

27 October 2017

Ann E. Misback
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Email: regs.comments@federalreserve.gov

Dear Ms Misback,

**Federal Reserve System Request for Information Relating to Production of Rates –
Docket Number OP-1573**

The Loan Market Association ("LMA") welcomes the opportunity to provide feedback on the above Request for Information published in August 2017 on the proposal to produce three new reference rates based on overnight repurchase agreement transactions secured by Treasuries.

The LMA is the trade body for the syndicated loan markets in Europe, the Middle East and Africa ("EMEA"). Its aim is to encourage liquidity in both the primary and secondary loan markets by promoting efficiency and transparency, as well as by developing template documentation and codes of market practice, which are widely used and adopted. Membership of the LMA currently stands at over 670 organisations across EMEA and consists of banks, non-bank investors, law firms, rating agencies and service providers.

We have not replied to each individual question in the Request for Information but have set out our principal thoughts below. The focus of our response is on the production of the Secured Overnight Financing Rate ("SOFR"), which has been selected by the Alternative Reference Rates Committee ("ARRC") as its recommended alternative to U.S. dollar LIBOR. Our member institutions are likely to have other thoughts on the proposals and we have encouraged them to submit their own feedback on the Request for Information.

Given the global nature of the syndicated loan market, the wide-ranging use of LIBOR and the need to promote efficiency in loan markets, the LMA is coordinating with the Loan Syndications and Trading Association ("LSTA") to seek to ensure that any transition away from LIBOR is carefully managed. The LSTA will be submitting its own feedback on the Request for Information.

The LMA would have concerns in relation to any recommendations as to the adoption of SOFR as an alternative to U.S. dollar LIBOR in the syndicated loan market. In particular, the

use of SOFR in the syndicated loan market would create significant practical and operational problems.

Usefulness of SOFR in the syndicated loan market

Any transition away from LIBOR in the syndicated loan market would involve a substantial amount of work and create uncertainty in terms of amending existing contracts and the updating of systems. By way of illustration, syndicated loan issuance based on U.S. dollar LIBOR in 2017 alone to date is approximately \$2.39 trillion (69.7% of total syndicated loan volumes).¹ This is a vast number for a 10 month period, especially in view of the fact that this does not include syndicated loans referenced to other LIBOR currencies, or indeed simple bilateral loans in the retail and general corporate space.

Typical maturities for syndicated loans vary depending on the relevant sector of the market. For example, corporate loans typically have a maturity of up to five years, but project finance loans can have significantly longer maturities. Therefore, there are a number of legacy deals which will be impacted by any discontinuation of U.S. dollar LIBOR post-2021. We estimate that if U.S. dollar LIBOR were to be discontinued on 1 January 2022, approximately \$2 trillion of existing historical loan issuance would be impacted up to 31 December 2025 alone, and over 5,000 individual transactions would need to be amended on a bilateral basis.² This clearly gives an illustration of the number of legacy deals which will be affected by any discontinuation of U.S. dollar LIBOR post-2021. In addition to existing legacy transactions, syndicated loans being documented now are likely to have a maturity extending beyond 2021 and will be documented based on LIBOR in the absence of an appropriate alternative rate; this will increase the number of legacy deals which will be impacted by any transition away from LIBOR.

Syndicated loans in EMEA are typically documented on LMA terms. The LMA template loan documentation is based on a LIBOR term benchmark, with interest being calculated on the basis of LIBOR plus a margin. The LMA template loan documentation reflects LIBOR's term based and forward looking nature, as well as its intention to reflect bank credit and term risk (which SOFR does not).

Whilst progress has been made on the identification of risk-free rates ("RFRs") in the context of the derivatives market (in line with the FSB report's recommendations), this work has not yet been carried out in respect of the syndicated loan market. Given the inter-relationship between the derivatives and syndicated loan markets, it is important that work on RFRs and adoption in the financial markets is not carried out in isolated product areas. Widespread agreement on the direction the market should take is necessary for successful adoption of any alternatives to LIBOR.

We note the international initiatives to promote RFRs and the inconsistency in the choice of RFRs across jurisdictions, particularly in respect of whether the RFR is secured or unsecured. Whilst SOFR is being recommended as an alternative to U.S. dollar LIBOR, it is important to remember that LIBOR is currently quoted for five different currencies. Similar issues with the adoption of RFRs in place of U.S. dollar LIBOR in the syndicated loan market will arise in respect of the different currencies for which LIBOR is quoted. Whilst different

¹ Source: Dealogic.

