

**ARRC RECOMMENDATIONS**  
**REGARDING MORE ROBUST FALLBACK LANGUAGE FOR**  
**NEW ORIGINATIONS OF LIBOR SYNDICATED LOANS**  
JUNE 30, 2020

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**Part I: Background about the ARRC and LIBOR Fallback Language**

The Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York convened the Alternative Reference Rates Committee (“ARRC”) in 2014 to identify alternative reference rates for U.S. dollar (USD) LIBOR (“LIBOR”), identify best practices recommendations for contract robustness in interest rate markets that currently use LIBOR, and create an implementation plan to support an orderly adoption of new reference rates. After accomplishing its initial set of objectives by selecting a recommended alternative reference rate (which is the Secured Overnight Financing Rate or “SOFR”) and setting out a Paced Transition Plan with respect to derivatives, the ARRC was reconstituted by the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York in 2018 with an expanded membership to help ensure the successful implementation of the Paced Transition Plan and to serve as a forum to coordinate cash and derivatives markets as they address the risk that LIBOR may not exist beyond 2021. The ARRC now serves as a forum to address the impact of a possible LIBOR cessation on market participants currently using LIBOR and the development of SOFR based products across cash and derivatives markets.

The [ARRC’s Second Report](#) noted that most contracts referencing LIBOR do not appear to have envisioned a permanent or indefinite cessation of LIBOR and have fallbacks that would not be economically appropriate if this event occurred. To meet its mandate to act as a forum for developing recommendations for voluntary transition, the ARRC formed a number of working groups to focus on various markets, including the Business Loans Working Group, and published its [Guiding Principles for More Robust LIBOR Fallback Contract Language](#) (“ARRC Guiding Principles”)<sup>1</sup> to create a framework for fallback language in cash products. Since September 2018, the ARRC has consulted on and [recommended fallback language](#) for floating-rate notes, syndicated and bilateral business loans, securitizations, and closed-end residential ARMs. These recommendations set forth robust fallback provisions that define the trigger events<sup>2</sup>, and allow for the selection of a benchmark replacement and a spread adjustment between LIBOR and that benchmark replacement to account for differences between these two benchmarks. In the case of syndicated and bilateral business loans, the ARRC recommendations provided two approaches – a “hardwired approach” and an “amendment approach”.

The ARRC Guiding Principles<sup>3</sup> state that “fallback language efforts should evolve iteratively, recognizing that language may initially include higher degrees of flexibility or discretion in order to facilitate quicker incorporation of more robust fallback language where none currently exists, but fallback language should be expected to evolve to more specific language that leaves less ambiguity as to how fallback

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<sup>1</sup> ARRC Guiding Principles for More Robust LIBOR Fallback Contract Language in Cash Products published on July 9, 2018 at: <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-principles-July2018>.

<sup>2</sup> A trigger event is an occurrence that precipitates the conversion from LIBOR to a new reference rate (i.e., a benchmark replacement).

<sup>3</sup> *Id.*

rates and spread adjustments will be selected.” In accordance with these Principles, and supported by responses to the 2018 consultation, the ARRC recommended fallback language for syndicated loans published in April 2019 (“2019 Fallback Language”) included both an “amendment approach” and a “hardwired approach.” To date, the “amendment approach” has seen robust adoption in the broadly syndicated loan market, but syndicated loan facilities incorporating the “hardwired approach” generally have not been seen. The “amendment approach” uses loans’ flexibility to create a simpler, streamlined amendment process, but it may simply not be feasible to use the “amendment approach” if thousands of loans must be amended in a short period due to LIBOR cessation. Additionally, as described in the loan consultations, the “amendment approach” is likely to create winners and losers in different market cycles. In a borrower-friendly market, a borrower may be able to extract value from the lenders by refusing to include a compensatory spread adjustment when transitioning to SOFR. Non-consenting lenders still would be subject to the lower rate. In a lender-friendly market, lenders might block a new proposed rate, forcing the borrower to pay a higher interest rate, such as ABR for a period of time.

In light of these considerations, and the greater visibility that market participants now have with respect to how SOFR-based rates will be operationalized, the ARRC published recommended best practices in May 2020 which recommended the adoption of hardwired fallback language in business loans by the end of the third quarter of 2020.<sup>4</sup> Hardwired fallback language offers certainty as to what the successor rate and adjustment will be and, in many cases, obviates the need for seeking consent for an amendment. Market participants that adopt these fallback provisions can know that they will pay or receive a version of SOFR plus a spread adjustment upon a trigger event and parties will not be able to take advantage of the then-current market environment to capture economic value. Moreover, hardwired fallback language will likely be more executable on a large number of transactions at LIBOR transition. For these reasons, many respondents to the 2018 consultation who preferred the use of the amendment approach at that time generally believed that eventually some version of a hardwired approach would be more appropriate.

The ARRC is now publishing refreshed recommended fallback language for market participants to consider for new originations of syndicated business loans referencing LIBOR. The refreshed recommendation provides for hardwired fallback provisions and does not provide a refreshed amendment approach. To the extent market participants continue to enter into LIBOR-based contracts, the ARRC recommends and endorses the fallback language and related guidance herein and believes the cash markets will benefit by adopting a more consistent, transparent and resilient approach to contractual fallback arrangements for new LIBOR products. It is important to note that regardless of this recommendation, the extent to which any market participant decides to implement or adopt any suggested contract language is completely voluntary. Therefore, each market participant should make its own independent evaluation and decision about whether or to what extent any suggested contract language is adopted.

Finally, while the ARRC’s final recommendations include a forward-looking term rate as the primary potential successor rate, it is important to note that although such rate may be the optimal fallback for

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<sup>4</sup> ARRC Recommended Best Practices for Completing the Transition from LIBOR dated March 27, 2020 at: <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC-Best-Practices.pdf>.

products that were initially referencing LIBOR, the ARRC does not recommend that financial market participants wait until a forward-looking term SOFR exists to begin using SOFR in cash products.

## **Part II: Fallback Language for New Originations of LIBOR Syndicated Loans**

The ARRC is recommending refreshed fallback language for new originations of LIBOR-referenced U.S. dollar-denominated syndicated business loans<sup>5</sup> (“syndicated loans”). That language is set out in this **Part II**. The fallback language, as well as certain drafting alternatives and related guidance, is discussed in further detail in **Part III: User’s Guide to Fallback Language for Syndicated Loans**.

### **Benchmark Replacement Setting**

(a) *Benchmark Replacement*. Notwithstanding anything to the contrary herein or in any other Loan Document<sup>6</sup> [(and any Swap Agreement shall be deemed not to be a “Loan Document” for purposes of this Section titled “Benchmark Replacement Setting”)]<sup>7</sup>, if a Benchmark Transition Event or an Early Opt-in Election, as applicable, and its related Benchmark Replacement Date have occurred prior to the Reference Time in respect of any setting of the then-current Benchmark, then (x) if a Benchmark Replacement is determined in accordance with clause (1) or (2) of the definition of “Benchmark Replacement” for such Benchmark Replacement Date, such Benchmark Replacement will replace such Benchmark for all purposes hereunder and under any Loan Document in respect of such Benchmark setting and subsequent Benchmark settings without any amendment to, or further action or consent of any other party to, this Agreement or any other Loan Document and (y) if a Benchmark Replacement is determined in accordance with clause (3) of the definition of “Benchmark Replacement” for such Benchmark Replacement Date, such Benchmark Replacement will replace such Benchmark for all purposes hereunder and under any Loan Document in respect of any Benchmark setting at or after 5:00 p.m. (New York City time) on the fifth (5<sup>th</sup>) Business Day after the date notice of such Benchmark Replacement is provided to the Lenders without any amendment to, or further action or consent of any other party to, this Agreement or any other Loan Document so long as the Administrative Agent has not received, by such time, written notice of objection to such Benchmark Replacement from Lenders comprising the Required Lenders [of each Class]<sup>8</sup>.

(b) *Benchmark Replacement Conforming Changes*. In connection with the implementation of a Benchmark Replacement, the Administrative Agent will have the right to make Benchmark Replacement Conforming Changes from time to time and, notwithstanding anything to the contrary

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<sup>5</sup> This language assumes a U.S. dollar-denominated only facility. Adjustments to these provisions will need to be made for multicurrency facilities.

<sup>6</sup> The following capitalized terms not defined herein will have the meanings ascribed in the relevant credit agreement: “Loan Document,” “Swap Agreement,” “Agreement,” “Business Day,” “Lenders,” “Administrative Agent,” “Class,” “Required Lenders,” “Borrower,” “Interest Period,” “Eurodollar Borrowing,” “Eurodollar Loans,” “Borrowing,” “ABR Loans,” and “ABR”. Such terms are included herein for illustrative purposes only and should be coordinated with definitions in the relevant credit agreement.

<sup>7</sup> If “Swap Agreements” (or similar documents) are included in the definition of “Loan Documents” in the relevant credit agreement, parties should consider whether “Swap Agreements” should be removed from the operative provisions of this Section. Excluding “Swap Agreements” may result in differing fallback rates applicable to any loan covered by the credit agreement and the swap documented in such Swap Agreement.

<sup>8</sup> Include if applicable and agreed by the parties.

herein or in any other Loan Document, any amendments implementing such Benchmark Replacement Conforming Changes will become effective without any further action or consent of any other party to this Agreement or any other Loan Document.

(c) Notices; Standards for Decisions and Determinations. The Administrative Agent will promptly notify the Borrower and the Lenders of (i) any occurrence of a Benchmark Transition Event or an Early Opt-in Election, as applicable, and its related Benchmark Replacement Date, (ii) the implementation of any Benchmark Replacement, (iii) the effectiveness of any Benchmark Replacement Conforming Changes, (iv) the removal or reinstatement of any tenor of a Benchmark pursuant to clause (d) below and (v) the commencement or conclusion of any Benchmark Unavailability Period. Any determination, decision or election that may be made by the Administrative Agent or, if applicable, any Lender (or group of Lenders) pursuant to this Section titled “Benchmark Replacement Setting,” including any determination with respect to a tenor, rate or adjustment or of the occurrence or non-occurrence of an event, circumstance or date and any decision to take or refrain from taking any action or any selection, will be conclusive and binding absent manifest error and may be made in its or their sole discretion and without consent from any other party to this Agreement or any other Loan Document, except, in each case, as expressly required pursuant to this Section titled “Benchmark Replacement Setting.”

