CONSULATION RESPONSE – SYNDICATED BUSINESS LOANS

SUBMITTED WITH A REQUEST FOR ANONYMITY

Question 1

As a policy matter, we believe the Amendment Approach is appropriate. Given the uncertainty regarding SOFR term rate conventions, behavior and pricing and the uncertainty regarding corollary interest rate hedging, we believe it is premature to adopt the Hardwired Approach. Once those attributes of SOFR term rate and interest rate hedging firm up, we believe adopting some version of the Hardwired Approach will be appropriate. Adopting the Hardwired Approach before SOFR term rate attributes are fixed or nearly fixed would lock hardwired contracts into an inflexible model that includes some challenging fallback approaches. Those fallback approaches may or may not be the most desirable approach at the time a trigger occurs.

The unknowns with respect to the SOFR term rate conventions include a) whether and when term SOFR will be developed, b) how term SOFR will behave, c) whether there will be SOFR term fixings available for all current LIBOR interest periods, d) how Compounded SOFR will be calculated and behave, e) whether Overnight SOFR could be effectively implemented and how the Replacement Benchmark Spread function for Overnight SOFR will be applied to various term periods, and f) how the Replacement Benchmark Spread will be calculated, whether it will be published, and in the absence of an ARRC-endorsed Replacement Benchmark Spread, will ISDA methodology be suitable.

Also, FASB's adoption of SOFR as a permissible benchmark for hedging could conceivably lag behind a LIBOR cessation trigger. In addition, even if term SOFR exists when a LIBOR cessation trigger has been tripped, term SOFR might be so immature that appropriate hedging markets lack depth and availability for normal hedging strategies.

Locking into a methodology that relies on so many unknown attributes could have significant unanticipated consequences and significant economic impacts for both lenders and borrowers.

We also believe that the ARRC should take into consideration that different syndicated loan markets may benefit from different solutions. For instance, the most suitable approach for the institutional term loan market may not be the best fit for the investment grade syndicated loan market.

The widely syndicated institutional term loan market, may have organic reasons to seek the highest level of certainty with respect to LIBOR cessation mechanics and may prefer the Hardwired Approach. For example:

- CLO vehicles investing in LIBOR-based loans are likely to seek certainty with respect to conversion mechanics so that they can better manage their own LIBOR-based borrowings thus enabling them to better manage their profits, which are largely based on the difference between funding costs (the CLO vehicle's LIBOR-based borrowings) and the yield on the assets (LIBOR-based loans).
- Many stakeholders in the institutional term loan market who hedge their exposure will likely seek certainty with respect to LIBOR conversion mechanics to match the more rigid LIBOR cessation conversion triggers likely to be adopted by the derivative market.

Stakeholders in other syndicated loan markets, for instance, the bank-led investment grade loan market, are not likely to require the same level of certainty with respect to LIBOR conversion mechanics and may prefer the Amendment Approach. Bank-led investment grade lending typically consists of a group of banks lending to a corporate borrower. The lending banks are generally "relationship banks" and amendments to those credit agreements are relatively routine and may be relatively easy to execute. In the investment grade market and other similar syndicated markets, interconnectedness with other stakeholders, e.g., CLO lenders and hedge providers, are more limited. So the Amendment Approach is more suitable, at this time, for the investment grade space and other similar spaces.

Accordingly, the ARRC's endorsement of both the Amendment Approach and Hardwired Approach may be appropriate as different markets have different commercial needs.

We also note that stakeholders in the institutional term loan market are well represented on the ARRC Business Loans Working Group. We have some concern that their heavy participation in that working group, and possible over-weight among respondents to the consultation, may result in an over-representation of expressed preferences suitable for the leverage lending/ institutional term loan market rather than the broader syndicated loan market. We do not believe this should be the case. The institutional term loan market represents neither a majority of syndicated loans by number of loans nor by principal amount. Other markets, like investment grade syndicated loan market, represent a significant share of the syndicated loan market. We believe that the ARRC should take into consideration the different needs and practices of stakeholders across all loan markets.

