February 5, 2019

By Electronic Mail to (arrc@ny.frb.org)

Golub Capital commends the Alternative Reference Rate Committee for publishing the Consultation for New Issuance of LIBOR Securitizations dated December 7, 2018 ("CLO Consultation"). The CLO Consultation is an important next step in ensuring an orderly transition from LIBOR to an alternative base rate.

Overview

We believe that it is important to analyze the CLO Consultation in the context of the previously released Consultation Regarding More Robust Fallback Contract Language for New Originations of LIBOR Syndicated Business Loans (the "Syndicated Loan Consultation"). To that end, we note initially our over-arching goal: to ensure that the market adopts CLO LIBOR fallback provisions that work nearly seamlessly with syndicated loan LIBOR fallback provisions. We believe that finely tailored CLO LIBOR fallback provisions will result in equitable treatment of CLO investors, regardless of position in the capital structure.

In this response, we set forth our views with respect to certain questions in the CLO Consultation and, where possible, note provisions that might be refined to reflect current market practice, the Syndicated Loan Consultation, our response to the Syndicated Loan consultation, or two or more of the foregoing.

Responses

Response to CLO Consultation Question 1.

We submit this response in reference to CLOs. The structural similarity between syndicated loan interest mechanics (i.e., floating rate yield) and CLO mechanics shapes our response. The constructive LIBOR fallback ideas generated by the CLO market in the past eighteen months also inform our response.[1] We believe that these considerations should serve as guiding principles in the ARRCs approach to CLO LIBOR fallback.

[1] Generally speaking, following the announcement that the FCA would cease sustaining LIBOR CLO market participants adopted an "Alternative Rate" approach that is found in most current CLO documents.

Response to CLO Consultation Question 2(a).

The ability to transition to an alternative base rate prior to a Cessation Date would be beneficial to the CLO market. LIBOR replacement mechanics adopted in the CLO market to date often permit the CLO manager to adopt an alternative base rate if the CLO manager reasonably believes that LIBOR will cease to be reported.[2] There is often no time limitation for such determination to take place.

We do not object to the inclusion of a time recommendation.[3] However, ARRC should consider whether a period longer than 30 days would be more appropriate. Many CLOs may have interest reset dates that fall outside of the proposed 30-day window. We believe CLO managers, investors, and trustees would support a mechanic that permits pre-cessation conversion on a quarterly interest reset date.[4]

Response to CLO Consultation Question 3(a).

As we stated in our response to the Syndicated Loan Consultation, we support the inclusion of pre-cessation triggers. The pre-cessation triggers included in the CLO Consultation are, for the most part, consistent with those included in the Syndicated Loan Consultation. We approve of this approach. These triggers will help sustain a “soft-landing”. CLO stakeholders (e.g., senior note investors, equity investors, CLO managers and trustees) will have a longer runway to implement alternative base rates. This will increase transparency and rate comparability. CLO stakeholders will also have time to “feel out” the new process. They will also be able to communicate with one another in the absence of a ticking clock.

Response to CLO Consultation Question 3(d).

We believe that a few factors protect investors from such transfer in value. First, the amendment and hardwired approach contained in the Syndicated Loan Consultation are either objective or require consent. As such, a loan agent that might also serve as the CLO Designated Transaction Representative would likely be unable to change the basis that loans bear for its benefit in a CLO.[5] Second, ARRC has the opportunity to take the lead on implementing a spread adjustment (to normalize the Replacement Benchmark to LIBOR) to minimize value transfer and basis mismatch.

---

[2] The Designated Transaction Representative in a CLO would properly be the CLO manager.

[3] We note that this is consistent with our comment regarding the “later of” approach in response to the Syndicated Loan Consultation.

[4] A typical CLO would designate four interest rate set dates per year.

[5] Golub Capital also suggested that a third party, such as ARRC, announce a date that SOFR is ready for use and that such date be a benchmark replacement date in loan documentation. Inclusion of this additional trigger would eliminate any concerns regarding such value transfer. Further, in many cases the CLO manager would not unilaterally control the conversion of the assets.

ARRC should supplement the proposed features of the Asset Replacement Percentage trigger (the "ARP Trigger") for CLOs. First, the ARP Trigger should allow for a partial transition, or blended basis, to the extent that assets with a SOFR basis[6] are included in the portfolio but below the pre-determined full transition level (i.e., 50% in the CLO Consultation). Second, the ARP Trigger for CLOs should take into account syndicated loans that have had a Benchmark Transition Determination and/or Benchmark Replacement Date.[7] Third, the determination of whether the ARP Trigger is met should be based on the assets in the pool on the cut-off date for the servicer report to the extent that the servicer report will trail an interest reset date.[8]

We believe that these additions would allow the CLO market to mirror the basis transition in the broader syndicated loan market. These revisions will also permit CLOs to be more receptive to the creation of new-issue, SOFR-bearing, loans in the primary market.

Response to CLO Consultation Question 4.

As noted in our response to CLO Consultation Question 2 above, (i) we support the inclusion of the pre-cessation transition mechanism and (ii) many active CLOs contain LIBOR replacement provisions that do not include a time limitation.