(d) Unavailability of Tenor of Benchmark. Notwithstanding anything to the contrary herein or in any other Loan Document, at any time (including in connection with the implementation of a Benchmark Replacement), (i) if the then-current Benchmark is a term rate (including Term SOFR or USD LIBOR) and either (A) any tenor for such Benchmark is not displayed on a screen or other information service that publishes such rate from time to time as selected by the Administrative Agent in its reasonable discretion or (B) the regulatory supervisor for the administrator of such Benchmark has provided a public statement or publication of information announcing that any tenor for such Benchmark is or will be no longer representative, then the Administrative Agent may modify the definition of “Interest Period” for any Benchmark settings at or after such time to remove such unavailable or non-representative tenor and (ii) if a tenor that was removed pursuant to clause (i) above either (A) is subsequently displayed on a screen or information service for a Benchmark (including a Benchmark Replacement) or (B) is not, or is no longer, subject to an announcement that it is or will no longer be representative for a Benchmark (including a Benchmark Replacement), then the Administrative Agent may modify the definition of “Interest Period” for all Benchmark settings at or after such time to reinstate such previously removed tenor.

(e) Benchmark Unavailability Period. Upon the Borrower’s receipt of notice of the commencement of a Benchmark Unavailability Period, the Borrower may revoke any request for a Eurodollar Borrowing of, conversion to or continuation of Eurodollar Loans to be made, converted or continued during any Benchmark Unavailability Period and, failing that, the Borrower will be deemed to have converted any such request into a request for a Borrowing of or conversion to ABR Loans. During any Benchmark Unavailability Period or at any time that a tenor for the then-current Benchmark is not an Available Tenor, the component of ABR based upon the then-current Benchmark or such tenor for such Benchmark, as applicable, will not be used in any determination of ABR.

(f) Certain Defined Terms. As used in this Section titled “Benchmark Replacement Setting”:

“**Available Tenor**” means, as of any date of determination and with respect to the then-current Benchmark, as applicable, any tenor for such Benchmark or payment period for interest calculated with reference to such Benchmark, as applicable, that is or may be used for determining the length of an Interest Period pursuant to this Agreement as of such date and not including, for the avoidance of doubt,

any tenor for such Benchmark that is then-removed from the definition of “Interest Period” pursuant to clause (d) of this Section titled “Benchmark Replacement Setting.”

“**Benchmark**” means, initially, USD LIBOR; provided that if a Benchmark Transition Event or an Early Opt-in Election, as applicable, and its related Benchmark Replacement Date have occurred with respect to USD LIBOR or the then-current Benchmark, then “Benchmark” means the applicable Benchmark Replacement to the extent that such Benchmark Replacement has replaced such prior benchmark rate pursuant to clause (a) of this Section titled “Benchmark Replacement Setting.”

“**Benchmark Replacement**” means, for any Available Tenor, the first alternative set forth in the order below that can be determined by the Administrative Agent for the applicable Benchmark Replacement Date:

- (1) the sum of: (a) Term SOFR and (b) the related Benchmark Replacement Adjustment;
- (2) the sum of: (a) Daily Simple SOFR and (b) the related Benchmark Replacement Adjustment;
- (3) the sum of: (a) the alternate benchmark rate that has been selected by the Administrative Agent and the Borrower as the replacement for the then-current Benchmark for the applicable Corresponding Tenor giving due consideration to (i) any selection or recommendation of a replacement benchmark rate or the mechanism for determining such a rate by the Relevant Governmental Body or (ii) any evolving or then-prevailing market convention for determining a benchmark rate as a replacement for the then-current Benchmark for U.S. dollar-denominated syndicated credit facilities at such time and (b) the related Benchmark Replacement Adjustment;

provided that, in the case of clause (1), such Unadjusted Benchmark Replacement is displayed on a screen or other information service that publishes such rate from time to time as selected by the Administrative Agent in its reasonable discretion. If the Benchmark Replacement as determined pursuant to clause (1), (2) or (3) above would be less than the Floor, the Benchmark Replacement will be deemed to be the Floor for the purposes of this Agreement and the other Loan Documents.

“**Benchmark Replacement Adjustment**” means, with respect to any replacement of the then-current Benchmark with an Unadjusted Benchmark Replacement for any applicable Interest Period and Available Tenor for any setting of such Unadjusted Benchmark Replacement:

- (1) for purposes of clauses (1) and (2) of the definition of “Benchmark Replacement,” the first alternative set forth in the order below that can be determined by the Administrative Agent:
  - (a) the spread adjustment, or method for calculating or determining such spread adjustment, (which may be a positive or negative value or zero) as of the Reference Time such Benchmark Replacement is first set for such Interest Period that has been selected or recommended by the Relevant Governmental Body for the replacement of such Benchmark with the applicable Unadjusted Benchmark Replacement for the applicable Corresponding Tenor;
  - (b) the spread adjustment (which may be a positive or negative value or zero) as of the Reference Time such Benchmark Replacement is first set for such Interest Period that would apply to the fallback rate for a derivative transaction referencing the ISDA Definitions to be effective upon an index cessation event with respect to such Benchmark for the applicable Corresponding Tenor; and
- (2) for purposes of clause (3) of the definition of “Benchmark Replacement,” the spread adjustment, or method for calculating or determining such spread adjustment, (which may be a positive or

negative value or zero) that has been selected by the Administrative Agent and the Borrower for the applicable Corresponding Tenor giving due consideration to (i) any selection or recommendation of a spread adjustment, or method for calculating or determining such spread adjustment, for the replacement of such Benchmark with the applicable Unadjusted Benchmark Replacement by the Relevant Governmental Body on the applicable Benchmark Replacement Date or (ii) any evolving or then-prevailing market convention for determining a spread adjustment, or method for calculating or determining such spread adjustment, for the replacement of such Benchmark with the applicable Unadjusted Benchmark Replacement for U.S. dollar-denominated syndicated credit facilities;

provided that, in the case of clause (1) above, such adjustment is displayed on a screen or other information service that publishes such Benchmark Replacement Adjustment from time to time as selected by the Administrative Agent in its reasonable discretion.

**“Benchmark Replacement Conforming Changes”** means, with respect to any Benchmark Replacement, any technical, administrative or operational changes (including changes to the definition of “ABR,” the definition of “Business Day,” the definition of “Interest Period,” timing and frequency of determining rates and making payments of interest, timing of borrowing requests or prepayment, conversion or continuation notices, length of lookback periods, the applicability of breakage provisions, and other technical, administrative or operational matters) that the Administrative Agent decides may be appropriate to reflect the adoption and implementation of such Benchmark Replacement and to permit the administration thereof by the Administrative Agent in a manner substantially consistent with market practice (or, if the Administrative Agent decides that adoption of any portion of such market practice is not administratively feasible or if the Administrative Agent determines that no market practice for the administration of such Benchmark Replacement exists, in such other manner of administration as the Administrative Agent decides is reasonably necessary in connection with the administration of this Agreement and the other Loan Documents).

**“Benchmark Replacement Date”** means the earliest to occur of the following events with respect to the then-current Benchmark:

- (1) in the case of clause (1) or (2) of the definition of “Benchmark Transition Event,” the later of (a) the date of the public statement or publication of information referenced therein and (b) the date on which the administrator of such Benchmark (or the published component used in the calculation thereof) permanently or indefinitely ceases to provide all Available Tenors of such Benchmark (or such component thereof);
- (2) in the case of clause (3) of the definition of “Benchmark Transition Event,” the date of the public statement or publication of information referenced therein; or
- (3) in the case of an Early Opt-in Election, the sixth (6<sup>th</sup>) Business Day after the date notice of such Early Opt-in Election is provided to the Lenders, so long as the Administrative Agent has not received, by 5:00 p.m. (New York City time) on the fifth (5<sup>th</sup>) Business Day after the date notice of such Early Opt-in Election is provided to the Lenders, written notice of objection to such Early Opt-in Election from Lenders comprising the Required Lenders.

For the avoidance of doubt, (i) if the event giving rise to the Benchmark Replacement Date occurs on the same day as, but earlier than, the Reference Time in respect of any determination, the Benchmark Replacement Date will be deemed to have occurred prior to the Reference Time for such determination and (ii) the “Benchmark Replacement Date” will be deemed to have occurred in the case of clause (1) or (2) with respect to any Benchmark upon the occurrence of the applicable event or events set forth therein with respect to all then-current Available Tenors of such Benchmark (or the published component used in the calculation thereof).

**“Benchmark Transition Event”** means the occurrence of one or more of the following events with respect to the then-current Benchmark:

- (1) a public statement or publication of information by or on behalf of the administrator of such Benchmark (or the published component used in the calculation thereof) announcing that such administrator has ceased or will cease to provide all Available Tenors of such Benchmark (or such component thereof), permanently or indefinitely, provided that, at the time of such statement or publication, there is no successor administrator that will continue to provide any Available Tenor of such Benchmark (or such component thereof);
- (2) a public statement or publication of information by the regulatory supervisor for the administrator of such Benchmark (or the published component used in the calculation thereof), the Federal Reserve Board, the Federal Reserve Bank of New York, an insolvency official with jurisdiction over the administrator for such Benchmark (or such component), a resolution authority with jurisdiction over the administrator for such Benchmark (or such component) or a court or an entity with similar insolvency or resolution authority over the administrator for such Benchmark (or such component), which states that the administrator of such Benchmark (or such component) has ceased or will cease to provide all Available Tenors of such Benchmark (or such component thereof) permanently or indefinitely, provided that, at the time of such statement or publication, there is no successor administrator that will continue to provide any Available Tenor of such Benchmark (or such component thereof); or
- (3) a public statement or publication of information by the regulatory supervisor for the administrator of such Benchmark (or the published component used in the calculation thereof) announcing that all Available Tenors of such Benchmark (or such component thereof) are no longer representative.

For the avoidance of doubt, a “Benchmark Transition Event” will be deemed to have occurred with respect to any Benchmark if a public statement or publication of information set forth above has occurred with respect to each then-current Available Tenor of such Benchmark (or the published component used in the calculation thereof).

**“Benchmark Unavailability Period”** means the period (if any) (x) beginning at the time that a Benchmark Replacement Date pursuant to clauses (1) or (2) of that definition has occurred if, at such time, no Benchmark Replacement has replaced the then-current Benchmark for all purposes hereunder and under any Loan Document in accordance with this Section titled “Benchmark Replacement Setting” and (y) ending at the time that a Benchmark Replacement has replaced the then-current Benchmark for all purposes hereunder and under any Loan Document in accordance with this Section titled “Benchmark Replacement Setting.”

**“Corresponding Tenor”** with respect to any Available Tenor means, as applicable, either a tenor (including overnight) or an interest payment period having approximately the same length (disregarding business day adjustment) as such Available Tenor.

