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Via Email to arrc@ny.frb.org

November 13, 2018

Alternative Reference Rates Committee (ARRC)
Board of Governors, Federal Reserve System
New York Federal Reserve

Re: Consultation Response – Syndicated Business Loans

To the Members of the ARRC:

Please accept this letter as the internally coordinated response from Umpqua Bank (the "Bank"). The Bank's commentary on the "ARRC Consultation Regarding More Robust LIBOR Fallback Contract Language for New Originations of LIBOR Syndicated Business Loans" follows.

Background

As a community financial institution with $26.6 billion in assets, we have approximately $8 billion or 40% of our loan portfolio referencing LIBOR. The composition of this exposure includes Multi-family loans, Residential mortgages, Commercial real estate mortgages, and Commercial & Industrial (C&I) lending. Our C&I lending includes both bilateral loans and syndicated credits. In addition to the on-balance sheet exposure, we also facilitate derivative transactions on behalf of our commercial clients.

Approach to Fallback Proposals

(Question 1) The Bank has reviewed the ARRC's proposed adoption of business loan fallback language and, of the options presented – amended or hardwired – we generally prefer the hardwired approach. However, we have concerns about this approach as presented; and would look to obtain a clearer understanding of SOFR's Term Option and Compounded SOFR, as well as the impact of ISDA and ARRC deviating from each other (should that occur) and the influence that may have on lenders' approaches. We wish to highlight that we view the inclusion of negative consent by Required Lenders in the hardwired approach as a positive. The Bank currently uses the negative consent amendment approach.

Triggers

Pre-Cessation Triggers

(Question 2(a)) It is the Bank's opinion, assuming the incorporation of ISDA fallback triggers 1 and 2 in the definition for USD LIBOR, that fallback language for business loans should include pre-cessation "Benchmark Discontinuance Event" triggers 3, 4 and 5 to transition to a SOFR-based alternative rate. This is based on our desire to avoid an index mismatch on agreements when there is a corresponding derivative

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product, possibly via a carveout for discretion provided to the Agent/Required Lenders, particularly on a hardwired approach.

The Bank deems trigger 5 to be a necessity since, as the final LIBOR publishing date approaches, several events could occur to impact the volatility, or meaningfulness, of the published LIBOR rates due to the survey mechanics of the existing process. Specifically, continued, sharp declines in LIBOR credit volumes could create more rate volatility due to ever fewer LIBOR observations, and a change or reduction in participating financial institutions engaged in the survey could create a mix shift in the data points used to calculate LIBOR. The presence of pre-cessation language would allow banks and borrowers to adapt their credit terms; and avoid volatile rate reset periods during the waning months/quarters of LIBOR.

(Question 2(b)) The Bank is also concerned that a disconnect in triggers (if Traded products can move sooner than Credit products) would create basis risk/yield curve risk, an issue our clients are already concerned about today. SOFR is an overnight rate, while LIBOR-based credit products commonly reference one-, three-, and six-month term points.

(Question 2(c)) In contrast, if pre-cessation triggers are not included in fallback language, it would seem the only approaches then available would be a loan amendment or the acceptance of increased regulatory and legal risk (and the potential need to underwrite that additional risk). The lenders or borrower may disagree about timing, risk, or other elements, which would make it difficult to push through a loan amendment. Although agreements tend to contain provisions to allow the selection of a new reference rate to replace LIBOR, these provisions are, in some cases, a bit unreasonable for the borrower or create a synthetic LIBOR, which is not ideal. Lenders may want to consider having another index (such as Fed Funds) as a hardwired backup if triggers 3, 4, and 5 are met, but lenders/borrower cannot agree to amend.

Early Opt-In Triggers

(Question 3(a)) The Bank also supports an opt-in trigger approach to reduce risk by promoting a reduction in LIBOR-based loans prior to a LIBOR discontinuance, as this would allow lenders to better manage their document/note conversion workloads. Given our size and complexity, this is less of an issue for syndicated credits, but is an extremely important consideration for the thousands of bilateral loans in our portfolio that will be affected.

(Question 3(b)) Both the amendment and hardwired approach “Benchmark Transition Determination” opt-in triggers would work for the Bank. As noted above, we prefer the hardwired approach, and would point out that the opt-in trigger for that approach seems to only mention Term SOFR; and wonder if the Compound SOFR might be considered. Overall, Term SOFR is preferred (which should have the same term-points as LIBOR today); however, if Term SOFR is not as robust, the hardwired approach should also include Compound SOFR.

