Wolters Kluwer

ARRC Secretariat
Alternative Reference Rate Committee

Subject ARRC *Bilateral Business Loan Consultation Feedback*

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Governance, Risk & Compliance

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Dear Ladies and Gentlemen:

On behalf of Wolters Kluwer, I am respectfully submitting feedback on selected questions relative to the ARRC's Bilateral Business Loan consultation. Wolters Kluwer greatly appreciates the leadership of the ARRC and its members in developing potential U.S. dollar (USD) LIBOR fallback contract language and alternatives in the bilateral business loan consultation as well as the other important consultations.

Wolters Kluwer provides numerous compliance solutions and services to the financial services industry. Wolters Kluwer Governance, Risk & Compliance (GRC) is a division of Wolters Kluwer which provides legal, finance, risk and compliance professionals and small business owners with a broad spectrum of solutions, services and expertise needed to help manage a myriad of governance, risk and compliance needs in dynamic markets and regulatory environments. Our compliance solutions and services are used by thousands of community banks and credit unions across the United States and the majority of the world's top 50 banks.

For convenience, the feedback below follows the same structure as the ARRC's Bilateral Business Loan consultation:

Preferred General Approach

Question 1. If the ARRC were to adopt one or more sets of bilateral business loan fallback language, which one, or both, of the recommended provisions (i.e., amendment and/or hardwired approach), in your view, is an appropriate policy? …

> ***Response:*** *The hardwired approach would be an appropriate policy as the general rule since it promotes mutuality between the parties, greater certainty, and lower risks at the outset of a new transaction. The amendment approach may be appropriate in limited circumstances or transactions. However, it would seem to promote uncertainty and undesirable risks that could initiate a resurgence of the lender liability litigation from the 1980's.*

Question 2. Beyond your response to Question 1, are there product or transaction types, or methods of documenting transactions, for which either of the fallback approaches would be problematic? If so, please explain. What other approach would you suggest?

> ***Response:*** *The amendment approach may be particularly problematic in real estate transactions in which selected loan terms (including interest rate, index definition, market rate, margins), as a matter of practice or law, are included in the original mortgage forms and are recorded in the real estate records. In such a scenario, a mortgage modification with the fallback language and new benchmark(s) would need to be subsequently recorded. For reference, please see 765 ILCS 5/11 which was amended in 2013 to counter the results of In re Crane, 487 B.R. 906 (C.D. Ill. 2013) (The Gifford State Bank v Richardson, 12-CV-21146).*

In addition, courts in some jurisdictions might hold that an amendment approach could be deemed a "de novo" contract, and/or that the amendment agreement induced an increased credit risk – resulting in a default on a "superior lien" to the detriment of subordinate lienholder. In other words, the uncertainty of terms (i.e., interest rate, margin), higher margins, and higher volatility or uncertainty of the index could result in an increased likelihood of default and a loss of a lienholder's superior lien position. Otherwise, a lienholder may be required to seek subordination agreements from all subordinate lienholders in order to retain the its superior lien position.

Triggers

Question 3.

(a) Should fallback language for bilateral business loans included any of the pre-cessation triggers (triggers 3, 4 or 5)? If so, which ones?

'…

(3) a Benchmark rate is not published by the administrator of such Benchmark for five consecutive business days and such failure is not the result of a temporary moratorium, embargo or disruption declared by the administrator of such Benchmark or by the regulatory supervisor for the administrator of such Benchmark and the Benchmark cannot be determined by reference to an Interpolated Period;

(4) a public statement or publication of information by the administrator of such Benchmark that it has invoked or will invoke, permanently or indefinitely, its insufficient submissions policy; or

(5) a public statement by the regulatory supervisor for the administrator of such Benchmark announcing that such Benchmark is no longer representative or may no longer be used." ***Source: ARRC***

Response: *Yes, the fallback language for bilateral business loans should include at least two pre-cessation triggers. From a safety and soundness perspective, Trigger 5 could be the minimum/ In the absence of Trigger 5, a collective and timely pronouncement by industry's federal (e.g., FFIEC on behalf the various federal banking supervisors) should be considered. Criteria that such an organization could consider are Triggers 3 and 4, plus others. A concern is that Trigger 3 is neither predictable nor reliable, and it may very well be permanent. Trigger 4, like Trigger 3, is dependent on the action of the administrator of the Benchmark which may not be reliable.*

(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 key concern for Triggers 3 and 4 is the dependency on the administrator who may be slow to act, unable to act or absent. Triggers 3 and 4 have no assurances to timeliness or reliability which could initiate a negative reaction in the market place due to lack of assurances or action.*

(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 a 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: *No response.*

Question 4.