**“Daily Simple SOFR”** means, for any day, SOFR, with the conventions for this rate (which will include a lookback) being established by the Administrative Agent in accordance with the conventions for this rate selected or recommended by the Relevant Governmental Body for determining “Daily Simple SOFR” for business loans; provided, that if the Administrative Agent decides that any such convention is not administratively feasible for the Administrative Agent, then the Administrative Agent may establish another convention in its reasonable discretion.

**“Early Opt-in Election”** means, if the then-current Benchmark is USD LIBOR, the occurrence of:



- (1) a notification by the Administrative Agent to (or the request by the Borrower to the Administrative Agent to notify) each of the other parties hereto that at least [five]<sup>9</sup> currently outstanding U.S. dollar-denominated syndicated credit facilities at such time contain (as a result of amendment or as originally executed) a SOFR-based rate (including SOFR, a term SOFR or any other rate based upon SOFR) as a benchmark rate (and such syndicated credit facilities are identified in such notice and are publicly available for review), and
- (2) the joint election by the Administrative Agent and the Borrower to trigger a fallback from USD LIBOR and the provision by the Administrative Agent of written notice of such election to the Lenders.

**“Floor”** means the benchmark rate floor, if any, provided in this Agreement initially (as of the execution of this Agreement, the modification, amendment or renewal of this Agreement or otherwise) with respect to USD LIBOR.

**“ISDA Definitions”** means the 2006 ISDA Definitions published by the International Swaps and Derivatives Association, Inc. or any successor thereto, as amended or supplemented from time to time, or any successor definitional booklet for interest rate derivatives published from time to time by the International Swaps and Derivatives Association, Inc. or such successor thereto.

**“Reference Time”** with respect to any setting of the then-current Benchmark means (1) if such Benchmark is USD LIBOR, 11:00 a.m. (London time) on the day that is two London banking days preceding the date of such setting, and (2) if such Benchmark is not USD LIBOR, the time determined by the Administrative Agent in its reasonable discretion.

**“Relevant Governmental Body”** means the Federal Reserve Board or the Federal Reserve Bank of New York, or a committee officially endorsed or convened by the Federal Reserve Board or the Federal Reserve Bank of New York, or any successor thereto.

**“SOFR”** means, with respect to any Business Day, a rate per annum equal to the secured overnight financing rate for such Business Day published by the SOFR Administrator on the SOFR Administrator’s Website at approximately 8:00 a.m. (New York City time) on the immediately succeeding Business Day.

**“SOFR Administrator”** means the Federal Reserve Bank of New York (or a successor administrator of the secured overnight financing rate).

**“SOFR Administrator’s Website”** means the website of the Federal Reserve Bank of New York, currently at <http://www.newyorkfed.org>, or any successor source for the secured overnight financing rate identified as such by the SOFR Administrator from time to time.

**“Term SOFR”** means, for the applicable Corresponding Tenor as of the applicable Reference Time, the forward-looking term rate based on SOFR that has been selected or recommended by the Relevant Governmental Body.

**“Unadjusted Benchmark Replacement”** means the applicable Benchmark Replacement excluding the related Benchmark Replacement Adjustment.

**“USD LIBOR”** means the London interbank offered rate for U.S. dollars.

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<sup>9</sup> Parties may choose to set a different threshold.

### **Part III: User's Guide to Fallback Language for Syndicated Loans**

While **Part II** sets forth the ARRC's updated recommendation for fallback provisions for LIBOR in new originations of syndicated loans, this **Part III** contains a detailed description of the syndicated loan fallback provisions and guidance for market participants to consider in the adoption of these fallback provisions.

Historically, most syndicated loans provided for a fallback waterfall that would, upon LIBOR not being available, first revert to either the average of quotes in the London interbank market obtained by polling banks or the unsecured borrowing rate in the London interbank market for the administrative agent and then would ultimately fall back to the alternate base rate<sup>10</sup> if such quotes could not be obtained. Because most observers now believe that banks would be unable or unwilling to provide the quotes implementing the first stage of this waterfall, it would appear that most syndicated loans would effectively convert to ABR upon a cessation of LIBOR (an average of 300 bps higher than current three-month LIBOR). After the speech in July 2017 by Andrew Bailey, chief executive officer of the UK's Financial Conduct Authority ("FCA") (which has been the regulator of LIBOR since 2013), that indicated that LIBOR may not continue after 2021, syndicated loan market participants swiftly began to incorporate new contractual language designed to allow for a streamlined amendment process to select a successor rate if LIBOR were permanently discontinued. The formulation, however, varied across agreements. After the publication of the ARRC's original recommendation in April 2019, which included an "amendment approach" and a "hardwired approach", market participants generally began to adopt the "amendment approach" recommendation contained therein. Market participants found the flexibility of the amendment approach, which postpones all decisions about the successor rate and adjustment until a future date, to be appropriate while the loan market sought further visibility into a replacement rate, a replacement spread, the related mechanics and implications, and related hedging tools. As discussed above, many respondents to the 2018 consultation who preferred the use of the amendment approach at that time generally believed that eventually some version of a hardwired approach would be more appropriate. In the 14 months since the ARRC's original recommendation for syndicated loans, market participants have gained greater insight into the successor rate options, and operationalization of those rate options, as well as further clarity into ISDA's fallback language plans.

Financial market participants, including those in the syndicated loan market, have sought to align fallback language in cash products, where appropriate, to the fallback language that will be incorporated into ISDA's standard documentation. ISDA has determined that the fallback for USD LIBOR will be compounded SOFR in arrears and a spread adjustment which will be added to the compounded rate. The spread adjustment will be based on the median over a five-year period of the historical differences between USD LIBOR in the relevant tenor and SOFR compounded over each corresponding period. Bloomberg will soon publish the adjustments and all-in fallback rates via a variety of distribution platforms, and the adjustments will be published on an indicative daily basis until a relevant LIBOR cessation/non-representativeness announcement, when the spread adjustment for each tenor of USD

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<sup>10</sup> The "Alternate Base Rate" or ABR is typically defined in syndicated loan credit agreements as the highest of (x) Prime Rate, (y) Federal Funds Rate + 0.50% and (z) 1-month LIBOR + 1% (prong (z) would be disregarded if LIBOR is no longer available).

LIBOR will be set (although the compounded SOFR in arrears will continue to change on a daily basis).<sup>11</sup> The specific interplay between the ARRC recommended fallback language for syndicated loans and ISDA's fallback language plans is discussed below.

The paragraphs below describe in detail the operative provisions of this fallback language as well as important considerations market participants should bear in mind when reviewing and implementing the recommended fallback language.

## A. Introduction to the Fallback Language

### 2019 Fallback Language

The explanatory provisions below do not detail every modification to the 2019 Fallback Language. Readers may also reference the explanatory guidance provided with the 2019 Fallback Language to fully compare the 2019 Fallback Language with the recommendation contained herein.

### Interpretative Provisions

The goal of the ARRC's recommended fallback language is to effectively and efficiently replace the Benchmark. Making the replacement of the Benchmark operational involves specifying a set of triggers, a successor rate, a spread adjustment, and some description of the conforming changes that could be made - each of which is specified in the recommended fallback language and discussed in turn below. The recommended fallback provisions set forth operative provisions specifying what is to happen if one or more of the trigger events (discussed in more detail below) have occurred with respect to the Benchmark:<sup>12</sup>

- (1) **Benchmark Replacement:** If one or more events that trigger a move to the successor rate (including an "early opt-in") have occurred, then the syndicated loan will reference the Benchmark Replacement (which includes the applicable spread adjustment) thereafter.
- (2) **Benchmark Replacement Conforming Changes:** At the time of the Benchmark transition, and from time to time thereafter, certain conforming changes will be needed to account for the move to the Benchmark Replacement.
- (3) **Notices; Decisions and Determinations:** In addition, standards are set forth for the various decisions that must be made in connection with a Benchmark transition. The fallback language

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<sup>11</sup> See ISDA's [Understanding IBOR Benchmark Fallbacks](https://www.isda.org/2020/05/11/benchmark-reform-and-transition-from-libor) and ISDA's Benchmark Reform and Transition from IBOR webpage at <https://www.isda.org/2020/05/11/benchmark-reform-and-transition-from-libor>.

<sup>12</sup> If it is not possible to determine USD LIBOR but none of the events that would trigger a move to a successor rate have occurred (that is, USD LIBOR has not been permanently or indefinitely discontinued nor has the regulator of the benchmark found that it is not representative), the syndicated loan will reference whatever is currently specified in the current sections of contract language for the *temporary* unavailability of LIBOR. However, as set forth in clause (d) of "Unavailability of Tenor of Benchmark", if one or more tenors of USD LIBOR are no longer published or are the subject of an announcement of non-representativeness, the administrative agent has discretion to remove such tenor(s). See below for a detailed discussion under "Unavailability of Tenor of Benchmark".

also specifies when the administrative agent is required to send notices to the borrower and the lenders.

In reviewing the recommended fallback language, it is helpful to be mindful that at different times the language alternately refers to the “determination” of the Benchmark Replacement and the “setting” of the Benchmark Replacement. As used in the language, the “determination” of a Benchmark Replacement refers to the one-time process that occurs at the transition of a benchmark in connection with ascertaining that such replacement rate (e.g., Term SOFR or Daily Simple SOFR) is available and should be the Benchmark Replacement. The “setting” of a Benchmark or a Benchmark Replacement refers to the ongoing process of setting the interest rate for the applicable Interest Period (e.g., the “setting” of Term SOFR for an Interest Period beginning on April 1).

### Concepts of “Interest Period,” “Available Tenor” and “Corresponding Tenor”

The refreshed fallback language for syndicated loans contains three related concepts of “Interest Period”, “Available Tenor” and “Corresponding Tenor”. These terms (and concepts) are utilized throughout the operative provisions, including in the unavailability of tenor provisions and the definitions of Benchmark Transition Event, Benchmark Replacement and Benchmark Replacement Adjustment.

**Interest Period:** For a USD LIBOR syndicated loan facility, the interest rate on LIBOR loans is fixed for discrete periods, referred to as “Interest Periods,” and these “Interest Periods” correspond to the tenors of USD LIBOR that are most commonly used. For many LIBOR loans, the borrower selects the length of its desired Interest Period for a loan at its option. “Interest Period” would refer to any concrete period pursuant to which a benchmark is calculated for a loan (or portion thereof) (e.g., an Interest Period from April 1 – April 30).

**Available Tenor:** “Available Tenor” refers to all of the tenors, or payment periods if the successor rate is a daily rate, available under the credit agreement with respect to the Benchmark. For example, a USD LIBOR facility may have Available Tenors of 1 month, 3 months and 6 months. The Available Tenor for a daily rate would be determined based upon the period during which interest is required to be paid (e.g., a Daily Simple SOFR loan may be payable once every month or once every 3 months, which would result in Available Tenors for such facility of 1 month and 3 months). Available Tenor is distinguishable from Interest Period because Available Tenor refers to the available tenors and Interest Period refers to the actual period applicable to such loan.