² Source: Dealogic.

jurisdictions may have different considerations in terms of deciding on an appropriate RFR, it would be helpful if there were to be coordination across the various currency working groups to ensure that the financial markets are not adversely impacted by lack of consistency.

It is understood that any adoption of an alternative to LIBOR will need to be market-led. However, given competition concerns there is a hesitance on the part of market participants to be actively involved in industry wide discussions on an alternative to LIBOR. Assistance by the regulators will therefore be needed to facilitate appropriate integration and coordination.

In the syndicated loan market, drawings in different LIBOR currencies under the same facility tend to be priced at the same margin. Therefore, if different approaches for an alternative rate are adopted across the different currencies for which LIBOR is quoted, significant adjustments are likely to be required. LIBOR is a global benchmark and any replacement rate should be considered on a global (or at least coordinated) basis, rather than just domestically. In 2016, borrowers in 113 different countries entered into syndicated loans based on U.S. dollar LIBOR; this shows how global the LIBOR benchmark is.³ If there are to be different approaches to different currencies it is likely that this will result in the need for different margins per currency which would be operationally intensive.

We note that SOFR is due to be published at 08:30am ET for the previous business day. The publication times for the various RFRs differ across the various currencies. The syndicated loan market and the LMA template loan documentation are based on LIBOR being published as of 11:00am London time for a forward-looking period. Any changes to this methodology will cause significant operational disruption in the loan market and in particular significant challenges for the syndicated loan market's current IT infrastructure. For example, given the publication time and current loan systems, interest for a loan based on SOFR could not be calculated for the relevant due date and payment could only be made on the next business day. This could mean up to three business days worth of delay in regards to payment of interest.

A transition away from LIBOR will impact legacy portfolios. The conversion of existing contracts with a maturity beyond 2021 which reference LIBOR to any new alternative benchmark (whether SOFR or otherwise) will be essential for market certainty.

As highlighted above, the LMA template loan documentation is based on a LIBOR term benchmark (for example, timings for utilisation) and this representing a lender's cost of funds. Amending the documentation to cater for an alternative benchmark is not therefore just a simple case of slotting in a description of the alternative benchmark. There are various aspects of the documentation which would need to be amended. The documentation can only be adapted once market thinking is more developed on the alternatives to LIBOR. It is noted in this respect that SOFR is a new rate and is not anticipated to be published until mid-2018. Once a viable replacement rate has been identified and has market acceptance, work can begin on reflecting this in documentation.

In the case of unavailability of a benchmark rate, the LMA template loan documentation contains fallbacks intended to deal with this situation. There are two optional waterfalls provided for (one shorter than the other). These two waterfalls are outlined in Appendix 1 of this letter. These fallbacks are unlikely to provide a long-term solution to any discontinuation

³ Source: Dealogic.

of LIBOR, as the ultimate fallback is to an individual lender's cost of funds. This will be operationally challenging for both lenders and agents to have to maintain for any significant period of time and is unlikely to be commercially acceptable.

In terms of a longer-term solution, the LMA template loan documentation has, since 2014, contained flexibility to replace a benchmark rate which becomes unavailable with the consent of the borrower group and the majority lenders. This provision (outlined in Appendix 2 of this letter) will be useful should LIBOR cease to be available and alternative benchmark rates are in place. However, this provision is only optional in the LMA template loan documentation and may not be included on all deals. In particular, it may not be commercially acceptable on all deals (where all lender consent may be considered more appropriate). In the absence of this provision, it is likely that amendments to documentation to replace LIBOR would require the consent of the borrower group and all of the lenders.

There may well be practical difficulties with obtaining the consent of the requisite lenders and the borrower group. The LMA does not have a protocol system for amendments (like ISDA) to syndicated loan agreements, because the terms of a syndicated loan agreement will differ from agreement to agreement. Therefore, each individual loan agreement which references LIBOR would need to be amended and renegotiated to refer to any new benchmark rate. This will have significant time and cost implications for both lenders and borrowers. This is because the amendment of a loan agreement would typically require a bespoke amendment agreement. The effectiveness of such an amendment agreement would also be subject to a number of conditions precedent, including the delivery of legal opinions on the validity and enforceability of the amendment agreement. Where there are multiple jurisdictions involved (which is typically the case on a syndicated loan), this will require coordination across those jurisdictions. In addition, any amendment of agreements for a replacement benchmark rate could lead to parties to the relevant loan agreement using it as an opportunity to renegotiate terms unrelated to LIBOR. The size of the relevant syndicate will be a factor impacting the ease of making any changes to agreements and could be more difficult where there are hundreds of lenders in the syndicate (as opposed to a smaller club deal).

