Clients&FriendsMemo

ARRC Publishes Refreshed Recommended Fallback Language for Syndicated Business Loans for LIBOR Transition Planning[1]

June 30, 2020

On June 30, 2020, the Alternative Reference Rates Committee ("ARRC")[2] published recommendations regarding more robust fallback language for new originations of U.S. dollar-denominated syndicated business loans that reference LIBOR.[3] The ARRC's recommendations contain refreshed hardwired fallback language (the "Updated Fallback Language") and an updated user's guide regarding such hardwired language and potential drafting alternatives (the "Updated User's Guide"). The Updated Fallback Language refreshes the hardwired fallback language that the ARRC previously recommended in April 2019 (the "2019 Fallback Language"), as contemplated by the recently published ARRC Recommended Best Practices for Completing the Transition from LIBOR (the "Recommended Best Practices").[4] This refresh is also in line with the ARRC Guiding Principles, which provide that "fallback language should be expected to evolve to more specific language that leaves less ambiguity as to how fallback rates and spread adjustments will be selected."[5]

Consistent with the Recommended Best Practices, a notable feature of the Updated Fallback Language is that only the hardwired approach, and not the amendment approach, from the 2019 Fallback Language has been refreshed. The ARRC reasoned in the Updated User's Guide that although the amendment approach from the 2019 Fallback Language has been broadly adopted in the syndicated loan market to date, it could pose operational challenges if all of the underlying contracts incorporating the amendment approach need to be amended during the same period as a result of LIBOR cessation. The hardwired approach provides more

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1 Disclaimer: Cadwalader acts as counsel to the ARRC on various matters. This memorandum solely represents the views of Cadwalader and not necessarily those of the ARRC or its members.

2 Further information on the ARRC is available at https://www.newyorkfed.org/arrc.

3 A copy of the Updated Fallback Language and the Updated User's Guide, is available at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/Updated-Final-Recommended-Language-June-30-2020.pdf.

4 A copy of the Recommended Best Practices is available at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC-Best-Practices.pdf.

5 A copy of the ARRC Guiding Principles for More Robust LIBOR Fallback Contract Language in Cash Products is available at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-principles-July2018.

certainty regarding a successor rate and spread adjustment and has the potential to take effect without requiring substantive negotiation among the parties.

One of the most significant changes in the Updated Fallback Language is that the second step of the benchmark replacement waterfall (which determines the replacement benchmark rate and spread adjustment upon the occurrence of a trigger event) is now recommended to be daily simple SOFR, as opposed to a compounded SOFR alternative. The corresponding commentary in the Updated User's Guide provides further color regarding the ARRC's business loans working group's decision that the default second step in the waterfall should be a daily simple rate. In an earlier publication[6], the ARRC showed that there is little basis between a daily simple SOFR and compounded SOFR in arrears, thus indicating that daily simple SOFR loans should still be able to be hedged with compounded SOFR in arrears hedging products. Likewise, daily simple SOFR has been further operationally developed and poses less operational risk than a compounded rate in the context of syndicated business loans. The Updated User's Guide also includes, as alternatives, sample provisions for market participants preferring a daily compounded SOFR (in arrears) rate or an average compounded SOFR (in advance) rate.

The Updated Fallback Language also includes a number of other important updates and modifications, including:

- an expanded early opt-in election feature, with a negative consent right for required lenders;
- clarification that a floor for rates subject to a fallback is to be applied to the benchmark rate plus the spread adjustment;
- a broadened ability for the administrative agent to "turn off" certain tenors of any benchmark that is a term rate, in order to allow greater flexibility to manage benchmark transitions where options may not be available or may cease to be available on a tenor-by-tenor basis;
- updated drafting of the benchmark transition event definition to reflect the view that a benchmark should transition upon the relevant trigger occurring with respect to *all* available tenors of the benchmark under the applicable credit agreement (to address the issue of potential tenor-by-tenor cessation or pre-cessation announcements);
- the change to "step 2" of the benchmark replacement waterfall discussed above;
- important clarifications regarding the timing of when spread adjustments are calculated, including discussions of when spread adjustments are expected to become static;

[6] A copy of A User's Guide to SOFR is available at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/Users_Guide_to_SOFR.pdf.

- updates to the benchmark replacement conforming changes definition to include additional enumerated provisions that are subject to modification; and
- general streamlining of the drafting and inclusion of more specific references where the market has better visibility into how a benchmark replacement would function for syndicated business loan products.

Overall, the Updated Fallback Language builds upon the 2019 Fallback Language by offering a more robust, yet operationally efficient, fallback solution following continued discussions with the ARRC's business loans working group and further insight regarding the implementation of SOFR-based rates. By reviewing the Updated Fallback Language and the corresponding commentary in the Updated User's Guide, market participants should gain a better understanding regarding many of the considerations involved in developing more transparent contractual fallback provisions. Though the Updated Fallback Language is just a recommendation, which may be voluntarily adopted or modified, it provides a framework for market participants to achieve the ARRC's recommendation set forth in the Recommended Best Practices that hardwired fallback language be incorporated in syndicated business loans by September 30, 2020.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys, or email us at LIBOR@cwt.com.

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