The definition of “Available Tenor” is set forth below:

*...as of any date of determination and with respect to the then-current Benchmark, as applicable, any tenor for such Benchmark or payment period for interest calculated with reference to such Benchmark, as applicable, that is or may be used for determining the length of an Interest Period pursuant to this Agreement as of such date and not including, for the avoidance of doubt, any tenor for such Benchmark that is then-removed from the definition of “Interest Period” pursuant to clause (d) of this Section titled “Benchmark Replacement Setting.”*

**Corresponding Tenor:** “Corresponding Tenor” is used to link tenors from one Benchmark to tenors of a Benchmark Replacement, and is drafted to account for minor differences that may occur as a result of a

transition. For example, the Corresponding Tenor for 1-month USD LIBOR may be a 30-day SOFR-based rate.

The definition of “Corresponding Tenor” is set forth below:

*with respect to any Available Tenor means, as applicable, either a tenor (including overnight) or an interest payment period having approximately the same length (disregarding business day adjustment) as such Available Tenor.*

## **B. Triggers**

### Permanent Cessation Triggers

The triggers specified in the syndicated loan fallback language that precipitate the transition away from LIBOR are set forth in the defined term “Benchmark Transition Event.” The first two triggers require a public statement or publication of information that the actual cessation of LIBOR has occurred or is expected by the administrator of LIBOR (the ICE Benchmark Administration), the regulatory supervisor of the administrator of LIBOR (the Financial Conduct Authority or “FCA”), the central bank for the currency of LIBOR (the U.S. Federal Reserve System) or a bankruptcy/resolution official or court with jurisdiction over the administrator of LIBOR. The first and second clauses of “Benchmark Transition Event” read as follows:

- (1) a public statement or publication of information by or on behalf of the administrator of such Benchmark (or the published component used in the calculation thereof) announcing that such administrator has ceased or will cease to provide all Available Tenors of such Benchmark (or such component thereof), permanently or indefinitely, provided that, at the time of such statement or publication, there is no successor administrator that will continue to provide any Available Tenor of such Benchmark (or such component thereof);*
  
- (2) a public statement or publication of information by the regulatory supervisor for the administrator of such Benchmark (or the published component used in the calculation thereof), the Federal Reserve Board, the Federal Reserve Bank of New York, an insolvency official with jurisdiction over the administrator for such Benchmark (or such component), a resolution authority with jurisdiction over the administrator for such Benchmark (or such component) or a court or an entity with similar insolvency or resolution authority over the administrator for such Benchmark (or such component), which states that the administrator of such Benchmark (or such component) has ceased or will cease to provide all Available Tenors of such Benchmark (or such component thereof) permanently or indefinitely, provided that, at the time of such statement or publication, there is no successor administrator that will continue to provide any Available Tenor of such Benchmark (or such component thereof);*

These triggers are intended to align with the triggers to be included in ISDA's standard documentation<sup>13</sup> and, according to the definition of "Benchmark Replacement Date," do not lead to a move away from LIBOR until the date that LIBOR ceases to be published (if that date is later than the date of the announcement/public information).

#### Pre-cessation Trigger - Benchmark is "No Longer Representative"

The third trigger recommended by the ARRC for syndicated loans is a "pre-cessation" trigger found in clause (3) of the definition of "Benchmark Transition Event," which is set forth below:

- (3) *a public statement or publication of information by the regulatory supervisor for the administrator of such Benchmark (or the published component used in the calculation thereof) announcing that all Available Tenors of such Benchmark (or such component thereof) are no longer representative.*

This trigger institutes a transition to an alternative rate upon a determination by a regulatory supervisor that the quality of the Benchmark has deteriorated such that it would likely have a significant negative impact on its liquidity and usefulness to market participants. As noted above, the regulator with authority over the administrator of LIBOR is the FCA. The EU Benchmark Regulation requires the FCA to make an assessment of LIBOR's representativeness in certain circumstances, such as the departure of one or more panel banks, or in any event, every two years. If the FCA determines that LIBOR is "no longer representative of the underlying market or economic reality," under the EU Benchmark Regulation LIBOR may in some circumstances continue to be published in order to avoid a disruptive cessation and potential financial instability, however in these circumstances EU-supervised entities could be prohibited from referencing LIBOR in new derivatives and securities. The ARRC's consultations indicated that most respondents believed that it was appropriate to include this pre-cessation trigger. The FCA has publicly stated that market participants may prefer to include a trigger "based on an announcement of non-representativeness rather than triggers based on cessation alone"<sup>14</sup> and the FSB's Official Sector Steering Group expressed a similar view in a letter to ISDA noting that such a trigger "would offer market participants with LIBOR-referencing derivative contracts the opportunity to move to new benchmarks rather than remain on a non-representative LIBOR rate."<sup>15</sup>

Since the ARRC published the 2019 Fallback Language, ISDA has again consulted market participants on the inclusion of a pre-cessation trigger in its definition amendments for derivatives and the results of that consultation have led ISDA to plan to amend the "floating rate option" for USD LIBOR in the 2006 ISDA Definitions to include fallbacks that would also apply upon a "non-representative" determination for USD LIBOR.<sup>16</sup> This decision will permit alignment of all three "mandatory" triggers in the fallback language for syndicated loans with the triggers for fallback language that will be included in

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<sup>13</sup> ISDA has not yet published the relevant Supplement to the 2006 ISDA Definitions or the relevant Protocol applicable to existing ISDA contracts, however the cessation triggers are set forth in the definition of "IBOR Cessation Trigger Date" in ISDA and Bloomberg's [IBOR Fallback Rate Adjustments Rule Book](#).

<sup>14</sup> See [speech](#) by Edwin Schooling Latter, Director of Markets and Wholesale Policy at FCA, delivered at ISDA Annual Legal Forum on January 28, 2019.

<sup>15</sup> See the FSB [letter to ISDA](#) dated March 12, 2019.

<sup>16</sup> See ISDA's Benchmark Reform and Transition from IBOR website at: <https://www.isda.org/2020/05/11/benchmark-reform-and-transition-from-libor>.

ISDA standard documentation. Market participants should be aware, however, that although the ARRC believes that the outcome of its recommended pre-cessation trigger will align with the outcome based on ISDA's trigger, there may be slight differences in how the pre-cessation trigger is drafted as ISDA has not released the final drafting for the pre-cessation trigger to be included in ISDA standard documentation.

### Unavailability of Tenor of Benchmark

Because syndicated credit facilities often permit borrowings under the credit agreement in different interest rate tenors, the 2019 Fallback Language for syndicated loans provided for the administrative agent to have the ability at its option to remove tenors for which Term SOFR is not available as a screen rate. The administrative agent could then elect to reinstate certain tenors if Term SOFR later becomes available as a screen rate. This ability helps ensure that a contract can stay in the first step of the benchmark replacement waterfall, i.e. Term SOFR, as long as possible. It also was designed to mitigate the risk of a split in the loan facility where certain tenors of a benchmark would transition to Term SOFR while others, for which Term SOFR is unavailable, would move to a different rate.

In the refreshed fallback language, the administrative agent has the same ability with respect to unavailable tenors of Term SOFR, but the provision has been broadened to apply to any term rate, in particular USD LIBOR. This ability has also been broadened to apply to a tenor of a benchmark that has been declared to be non-representative. Both of these expansions, interacting with the concepts of "Available Tenor", "Interest Period" and "Corresponding Tenor" discussed above, are designed to give the administrative agent additional flexibility to administer syndicated credit facilities with multiple available tenors in a manner that achieves more optimal outcomes for borrowers and lenders by allowing the administrative agent to maintain consistency across those rates that are offered to the borrower at any point in time, for example, avoiding an offering of certain tenors of LIBOR and other tenors of SOFR.

This ability to "turn off" available tenors is particularly necessary in light of the possibility that certain tenors of USD LIBOR may be found to no longer be representative, or indeed may permanently cease, before others. In its March 2020 statement on LIBOR contractual triggers<sup>17</sup>, the FCA clarified that the FCA does not expect a cessation or pre-cessation event to occur prior to the end of 2021, however, announcements regarding future cessation or pre-cessation events may occur before the end of 2021. The announcements relating to LIBOR are expected to be clear that they are being made in the awareness that they will engage certain contractual triggers. The statement also specifies that any announcement would be clear about the LIBOR currencies and tenors it relates to and include the date of cessation, or, if applicable, date from which the relevant LIBOR settings are not going to be representative.

Given that a cessation event or pre-cessation event may occur with respect to LIBOR generally, or it may occur in phases, the drafting of the triggers set forth in the definition of "Benchmark Transition Event" that was included in the 2019 Fallback Language has been modified in the refreshed fallback language to

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<sup>17</sup> FCA statement titled "LIBOR contractual triggers" dated March 11, 2020 available at: <https://www.fca.org.uk/markets/transition-libor/libor-contractual-triggers>.



more clearly address this potentiality. If the refreshed fallback language for syndicated loans is incorporated into a credit agreement, the cessation and pre-cessation triggers will occur, and a transition to a successor rate will commence, once a statement or announcement with respect to “all Available Tenors” is made. This approach reflects the consensus view of the ARRC Business Loans Working Group that a transition away from LIBOR should not occur until the last USD LIBOR tenor that is available for borrowings under a particular credit agreement ceases or is no longer representative. The pre-cessation trigger (clause (3) of the definition of “Benchmark Transition Event”), as a representative example, is set forth again below (emphasis added):

*...a public statement or publication of information by the regulatory supervisor for the administrator of such Benchmark (or the published component used in the calculation thereof) announcing that **all Available Tenors of such Benchmark** (or such component thereof) are no longer representative.*

The trigger events in “Benchmark Transition Event” are now more explicitly linked to the LIBOR tenors available under the credit agreement in order to trigger a transition at the time that parties expect. As drafted, a Benchmark Transition Event would occur once a cessation or pre-cessation event had occurred for **all** available tenors under such facility. For example, if the facility allowed for both 1-month and 3-month USD LIBOR tenors, and the 3-month LIBOR tenor ceased on October 1 while the 1-month LIBOR tenor ceased on December 1, the facility would still reference USD LIBOR until December 1. The mechanics of the “Unavailability of Tenor of Benchmark” provision (clause (d) of the Section titled “Benchmark Replacement Setting”) would allow the administrative agent to remove the 3-month USD LIBOR option during the interim period when it is not available, so that only 1-month LIBOR would be offered after October 1.