A key consideration will be how to deal with any economic discrepancy between LIBOR and SOFR. Pricing differences between SOFR and LIBOR are likely to result in the parties looking for any amendment to the loan agreement to put them in an equivalent economic position. Whilst there is the (optional) ability in the LMA template loan documentation to amend the benchmark rate referred to in the agreement with less than all lender consent, this does not give the majority lenders the ability to amend the margin. Such a change would likely require all lender consent and discussions on alternative pricing to reflect the change in economics in the new benchmark rate could lead to substantial delays and uncertainty in amending existing agreements. It will therefore be essential to find a way forward to amend legacy contracts and think about how transactions going forward can be documented and amended. Lenders will naturally want to avoid any value shift in any move away from LIBOR to an alternative benchmark rate. If the alternative benchmark rate is to avoid a value shift, there needs to be a mechanism for incorporating a term bank credit risk component. If there is no such mechanism, this will delay the take up of an alternative benchmark rate and could lead to different approaches being discussed and adopted across the market. This in turn may lead to inconsistency and less liquidity.

Changes to SOFR to make it more useful

As mentioned above, LMA template loan documentation is based on LIBOR, which is a forward-looking term rate. It is essential for syndicated loan market participants to have a workable forward-looking term rate (from both a commercial and operational perspective), and one which accommodates a range of different interest periods. In this respect it is helpful that the ARRC has a term rate working group to consider the creation of a term RFR.

A forward-looking term rate is key in providing certainty to both borrowers and lenders as payments will be known in advance. This would not be the case were a backward-looking rate to be used. Borrowers require certainty of cash flow which a backward-looking rate cannot provide; this would be particularly problematic for smaller borrowers.

In addition to a lack of certainty, a backward-looking rate would also cause undue complexity. The administration of a backward-looking rate that fluctuates daily is not currently supported by the loan product systems used by most lenders in the syndicated loan market. Adjustment of the rate each day to capture overnight SOFR would therefore be a manual process (absent the development of an automated feed); this would be operationally intensive.

Computing daily averages based on overnight rates for a specific period or based on the derivatives market would also be operationally problematic as it would require an automated solution which does not currently exist. This would require manual calculation and therefore significant operational resource in validating the amount due; any discrepancies would also be difficult to resolve. Any rate calculated on the basis of the derivatives market would also become more driven by the derivatives markets rather than directly being aligned to the market in cash advances.

Interest payments on loans are made at less frequent intervals (typically on a 1-, 3- and 6-month basis). The creation of multiple term options would therefore be more aligned to how the market currently compensates lenders for making longer-term funds available and would be necessary for operational continuity in the syndicated loan market. We understand that the ARRC is considering the production of a term rate. It would be very helpful in this respect if the ARRC were able to provide more detail on how a term RFR might be generated.

There is a significant risk that the absence at some future date of benchmarks which are suitable for use in the syndicated loan market, taking into account the factors noted above, could result in increased lending costs and/or a reduction in funding available to the corporate sector.

We would be pleased to discuss any aspect of the above with you in more detail. If we can be of any further assistance, please do not hesitate to contact me by email at clare.dawson@lma.eu.com or on +44 (0)20 7006 6007. We would also be pleased to meet to discuss the above at your convenience.

Yours faithfully,



Clare Dawson
Chief Executive

Appendix 1

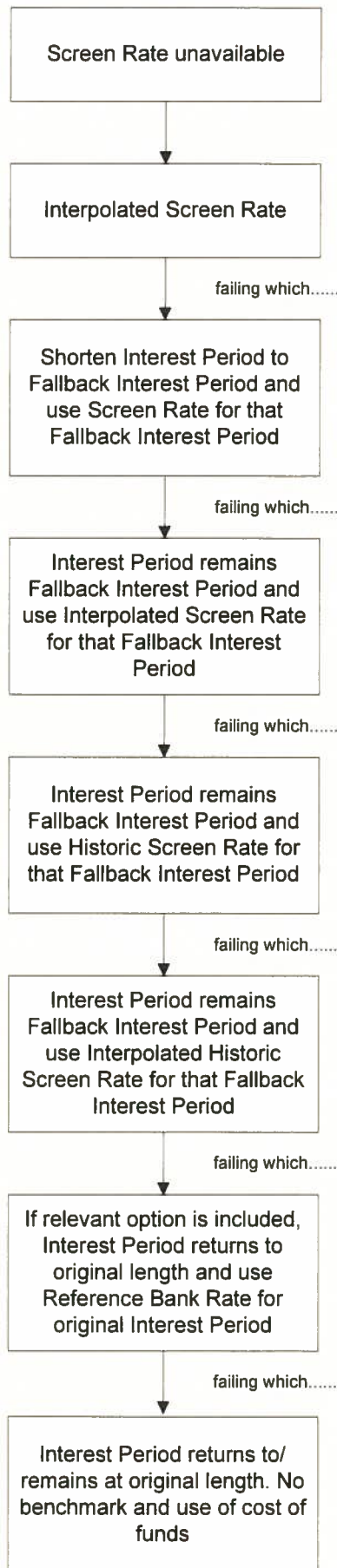
LMA Fallbacks for Unavailability of a Screen Rate