<u>Question 2</u>

a) We believe all suggested pre-cessation triggers are appropriate. Each pre-cessation trigger indicates either a significant deficiency in LIBOR (not published or insufficient submissions) or a critical impediment to LIBOR usage (Agent's regulator indicating LIBOR is not representative or may not be used). In all of these pre-cessation circumstances, it would be very challenging to continue to use LIBOR.
b) Pre-cessation triggers that are not replicated in corresponding interest rate hedges are challenging. Consideration should be given to harmonizing triggers between loans and derivatives. Failing that, consideration should be given to using correlated triggers for hedged loans and for loans that are not hedged to use the more robust set of pre-cessation triggers. In any case, pre-cessation trigger "5" that occurs when an Agent's regulator in essence limits the

use of LIBOR by the Agent will be necessary in the syndicated loan space – so if not adopted in the derivatives space, some asymmetry between triggers may be unavoidable.

c) See above.

Question 3

a) Opt-in trigger is appropriate policy. Depending on timing of LIBOR cessation, lenders may have significant inventory of LIBOR contracts and conversions to work through. Having contractual flexibility to do so is highly desirable. Similarly, many borrowers may desire to convert prior to cessation and contemplating that possibility within the contract will facilitate execution.
b) We prefer the Amendment Approach opt-in text to the opt-in text suggested in the Hardwired Approach. The Amendment Approach is less rigid and mechanical. We believe that it is highly likely that if opt-in conversions to a new reference rate occur, they will occur as part of a market movement in a particular direction and that instances of one-off conversions not consistent with market sentiment will be low. Because of this, we do not believe rigid, objective pre-conditions to opt-in conversions are necessary. Note that while we prefer the Amendment Approach's opt-in text, if the Hardwired Approach is recommended, we believe it should be recommended with an opt-in feature, whether or not that feature reflects the current hardwired or amendment draft.

Question 4

No.

Question 5

Yes. Forward-looking term rates should be the primary fallback for syndicated loans referencing LIBOR. Ideally, derivative conventions and cash product conventions will be harmonized. With market demand that may come to be. We do not believe ISDA's current intention to develop conventions based on overnight rates should drive the cash market to corresponding conventions, given borrower and lender commercial expectations for term rates.

Question 6

Given the possible absence of certain SOFR term periods, the Agent ought to be able to reasonably eliminate the option to convert to SOFR term periods that are not published and cannot be interpolated.

Question 7

While we prefer the Amendment Approach, if the Hardwired Approach is adopted, Compounded SOFR is a credible fallback.

Question 8

Compounded SOFR calculated in arrears is likely to be unacceptable to certain types of borrowers. For instance, a significant segment of borrowers is likely to desire certainty on their borrowing costs prior to incurring debt and to not be subject to market swings after a borrowing is made. In addition, borrowers with access to several different pools of capital who borrow under a working capital revolving line of credit will likely want to know the rate charged for a loan prior to borrowing so that they can evaluate the relative cost of capital among various sources. We believe a significant segment of borrowers will have legitimate commercial expectations to know what rate they are accruing in advance of borrowing. If "in arrears" calculated Compounded SOFR were hardwired into the fall back waterfall, those borrowers with legitimate need for borrowing cost certainty would be locked into a borrowing structure that may be commercially unreasonable for them.

In addition, operationalizing an in arrears approach may be challenging. If Compounded SOFR is the selected rate under the waterfall, there is some likelihood that LIBOR cessation is occurring on the early side of the possible timeline of cessation because Term SOFR will, by definition, not be viable. In connection with an early LIBOR cessation, many market participants may not be ready to operationalize an in arrears rate.

<u>Question 9</u>

Using an overnight rate for various term periods, including extended periods, e.g., six months, one year, is very challenging. Overnight rates can be erratic. Also, no viable mechanism for consistent spread adjustment for operationalizing an overnight rate for a term period is proposed. Accordingly, omitting an Overnight SOFR rate in the hardwired waterfall is appropriate.