Given the potentiality that cessation or pre-cessation could occur with respect to one or more tenors (and not others), the refreshed fallback language would grant administrative agents the ability to remove (and reinstate at a later date) those tenors so they are no longer available under the credit agreement. The remaining tenors of USD LIBOR which are permitted under the credit agreement would remain available. This feature would allow market participants to use USD LIBOR generally for as long as possible and recognizes that the most commonly used tenors in the syndicated loan market – 1-month and 3-month USD LIBOR – are also the most liquid and unlikely to be the first tenors to cease/be found non-representative (if these events were on a tenor(s) by tenor(s) basis).

The explanatory provision in the definition of “Benchmark Replacement Date” makes it clear that the transition date occurs when a relevant trigger occurs with respect to **all** available tenors, which may include one announcement referencing multiple tenors (or the concept of USD LIBOR more generally) or multiple announcements each referencing one or more individual tenors.

### “Early Opt-in”

The refreshed syndicated loan fallback language continues to include an “early opt-in” that is available even if LIBOR still is being published and none of the other enumerated triggers have been met. This mechanism takes advantage of a syndicated loan’s natural flexibility to reduce risk by helping to reduce the inventory of LIBOR-based loans prior to an actual LIBOR discontinuance event. As drafted, the “early opt-in” is only available if the then-current Benchmark is USD LIBOR.



The early opt-in trigger is found in the definition of “Early Opt-in Election” and is set forth below:

- (1) a notification by the Administrative Agent to (or the request by the Borrower to the Administrative Agent to notify) each of the other parties hereto that at least [five]<sup>18</sup> currently outstanding U.S. dollar-denominated syndicated credit facilities at such time contain (as a result of amendment or as originally executed) a SOFR-based rate (including SOFR, a term SOFR or any other rate based upon SOFR) as a benchmark rate (and such syndicated credit facilities are identified in such notice and are publicly available for review), and*
- (2) the joint election by the Administrative Agent and the Borrower to trigger a fallback from USD LIBOR and the provision by the Administrative Agent of written notice of such election to the Lenders.*

The initiation of the “early opt-in election” trigger has two steps. The first step is that the trigger may be initiated by either the administrative agent or the borrower if, at such time, there are in existence at least “[five]” (the exact number to be selected by the parties to the contract) publicly available new or amended syndicated loan facilities referencing a SOFR-based rate. The rationale for looking to a specified number of loan facilities is to provide for an objective trigger that limits administrative agent discretion. Where the “early opt-in” trigger was drafted narrowly in the 2019 Fallback Language, the current drafting is broader so that the trigger looks to syndicated loan facilities referencing any SOFR-based rate (not just Term SOFR) and does not require that those facilities also use a “Benchmark Replacement Adjustment”. Parties are encouraged to consider whether “five” is the appropriate threshold number when drafting their own agreements and may choose a higher or lower number depending on their tolerance levels. Market participants should carefully consider the choice of threshold number to ensure that it is high enough to allow for objective, clear direction, but low enough to not force parties to wait before being able to transition to a successor rate if so desired. The second step requires a joint election by the administrative agent and the borrower to trigger a fallback from USD LIBOR and the provision of notice of such election to the lender group (see clause (2) of the definition of “Early Opt-in Election”).

Once initiated, there is a third step before an “early opt-in” is successful. Once notice is provided to the lenders, the lenders have five business days in which to object to the “early opt-in election”. If lenders comprising “Required Lenders”<sup>19</sup> have not objected to the election, then the “early opt-in” will take effect on the next business day. If the Required Lenders give objection to the Early Opt-in Election by the deadline, then the Benchmark Replacement Date with respect thereto never occurs (and the current Benchmark is not replaced). This process is set out in clause (3) of the definition of “Benchmark Replacement Date” and is set forth below:

- (3) in the case of an Early Opt-in Election, the sixth (6<sup>th</sup>) Business Day after the date notice of such Early Opt-in Election is provided to the Lenders, so long as the Administrative Agent has not received, by 5:00 p.m. (New York City time) on the fifth (5<sup>th</sup>) Business Day after the date notice of such Early Opt-in Election is provided to the Lenders, written notice of objection to such Early Opt-in Election from Lenders comprising the Required Lenders.*

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<sup>18</sup> Parties may choose to set a different threshold.

<sup>19</sup> “Required Lenders” is most commonly defined as a majority of the lenders.

For illustrative purposes, if notice of an Early Opt-in Election is provided on Monday to the Lenders, the following Monday by 5:00 p.m. is the deadline for objecting to the Early Opt-in Election. To the extent the Required Lenders have not objected in writing by such time, the Benchmark Replacement will go into effect Tuesday, the next business day. For purposes of determining interest, Tuesday would be used for settings of interest starting on the Thursday thereafter (which would be the next day that looked to Tuesday for setting of LIBOR given a standard two business day lookback) and any settings of interest made prior to Thursday would continue to use USD LIBOR

The ARRC has indicated that its recommended spread adjustment will be fixed at the time of an announcement by LIBOR’s regulator or administrator that LIBOR has or will cease or become no longer representative. In the case of the “early opt-in,” the successor rate and spread adjustment would be determined as they would be under any of the “mandatory” triggers set forth in the definition of “Benchmark Transition Event”. However, because the “early opt-in” necessarily occurs before a LIBOR cessation or non-representativeness event when the spread adjustment becomes static, the spread adjustment will be updated at the start of every “Interest Period” until such time as the spread adjustment becomes static. For a detailed description of spread adjustment mechanics, refer to **Part III.D.** below.

### C. Benchmark Replacement

In the ARRC-recommended fallback language for syndicated loans, if a trigger event and its related replacement date with respect to a Benchmark occur, all references to the Benchmark will be replaced throughout the documentation with the “Benchmark Replacement.” Note that the defined term “Benchmark Replacement” in the fallback language encompasses the successor rate and any spread adjustment, which is discussed separately below; the defined term for the successor rate prior to adjustment is “Unadjusted Benchmark Replacement.”

#### Waterfall

The defined term “Benchmark Replacement” sets forth a waterfall to determine the particular successor rate to be used. It is important to note that for administrative ease and hedging purposes, each step in the waterfall must be assessed as of the first time a trigger event with respect to the Benchmark becomes effective (this time is called the “Benchmark Replacement Date”). The availability of each step in the waterfall is not re-evaluated at a later point in time. The table below displays the waterfall:

<b>Benchmark Replacement Waterfall</b>
<b>Step 1:</b> Term SOFR + Adjustment
<b>Step 2:</b> Daily Simple SOFR + Adjustment
<b>Step 3:</b> Borrower and Administrative Agent Selected Rate + Adjustment

As is discussed in further detail below, counterparties may reasonably choose to eliminate the first step of this waterfall if they deem it appropriate at the time that they enter in to the credit agreement, or

may reasonably replace the second step with Daily Compounded SOFR + Adjustment or SOFR Average + Adjustment (i.e., Compounded in Advance).

### Step 1: Term SOFR + Adjustment

The first step in the “Benchmark Replacement” waterfall is specified in the fallback language as follows:

*the sum of (a) Term SOFR and (b) the related Benchmark Replacement Adjustment<sup>20</sup>*

“Term SOFR” is defined as the forward-looking term rate based on SOFR that is selected or recommended by the Relevant Governmental Body. The “Relevant Governmental Body” means the Federal Reserve Board or the Federal Reserve Bank of New York, or a committee officially endorsed or convened by the Federal Reserve Board or the Federal Reserve Bank of New York (e.g., the ARRC), or any successor thereto. The definition further provides that “Term SOFR” relates to the Corresponding Tenor (meaning a period equivalent to the LIBOR tenor, e.g., 1-month SOFR, 3-month SOFR) as of the applicable Reference Time (meaning, for each interest setting, the time and day that the rate is taken).

While the ARRC expects to select a forward-looking term SOFR for use as a fallback rate in cash products that originally referenced LIBOR<sup>21</sup>, this is only possible if the ARRC determines that an IOSCO-compliant benchmark<sup>22</sup> exists and meets appropriate criteria set by the ARRC. Therefore, it is not certain that such a benchmark will be produced prior to the discontinuation of LIBOR.

In addition, because standard derivatives will not reference a forward-looking term rate, either as a fallback to USD LIBOR or in new SOFR-based derivatives, borrowers in the loan market who execute swaps may prefer to remove Term SOFR (and adjust all of the corresponding cross references within the fallback language) in order to fall back to Daily Compounded SOFR, to better align with ISDA’s selected fallback rate. Note that other conforming changes may also be needed at the time a fallback is activated in order to maintain alignment with hedges.

### Step 2: Daily Simple SOFR + Adjustment

If the ARRC has concluded that a robust, IOSCO-compliant forward-looking SOFR term rate is not available and has therefore not selected or recommended such a rate per the first step of the waterfall, then the second step specified in the “Benchmark Replacement” waterfall of the refreshed fallback language is as follows<sup>23</sup>:

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<sup>20</sup> “Benchmark Replacement Adjustment” is the defined term for the spread adjustment discussed further below.

<sup>21</sup> See ARRC 2020 Objectives which includes, as a priority/milestone projected for completion by the end of 3Q20, establishing an RFP process and criteria for recommendations in order to select an administrator of an ARRC recommended forward-looking term SOFR rate to be published in the first half of 2021 if liquidity in SOFR derivatives markets has developed sufficiently, and also establishing recommended scopes of use for such a term rate at: [https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC\\_2020\\_Objectives.pdf](https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_2020_Objectives.pdf).

<sup>22</sup> See the *Principles for Financial Benchmarks*, final report of the Board of the International Organization of Securities Commissions dated July 2013 at: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf>

<sup>23</sup> Once a trigger event (or early opt-in election) occurs, the successor rate is determined in accordance with the “Benchmark Replacement” waterfall once at the time of transition. The fallback language for syndicated loans does not provide for subsequent retesting of the “Benchmark Replacement” waterfall once a transition from LIBOR has

*the sum of: (a) Daily Simple SOFR and (b) the related Benchmark Replacement Adjustment*

As discussed above, it is important to note that LIBOR is produced in various tenors (e.g. one-month, three-month, six-month). At each tenor LIBOR acts as a forward-looking rate whereby the interest due at the end of the period is known at the beginning of that interest period. SOFR, however, is an overnight rate, with SOFR for a given day being published the following day. Recently, on March 2, 2020 the Federal Reserve Bank of New York also began publishing SOFR Averages.<sup>24</sup> SOFR Averages are compounded averages of SOFR over rolling 30-, 90-, and 180-calendar day periods. While SOFR Averages can generally be used for “in advance” or “in arrears” interest rate settings, as discussed fully below, syndicated loans will only be able to reference SOFR Averages if the loan facility has compounded SOFR in advance as the relevant benchmark. After robust discussion with market participants as well as loan systems providers, it is clear that loan facilities will need to be able to accrue interest on a daily basis. For this reason, use of an average rate that is not known until toward the end of the interest period is not operationally feasible because of, among other things, the intraperiod principal fluctuations customary in syndicated loans. While aspects of this challenge can be addressed by having accrued interest paid together with prepayments, the preference of market participants is to instead apply SOFR on a daily basis throughout the interest period.

