ARRC Consultation on Syndicated Loans

Section B: Triggers

**Question 1.** If the ARRC were to adopt one or more sets of 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?

**Answer:**
- We believe that the best option is the amendment approach and then to shift to a hardwired approach when a term SOFR rate or another market-agreed benchmark develops.
- However, the concern with the amendment approach is that there could be a rush to amend a large volume of loan documentation as the date of the discontinuation of LIBOR approaches.

**Question 2.** (a) Should fallback language for business loans include any of the pre-cessation triggers (triggers 3, 4 or 5)? If so, which ones?

**Answer:**
- Yes, we support triggers 3, 4 and 5.
- We also support an additional “catchall” trigger that would transition the loans to a replacement reference rate in other relevant events, as appropriate.

(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.

**Answer:**
- One concern is that triggers 3-5 would not conform to standard derivatives documents and a misalignment between the syndicated loans and the associated derivatives documents could result. While the triggers make sense from a loan perspective, misalignment is a concern.
- There is also a concern as to whether derivatives that include the additional pre-cessation triggers (triggers 3-5) could be cleared.

(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?

**Answer:**
- We encourage the ARRC to work with ISDA to determine whether the pre-cessation triggers could be included as possible fallback triggers for derivatives contracts (either a mandatory or opt-in trigger).
- We also encourage the ARRC to work with the major central counterparties (CCPs) to ensure that derivatives which include the pre-cessation triggers can be cleared.
**Question 3.** (a) Is an “opt-in” trigger appropriate to include? Why or why not? (b) If you do believe an “opt-in” trigger should be included, do you prefer the approach in the hardwired proposal or the amendment proposal? Please explain.

**Answer:**
- Yes, if a term SOFR rate or another market-agreed benchmark rate has developed, there should be an opt-in trigger. However, work needs to be done to figure out what the appropriate trigger should be.

(b) If you do believe an “opt-in” trigger should be included, do you prefer the approach in the hardwired proposal or the amendment proposal? Please explain.

**Answer:**
- At this point there is no term SOFR rate or another market-agreed benchmark rate; therefore, we believe the optimal approach is to use an amendment approach until a term SOFR rate or another market-agreed benchmark develops.

**Question 4.** Are there any other trigger events that you believe should be included for consideration? If yes, please explain.

**Answer:**
- We support an additional “catchall” trigger that would transition the loans to the replacement reference rate in other relevant events, as appropriate.

**Section C: Replacement Benchmark**

**Question 5.** If the ARRC has recommended a forward-looking term rate, should that rate be the primary fallback for syndicated loans referencing LIBOR even though derivatives are expected to reference overnight versions of SOFR? Please explain.

**Answer:**
- Yes, the ARRC recommended forward-looking term rate should be the primary fallback for syndicated loans referencing LIBOR. Ideally all product classes would move towards this forward-looking term rate, whether it is term SOFR or another market-agreed benchmark rate.
- Sophisticated firms (such as banks and other large financial institutions) may manage their exposures to term SOFR and compounded SOFR separately. Firms may have to put capital against, and incur basis risk for, any mismatch between their loans and the related hedges; corporations may have more flexibility. However, a bifurcation in the market between lenders that use swaps and those which do not is likely not to be sustainable or desirable. It is very likely that the methodologies would ultimately align with the derivatives market.

**Question 6.** Should the administrative agent (by itself or with some other party) be able to eliminate certain interest period options if there are no equivalent SOFR terms available? If so, consider the following options: (i) the administrative agent (and/or some other party) may remove all interest periods for which there is not a published term rate or (ii) the administrative agent (and/or some other party)
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?

Answer:
- We support the following approach:
  - Required Lenders should have the ability to eliminate certain interest period options if there are no equivalent term SOFR rates or other market-agreed benchmark rates available.
  - Current credit agreement language defaults to base rate if lender consent is not provided. This limits the holdup value each lender has. Provisions should be included to the effect that lenders cannot unreasonably withhold consent.

**Question 7.** 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?

Answer:
- Yes. Alignment with the derivatives market (which is expected to select compounded SOFR) is key. It is important to align the loan and derivatives documentation as much as possible.

**Question 8.** If you believe that Compounded SOFR should be included, would a Compounded SOFR in advance or Compounded SOFR in arrears be preferable for syndicated loans? Please explain.

Answer:
- While the preference for the loan market is a forward-looking rate, the stronger preference is to have the derivatives and loan documentation align. As a result, the loan market should use a compounded SOFR in arrears methodology if the derivatives market goes in that direction. We note that this methodology is already in place for several existing replacement reference rate products.