Other Potential Triggers

(Question 4) As noted, the Bank is concerned that the ARRC may deviate from ISDA’s approach, and we suggest consideration of an additional trigger to manage a derivative index change that triggers a loan index change to avoid a mismatch (basis risk).

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Replacement Benchmark Waterfall

Step 1. Forward-Looking Term SOFR

(Question 5) The Bank has concerns about the use of a forward-looking term SOFR as the primary fallback for syndicated loans referencing LIBOR when derivatives reference overnight versions of SOFR. Ideally, term point availability between credit and traded products should be aligned. Banks may lose revenue and customers/borrowers might be exposed to **more** interest rate risk if a disconnect makes it less attractive to obtain a derivative hedge. The Bank prefers a forward-looking term rate with the same term-points as currently available with LIBOR, if possible.

(Question 6) However, if no equivalent SOFR term-points are available, the administrative agent must be permitted and be able to address the issue. The Bank prefers an option that allows the administrative agent to remove all interest periods for which there is not a published term rate if SOFR establishes limited term-points, and interpolation is used. We have concerns about Term SOFR as currently described, and our ability to reasonably interpolate a rate. As the discussion around Term SOFR progresses, we may be willing to accept as well as issue an interpolated rate.

Step 2. Compounded SOFR

(Question 7) The Bank agrees that Compounded SOFR should be included as the second step in the Replacement Benchmark Waterfall but, as described in the September 24, 2018 ARRC Consultation, a new calculation methodology would increase the operational risk to interest rate setting due to the extra process needed in performing a calculation. Compounded SOFR raises several large considerations for us:

- It is largely driven by what ISDA does;
- Impacts to a bank are a function of its level of volume/activity in its swap program; and
- Particularly for bilateral loans, we want the agreements between credit and traded products to be aligned.

It is possible for the Bank to support a Compounded SOFR for our syndicated loans (particularly if it becomes a screen rate, which would be preferable) in advance. We do not recommend a Compounded SOFR in arrears, as it would be an operational difficulty; and would frustrate borrowers as they would have less transparency and clarity about their interest rates. This could also cause additional confusion about the value of interest rate locks. Transparency and clarity for both the bank and the borrower are critical.

(Question 8) A Compounded SOFR in advance is preferred. A lack of interest rate clarity could cause borrowers to start looking toward daily floating options, which would increase operational work volumes. In addition, our accounting system would likely need a significant – and very costly – upgrade to handle calculations in arrears. Lastly, many banks accrue interest income daily. A daily reference rate recalculation could make the accounting process more difficult.

Step 3: Overnight SOFR

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(Question 9) In considering the appropriateness of Overnight SOFR as a fallback reference rate for syndicated loans, the Bank would look for consistency with ISDA-implemented fallbacks; and prefers the use of a Compounded SOFR to a more volatile Overnight SOFR reference rate. Overnight SOFR for longer-term loans seems disconnected and could increase interest rate volatility for both bank and borrower.

(Question 10) The Bank would be reluctant to enter into an agreement with the described Overnight SOFR due to concerns about large interest rate swings, and timing disconnects between interest income resets and our funding strategy/cost-of-funds resulting in reduced net interest margin.

The Bank recognizes that there are fundamental differences between the SOFR "risk-free" rate and LIBOR, which captures credit risk. Day-to-day drivers such as fiscal policy and geo-politics in the news will bring new variables into the daily output. The possibility exists that borrowers may show increased demand for fixed-rate loans to control for volatility. Using a comparison of the daily data for SOFR versus 3-month LIBOR in September/October 2018 as an example, we can see that SOFR increased by more (in bps) than 3-month LIBOR over that time horizon and had a more volatile up/down daily percentage change. SOFR also has issues with large volatility on certain days, which also opens a large risk to banks selecting a poor representation of even a 3-month term.

Other Fallback Rates

(Question 11) In contemplating another potential replacement rate for the hardwired approach waterfall, the Bank notes that FHLB interest rates are published across the different FHLB districts for numerous term-points and structures. We posit that a replacement rate based on an aggregated, calculated and statistically "sanitized" (to account for possible variances between rates for the same term-point across FHLB banks) FHLB set of rates might be created and considered as a replacement rate to be used before Step # 3 of the waterfall.

Spread Adjustments

Step 1: ARRC Spread Adjustment

(Question 12) The Bank favors the use of an ARRC-recommended spread adjustment for cash products, including syndicated and bilateral loans. There will be concerns by borrowers that any spread adjustment will be unequitable or disadvantageous to them. A recommended and publicized ARRC spread adjustment, as well as industry-wide borrower education and outreach, will be key to applying any spread adjustment; and the use of a consistent spread across the industry may alleviate borrower concerns.