The definition of “Daily Simple SOFR” is set forth below:

*“Daily Simple SOFR” means, for any day, SOFR, with the conventions for this rate (which will include a lookback) being established by the Administrative Agent in accordance with the conventions for this rate selected or recommended by the Relevant Governmental Body for determining “Daily Simple SOFR” for business loans; provided, that if the Administrative Agent decides that any such convention is not administratively feasible for the Administrative Agent, then the Administrative Agent may establish another convention in its reasonable discretion.*

If the Benchmark Replacement is “Daily Simple SOFR” then, in its basic form, the loan would accrue interest based on SOFR for each day of the interest period. Because it is a daily rate, the applicable “Interest Period” here represents the applicable payment period for interest, e.g. monthly or quarterly,

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occurred. It is not certain that Term SOFR will have developed before a “Benchmark Transition Event” (or an “early opt-in”) occurs, so it is possible that the syndicated loan falls back to the second step of the waterfall. Retesting of the “Benchmark Replacement” waterfall has been rejected by the ARRC’s Business Loans Working Group, but, given the operational ease and familiarity of a term rate, some market participants may still prefer to outline a means of transitioning a syndicated loan to Term SOFR should such rate become available post-transition. Interested parties may consider adding a feature to the fallback language that provides for a later transition to Term SOFR. One way to do so would be to hardwire an automatic transition by including an additional transition event definition and referencing that definition in the operative provisions, clauses (a) and (c) of the Section titled “Benchmark Replacement Setting”, and updating relevant definitions, such as “Benchmark,” “Benchmark Replacement,” and “Benchmark Replacement Date.” Alternatively, parties may consider modifying the definition of “Early Opt-in Election” to be not only available if the loan is falling back from USD LIBOR, but rather from the then-current Benchmark, if they prefer to transition via amendment. In all cases, parties should carefully consider their preference for Term SOFR against the potential operational challenges of a second transition and, importantly, implications for existing hedging arrangements.

<sup>24</sup> SOFR Averages are published shortly after SOFR is published at approximately 8:00 a.m. ET. The published rates are available on the Federal Reserve Bank of New York’s website at:

<https://apps.newyorkfed.org/markets/autorates/sofr-avg-ind>.

rather than the tenor of the loan as it does for LIBOR loans, e.g. one-month or three-month. While that is a simple description of how the rate functions, an important component of the definition are the conventions it specifies. As a daily rate loan, interest accrues on a real-time basis (also known as “in arrears”) so the amount of interest owed by the borrower would not be known until the end of the period without use of a convention to achieve certainty regarding cash flows before an interest payment is due. While there are different approaches that can be taken, such as a “lockout” (where a SOFR rate is repeated for the final few days in each observation period) or a “payment delay” (where the payment of the interest period is made after the last day of the interest period), for syndicated loans the ARRC Business Loans Working Group supports the use of a lookback which is expressly included in the definition of “Daily Simple SOFR”. A lookback shifts backwards the period of time that the rates are observed. The exact length of the lookback will be established through the administrative agent’s use of “Benchmark Replacement Conforming Changes.” As an example, assume a 30-day Daily Simple SOFR loan with a five business day lookback starts on Wednesday, April 1<sup>st</sup>. The first SOFR rate applicable to the loan was SOFR for Wednesday, March 25<sup>th</sup> (five business days before the start of the interest period). This process of taking the daily rates would continue for the next twenty-nine days with the last day looking to the SOFR rate for Thursday, April 23<sup>rd</sup> (five business days before the end of the interest period on April 30<sup>th</sup>). The definition further provides that, in addition to the lookback, additional conventions shall be established by the administrative agent in accordance with the conventions selected or recommended by the Relevant Governmental Body (e.g. the ARRC). The ARRC has stated that it will finalize recommended conventions for business loans by the end of July 2020.<sup>25</sup> While the recommended conventions are the primary source for establishing conventions when determining “Daily Simple SOFR,” administrative agents are able to select alternative conventions, in their reasonable discretion, should one or more of the recommended conventions be found not administratively feasible.

Unlike the 2019 Fallback Language, the second step of the waterfall is not a compounded rate. While alignment with standard derivatives documentation, i.e. compounded SOFR in arrears, may be important to market participants, the Business Loans Working Group decided that Daily Simple SOFR should be the default second step. “A User’s Guide to SOFR”<sup>26</sup> demonstrated that there is little basis between Daily Simple SOFR and compounded SOFR in arrears, thus indicating the rate is still hedgeable with compounded SOFR in arrears hedges. Due to the requirements for an instrument with fluctuating principal, compounded SOFR in arrears as used in loan products would likely have different conventions than those used by ISDA, thereby generating differences between the two products even if both used compounded SOFR in arrears. In addition, Daily Simple SOFR is already operationalized, reduces operational risk relative to compounded SOFR in arrears, and poses fewer challenges for a heavily traded asset, like syndicated loans, where intraperiod payments are routine.

### Modifications to the Waterfall

The refreshed fallback language sets forth a set of contractual provisions which identify clear, objective triggers, a successor rate waterfall and a spread adjustment waterfall. While this architecture is

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<sup>25</sup> ARRC 2020 Objectives at:

[https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC\\_2020\\_Objectives.pdf](https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_2020_Objectives.pdf).

<sup>26</sup> See Figure 3 on page 6 of *A User’s Guide to SOFR*, published by the ARRC in April 2019 at:

<https://www.newyorkfed.org/arrc/publications>.

endorsed by the ARRC as a means of ensuring a smoother transition away from LIBOR, the ARRC recognizes that certain modifications to the “Benchmark Replacement” waterfall may be aligned with the ARRC’s principles. Alternative steps of the waterfall, “Daily Compounded SOFR” and “SOFR Average,” are discussed below. A modification to the waterfall as discussed in detail below would be fully aligned with the ARRC’s principles.

#### Daily Compounded SOFR

Market participants may prefer to reference daily SOFR compounded over the interest period in the second step (or even first step) of the successor rate waterfall in order to more closely align with derivatives or with other asset classes or currencies which will likely transition to a compounded rate.<sup>27</sup> This can be accomplished by changing the “Daily Simple SOFR” definition in the recommended fallback language to the “Daily Compounded SOFR” definition set forth below and changing all of the corresponding references within the fallback language from “Daily Simple SOFR” to “Daily Compounded SOFR.”

*“Daily Compounded SOFR” means, for any day, SOFR, with interest accruing on a compounded daily basis, with the methodology and conventions for this rate (which will include compounding in arrears with a lookback) being established by the Administrative Agent in accordance with the methodology and conventions for this rate selected or recommended by the Relevant Governmental Body for determining “Daily Compounded SOFR” for business loans; provided, that if the Administrative Agent decides that any such convention is not administratively feasible for the Administrative Agent, then the Administrative Agent may establish another convention in its reasonable discretion.*

Market participants may want to consider their operational capabilities when adopting fallback language that includes a “Daily Compounded SOFR” option.

#### Compounded SOFR in Advance

Similarly, market participants that wish to use “in advance” rates, which are the most similar to how LIBOR functions today and thus easiest to operationalize, may wish to use compounded SOFR in advance as the second step in the successor rate waterfall. Indeed, given that Term SOFR does not yet exist, market participants may prefer to include compounded SOFR in advance as the first step of the waterfall in lieu of Term SOFR. If parties wish to include a compounded SOFR in advance rate, this can be accomplished by using the SOFR Averages. Parties can replace the definition of “Daily Simple SOFR” (or “Term SOFR”) with the definition of “SOFR Average” set forth below:

*“SOFR Average” means, for the applicable Corresponding Tenor as of the applicable Reference Time, the compounded average of SOFR published by the Federal Reserve Bank of New York (or a successor administrator of the SOFR Average).*

Parties who choose to include “SOFR Average” should note that the Federal Reserve Bank of New York currently publishes 30-, 90-, and 180-Day Averages and any additional tenors that were available for

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<sup>27</sup> For the avoidance of doubt, compounding does not apply to the Benchmark Replacement Adjustment or any margin specified in the underlying terms.

LIBOR loans may need to be removed by the administrative agent pursuant to clause (d) of the Section titled “Benchmark Replacement Setting.”

### Step 3: Borrower and Administrative Agent Selected Rate + Adjustment

If, however, the Benchmark Replacement cannot be determined under Step 1 or 2, then the third and final step specified in the “Benchmark Replacement” waterfall is:

- (3) *the sum of: (a) the alternate benchmark rate that has been selected by the Administrative Agent and the Borrower as the replacement for the then-current Benchmark for the applicable Corresponding Tenor giving due consideration to (i) any selection or recommendation of a replacement benchmark rate or the mechanism for determining such a rate by the Relevant Governmental Body or (ii) any evolving or then-prevailing market convention for determining a benchmark rate as a replacement for the then-current Benchmark for U.S. dollar-denominated syndicated credit facilities at such time and (b) the related Benchmark Replacement Adjustment;*

This final step of the waterfall sets out a streamlined amendment process for selecting a Benchmark Replacement. This is an escape hatch that allows an easier transition from LIBOR in the event that Steps 1 and 2 of the Benchmark Replacement waterfall do not produce a usable rate. The borrower and the administrative agent will select an alternate rate of interest giving due consideration to any selection or recommendation that has been made by the Fed or the ARRC or any evolving or then-prevailing market convention for determining interest rates in U.S. dollar syndicated loans. In addition, such “Benchmark Replacement” will include the applicable Benchmark Replacement Adjustment described below. Once selected, the administrative agent will give notice of the proposed Benchmark Replacement to the lender group. The lenders then have five days in which they can object to the proposed Benchmark Replacement and if lenders constituting Required Lenders do object, then the amendment fails. The process would then begin again and continue until a Benchmark Replacement is successfully selected. In the meantime, after a “Benchmark Replacement Date” and before an amendment selecting the Benchmark Replacement is made effective, outstanding loans (and new loans) will accrue interest at ABR (see the “Benchmark Unavailability Period” provision and definition and the discussion in **Part III.G.** below).