**Question 9.** Is Overnight SOFR an appropriate fallback reference rate for syndicated 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)? Would this preference be influenced by whether ISDA implements fallbacks referencing compounded SOFR or overnight SOFR? Please explain.

Answer:
- Overnight SOFR (plus a credit spread) is the appropriate fallback for the time being, recognizing that the industry may negotiate other fallbacks over time. This is regardless of whether ISDA implements fallbacks referencing compounded SOFR and overnight SOFR.
  - This could result in a divergence between syndicated loans and their associated hedges and permanent basis between the product classes.

**Question 10.** Is it acceptable to fix one observation of Overnight SOFR as the reference rate for a loan lasting three months (or longer)? Would lenders refuse to offer longer-duration loans if they were priced over one Overnight SOFR observation? Please explain.

Answer:
- No. Lenders would generally not offer longer dated duration if they were priced overnight. There is a potential mismatch between funding and duration.

**Question 11.** *Is there any another 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?*

**Answer:**
- The waterfall in the hardwired approach is comprehensive.

**Section D: Spread Adjustments**

**Question 12.** *Do you believe that the ARRC should consider recommending a spread adjustment that could apply to cash products, including syndicated business loans?*

**Answer:**
- Yes, the ARRC should consider recommending a spread adjustment for cash products. The regulators have the authority and clout to recommend a spread adjustment that could be adopted broadly in the market. This would be particularly needed if there is material impact as a result of transitioning to a new replacement reference rate.
- Alternatively, the ARRC could recommend a methodology for the spread adjustment which allows for a more dynamic spread.
- While some vendors are trying to occupy this space (ex. ICE), it is unclear if they would have the authority or influence to recommend a spread adjustment that would be widely accepted.

**Question 13.** *Is a spread adjustment applicable to fallbacks for derivatives under the ISDA definitions appropriate as the second priority in the spread waterfall even if syndicated business loans may fall back at a different time or to a different rate from derivatives? Please explain.*

**Answer:**
- Alignment between loans and derivatives contracts is paramount; the aim should be to maintain this consistency. Some lenders, seeking alignment, may even want this as the first priority (this would get rid of basis risk between the loan and the derivative). If there are different rates used (term vs compounded rate), the adjustments could be different.

**Question 14.** *Is there any another spread adjustment that should be added to the hardwired approach 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?*

**Answer:**
- It is hard to answer this question, as there is not yet a developed term SOFR or another market-agreed benchmark rate. As a result, we don’t currently recommend the hardwired approach.
- With the development of the term SOFR rate or another market-agreed benchmark, a hardwired approach could be transitioned to over time.

**Section E: Lender Vote**
Question 15. (a) Under the amendment approach proposal, if parties are selecting a replacement rate through the amendment process, should the objection of the Required Lenders be by class (if applicable) (see clause (b) of the section titled “Effect of Benchmark Discontinuance Event” in Appendix I)? Why or why not?

Answer:
- Required Lenders vote should not be by class. The economics of the reference rate should be consistent across the credit agreement.
- There should be negative consent rights for Required Lenders; this is consistent with what current loan documentation provides.

(b) Under the amendment approach proposal, if parties choose to select a replacement rate through the “opt-in” amendment process, should the affirmative consent of the Required Lenders be by class (if applicable) (see clause (b) of the section titled “Effect of Benchmark Discontinuance Event” in Appendix I)? Is affirmative consent appropriate or should negative consent be considered instead? Please explain.

Answer:
- I) Vote should not be by class.
- II) Negative consent is appropriate given this is consistent with current loan documentation for changes to reference rate.

Question 16. (a) Under the hardwired approach proposal, if parties must fallback to selecting a replacement rate through the amendment process because none of the options in the replacement rate waterfall are available, is the objection of the Required Lenders by a class appropriate (if applicable) (see clause (d) of the section titled “Effect of Benchmark Discontinuance Event” in Appendix II)? Why or why not?

Answer:
- Yes, objection of Required Lenders (not by class) is appropriate.

(b) The hardwired approach proposal provides two bracketed options for a successful declaration of the “opt-in” amendment process - Required Lenders (typically a majority) vs. supermajority (2/3) of lenders (see clause (B) of the definition of “Benchmark Transition Determination” in Appendix II). What should be the standard affirmative lender voting threshold for consenting to the “opt-in”? Please explain.

Answer:
- Required Lenders opt in, not by class. Our preference is for a majority threshold, not a 2/3 supermajority. The latter hinders an efficient transition.

Section F: Role of the Administrative Agent

Question 17. For respondents that act as administrative agents in the syndicated 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 term SOFR if there is a missing middle maturity and, (v) execute one-time or periodic technical or operational amendments to allow the administrative agent to appropriately administer the replacement benchmark? Please respond to each and explain.

