ARRC CONSULTATION

REGARDING MORE ROBUST LIBOR FALLBACK CONTRACT LANGUAGE FOR

NEW ORIGINATIONS OF LIBOR BILATERAL BUSINESS LOANS

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 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 which functioned similarly to the proposed hardwired approach provisions. Most of those instances were bilateral facilities and the effort required to notify clients and change billing was a significant undertaking. The additional administrative requirements as provided in the amendment approach would only serve to complicate and delay a process which could 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 Lender (or 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 limit subjectivity and discretion by the lending community so as to foster a degree of transparency and trust in this broader process.

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. 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?

No Comment.

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?

While we support pre-cessation triggers in concept, not all of the proposed triggers would appear meaningfully additive or beneficial to the process. For the trigger 3 proposal (5 day failure to publish), this would seem to accomplish little as there is already fallback language within existing documents which contemplate a temporary lack of availability of a LIBOR index. Attempting to directly address a period of days (or even weeks) as warranting legal clarification beyond that already included in existing contracts would seem in excess as such a scenario would either already be addressed within the existing terms of a prospectus or would likely be a systemic event significant enough such as to warrant formal direction from the administrator and/or regulators associated with the LIBOR submission process.

As for trigger 4, this would also seem be excessive as the administrator has already provided guidance as to how such occurrences may be handled. While this may result in the IBA having significant discretion in the outcome for how such a scenario may be handled, the markets' failure to acknowledge existing IBA resolution protocol may result in increased legal risk for the determining party (i.e. Lender) in the event of such an occurrence.

The last proposed pre-cessation clause, trigger 5, may have merit as it addresses a scenario which is likely not appropriately contemplated within current fallback language. Specifically, this could provide additional clarity in the event LIBOR continues to exist, including instances such as that portrayed by triggers 3 or 4, but is formally deemed not appropriate for continued use by the relevant regulatory authority overseeing LIBOR (i.e. the FCA). While specifically excluded within trigger 5, it may also be worthwhile to consider including such a directive by a US regulatory body. This would appear to have limited downside and would address the unlikely scenario in which the UK regulatory agency overseeing LIBOR continues to support the submission process but a US regulator has prohibited US firms' continued use of LIBOR.

Question 3. (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.

As noted, for triggers 3 and 4, the highlighted concerns are specific to the triggers themselves and would likely further complicate matters when compared with derivatives markets. As proposed, trigger 5 could theoretically result in differences between bilateral loans and derivatives contracts; however, it would seem advisable, and likely, that such a scenario could be addressed through updating the standard ISDA fallback language which should support consistency in interpreting the occurrence of such a trigger "event" (be it for new or 'legacy' contracts).

Question 3. (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 support the inclusion of clear, pre-cessation triggers (including Triggers 1, 2, and possibly 5) as part of enhancing fallback language in order to avoid market disruption and more clearly address a potential unavailability of LIBOR, whether that cessation is expected or unexpected. Absent clear pre-cessation triggers, any signs of a potential lack of availability of LIBOR would likely foster concerns within the market and thus result in a considerable repricing of basis risk as certain market participants look to reduce LIBOR exposure where possible (i.e. unwind positions, move to alternative indexes, etc.) while others take advantage of the potential uncertainty and dislocation. This would seem likely to result in a considerable transfer of value which would appear contrary to the ARRC's objectives.

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

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 actions of a limited number of stakeholders within the defined process. 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 a limited number of transactions required to trigger such a process. We believe this threshold is too low 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 existing loans to opt-in to a new benchmark or refinance at any time; albeit it would be a cumbersome process given the standard voting requirements.

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

No comment.

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.*

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 loans hedged by derivatives based off of overnight rates. However, this may be reliant upon Swap Dealers helping to accept and facilitate the risks associated with this disconnect as end-users may require more perfect alignment from either an operational and/or a hedge accounting perspective (i.e., ASC-815).

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?*

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 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 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 Overnight ('Spot') SOFR and, if used "in arrears", would likely have the 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 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"?*

The "in arrears" methodology is not ideal but preferable to using an "in advance" rate that is backward looking and not representative of future interest rates and/or risks. This preference would indeed be impacted by ISDA's ultimate implementation though that would only be one factor in determining the preferable means of resolution.

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)?*

As presented, Overnight ('Spot') 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. If consistent with the approach taken by ISDA, using Compounded SOFR would at least provide the benefit of consistency with the derivatives market and help capture the appropriate interest rate compensation for the relevant period.