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

Response: *Yes. An "opt-in" trigger is appropriate as it may facilitate a faster transition away <u>from</u> a failing (or unreliable) benchmark <u>to</u> a benchmark with greater certainty and long-term reliability. An opt-in trigger offers continuity and can avoid uncertainty and other risks.*

(b) Do you believe an "opt-in" trigger should be included in both the hardwired and amendment proposals or only in one (please specify which and explain).

Response. *Yes. Consistency of available options can promote informed decisioning and mitigate risks of complexity, uncertainty and confusion.*

Questions 5. Are there any other trigger events that you believe should be included for consideration? If yes, please explain.

Response: *Yes. Another triggering event that might be considered is a <u>pre-negotiated</u> alternative benchmark and margin that the **borrower or creditor** may trigger with advance [45 days'] notice. My understanding is that some lenders already offer this an optional index with or without regard to LIBOR. This feature could either be an additional triggering event (or an alternative benchmark) could enhance mutuality of the terms by giving the borrower an <u>alternative</u> benchmark at the outset and mitigate the lender's litigation risks.*

<u>Replacement Benchmarks</u>

Questions 6-11. *No response.*

<u>Spread Adjustments</u>

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

Response: *Yes. Recommending a spread adjustment for any given benchmark would minimize the litigation risks as to whether the spread adjustment was reasonable or equivalent in terms of parity.*

Questions 13-14. *No response.*

<u>Role of Lender</u>

Question 15. *No response.*

Question 16. In any of these situations, should the lender have the right to take the relevant action, for example, to designate loan terms unilaterally within the framework of either Appendix I or Appendix II, simply by notice to the Borrower? Alternatively, should the lender have the right to take action, subject only to the Borrower's right to withhold consent? Please explain which approach, or what alternative approach you think would be better.

> ***Response:*** *Only in specified emergency situations (to be defined) would the lender have the right to designate loan terms unilaterally and only for a limited duration (e.g., up to 60 days). Otherwise, the Lender would be obligated to pre-negotiate the relevant action with the borrower which would negate the need to subsequently to obtain, or even solicit, the Borrower's consent. A reasonable time period should be determined by which a new agreement or a new amendment is bilaterally negotiated between the lender and the borrower. Also, in terms of loan participations, the terms should be clear that the Participating Bank has the sole power to negotiate and agree on the designated loan terms with the borrower.*

Question 17. *No response.*

Question 18. Given that market practices and conventions may change over time, should the Lender's limited ability to make conforming changes be available only at the point of transition or a periodic, ongoing basis? Why or why not?

> ***Response:*** *Federal legislation and regulatory guidance should address these questions. In the absence, the courts will use their judicial powers in the courts' best judgment. For the short term, the Lender's ability to make conforming changes should be available at the point of transition. Otherwise, lenders and borrowers should be obligated to undertake good faith and reasonable measures to reach a mutual agreement – short of declaring an event of default (e.g., through use of an insecurity clause).*

<u>Operational Considerations</u>

Question 19. Are there operational concerns about having the ability to convert many loans over a short period of time. Please explain**.**

> ***Response.*** *The sheer volume of outstanding transactions from one lender to the next with limited resources (i.e., people, time and money) are a concern for converting so many loans over a short period of time. For that reason alone, the industry or the collective federal [banking] supervisors should seek legislative authority to establish necessary and prudent fallback language, benchmarks and spreads in the absence of any outstanding agreements that have not been converted or otherwise re-negotiated.*

Question 20. Do you see other operational challenges that fallback language should acknowledge or of which the ARRC should be aware? For example, both approaches to fallback language involve various notices from the Lender – do these requirements and the resulting communications between parties impose undue operational burdens?

> ***Response****. Although maybe not the best analogy, the enviable LIBOR benchmark transition reminds me of the Y2K event that required up to three years of focused effort that was wildly successful as a non-event. However, without the planning, investment and re-programming, Y2K could have had a large adverse impact. At least for adjustable rate transactions, LIBOR's impending demise (or unreliability) should foster a positive and urgent transition to a more*

certain set of triggers and waterfalls to a dependable set of alternative benchmarks and spreads.

The communications and negotiations with customers, timing, follow-up, follow-through, and re-programming of software solutions (e.g., loan documentation systems, processing, interest accrual, payments) will all consume substantial resources and will require substantial coordination, integration and implementation. The extent of impact will vary from one customer to the next.

ARRC should be aware that more options and flexibility can easily translate into the more complexity and effort – not less, and lost opportunities for an orderly transition. With that in mind, the financial services industry and federal banking supervisors are encouraged to collectively seek legislative authority to establish a "safe harbor" fallback option and benchmark. Such efforts could act as a safety net that builds "resiliency" and "stability" into the financial markets while the private sector seeks to implement various fallback options in parallel.

Hedging Issues
Questions 21-23. No response.

General Feedback
Questions 24-25. No response.

On behalf of Wolters Kluwer, I thank for this opportunity to provide feedback.

Respectfully,

/s/ Gary S Renick

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