Answer:
- (i) Yes, we would work with the borrower to identify a new reference rate. Where there is a change to the reference rate, we would work with the borrower to develop the spread in order to ensure the same all-in yield. Ideally, we would look to regulators for guidance on the spread adjustment.
- (ii) We would work with borrowers and lenders to determine if a trigger has occurred.
- (iii) Yes, only if new syndicated loans have started to adopt a new benchmark interest rate.
- (iv) We would calculate as per the loan agreement. Agents would not interpolate unless the borrowers and lenders agree to interpolation methodology in the loan documents.
- (v) The preference would be to execute a one-time operational amendment to allow the administrative agent to administer the replacement benchmark. It is administratively impossible to do periodic or ongoing amendments. Banks have hundreds of credit agreements, and it would be impossible to have periodic or ongoing notifications for changes.

**Question 18. 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?**

Answer:

- Yes, the replacement rate should be published on a screen by a third party as this would eliminate questions from the syndicate. We have not seen spread adjustment published on a screen, but believe this could provide greater market transparency, especially if published by regulators.
- This can be done if the only adjustment is to account for the difference between the old and new reference rates.

**Question 19. Given that market practices and conventions may change over time, should the administrative agent’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?**

Answer:

- Administrative agent should confirm changes only at the point of transition. Periodic or ongoing changes are administratively impossible.

**Section G: Operational Considerations**

**Question 20. How important is it for the fallback rate to be available prior to making a narrowing/advancing funds? For instance, if the rate was a compounded three-month rate calculated at the end of the interest period, would that be problematic? Please explain.**

Answer:

- It is important for the fallback rate to be available prior to narrowing/advancing funds. We foresee a number of issues that would arise if the rate is calculated at the end of the interest period.
  - Finance – From a finance perspective, it is not acceptable to delay revenue recognition until the end of the accrual period (i.e. cash based accounting). It may be possible to estimate and “recognize” the accrued interest revenue over the accrual period. However, those estimates must be corrected once the true interest rate is known and
there is a possibility of material deviation between actual and estimated accrued interest.

- Treasury and Corporate Banking – There is a risk that the funding rate (set at the beginning of the accrual period) may turn out to be lower than the realized interest rate, making the costs of providing the loan greater than the revenue generated. Another issue is the mechanics of a borrower prepaying the loan prior to the maturity (how would the interest rate be calculated, how would breakage costs be calculated, etc.).
- IT and Systems – A firm’s internal systems may not be able to handle an interest rate determined at the end of an accrual period. This is a much greater issue for smaller firms.
- Clients – Clients are used to having a forward-looking term rate available to them at the beginning of an interest accrual period. It gives them certainty as to what interest payments would be due at the end of the period.

**Question 21. Are there operational concerns about having the ability to convert many loans over a very short period of time? Please explain.**

**Answer:**
- We believe that the smoothest way is to convert each loan on the last day of its interest period to avoid breakage cost. Volume also is a big concern here.
- There are concerns with transitioning a large volume of loans over a short period of time through the amendment approach. A shift to the hardwired approach once term SOFR rate or another market-agreed benchmark has developed would prevent this.

**Question 22. Do you see other operational challenges that fallback language should acknowledge or of which the ARRC should be aware? Please explain.**

**Answer:**
- Other than the issues noted above, we do not foresee any other operational challenges.

**Section H: Bilateral Loans**

**Question 23. What modifications to the syndicated loan consultative language may be helpful to market participants as they consider more robust fallback language in a bilateral or single-bank business loan context, if any? Please explain. Specifically, what modifications to the language may be appropriate in instances in which the bilateral loan is fully or partially hedged? Please explain.**

**Answer:**
- There are similar issues across syndicated and bilateral loans. However, it may not be as complex as syndicated loans as there is only one lender facing one (or more) borrower(s).

**Section I: General Feedback**

**Question 24. Are there any provisions in the fallback language proposals that would significantly impede syndicated loan originations? If so, please provide a specific and detailed explanation.**

**Answer:**
- We have no further comments on this point other than what we have outlined above.
Question 25. Please provide any additional feedback on any aspect of the proposals.

Answer:
- Ideally, the fallback would be a forward-looking term rate if one develops to be consistent with cash products currently.
- A key goal is alignment between the derivatives and cash products.
- Firms wish to avoid mismatches between the rates at which they access funding and the rates which are charged to clients on syndicated loans.
- The transition from LIBOR to SOFR or another market-agreed rate will pose significant operational challenges on market participants. These issues include: product valuation and risk management, updating internal systems/models, cross-currency market (the characteristics of the alternatives rates differ between jurisdictions), harmonization of the transition across products/jurisdictions, and tax/accounting.