Syndicated Loans Consultation - Response to ARRC

Our respondees by a large margin preferred the option called the ‘amendment approach’ for the Syndicated Loans legal amendment language (the topic of this consultation). This is largely due to uncertainty related to both development of and timing of development of the SOFR benchmarks. A list of suggested steps that will help insure adequate market functioning of the SOFR benchmarks appear in ‘question 1’.

A. CHOICE OF THE TWO FALBACK PROPOSALS

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?

Composite Response: We choose the Amendment Approach (‘AA’), which is an agreement to enter accelerated negotiations to choose the LIBOR replacement benchmark at some point prior to demise. The principal reason for this choice is that it allows us to be sure that all the development steps for the SOFRs are highly likely or certain to be completed, before committing to SOFR legal language. This is a wait and see approach which will allow us to enter agreements with customers, before gaining full certainty on SOFR.

We also believe here is merit to a spelled out path like the Hardwired, waterfall of SOFRs, although it is agreed we have to take note of possible risks.

Suggested support features that will help insure adequate market functioning for the SOFR benchmarks are:

- FASB compliant hedging tools for the waterfall-selected SOFR (no basis risk).
- More complete ARRC methodology articulation for ‘adjustment spreads’ for the waterfall-selected SOFR.
- Assurance that deep and wide bank funding market in SOFR are developing.
- Although self-evident, a reliable, cleared basis swap to map the waterfall-selected SOFR to Banks Cost of Funds.

B. TRIGGERS

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? (b) Please indicate whether any concerns you have about these pre-cession triggers relate to differences between these triggers and those for standard derivatives or relate specifically to the pre-cessation triggers themselves. (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?
**Composite Response:** (a) Trigger three, four, and five, should be included. (Answer assumes the implementation timing under ‘replacement date’). We also believe that trigger 4 may not be necessary. (b) Not applicable.

**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.

**Composite Response:** (a) Yes. Primary purpose is to allow us to take action early to get our institution’s book ready well in advance of demise. (b) Prefer the Amendment Approach’s Opt in trigger.

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

**Composite Response:** No. It has been covered by the above.

**C. THE REPLACEMENT BENCHMARKS IN THE HARDWIRED APPROACH WATERFALL**

**Step 1 Benchmark: Term SOFR**

**Question 5:** If the ARRC has recommended a forward-looking term rate [e.g. Term SOFR], 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.

**Composite Response:** Yes. Our preliminary understanding is that Term SOFR can be accurately hedged by the ISDA swaps.

**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?

**Composite Response:**

The response from our Syndications Transaction Management team is No, the administrative agent (by itself or with some other party) should not be able to eliminate certain interest period options if there are no equivalent SOFR terms available. The elimination of certain interest period options should be decided by the required/majority lenders and that decision should be directed to the administrative agent.
In terms of the remainder of the question, regarding non published interest periods, the interpolation protocols currently used for LIBOR could apply. Specifically, use point ‘(ii)’ in the question because interpolation is generally a simple, auditable process which the entire market is familiar with.

**Step 2 Benchmark: Compounded SOFR**

**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?

**Composite Response:** Yes. Reason is the high likelihood that the ISDA swaps will hedge Compounded SOFR accurately. Second question, yes, for the same reason.

**Our institution’s recent response to the ISDA on this topic:** Yes. Compounded is less volatile than the O/N Rate. And, as the ISDA has no Term SOFR yet, Compounded SOFR is the closest IDA has match to the market’s term structure.

This answer considers the ‘adjustment spreads’ likely to be applied to Compounded SOFR (see question 13 Background note)

**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.

**Composite Response:** ‘In advance’. For a borrower, knowing the exact interest cost in advance of a drawing or a roll over is customary, paramount and in most cases non-negotiable. We also believe that the ‘in arrears’ option will be preferable for other products. For example, in our response (see immediately below) to the July ISDA public consultation, our institution chose ‘in arrears’ as the number 1 choice, but that followed closely by ‘in advance’ as the number 2 choice (2nd out of 9 so almost equally attractive).

**Our institution’s recent response to the ISDA on this topic:** In Arrears is the 1 choice, as it reflects actual rate movements and is the closest match to the term structure. Note however that ‘in advance was our institution’s second choice (#2 out of 9 choices given by the ISDA).