### Rate Floors

Many credit agreements have floors applicable to LIBOR (zero or nonzero floors). It is assumed that parties would expect a negotiated rate floor to apply after a benchmark transition. Because the successor rate plus the spread adjustment together represent LIBOR’s successor it is appropriate for, and the ARRC Guiding Principles<sup>28</sup> should be interpreted to mean that, the floor applicable to LIBOR would be applicable to the Benchmark Replacement (which includes both components). The rate floor appears at the end of the definition of “Benchmark Replacement” and the corresponding definition of “Floor”:

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<sup>28</sup> ARRC Guiding Principles for More Robust LIBOR Fallback Contract Language in Cash Products published on July 9, 2018 at: <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-principles-July2018>.

*...If the Benchmark Replacement as determined pursuant to clause (1), (2) or (3) above would be less than the Floor, the Benchmark Replacement will be deemed to be the Floor for purposes of this Agreement and the other Loan Documents.*

*“Floor” means the benchmark rate floor, if any, provided in this Agreement initially (as of the execution of this Agreement, the modification, amendment or renewal of this Agreement or otherwise) with respect to USD LIBOR.*

Operationally, there may be further specifications with respect to how rate floors are applied to a Benchmark Replacement and market participants are encouraged to refer to the upcoming ARRC recommendations on conventions for business loans for more detail.

### Use of Screen Rates

The ARRC’s 2018 consultation on syndicated loans requested feedback from market participants on whether it was necessary that any successor rate or applicable spread adjustment be published on a screen by a third party. Respondents were unanimous in identifying the availability of screen rates and screen adjustments for any successor rate as necessary for smooth market transition. The Business Loans Working Group unanimously concurred. The ARRC has stated that it intends to ensure the publication of screen rates for its recommended SOFR fallbacks and spread adjustments.

A screen rate requirement applies to Term SOFR and Daily Simple SOFR (or Daily Compounded SOFR), but appears in different places in the fallback language. For Term SOFR, the first step of the replacement rate waterfall, the screen rate requirement is set forth at the end of the “Benchmark Replacement” definition:

*...provided that, in the case of clause (1), such Unadjusted Benchmark Replacement is displayed on a screen or other information service that publishes such rate from time to time as selected by the Administrative Agent in its reasonable discretion.*

It is anticipated that Term SOFR, if developed, will be available as a screen rate much like LIBOR is now. For parties that choose to include “SOFR Average” as the second step of the Benchmark Replacement waterfall, they may wish to expand the screen rate requirement above to apply to “clauses (1) and (2)”.

For Daily Simple SOFR (or Daily Compounded SOFR), the screen rate requirement is effectively found in the definition of “SOFR”, which refers to the rate that is published on the Federal Reserve Bank of New York’s website or a successor source.

Likewise, the definition of “Benchmark Replacement Adjustment” sets forth a screen requirement for the first and second steps of the Benchmark Replacement Adjustment waterfall. The relevant language is found at the end of the definition and is set forth below:

*...provided, that, in the case of clause (1) above, such adjustment is displayed on a screen or other information service that publishes such Benchmark Replacement Adjustment from time to time as selected by the Administrative Agent in its reasonable discretion.*

If the first two steps in the successor rate waterfall (Term SOFR and Daily Simple SOFR) are not available, it is still expected that a rate and adjustment (if applicable) that is selected by the borrower and



administrative agent would be preferred to appear on a screen. However, to avoid fallback language failure, the drafting would allow for an unpublished rate or adjustment (if applicable) to be selected by the administrative agent and the borrower at that time.

#### **D. Benchmark Replacement Adjustment**

LIBOR and SOFR are different rates and thus the transition from LIBOR to SOFR will require a spread adjustment to make the rate levels more comparable. As noted above, LIBOR is produced in various tenors and SOFR is an overnight rate. Another critical difference between LIBOR and SOFR is that LIBOR is based on unsecured transactions and is intended to include the price of bank credit risk. SOFR, on the other hand, is a near risk-free rate that does not include any bank credit component, as the transactions underpinning SOFR are fully secured by U.S. Treasuries.

Therefore, the ARRC-endorsed fallback language provides for an adjustment (which may be a positive or negative value or zero) to be included in the determination of any Benchmark Replacement. The particular spread adjustment to be used is selected at the time that the Benchmark Replacement is determined according to a waterfall in the definition of “Benchmark Replacement Adjustment.” Note that the fallback adjustment would differ for each LIBOR tenor and would be implemented as part of the Benchmark Replacement in order to encompass all credit, term and other adjustments that may be appropriate for a given tenor of the benchmark rate. The table below displays the syndicated loan spread adjustment waterfall:

<b>Benchmark Replacement Adjustment Waterfall</b>
<b>Step 1:</b> ARRC Selected Adjustment
<b>Step 2:</b> ISDA Fallback Adjustment
<b>Step 3:</b> Borrower and Administrative Agent Selected Adjustment

Steps 1 and 2 of the Benchmark Replacement Adjustment are applicable to Steps 1 and 2 of the Benchmark Replacement (i.e., Term SOFR and Daily Simple SOFR). Step 3 of the Benchmark Replacement Adjustment is applicable to Step 3 of the Benchmark Replacement (i.e., the rate selected in the streamlined amendment process).

##### [Step 1: ARRC Selected Adjustment](#)

The first step of the adjustment waterfall set forth in clause 1(a) of the definition of “Benchmark Replacement Adjustment” provides that the adjustment will be:

- (a) the spread adjustment, or method for calculating or determining such spread adjustment, (which may be a positive or negative value or zero) as of the Reference Time such Benchmark Replacement is first set for such Interest Period that has been selected or recommended by the Relevant Governmental Body for the replacement of such Benchmark with the applicable Unadjusted Benchmark Replacement for the applicable Corresponding Tenor;*

In April 2020, the ARRC announced that it will be recommending a spread adjustment methodology based on a historical median over a five-year lookback period calculating the difference between USD LIBOR and SOFR.<sup>29</sup> The five-year median spread adjustment methodology matches the methodology recommended by ISDA for derivatives and would make the ARRC's recommended spread-adjusted version of SOFR comparable to USD LIBOR and consistent with ISDA's fallbacks for derivatives markets. In June 2020, the ARRC further announced, with respect to business loans, that the ARRC's recommended spread adjustments will match the value of ISDA's spread adjustments to USD LIBOR and, in the event that a pre-cessation event is operative, the ARRC's recommended spread adjustments will be determined at the same time as ISDA's spread adjustments, i.e. the time of any announcement that LIBOR will or has ceased or will or has become no longer representative.<sup>30</sup> The ARRC has committed to making sure its recommended spread adjustments are published and will work with potential vendors to make sure that these spread adjustments are made publicly available.

Market participants that wish to maintain parity with hedges and fall back first to Daily Compounded SOFR may consider removing this first step of the Benchmark Replacement Adjustment waterfall and instead only use, the second step of the spread adjustment waterfall, the ISDA Fallback Adjustment.

## Step 2: ISDA Fallback Adjustment

In the absence of a spread adjustment selected or recommended by the Relevant Governmental Body being available, the second step in the waterfall set forth in clause 1(b) of the definition of "Benchmark Replacement Adjustment" is the spread adjustment applicable to fallbacks for derivatives that ISDA will implement in its definitions.<sup>31</sup> The relevant language is set forth below:

*(b) the spread adjustment (which may be a positive or negative value or zero) as of the Reference Time such Benchmark Replacement is first set for such Interest Period that would apply to the fallback rate for a derivative transaction referencing the ISDA Definitions to be effective upon an index cessation event with respect to such Benchmark for the applicable Corresponding Tenor;*

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<sup>29</sup> "ARRC Announces Recommendation of a Spread Adjustment Methodology for Cash Products," dated April 28, 2020 at: [https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC\\_Spread\\_Adjustment\\_Methodology.pdf](https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Spread_Adjustment_Methodology.pdf).

<sup>30</sup> "ARRC Announces Further Details Regarding Its Recommendation of Spread Adjustments for Cash Products," dated June 30, 2020 at: [https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC\\_Recommendation\\_Spread\\_Adjustments\\_Cash\\_Products\\_Press\\_Release.pdf](https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Recommendation_Spread_Adjustments_Cash_Products_Press_Release.pdf).

<sup>31</sup> We note that the ISDA spread adjustment will be intended for use with compounded SOFR in arrears as the fallback in its standard derivatives documentation. Given that a spread adjustment designed to be suitable with Term SOFR, a daily simple SOFR or a daily compounded SOFR, and a spread adjustment designed to be suitable for the ISDA version of compounded SOFR in arrears, should be economically equivalent, the second step of the spread waterfall could apply to any of a Term SOFR, a Daily Simple SOFR or a Daily Compounded SOFR for the Corresponding Tenor (meaning a period equivalent to relevant LIBOR tenor, e.g. 1-month SOFR, 3-month SOFR).

ISDA and Bloomberg have announced that Bloomberg will publish, on every business day, the spread adjustment to be used in the fallback language for ISDA standard documentation. The spread adjustment will be based on the median over a five-year period of the historical differences between the IBOR, here USD LIBOR, in the relevant tenor and the relevant risk-free rate, here SOFR, compounded over each corresponding period. Bloomberg will soon publish these adjustments via a variety of distribution platforms on an indicative basis until a relevant LIBOR cessation/non-representativeness announcement, when the adjustment for each tenor of USD LIBOR is set. It is important to note that ISDA has not analyzed, and will not analyze, whether the fallbacks it anticipates implementing, including spread adjustments in the fallbacks, would be appropriate for non-derivatives.

### Step 3: Borrower and Administrative Agent Selected Adjustment

If neither Term SOFR nor Daily Simple SOFR is the successor rate (meaning the successor rate is a different rate which is selected by the borrower and the administrative agent), then the third and final step of the spread adjustment waterfall applies. This step requires that the borrower and administrative agent select a Benchmark Replacement Adjustment giving due consideration to any selection or recommendation that has been made by the Fed or the ARRC or any evolving or then-prevailing market convention for determining a spread adjustment for the replacement of the then-current Benchmark in U.S. dollar syndicated loans. This step is found in clause (2) of the definition of “Benchmark Replacement Adjustment” which is set forth below:

*...the spread adjustment, or method for calculating or determining such spread adjustment, (which may be a positive or negative value or zero) that has been selected by the Administrative Agent and the Borrower for the applicable Corresponding Tenor giving due consideration to (i) any selection or recommendation of a spread adjustment, or method for calculating or determining such spread adjustment, for the replacement of such Benchmark with the applicable Unadjusted Benchmark Replacement by the Relevant Governmental Body on the applicable Benchmark Replacement Date or (ii) any evolving or then-prevailing market convention for determining a spread adjustment, or method for calculating or determining such spread adjustment, for the replacement of such Benchmark with the applicable Unadjusted Benchmark Replacement for U.S. dollar-denominated syndicated credit facilities.*

As discussed in more detail in **Part III.G.** below, in the event of a future transition away from the Benchmark Replacement, it is third step of the “Benchmark Replacement” waterfall and “Benchmark Replacement Adjustment” waterfall that would apply if neither Term SOFR nor Daily Simple SOFR are available.