Although a spread adjustment is needed, the volatility of SOFR versus today's (as an example) more stable 3-month LIBOR term point would make it a challenge to pick the "right" spread. Ultimately, the goal is to identify a spread adjustment that factors in the difference between the "risk-free" SOFR and the credit risk capturing LIBOR. However, determining this spread adjustment could include qualitative components. While a purely quantitative approach would be ideal, and the easiest to explain to borrowers; there would likely be noise in a historical/statistical analysis. For example, the spread between 3-month LIBOR and SOFR has decreased since 6/1/18 from 51bps to 26bps as of 10/16/18. Was this driven by SOFR process/calculation refinements, the Treasury market, or a change in relationship between financial institution credit risk and Treasuries? More data will be needed to ensure the credit spread selected doesn't punish the borrower or the bank.

Step 2: ISDA Spread Adjustment

(Question 13) The Bank does not consider a spread adjustment applicable to fallbacks for derivatives under anticipated ISDA definitions appropriate. We do not favor using a spread adjustment that is fixed, or one that fixes based on a trigger event, as that event could occur on a date such as a quarter end, which may not be a reasonable adjustment.

Other Spread Adjustments

(Question 14) In thinking about other potential spread adjustments, the Bank concludes that the spread adjustment will need to be published on a trading screen. Interest rates set offline and independently by lenders, the agent, etc. may not work, particularly on derivatives and syndicated loans.

Lender Vote

The Bank agrees with the proposals to require the affirmative consent of the Required Lenders to be by class in selecting a replacement rate through the amendment or "opt-in" amendment processes under the amendment approach; but notes that negative consent may be preferable in the "opt-in" process.

(Question 15(a)) We deem the "by class" option as optimal when selecting a replacement rate through the amendment process since it provides some assurance for smaller lenders that they can still opine should one or more larger banks attempt to make undesirable choices, or choices that benefit themselves over the lenders. In addition, this option adds the flexibility to handle different facilities in different ways, if warranted.

(Question 15(b)) We see the argument for the "opt-in" portion to be affirmative consent; and would be amenable to it. However, we posit that negative consent may be the best option to provide flexibility to allow for slow moving lenders within the syndication, or lenders who passively agree but can't complete credit requests in time, to make the changes.

As mentioned above, the Bank favors the use of the hardwired approach.

(Question 16(a)) If fallback to selecting a replacement rate through the amendment process was necessary because none of the options in the replacement rate waterfall is available, we would consider a class-by-class change as an option, but it might be operationally difficult to maintain. Renegotiating terms by deal would be a function of the variety/number of banks participating in the syndication, as well as the variability in their individual size, complexity, and interest rate management preferences.

(Question 16(b)) If fallback to selecting a replacement rate through the "opt-in" amendment process became necessary, the Bank would prefer the Required Lenders (majority vote) versus the super majority (2/3 vote) option. The market will generally be moving together, and this event is not surprising (or shouldn't be) and all banks should be prepared for it to occur.

Role of the Administrative Agent

(Question 17) (i) In acting as an administrative agent, the Bank considers working with borrowers vital. Of course, banks would prefer to have protections from a borrower trying to leverage the situation and convert it into an interest rate lowering negotiation. We may not wish to negotiate the "adjustment" rate, as that should be mechanical and set by the market/banks together, rather than independently. (ii) We would be willing to determine whether triggers have occurred; however, we would prefer to have "standardized" triggers, supported by a central group that also opines. (iii) We would also be willing to select screen rates unless they're only published to a screen that would be cost prohibitive to access. (iv) The Bank would possibly interpolate term SOFR; however, we would want the authority to then dictate the rate to other lenders. (v) We would be willing to execute one-time or periodic amendments; however, cost is a consideration here, and the administrative agent shouldn't be unduly burdened.

(Question 18) The Bank deems it necessary for any replacement rate and/or applicable spread adjustment to be published on a screen by a third party. Operationally, we prefer it to be published in a manner that allows for an easy feed into our accounting system. While we could use lookups online, rate screens are easy to use; publish change logs and alerts for our operations staff; and are generally more predictable than other sources. We can also attempt to save on costs when rates are published by a single provider instead of having multiple providers to pay. We also firmly believe the "modifier" or spread adjustment needs to be published so that all lenders are on the same page; and it would possibly allow for inclusion in the ISDA, which would make it possible to hedge the entire rate.

(Question 19) Since market practices and conventions may vary over time, we believe the administrative agent should be afforded some flexibility to make conforming changes. It may be most appropriate to set a limited window for "corrective" updates to be made under rules similar to those in place at the point of the initial change. As market standards change over time, we generally just need to catch those at the earliest amendment point that arises. A one-year window for updates and corrections seems reasonable.

