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July 10, 2020

ARRC Releases Updated LIBOR Fallback Language for USD Syndicated Loans

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Quick Overview

- The ARRC released an updated version of its recommended LIBOR fallback language for USD LIBOR syndicated loans on June 30, 2020.
- Among other updates, the updated fallback language recommends a "Hardwired Approach" to effect LIBOR replacement and removes the previous alternative recommendation for an "Amendment Approach." The proposed waterfall of alternative reference rates has also been updated to include Daily Simple SOFR as the second alternative (after term SOFR).
- Market participants should note that the updated fallback language represents a proposed template, but the ARRC anticipates that institutions will use their own judgement in making adjustments or modifications to the proposed terms when updating their own agreements.
- As foreshadowed in the ARRC's document, market participants will want to independently evaluate the factors discussed in the ARRC's recommendations, taking into consideration their own operational preferences, treasury financing practices, and market trends.

Discussion

On June 30, 2020, the Alternative Reference Rates Committee ("ARRC") released an updated version of its recommended reference rate fallback language for U.S. dollar ("USD") LIBOR syndicated loans ("Updated Syndicated Loan Fallbacks"), intended to serve as a template for new originations in order to facilitate a smooth transition to an alternative reference rate.

The ARRC is a group of private-market participants and regulators initially convened in 2014 by the Federal Reserve Board and the Federal Reserve Bank of New York in anticipation of the expected phase-out of LIBOR-based reference rates and the transition to the Secured Overnight Financing Rate ("SOFR"), the ARRC's recommended alternative reference rate for USD financing markets[1]. The ARRC is working in parallel with similar efforts to facilitate transitions to new reference rates in other local currency jurisdictions, and with those being undertaken by the International Swaps and Derivatives Association, Inc. ("ISDA") and its members in promulgating updates to reference rate replacement terms in standard documentation governing derivatives products.

Because the ARRC observed (in its Second Report, March 2018) that, as of the spring of 2018, most derivatives, syndicated loan and other financing agreements referencing USD LIBOR did not yet appear to envision a permanent or indefinite cessation of LIBOR or to contain economically appropriate fallback provisions to address such an eventuality, the ARRC undertook to publish new recommended contractual fallback language to designate trigger events for rate replacement and to allow for selection of a new benchmark replacement rate (SOFR) and a spread adjustment to account for differences between LIBOR and SOFR.

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[1] See The Alternative Reference Rates Committee, *A User's Guide to SOFR*, April 2019.

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After significant industry consultation and input, the ARRC published its recommended fallbacks for USD LIBOR syndicated loans in proposed form in a consultation document in September 2018 (the "Consultation on Syndicated Loan Fallbacks"), followed by its then-final version of the recommended fallbacks in April 2019 (the "April 2019 Syndicated Loan Fallbacks").

The Updated Syndicated Loan Fallbacks are an update to the April 2019 Syndicated Loan Fallbacks reflecting certain developments in the market over the past year. While they are in many ways consistent with the April 2019 Syndicated Loan Fallbacks, there are certain key modifications. Below is a brief summary of a few of the key changes and observations made by the ARRC at the time of publication of the Updated Syndicated Loan Fallbacks:

- The reference rate replacement trigger events in the April 2019 Syndicated Loan Fallbacks included (1) a public announcement of permanent or indefinite cessation of LIBOR by the LIBOR administrator without a successor administrator, (2) a public announcement of permanent or indefinite cessation of LIBOR by a regulatory supervisor, central bank, insolvency official, resolution authority, court or other entity with insolvency or resolution authority over the LIBOR administrator, without a successor administrator, (3) a public announcement by the regulatory supervisor for the LIBOR administrator that LIBOR is no longer representative, or (4) an early opt-in trigger at the election of the administrative agent in its own discretion, at the request of the borrower, or by joint election of the administrative agent and the borrower (subject to negative affirmation by the "required lenders" if not made by joint election).

- In the Updated Syndicated Loan Fallbacks, the trigger event based on regulator or central bank announcement (in the foregoing clause (2)) was revised to replace a reference to "the central bank for the currency of the Benchmark" (which would have given such discretion to the Bank of England) with specific references to the Federal Reserve Board and the Federal Reserve Bank of New York.

  In addition, the replacement trigger events have been revised so that they are more explicitly linked to unavailability (or non-representativeness) of all available tenors of LIBOR – reflecting what the ARRC observed was the consensus view that a transition away from LIBOR should not occur until the last USD LIBOR tenor that is available for borrowings under a credit agreement ceases or is declared non-representative. In addition, the Updated Syndicated Loan Fallbacks explicitly contemplate an administrative agent's ability to remove (and potentially later reinstate) certain affected tenors of LIBOR under a credit agreement without triggering replacement of the reference rate for other unaffected tenors.

- The April 2019 Syndicated Loan Fallbacks provided for two alternative approaches for reference rate replacement following the occurrence of a replacement trigger event:

  - the Hardwired Approach, providing for automatic replacement of the reference rate with a new reference rate determined under a waterfall of specified alternatives following notice to the lender group, without the need for consent of lenders, unless the new reference rate is neither term SOFR nor Daily Simple SOFR (in which case, the borrower and administrative agent would select the new reference rate in a manner similar to that of the Amendment Approach, subject to negative affirmation by the "required lenders"), or

  - the Amendment Approach, setting forth a streamlined, optional process to permit borrowers and/or administrative agents to amend loan documents (subject to negative affirmation by the "required lenders") to adopt a new reference rate, to be selected by the borrower and

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administrative agent giving due consideration to recommendations of relevant governmental bodies and/or evolving or prevailing market conventions.

