ROPES & GRAY

CONSIDERATIONS

TRANSITIONING FROM LIBOR TO SOFR

AS LIBOR'S END COMES CLOSER, loan market participants are increasingly focused on the specific provisions implicated in credit agreements and what changes must be made to switch from LIBOR to SOFR.

LIBOR is scheduled to become unavailable sometime around the end of 2021, though the precise date is not certain. As that time approaches, pressure in the loan market has increased to understand what loan market participants need to do to prepare. LIBOR is expected to be replaced by the Secured Overnight Funding Rate ("SOFR"), which is an interest rate based on transactions in the Treasury repurchase market. SOFR fundamentally differs from LIBOR in the way it is sourced and the fact that it does not currently offer a forward-looking term curve. SOFR has gained traction in the market, and the Fed started publishing 30, 90 and 180 compounded SOFR averages in the first quarter of 2020.

THE LSTA IS DEVELOPING A SOFR-BASED FORM CREDIT AGREEMENT

The Loan Syndications and Trading Association ("LSTA"), an industry group for the syndicated lending market, has been working steadily with various constituents on a SOFR Concept Credit Agreement that shows what a SOFR-based loan agreement would look like. The document is still in draft form but is helpful when thinking through the changes that would need to be made to loan agreements in order to transition from LIBOR to SOFR.

While the LSTA provisions are not *per se* binding, it can be expected that they will set a market practice that commercial banks and similar private debt providers will follow to ensure uniform market standards and procedures.

The SOFR Concept Credit Agreement includes the following provisions:

- **Benchmark Replacement:** "Benchmark Replacement" provisions lay out the triggers and mechanics for the switch. There are two slightly different "cessation" triggers. The first is tied to a public statement or publication of information by the administrator of LIBOR that cessation of LIBOR has occurred or is expected. The second is tied to a public statement or publication of information by any of (i) the regulatory supervisor of the administrator of LIBOR, (ii) the central bank for the currency of LIBOR or (iii) a bankruptcy/resolution official or court with jurisdiction over the administrator of LIBOR that cessation of LIBOR has occurred or is expected. The occurrence of either of those triggers would cause an immediate switch from LIBOR to SOFR. The third trigger is a "pre-cessation" trigger and would require an earlier switch to SOFR if a public statement or publication of information is issued by the regulatory supervisor for the administrator of LIBOR announcing that LIBOR is no longer representative. The "Benchmark Replacement" provisions in the SOFR Concept Credit Agreement are sufficiently generic so that they could be used again in the (hopefully unlikely) event that SOFR rates are discontinued.

- **SOFR as the Replacement Reference Rate:** Loan market participants had originally hoped that a SOFR term curve would be available to replace LIBOR, which operates as a forward-looking term curve. The use of a forward-looking term curve currently allows borrowers and issuers with debt tied to LIBOR to know and lock in at the outset of an interest period what the reference rate will be for such interest period. Since Term SOFR now appears unlikely to be available within the existing timeframe, loans are expected to use Daily Simple SOFR as the new reference rate. Under such regime, the reference rate will not be calculated until the end of an interest period, and borrowers will not know in advance what the reference rate will be. Because the rate won't be known in advance, SOFR conventions provide that parties use a lookback method to allow for additional time to calculate the correct reference rate. The lookback method provides that for every day in the current interest period, the parties apply the SOFR rate from a certain number of days earlier. The length of that lookback is to be determined by the parties and may depend on a borrower's operational needs.

To provide sufficient flexibility, the SOFR Concept Credit Agreement permits loan parties to switch from Daily Simple

SOFR to Term SOFR if and when Term SOFR becomes available, and the document is drafted to accommodate either of those options (as well as Daily Compounded SOFR, which is compounded and therefore closer to Compounded SOFR in Arrears, the reference rate expected to be used for ISDA-governed documents).

- **Terms and Definitions:** The SOFR Concept Credit Agreement includes all of the needed SOFR definitions, such as SOFR, SOFR Administrator (the Fed), SOFR Administrator's Website (the Fed's Website), SOFR Borrower and necessary conforming changes to other definitions. It also includes changes to the definition of "Interest Period" and related definitions, because the concept of an "Interest Period" is not required for loans that do not accrue interest based on a term-based reference rate. Parties can choose when payments are due (monthly, quarterly, etc.).

TO IMPLEMENT THE CHANGES, BORROWERS CONTINUE TO FAVOR THE "AMENDMENT APPROACH" OVER THE "HARDWIRED APPROACH," BUT PRESSURE TO HARDWIRE SOFR IS RISING

Since the Financial Conduct Authority announced in 2017 that LIBOR was going to become unavailable sometime after 2021, new loan agreements and amendments to existing loan agreements have almost universally included some form of fallback language, which determines what reference rate applies when LIBOR becomes unavailable.

In April 2019, the Alternative Reference Rate Committee (the "ARRC"), a group of private-market participants convened by the Federal Reserve and the NY Fed to manage the transition away from LIBOR, published suggested fallback language for many assets, including syndicated loans. The language included two iterations. The first was the "amendment approach" in which the Administrative Agent and the Borrower would jointly choose a new reference rate to replace LIBOR at some future date and would then amend the loan agreement accordingly; lenders holding a majority of the debt would be given five business days to object to the amendment. The second approach was the "hardwired approach" in which the reference rate would automatically switch from LIBOR to a new rate upon the occurrence of any one of a set of triggers. Use of the hardwired approach would preclude the need for an amendment process, but would also eliminate the Borrower's and the Lenders' rights to consent to the changes and to make adjustments at the time the switch to the new rate is made. The ARRC initially offered both the amendment and hardwired approaches to the loan market, with the understanding that it would take some time for parties to adopt a hardwired approach that would forego the amendment process. The ARRC at the time was optimistic that the hardwired approach would become more prevalent by the end of 2020. This has not yet materialized.

In June 2020, the ARRC published updated fallback language that now only includes an updated hardwired approach, thereby encouraging commercial lenders and underwriters to hardwire the move to SOFR into their agreements. Lending banks have begun to include the hardwired language in loan documents, and they will likely continue to press for that language to be included. To date, borrowers have resisted those changes. At the same time, it is likely not practicable for every loan agreement to simultaneously require an amendment that is achieved through a process in which the borrower and majority lenders have consent rights. As SOFR becomes more prevalent and accepted, we should expect to see processes and procedures emerge to effect the transition to SOFR without requiring a full amendment process.

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