### Setting of the Benchmark Replacement Adjustment

Both ARRC and ISDA intend to publish their spread adjustments on an indicative daily basis before any LIBOR cessation or pre-cessation will occur to better familiarize market participants with the comparative behavior of the recommended adjustment to SOFR. The indicative spread adjustments will be published until the announcement of the relevant cessation or pre-cessation event at which time the spread adjustment will become fixed and apply on a static basis.

As discussed above, parties may elect to exercise an “early opt-in” with respect to their transition from USD LIBOR. To accommodate this, the refreshed fallback language looks to the indicative spread adjustments with respect to Term SOFR or Daily Simple SOFR during the period until the spread adjustments become static. As set forth in the definition of “Benchmark Replacement Adjustment,” the spread adjustment will be determined at the time the early opt-in election becomes effective, but the applicable spread adjustment (for the applicable tenor or payment period) will be set at the beginning of every interest period, subject to the lookback described above, and will apply for the duration of that interest period. At the time that the ARRC or ISDA spread adjustment becomes static, the same spread adjustment will apply, via the same process, over the life of the contract. The definition of “Benchmark Replacement Adjustment” is set forth below (emphasis added):

***“Benchmark Replacement Adjustment” means, with respect to any replacement of the then-current Benchmark with an Unadjusted Benchmark Replacement for any applicable Interest Period and Available Tenor for any setting of such Unadjusted Benchmark Replacement:***

*...the spread adjustment, or method for calculating or determining such spread adjustment, (which may be a positive or negative value or zero) as of the Reference Time such Benchmark Replacement is first set for such Interest Period that has been selected or recommended by the Relevant Governmental Body for the replacement of such Benchmark with the applicable Unadjusted Benchmark Replacement for the applicable Corresponding Tenor.*

In this way, whether a loan facility transitions through an “early opt-in” or upon the occurrence of a “mandatory trigger,” the same spread adjustment will apply across different loan facilities after the ARRC or ISDA spread adjustment becomes static, even if the “early opt-in” was triggered during a time when the spread adjustment was not static. Market participants who choose to transition through an “early opt-in” will be, at that time, in the same position as if they had waited until the “mandatory trigger” occurred.

#### **E. Conforming Changes**

Even though the fallback language is “hardwired,” there will certainly be conforming changes needed upon the transition to a successor rate that have not been specifically addressed in the fallback language. For this reason, the fallback language provides the administrative agent the ability to execute certain conforming changes to the syndicated loan in order to appropriately implement and administer the successor rate. Several non-exhaustive examples of such changes include moving from months to day count (1 month vs. 30 days), the setting of the length of the lookback period, or perhaps an adjustment to the length of interest accrual periods or frequency of determining rates. The definition of “Benchmark Replacement Conforming Changes” is set forth below:

***“Benchmark Replacement Conforming Changes” means, with respect to any Benchmark Replacement, any technical, administrative or operational changes (including changes to the definition of “ABR,” the definition of “Business Day,” the definition of “Interest Period,” timing and frequency of determining rates and making payments of interest, timing of borrowing requests or prepayment, conversion or continuation notices, length of lookback periods, the applicability of breakage provisions, and other technical, administrative or operational matters) that the Administrative Agent decides may be appropriate to reflect the adoption and implementation of such Benchmark Replacement and to permit the administration thereof by***

*the Administrative Agent in a manner substantially consistent with market practice (or, if the Administrative Agent decides that adoption of any portion of such market practice is not administratively feasible or if the Administrative Agent determines that no market practice for the administration of such Benchmark Replacement exists, in such other manner of administration as the Administrative Agent decides is reasonably necessary in connection with the administration of this Agreement and the other Loan Documents).*

Because conventions may evolve over time, the administrative agent's ability to implement conforming changes is not only available at the time of transition, but also from time to time thereafter. The administrative agent may consider using its ability to make conforming changes to address the timing of borrowing requests or prepayment, conversion or continuation notices during the interim period around a benchmark transition, as such notice periods may not align for the current benchmark and the benchmark replacement.

#### **F. Notices and Standards for Decisions and Determinations**

Because it is important that the borrower and lenders, as applicable, are properly notified of changes resulting from the cessation or pre-cessation of USD LIBOR and transition to a Benchmark Replacement, clause (c) of the Section titled "Benchmark Replacement Setting" enumerates the events which require the administrative agent to promptly notify the borrower and lenders. The requirement that the administrative agent send such notices is narrow, but includes (i) any occurrence of a trigger event, including an early opt-in election, as applicable (and the related "Benchmark Replacement Date" and "Benchmark Transition Start Date"), (ii) the implementation of any Benchmark Replacement, (iii) the effectiveness of any "Benchmark Replacement Conforming Changes," (iv) the removal or reinstatement of any tenor of a Benchmark and (v) the commencement or conclusion of any "Benchmark Unavailability Period," i.e. when the loans would accrue interest at ABR.

The fallback provisions specify that the administrative agent must make certain decisions and determinations, for example, whether a trigger has occurred and what is the applicable successor rate and spread adjustment. In certain cases, such as in the case of an "early opt-in" or in the determination of the successor rate via the streamlined amendment process, lenders also must make certain decisions. The fallback language specifies in the operative provisions that any determination, decision, including decisions regarding whether to take action or refrain from taking action, or election may be made "in the sole discretion" of the administrative agent or lender (or group of lenders). The standard set forth for any such decision, determination or election is "conclusive and binding absent manifest error."

#### **G. General Considerations**

##### Future-proofing

It is important to note that the fallback provisions refer to the "Benchmark" throughout and define the Benchmark as, initially, USD LIBOR; provided that if USD LIBOR has been replaced in the contract, then the term "Benchmark" means the applicable "Benchmark Replacement" (which is a defined term that combines the successor rate and the spread adjustment). This drafting is intended to allow the fallback provisions to apply again in the highly unlikely event that during the term of a contract, the successor for

LIBOR is later discontinued. If that were to occur when the then-current Benchmark is Term SOFR, the successor rate would be Daily Simple SOFR (so long as SOFR is being published). In other circumstances, the successor rate would be chosen through the streamlined amendment process (as presumably neither Term SOFR nor Daily Simple SOFR would be available). It is worth noting too that the fallback language only contemplates for the “early opt-in” feature to be available if the “Benchmark” is USD LIBOR.

#### Benchmark Unavailability Period

The Benchmark Unavailability Period provisions are designed primarily to address timing or acceptance issues surrounding a Benchmark Replacement. If the Benchmark Replacement is determined pursuant to clause (3) of the definition thereof (the streamlined amendment process), such replacement will not become effective until 5:00 p.m. on the 5<sup>th</sup> business day after notice is provided to the lenders. Further, such clause (3) Benchmark Replacement may not become effective at all if the Required Lenders timely object to the benchmark rate and spread adjustment selected by the administrative agent and borrower. If during such five business day period or after such rejection the current Benchmark has actually ceased or a pre-cessation event has actually occurred, such that the Benchmark would no longer be usable, all relevant loans that are set during such period would accrue interest at ABR instead of such Benchmark. Any Benchmark Unavailability Period will end when a Benchmark Replacement is made effective. Further, any ABR prong based upon any unavailable Benchmark or an unavailable tenor thereof would be disregarded.

#### Scope of Recommendation

This ARRC recommendation offers a complete fallback solution, but it is not possible to address every aspect of a credit agreement that would be impacted when LIBOR is replaced and such other changes to operative provisions fall outside the scope of this project. For example, recognizing that changes to interest rates would typically require the consent of all lenders, it is the assumption here that changes to the fallback language once included in a credit agreement would require the consent of all lenders. Additionally, there are a number of customary credit agreement provisions that have developed around the historical construct of LIBOR and such provisions, e.g. breakage, increased costs, and illegality, may need to be reconsidered if LIBOR is not the reference rate.

Finally, there are certain decisions and determinations that must be made by administrative agents in connection with a transition to a Benchmark Replacement. Administrative agents may deem it prudent to include general disclaimer language with respect to LIBOR or any successor rate. While such provisions are individual to each administrative agent, the ARRC understands the needs of administrative agents and the ARRC does not consider the inclusion of such language to be at odds with its principles.

#### **H. Multicurrency Facilities**

The recommended fallback language contained herein has been developed for, and is limited to, a U.S. dollar-denominated only syndicated loan facility. However, in the syndicated loan market there are many multicurrency facilities which allow for a borrower to make draws on the same facilities in additional eligible currencies as set forth in the relevant credit agreement. Multicurrency facilities that

permit loans to be made in U.S. dollars, Canadian dollars as well as other LIBOR currencies, such as British pounds sterling, Euros, and Japanese yen, are frequently seen.

The ARRC Guiding Principles do provide high-level guidance with respect to multicurrency facilities: Market participants should seek an alignment of outcomes, where possible, with contract language in other jurisdictions in order to simplify transition and minimize value transfer in multi-currency facilities and minimize basis risks in other agreements or interrelated transactions involving multiple currencies.

Because of the complexity of multicurrency facilities and the lack of full clarity with respect to the transition plans of the other LIBOR currency jurisdictions, the ARRC is not recommending fallback language for use in multicurrency facilities at this time. Market participants that wish to adopt hardwired fallback language in a multicurrency facility can consider adapting the refreshed fallback language contained in this recommendation to apply to the U.S. dollar loans of the multicurrency facility. However, it may be that an amendment approach to fallback language in multicurrency facilities is more suitable at this time – until greater clarity with respect to plans for the implementation of each currency’s respective risk-free rate is available.<sup>32</sup> As the ARRC recommendations for syndicated loans have evolved from an amendment approach to a hardwired approach over the last fourteen months, a similar evolution in fallback language for multicurrency facilities would offer more robust, safer fallback language and ultimately a smoother transition away from LIBOR.

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<sup>32</sup> The ARRC Guiding Principles state that “...efforts should evolve iteratively, utilizing market information and developments from other products to inform standard interest rate language in new agreements. Suggested contract language may initially include higher degrees of flexibility or discretion in order to facilitate quicker incorporation of more robust fallback language where none currently exists, but should be expected to evolve to more specific language that leaves less ambiguity as to how fallback rates and spread adjustments will be selected...”