Option 1

If a Screen Rate is unavailable the relevant interest rate benchmark is determined in the following order of precedence:

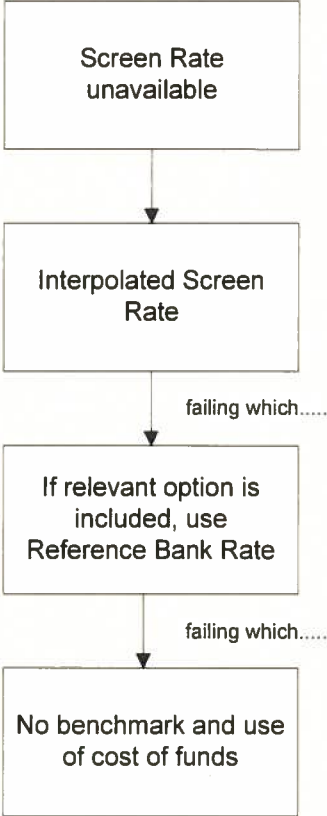
- ***Interpolated Screen Rate:*** The benchmark is determined by linear interpolation of the nearest lowest and nearest highest available Screen Rates.
- ***Screen Rate or Interpolated Screen Rate for a shortened Interest Period:*** The Interest Period is shortened in length to the Fallback Interest Period. The benchmark is then determined for that shortened Interest Period on the basis of the definition of the relevant benchmark (i.e. first by reference to a Screen Rate for a period equal in length to the Fallback Interest Period and, failing that, by linear interpolation of the nearest lowest and nearest highest available Screen Rates for the Fallback Interest Period).
- ***Historic Screen Rate for Fallback Interest Period:*** The Interest Period remains at the shortened length. The benchmark is determined for the shortened Interest Period by reference to a historic Screen Rate for a period equal in length to the Fallback Interest Period.
- ***Interpolated Historic Screen Rate for Fallback Interest Period:*** The Interest Period remains at the shortened length. The benchmark is determined for the shortened Interest Period by linear interpolation of the nearest lowest and nearest highest available historic Screen Rates.
- ***Reference Bank Rate:*** The Interest Period returns to its original length and the benchmark is determined for the original Interest Period on the basis of rates supplied to the Agent by the Reference Banks.
- ***Cost of funds:*** There is no benchmark. The Interest Period returns to/remains at its original length and the interest rate is determined on the basis of the Lenders' cost of funds.)

This is shown diagrammatically overleaf.



Option 2

This option is similar to that described above, but does not use shortened interest periods or historic rates. This is shown diagrammatically below.



Appendix 2

LMA Optional Clause for Replacement of a Screen Rate

35.4 Replacement of Screen Rate

- (a) Subject to Clause 35.3 (*Other exceptions*), if any Screen Rate is not available for a currency which can be selected for a Loan, any amendment or waiver which relates to providing for another benchmark rate to apply in relation to that currency in place of that Screen Rate (or which relates to aligning any provision of a Finance Document to the use of that other benchmark rate) may be made with the consent of the Majority Lenders and the Obligors.
- (b) [If any Lender fails to respond to a request for an amendment or waiver described in paragraph (a) above within [] Business Days (unless the Company and the Agent agree to a longer time period in relation to any request) of that request being made:
 - (i) its Commitment(s) shall not be included for the purpose of calculating the Total Commitments under the relevant Facility/ies when ascertaining whether any relevant percentage of Total Commitments has been obtained to approve that request; and
 - (ii) its status as a Lender shall be disregarded for the purpose of ascertaining whether the agreement of any specified group of Lenders has been obtained to approve that request.]