While we do not object to the inclusion of a time recommendation, ARRC should consider current market practice and commonplace CLO interest rate mechanics. ARRC should also consider that many CLO managers would be required to transition billions of dollars of securities outstanding across numerous deals. Likewise, many CLO investors will need to account for basis changes to billions of dollars of CLO securities that they hold. During the transition, CLO managers will need to take into account what the market will bear. CLO managers will also likely be marketing new-issue CLO transactions while transitioning from LIBOR to SOFR in existing deals. As with the implementation of the Volcker Rule into existing CLOs, these market forces may serve as a sufficient de-facto limitation.[9]

[6] Or other primary Replacement Benchmark in the case that such rate is not SOFR. The ability to use a blended basis may be limited to a period following the transition date. Because the interest would be set quarterly such basis blend could be based on rolling or weighted averages of portfolio composition.
[7] In the Syndicated Loan Consultation, the Replacement Benchmark is not given effect until the "Benchmark Reset Date" (i.e., the next interest reset date) following the Benchmark Replacement Date. Obligors, agents and lenders may elect to implement the rate pending only the next reset date. Notably, syndicated loans may transition following utilization of the "opt-in" trigger set forth in the Syndicated Loan Consultation. It is sensible to structure LIBOR fallback for CLOs to progress with the syndicated loan market in this regard.
[8] For many CLOs, the CLO manager makes the report available after the interest reset date, thus potentially causing a 1-quarter lag in transition.
[9] The pre-cessation trigger is also consistent with the opt-in provisions of the Syndicated Loan Consultation.

Response to CLO Consultation CLO Question 5(a).

CLOs are match-funded investment vehicles. The Syndicated Loan Consultation proposed forward-looking term SOFR as the primary fallback for syndicated loans. To the extent that forward-looking term SOFR remains the primary fallback for loans it should also remain the primary fallback for securitizations. Perhaps the best approach would be for the primary fallback to be the Replacement Benchmark utilized (or expected to be utilized) in the syndicated loan market. This would be consistent with the technology implemented by the CLO market in the past eighteen months.

Response to CLO Consultation Question 6(a).

To the extent possible, the Replacement Benchmark waterfall should mirror the waterfall in the "hardwired approach" contained in the Syndicated Loan Consultation.[10] As stated in our response to CLO Consultation Question 5 above, we also believe that the Replacement Benchmark waterfall should include the replacement rate implemented by the syndicated loan market.

Response to CLO Consultation Question 6(b).

Compounded SOFR should be calculated "in advance" (i.e., before the period starts). We acknowledge that this may initially lead to "lag" in rate movement. We base this preference on a desire to avoid imposing additional late-quarter burdens on CLO investors and trustees. These burdens would include less transparent CLO interest coverage testing and increased complication of interest accrual tie outs.

Response to CLO Consultation Question 6(c).

We believe that parties to a CLO transaction have sufficient resources to perform the SOFR-compounding effectively. In a typical CLO, the trustee and the CLO manager work closely to tie out interest on existing contracts and to calculate LIBOR for the securities. We see no reason why this model should not continue during and following the transition from LIBOR to SOFR.

Response to CLO Consultation Question 10.

Allowing the Designated Transaction Representative to determine a Replacement Benchmark in this scenario is appropriate. In CLO LIBOR fallback provisions, this step in the Replacement Benchmark waterfall should also permit the Designated Transaction Representation to determine that such rate is not consistent with the rate utilized in the syndicated loan market (rather than just the securitization

[10] Leaving aside the inclusion of overnight SOFR in the "hardwired" waterfall.

market).[11] ARRC should retain for CLOs the voting mechanics adopted by the CLO market for current CLO fallback provisions.[12]

Response to CLO Consultation Question 11.

We do not believe that a Replacement Benchmark should continuously utilize a spot rate based on conversion-date basis delta. It may be appropriate for the Replacement Benchmark to include this spread as a first option for a limited period. Utilizing this spread for more than a short period is not advisable. The market should move away from relying on LIBOR.

Response to CLO Consultation Question 12.

As stated in our response to Question 12 in the Syndicated Loan Consultation (and for the same reasons), ARRC should consider recommending a spread adjustment.

Response to CLO Consultation Question 16.

There are a numerous sources of potential misalignment between syndicated loan LIBOR transition and CLO LIBOR transition. We have endeavored to identify a number of those in our response above. We have also identified additional sources of misalignment. First, the adoption by ARRC of the “amendment approach” could result in misalignment. Participants in the syndicated loan market could have trouble balancing new issue deals with thousands of amendments. Second, the Syndicated Loan Consultation contains a third step in the spread waterfall that would utilize a streamlined amendment approach to determine a spread. If syndicated loan market participants used this[13] approach it could result in potentially significant basis mismatch. A number of the updates that we suggest herein[14] might reduce the misalignment that could result from these sources.

---

[11] To the extent that ARRC includes a reference to the standard Replacement Rate utilized in the syndicated loan market reliance on this step in the waterfall may be limited.
[12] Standard CLO fallback mechanics include limited consent rights that often permit the CLO manager to utilize rates utilized in other CLOs or in syndicated loans without consent. This provision reflects that CLO stakeholders expect CLO interest basis to mirror that of the syndicated loan market.
[13] I.e., if ARRC does not propose a spread adjustment.
[14] Including reference to the basis utilized by syndicated loans.

Golub Capital appreciates the opportunity to comment on the CLO Consultation. We would be pleased to discuss any of these comments in further detail and to provide any further comment or assistance that would be helpful. If you have any questions please contact Daniel Colaizzi at dcolaizzi@golubcapital.com. Thank you for your consideration.

David B. Golub
President

Craig Benton
Managing Director, Head of Structured Products