- The Updated Syndicated Loan Fallbacks recommend only the Hardwired Approach.

  The ARRC explained its preference for the Hardwired Approach (even though the Hardwired Approach has seen limited (if any) adoption to date, while modified versions of the Amendment Approach have begun to be broadly adopted) by observing that continued and widespread reliance on amendments will not be feasible (and would be potentially vulnerable to opportunistic behavior) as the market approaches the anticipated cessation of LIBOR in 2021; that the market will benefit by adopting a more transparent and contractually robust approach to rate replacement that eliminates the need for consent in many cases; and that, in the past year, the market has also gained additional visibility as to operational details of SOFR-based rates and spread adjustments.

- Both the April 2019 Syndicated Loan Fallbacks and the Updated Syndicated Loan Fallbacks contain an early opt-in trigger allowing the borrower, the administrative agent or both, in a joint election, to trigger a reference rate replacement in the absence of another rate replacement trigger (provided that, if it is not a joint election, the template language requires a finding that “at least [five] currently outstanding U.S. dollar-denominated syndicated credit facilities” then reference a SOFR rate). The Updated Syndicated Loan Fallbacks broaden the early opt-in trigger by not requiring that the other outstanding credit facilities reference any specific SOFR rate (as the April 2019 Syndicated Loan Fallbacks did).

- It is important to note that the Updated Syndicated Loan Fallbacks (like the previous versions of the fallback language circulated by the ARRC) reflect only proposed template language, and certain provisions invite and anticipate a degree of customization and modification.

  For example, while the recommended waterfall of alternative reference rates includes a forward-looking term SOFR rate as the first alternative, such a term SOFR rate does not yet exist. In addition, the ARRC explicitly notes that it anticipates parties will make their own determination as to the appropriate number of existing SOFR credit facilities required for an early opt-in trigger. The ARRC acknowledges in the Updated Syndicated Loan Fallbacks guidance that parties are encouraged and expected to make independent evaluations as to whether or to what extent to deviate from these and other proposed recommendations in their own agreements.

- Although the Updated Syndicated Loan Fallbacks are presented in the form of a streamlined, hard-wired set of provisions that could potentially lead to more uniform reference rate replacement practices across the market, the existence of several types of provisions where discretionary elections or adjustments are expected or even necessary in the implementation process will mean that there are substantial questions still to be answered before a market-standard provision is likely to exist in the syndicated loan market.

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Conclusion

As the market moves closer to the anticipated date of LIBOR cessation, institutions will want to carefully consider the above and other factors discussed in the ARRC's Updated Syndicated Loan Fallbacks document, while taking into consideration their own operational preferences and treasury financing practices, as well as anticipated developments in their derivatives agreements in light of ISDA's ongoing efforts to update its floating rate definitions and fallback provisions for new and legacy trades. Institutions will also want to stay abreast of regulatory developments and/or public statements that could affect not only the recommended fallbacks adopted by the ARRC and/or ISDA[2], but also potentially the receptiveness of the market to adopting such proposed fallbacks[3].

For more information or questions on the matters covered in this alert, please contact a member of our **Finance Practice Group**, or any of the lawyers below.

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[2] For example, ISDA's revision of its proposed amendments earlier in 2020 to include "pre-cessation" triggers appears to have been motivated at least in part by regulators' public statements encouraging such inclusion.

[3] Following recent public statements from the U.K. Financial Conduct Authority, HM Treasury, the Bank of England and the U.K. Working Group on Sterling Risk-Free Reference Rates (the "RFRWG") regarding (i) the potential for legislative action and/or continued publication of a limited-use "synthetic LIBOR" if needed to wind down certain "tough legacy" contracts that cannot be amended, and (ii) temporary postponement of the target date to cease new GBP-denominated LIBOR loans (from the end of the third quarter of 2020 to the end of the first quarter of 2021), due to market disruptions arising from the Covid-19 pandemic, certain market participants have raised concerns that borrowers and lenders could be encouraged or perceive an incentive to delay adoption of the ARRC-recommended fallback provisions until there is greater visibility on such developments and/or spread adjustments that would be determined at the time of a pre-cessation trigger event. Similarly, in the US, the Federal Reserve recently modified the terms of its Main Street Lending Program to use LIBOR rather than SOFR after encountering difficulties in disbursing SOFR loans, and the ARRC issued in March 2020 a proposal for New York state legislation to facilitate transition of reference rates under certain New York law-governed contracts by overriding certain existing contractual fallbacks and substituting ARRC-recommended fallbacks, and creating safe harbors from litigation for parties acting in reliance thereon. The RFRWG, the U.K. Financial Conduct Authority and the Bank of England have confirmed, however, that their overall expectation remains that LIBOR will cease to be published by the end of 2021 and that market participants should continue to work diligently towards remediation efforts with that timeline in mind.

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