ARRC Syndicated Loans Consultation Response – BMO Capital Markets

Questions

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?

Response: BMO Capital Markets ("BMO CM") is of the opinion that the hardwired approach is the appropriate approach for business loan fallback language. BMO CM prefers this approach because it reduces uncertainty and avoids the instability and resourcing issues that might result from attempting to amend thousands of transactions within a short period.

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?

Response: Yes, business loan fallback language should include all of the pre-cessation triggers. The triggers are helpful because they address a deterioration in the quality of Libor, in advance of a complete discontinuation. The triggers will also help BMO CM deliver a better customer experience as some borrowers have a strong desire for clarity. While there are still various unknowns in the Libor transition process, the hardwired approach and the pre-cessation triggers provide more comfort that there is a plan and a process to ensure a smooth transition away from Libor. Pre-cessation triggers will help mitigate the risk a borrower could assert contract frustration. This approach will also serve an important function in disclosing to borrowers that there is a risk that Libor could significantly deteriorate or cease.

(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.

Response: The primary concern related to pre-cessation triggers is the possibility of a mismatch with a hedge. Not every transaction, however, includes a hedge and it is encouraging that ISDA is working or will be working to develop templates to include similar triggers in hedges.

(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?

Response: BMO CM is concerned about the potential risks from the prospect of a weakened Libor. We do not see a viable option for managing the potential risks outside of pre-cessation triggers. For this reason BMO CM supports the efforts to standardize the options and approach.

Question 3:

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

Response: Yes, an "opt-in" trigger would be appropriate to include as it provides flexibility which will enhance stability.

(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.

Response: BMO CM believes an "opt in" trigger should be included, and consistent with our general views, we prefer the approach in the hardwired proposal. We think it's important that the agent plays a key role, and that the agent has some control over the process.

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

Response: BMO CM has not identified any additional trigger events and believes the current, suggested triggers are thorough.

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.

Response: Yes, BMO CM prefers a forward-looking term rate. Overnight rates can have spikes or fluctuations which make them a less reliable indicator for setting a term rate. Our preference is to have a fallback rate that is consistent with ISDA provisions, since term rate management will have basis risk if hedged using the compounded overnight reference rate. As such, the various forward-looking term rates would be welcome if supported by ISDA, FASB, IOSCO, etc. and are used in/ become part of the derivatives trading universe. Additionally, BMO CM is of the opinion that it would be greatly beneficial if a relevant government body was responsible for the fixing/setting, publication, and endorsement of the forward-looking term SOFR rates.

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?

Response: Yes, the administrative agent should be able to eliminate certain interest period options if there are no equivalent SOFR terms available. BMO CM prefers option (i) "… remove all interest periods for which there is not a published term rate …" An interpolated rate can be quite inaccurate if interpolation is done over terms that are far apart, e.g. interpolating 3M SOFR from 1M and 6M rates.

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?

Response: Yes, compounded SOFR should be included if it is the ISDA fallback rate. ISDA implementation is preferable. BMO CM otherwise does not have a strong preference whether to include compounded SOFR if it is not chosen as the ISDA fallback rate.

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.

Response: BMO CM's preference is to have a fallback rate consistent with the ISDA fallback rate, which will likely be the compounded in arrears rate. We recognize that the "in arrears" approach is not ideal for syndicated loans, since the interest rate will not be known at the start of the interest period. We anticipate that this will be a challenge for borrowers.

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.

Response: BMO CM is of the opinion that the final step in the replacement rate waterfall should be the Compounded SOFR.

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.

Response: BMO CM is of the opinion that it is not acceptable to fix one observation of Overnight SOFR as the reference rate for a loan lasting three months (or longer). A fixing based on a single observation of an Overnight SOFR rate can be volatile, especially at month end. This would expose lenders to unnecessary volatility.

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?

Response: No, there are no other replacement rates that BMO CM believes should be added to the hardwired approach waterfall before parties move to the streamlined amendment process.

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

Response: BMO CM does not believe that it is absolutely necessary for the ARRC to consider recommending a spread adjustment that could apply to cash products, including syndicated business loans. This may, however, be beneficial if the consensus is to use a fallback rate that is different from the rate recommended by ISDA.

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.

Response: BMO CM is of the opinion that an ISDA spread adjustment is appropriate if the fallback rate choice is the same as the one recommended by ISDA. If the recommended rates are not the same, however, it would not be appropriate.

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?

Response: No, BMO CM does not believe any other adjustment is needed. The spread adjustments in the waterfall structure should be sufficient.

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?

Response: No, the objection of the Required Lenders should not be by class, simple is better. If the amendment approach is adopted and the market moves in that direction, there will be disruption at the time of Libor cessation. Class voting could complicate and delay the transition process.

(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.

Response: No, the affirmative consent of the Required Lenders should not be by class, again simple is better. If the amendment approach is adopted and the market moves in that direction, there will be a disruption at the time of Libor cessation. Class voting could complicate and delay the process. Negative consent is a better option.

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?

Response: No, the objection of the Required Lenders by class is not appropriate, simple is better. If the hardwired approach is adopted, and the options in the replacement rate waterfall are not available the parties will fallback to the amendment approach. There will be a disruption at the time of Libor cessation. Class voting could complicate and delay the process.

(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.

Response: BMO CM is of the opinion that simple is better and the Required Lenders (typically a majority) would be preferred approach over the requirement for a supermajority of lenders.

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.

Response: Yes, BMO CM would be willing to complete these tasks as needed. BMO CM would prefer not to, but understands that these responsibilities may fall on the admin agent. BMO CM is most concerned about (iv) interpolate term SOFR if there is a missing middle maturity, because it is an activity unlike any BMO CM currently performs as admin agent, and it appears to be the most prone to allegations of error or wrongdoing.

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?

Response: Yes, BMO CM believes it would be helpful if any replacement rate and/or applicable spread adjustment be published on a screen by a third party. This would ensure consistency and transparency.

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?

Response: Yes, the admin agent should have the ability to make conforming changes on a periodic, ongoing basis. Flexibility is desirable, and this would simplify the process of making conforming changes.

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.

Response: BMO CM anticipates that it will be very important for our customers to know the rate before they borrow. Not having the rate in advance, or at the time of the borrowing, exposes them to uncertainty.

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

Response: Yes, BMO CM believes there are operational concerns from both a documentation perspective and a back office perspective. It would take significant resources on both those fronts to complete the amendment process at the time of a Libor cessation.

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

Response: BMO CM has not identified any other operational challenges that fallback language should acknowledge or of which the ARRC should be aware.

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.

Response: BMO CM envisions similar language, but without the co-lender provisions. BMO CM is of the opinion it would be helpful for the bilateral market to have standard fallback language, and to have language that is consistent with and closely tracks the language for the syndicated market, with modifications, as appropriate, to recognize that there is no agent.

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.

Response: BMO CM has not identified any provisions in the fallback language proposal that would significantly impede syndicated loan originations. BMO CM believes it is better for the loan market to have standard language.

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

Response: BMO CM does not have any further comments at this time.