**Step 3 Benchmark: Overnight SOFR**

**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.

**Composite Response:** The consensus is ‘No’ on O/N SOFR.

**Our institution’s recent response to the ISDA on this topic:** No. Spot overnight was the 9th out of 9 ISDA choices at our institution. **However** note, ‘convexity adjusted spot’, a variation, was 4th out of 9. Importantly, convexity adjusted spot does not ignore the effect of term, even before considering that
‘forward looking’ adjustment spreads will also be available, i.e. and being 4th brings it much closer towards our top choice in the ISDA consultation.

**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.

**Composite Response:** The consensus is ‘No’ on O/N SOFR. We would not cease to offer longer duration loans, we would simply use another benchmark if O/N SOFR were the only option.

**Our institution’s recent response to the ISDA on this topic:** No to spot overnight. (‘Spot overnight’ was the 9th out of 9 choice for our institution.) (However, ‘Convexity adjusted spot’ was our 4th out of 9 choice.)

**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?

**Composite Response:** Nothing specific suggested.

**D. SPREAD ADJUSTMENTS**

**Step 1 Spread: ARRC 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?

**Composite Response:** Yes, although our suggestion is further articulation and disclosure of the spread adjustment methodology of ARRC.

**Step 2 Spread: ISDA Spread Adjustments**

**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.

**Composite Response:** Yes. Please also see answer to Q 12 above.

**Our institution’s recent response to the ISDA on this topic:** Yes in general - to the planned ISDA adjustment spreads. Background note: ISDA is seeking feedback on several alternative spread adjustment methodologies, which include options we like such as ‘forward looking with credit risk, and term risk components’.

**Adding of Other Spread Adjustments**
**Question 14:** Is there any another 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?

**Composite response:** No need for other spread adjustments.

**E. LENDER VOTES**

**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?  
(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.

**Composite Response:**  
(a) Negotiated matter. You can’t standardize answers to these questions. Voting rights for each class of lenders are usually determined on a per deal basis and would be subject to comment by the various parties negotiating the document.  
(b) Yes, same reasoning as ‘a)’.

**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?  
(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.

**Composite Response:**  
(a) Negotiated matter. You can’t standardize answers to these questions. Voting rights for each class of lenders are usually determined on a per deal basis and would be subject to comment by the various parties negotiating the document.  
(b) Majority. As you are already in the hardwired approach in this question, the member banks have already adopted the major parts of the process.

**F. THE 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.

Composite response:

(i) No. It will be essential to have fairly wide-spread industry consensus on a benchmark since the entire industry faces LIBOR demise simultaneously. We also believe a ‘Yes’ answer has other merits, (for Agent banks, not Admin Agents as they receive instructions regarding decisions of the majority lenders) as banks must work with their individual customers. (ii) Yes, (iii) Yes. It would be required in any case. (iv) Yes. (v) Yes.

**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?

**Composite Response:** Yes, this assists with transparency in the process.

**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?

**Composite Response:** No. Market will not accept this as a blanket right.

**G. OPERATIONAL CONSIDERATIONS**

**Question 20:** How important is it for the fallback rate to be available prior to making a borrowing/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.

**Composite Response:** ‘In advance’. For a borrower, knowing the exact interest cost in advance for an initial funding or draw , customary and likely nonnegotiable. We also believe there is merit in the ‘in arrears’ option, as it will be preferable for other non loan products. For example, in our response (see immediately below) to the July ISDA public consultation, our institution chose ‘in arrears’ as the number 1 choice, but that followed closely by ‘in advance’ as the number 2 choice (2nd out of 9 so almost equally attractive).

**Our institution’s recent response to the ISDA on this topic:** Having rate up front important, but In Arrears is best for Compound SOFR. In Arrears therefore was our first choice. However, our second choice (2nd out of 9) was Compound SOFR in Advance.

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

**Composite Response:** Yes, the LIBOR portfolio must be amended in well in advance with the mutually agreed fallback plan. Loan systems must be able to handle the new rate, plus other updates must be in place (MIS reporting, policy revisions, procedure revisions, training etc.)
Question 22: Do you see other operational challenges that fallback language should acknowledge or of which the ARRC should be aware? Please explain.

Composite Response: Yes, comments include: “at the time of demise, clients will want to shop around again to insure they are getting the best spread adjustment and margin”; and “some banks will have skewed portfolios and will reject any one size fits all amendment”.

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.

Composite Response: We have separately shared our comments for consideration.

I. GENERAL QUESTIONS

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.

Composite Response: We have included suggestions herein which reduce or eliminate these risks.

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

Composite Response: See above. Also, one respondee expressed that the historical mean approach for adjustment spreads, found in the ISDA consultation, should be a serious contender, as it makes the most sense of any fallback spread adjustment approaches, and while it may create winners and losers, it is simplest and most straight-forward.