Operational Considerations

(Question 20) As noted above, the Bank deems it important to have the fallback rate available prior to making a borrowing/advancing funds. A fallback rate made in arrears would be problematic for several reasons. Operationally, many of our systems are not configured for this type of occurrence. We also believe customers will not be as interested in forward-term rates if they're suddenly locked into unpredictable rates that seem to provide protection to banks, but not to them. In addition, many lenders have their interest accruals accounted for more frequently than the interest payment date; this would make that inaccurate and banks would have to post retroactive corrective adjustments.

(Question 21) The Bank has two major operational concerns about converting a large volume of loans in a limited timeframe. First, it is a system and manpower challenge to update 100% of legal documents in a timely manner with minimal interruption to the loan payment process. Specific challenges include:

- The coordination of signatures on amendments between all processes.
- Archiving old versus new documentation.
- Personnel and IT system costs to support SOFR conversion.
- Staff could be stretched thin to support SOFR conversion of existing loans versus originating new loans; or servicing existing loans for non-SOFR related reasons.

Second, there is the concern that customers will see this as an opportunity to negotiate more favorable terms (credit, collateral, payment) after funds have been extended.

(Question 22) As fallback language to acknowledge and address operational challenges is developed, the Bank would appreciate the ARRC's consideration of the following:

- Should there be issues in calculating a new interest rate as a function of the waterfall, documentation of the timing of how the waterfall functions in terms of progressing from one waterfall option to the next (or back) would be beneficial. The process and market needed to support Option #1 would need to be established according to a clear timeline. However, assuming Option #1 is not ready for rollout, and a bank progresses to Option #2, if there are issues performing the calculation, would that mean there an immediate progression to Option #3 or do banks wait for Option #2 to be finalized? If Option #1 is "better" but not ready, do banks move to Options #2 and/or #3 temporarily and then move back to Option #1 at a later time?

- The addition of a disclosure stating the bank will not hold the borrower responsible for delays in resetting/recalculating a SOFR interest rate. As mentioned, operational issues exist with several of the SOFR waterfall options. Challenges or delays in calculation would trigger false-positive delinquencies, without systems being able to differentiate the true cause of the delinquency (borrower/credit driven vs. bank/SOFR operational).

Bilateral Loans

(Question 23) The Bank would appreciate the ARRC's consideration of appropriate language when considering bilateral loan consultation with the industry:

A lack of guidance in support of loan purchases/sales could create a disruption to the liquidity of that market. For instance, if a loan is sold between now and the point when LIBOR is formally retired, both the

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buying and selling institution (or agency) would need to agree with the fallback language, waterfall, and spread adjustment.

Also, larger borrowers may be well equipped to understand and accept that, on their syndicated deals, derivatives may change; but on the bilateral deals, it seems additional focus is warranted to ensure derivatives do not somehow become unmatchable to the notes, particularly for existing notes that transition to a new index.

General Feedback

(Question 24) The Bank would appreciate the ARRC's consideration of additional provisions in the fallback language proposals to better facilitate syndicated loan originations.

- Specifications as to how costs are shared and who pays across the participating financial institutions.

- Stronger codification of the consequences of lenders and/or /borrower refusal of the new index, i.e., the syndication falls back to a rate that lenders accept today. This "emergency" fallback could also be an opportunity to take out any dissenting lender(s) as if they were a non-consenting lender generally.

(Question 25) The Bank offers the following additional feedback regarding the SOFR process for consideration:

Given the LIBOR dislocations and operational risk with the current LIBOR process, it is understandable that SOFR has been identified as a solution to remove/mitigate the risk to future financial/credit market disruptions. However, it is our opinion that, as presented, the SOFR process is missing several key components to make it operationally equivalent, transparent, and efficiently executable to banks and borrowers as LIBOR is today.

The limited historical data for SOFR indicates changing relationships with LIBOR; and illustrates some volatility that LIBOR does not have currently. SOFR is a new, somewhat volatile or less understood rate in comparison to the existing LIBOR rate, which was volatile in the past; but has somewhat more market understanding and a comprehensive forward-term framework.

Unknown variables such as U.S. fiscal policy, U.S. dollar demand, and Fed actions along the Treasury curve (now and in the future) create more uncertainty for the use of SOFR. While it is clear LIBOR has flaws and could benefit from more automation and controls, SOFR does not definitively appear to be a less volatile option at this point.

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We appreciate this opportunity to share our comments; and invite the ARRC to contact us for discussion or additional information.

Sincerely,

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