<u>Question 10</u>

Using one observation of Overnight SOFR for an extended term period would not be acceptable. Given that overnight rates can be erratic, giving the borrower optionality to use that rate for an extended term is not commercial.

<u>Question 11</u>

We prefer the Amendment Approach and do not recommend the inclusion of other rates in the Hardwired Approach waterfall.

<u>Question 12</u>

We believe an ARRC-endorsed spread adjustment methodology is appropriate if the methodology is developed by the market with support across market participants of various sizes and complexities.

<u>Question 13</u>

Because the derivatives market is expected to fall back to overnight rates, and because derivatives may not be falling back at the same time as business loans, using derivatives market spread adjustment methodology for the cash market is challenging and is another strong reason why adopting the Hardwired Approach at this time is premature.

<u>Question 14</u>

No.

Question 15

a) We believe that the market will determine whether class voting is required for objection to a selected replacement rate. While generally not requiring class voting to object to a new rate will make adoption of a new rate easier -- which will be in the interest of the market especially if conversion is early -- there may be specific deal dynamics that lead to class voting.
b) In order to facilitate rate conversion, we believe negative consent of the lenders is appropriate to adopt a new reference rate under the Amendment Approach. We believe whether negative consent will be required by class or not will be determined by the market consistent with unique transactional characteristics and market dynamics.

Question 16

a) See above for discussion of class voting.
b) It is likely that the threshold for opt-in amendment approval, majority vs. super-majority, will be determined by the market. But as a general over-arching policy matter, given the likelihood that reference rate conversion will be actively invoked in connection with a market migration away from LIBOR or in anticipation of LIBOR cessation, majority negative consent would be preferable.

Question 17

As an Agent, we would be prepared to perform all of the enumerated tasks (identifying replacement rates, determining whether triggers have occurred, selecting new screen rates, interpolating SOFR term rates for "missing" terms, and adopting technical amendments to implement new reference rates).

Question 18

It is highly preferable for the replacement rate and spread adjustment to be published. Publication will add credibility and transparency and facilitate operational implementation. To the extent that the market has, for some limited period of time, not identified and adopted a published rate, publication may not be necessary so long as the rate implemented is more favorable to the borrower than the ultimate fallback of Base Rate.

Question 19

The Agent's ability to make conforming changes should not be limited to a one-time only event given the possibility that conversion to a replacement rate could occur on a rushed basis with unexpected timing and before replacement rate conventions are fully regularized. As market conventions develop, it may be desirable and appropriate to limit the amount and timing of conforming changes, but at this point, with so many unknowns, it would increase market challenges to limit the Agent's qualified discretion on these matters.

Question 20

In arrears rates are generally not desirable. See response to Question 8.

Question 21

Any system conversion introduces the possibility of operational risk. Converting from LIBOR to a new reference rate may introduce unique challenges. Unlike conversion to the Euro currency and Y2K operational readiness, the timing of conversion may not be known well in advance. Accordingly, depending on the timing of conversion from LIBOR to a new reference rate and whether that conversion is scheduled well in advance of its occurrence, the conversion off of LIBOR over a short time frame could introduce the likelihood of operational errors.

Question 22

No.

Question 23

We believe bi-lateral loans should contemplate the ability to convert to a new reference rate upon lender notice to the borrower which, in the case of opt-in conversion only, should be subject to a borrower negative consent.

We do not believe that any special text should be included in bi-lateral loans to anticipate interest rate hedges. Interest rate hedges are independent contracts and creating some type of integration with the loan is akin to creating a new product. It is possible that a product might develop for loans whose interest rates are completely hedged (principal amount and full term) that provides for conversion to a new replacement rate upon LIBOR cessation in an automatic fashion, but that type of product innovation is suitable for competitive market dynamics. We are not aware of any distinction between syndicated loans and bi-lateral loans with respect to hedging that ought to give rise to an ARRC bi-lateral approach that deviates from the syndicated approach.

Question 24

No.

Question 25

None.