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.*

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 bilateral business loans?*

Yes. However, given the term structure of interest rates and credit spreads, providing a "one size fits all" spread adjustment would not seem to be a viable solution. Such a simplified spread approach if provided by ARRC would be actionable but would likely exacerbate the transfer of value. Conversely, ARRC failing to provide guidance would prevent an orderly transition and potentially increase litigation risk among market participants.

It may be preferable if ARRC provided a recommended methodology for making spread adjustments. This would likely reduce legal liability risk within the system and would hopefully still provide a clear methodology by which Lenders, or the relevant party, might implement fallback provisions in a way that is both reasonably transparent and minimizes the transfer of value.

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.*

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 timing of any transition between loans and derivatives may differ, this would likely lead to a less orderly transition, particularly if there is a lack of clarity around the subsequent timing of resolution for either of the instruments.

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 Comment.

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.*

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 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.*

Our preference is to only consider unilateral Lender action, with only notice provided to Borrower, for actions that are based on clear, objective criteria and should be above reproach. For Lender actions that involve subjective determinations, we think the Borrower's right of negative consent is appropriate. Sophisticated borrowers will be unwilling to agree to vest unilateral discretion with the Lender. Limiting Lender unilateral action to only scenarios where the action taken is based on clear, objective criteria supports our overall goal of transparency in order to create trust in the new benchmark(s) and the broader process as a whole and should help to minimize potential borrower disputes.

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?*

Generally speaking, yes. The need to publish gains greater importance to the extent 'Term SOFR' is reliant upon forward market rates (i.e. a modeling process). Publishing all industry standard terms of SOFR would seem warranted as part of the effort to instill confidence in the transition and support consistency and transparency for all stakeholders.

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'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 Lender's ability to make conforming changes to only the point of transition might impact liquidity in the respective loan (including the prospects for support from other Lenders via Loan Participations).

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 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 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 Lender14 – do these requirements and the resulting communications between parties impose undue operational burdens? 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. Oftentimes, early repayment is subject to breakfunding compensation to the impacted lender(s). Term SOFR would likely allow for a similar methodology but using an overnight SOFR 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 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?*

If loans fall back to a different rate from derivatives, there are currently no provisions within ISDA contracts that will trigger an automatic termination, and it is not our firm's intention to begin including such provisions in contracts. Based on the terms of their ISDA agreements, market participants should not necessarily expect that current swaps will be terminated. Some market participants may choose to terminate existing swaps and enter into new ones, while others may choose to amend the terms of their existing swaps. Market participants will consider a range of factors when weighing this decision, including the market standards that develop in both the loan and derivatives markets, related FASB guidance on hedge accounting treatment, and the related costs and administrative effort involved.

As it relates to this question, it is worth noting that both aligning the timing of any transition (trigger or implementation) and providing certainty on the path of resolution for both exposures would ultimately determine how market participants handle their derivatives hedges. Said another way, market participants will be much less likely to terminate derivatives hedges if they have certainty that both products will transition in a consistent manner and changes will occur contemporaneously. If market participants lack clarity on the timing or the process for transitioning to an alternative rate for either loans or derivatives, they are more likely to terminate/prepay in order to bring certainty to their exposures in advance of either product reaching a 'trigger' event.

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.*

Consistent with the response to Question 6, the potential mismatch of loans transitioning to (or from) a term rate and derivatives referencing overnight SOFR is a concern. All else equal, borrowers are going to continue to push to try to be perfectly hedged so having consistency in the event of a transition would be preferable. However, transitioning a loan in this manner from a term rate to an overnight rate will transfer the risk of the benchmark rate conversion and the associated "spread adjustment" to

Lenders. In such a scenario, it would be advisable for Lenders to be heavily engaged in the ISDA consultations so as to influence the ultimate fallback guidance and the calculation of any associated spread adjustment for derivatives, regardless of whether a Lender actually has significant derivatives-based fallback risk.

As it relates to the proposal of Appendix VI, we see significant operational risks in explicitly tying fallback protocol to an outstanding balance of a loan or derivative notional (see Question 23).

Lastly, we suspect that a certain contingent of end-users will continue to prefer term rates be used for borrowings, regardless of any consistency with derivatives market conventions.

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?*

Regarding the language set forth in Appendix VI, the concept of the hedge and unhedged portions of the loan falling back to different rates/spread is operationally untenable from a lender perspective. In clause (2) of the definition of "Replacement Benchmark", we would prefer to see the implementation of a deliberately crafted fallback structure (for rates and spreads) in this circumstance (ABR alternatives) rather than leaving the issue to Lender discretion, as we believe this would reduce the risk of disputes from the Borrower. This would eliminate the need for the negative consent right in clause (d) of the proposed 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 Comment.

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

No Comment.