exercise. A facility agent on an EMEA syndicated loan transaction is generally unwilling to exercise any discretion without instructions from the syndicate on all but the most administrative decisions. Therefore, in the context in which our members operate, we are of the view that the proposals set out in the Consultation Paper offer too much discretion to the administrative agent to determine changes to documentation.

Finally, the acknowledgement that even in a "hardwired" approach regime there remains a need for "technical and conforming" changes, underscores the difficulties in attempting to hardwire the fallbacks before all the conventions for any Replacement Benchmark are established. While the hardwired approach attempts to deal with the most fundamental elements of LIBOR cessation (i.e. establishing a new reference rate and a spread adjustment without the need for a lender vote), the consequential changes to documents (which are likely to be reasonably extensive) are not dealt with. In practice, this means the administrative burden of properly aligning documents to a new reference rate is only slightly reduced under the "hardwired" approach.

Co-ordination

As syndicated loans may be either single currency or multicurrency (i.e. available for drawing in different currencies) it will be important to coordinate efforts to develop forward-looking term rates across the key currency groups to the extent possible. This will be important for the amendment and administration of multicurrency facilities.

We would be pleased to discuss any aspect of the above with you in more detail. If we can be of any further assistance, please do not hesitate to contact me by email at clare.dawson@lma.eu.com or on +44 (0)20 7006 6007.

Yours sincerely,

Clare Dawson

Clare Dawson
Chief Executive