LIBOR Transition & CLOs

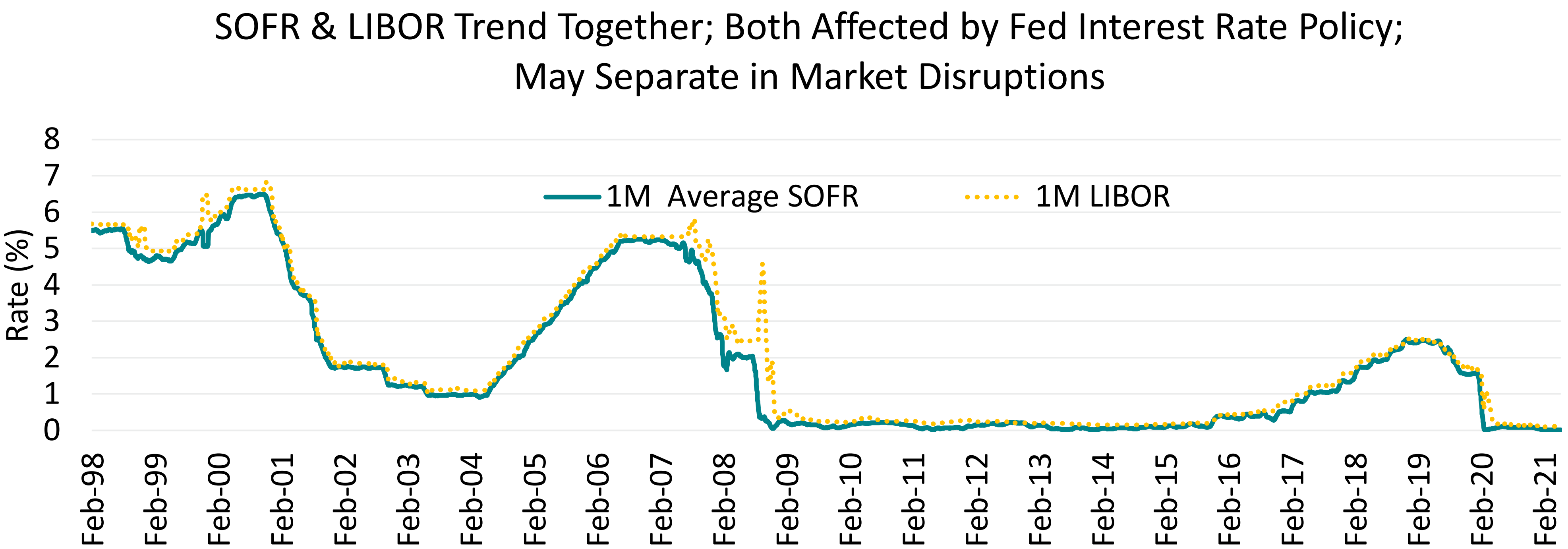
Meredith Coffey, LSTA, mcoffey@lsta.org

Things to Know

- Economics: How SOFR behaves; why the CSA; relevance of the floor

- Where we go from here: All SOFR, (nearly) all the time; Getting your ducks in a row; Remediation looms

Economics: LIBOR & SOFR Generally Trend Together, May Separate in Market Disruptions

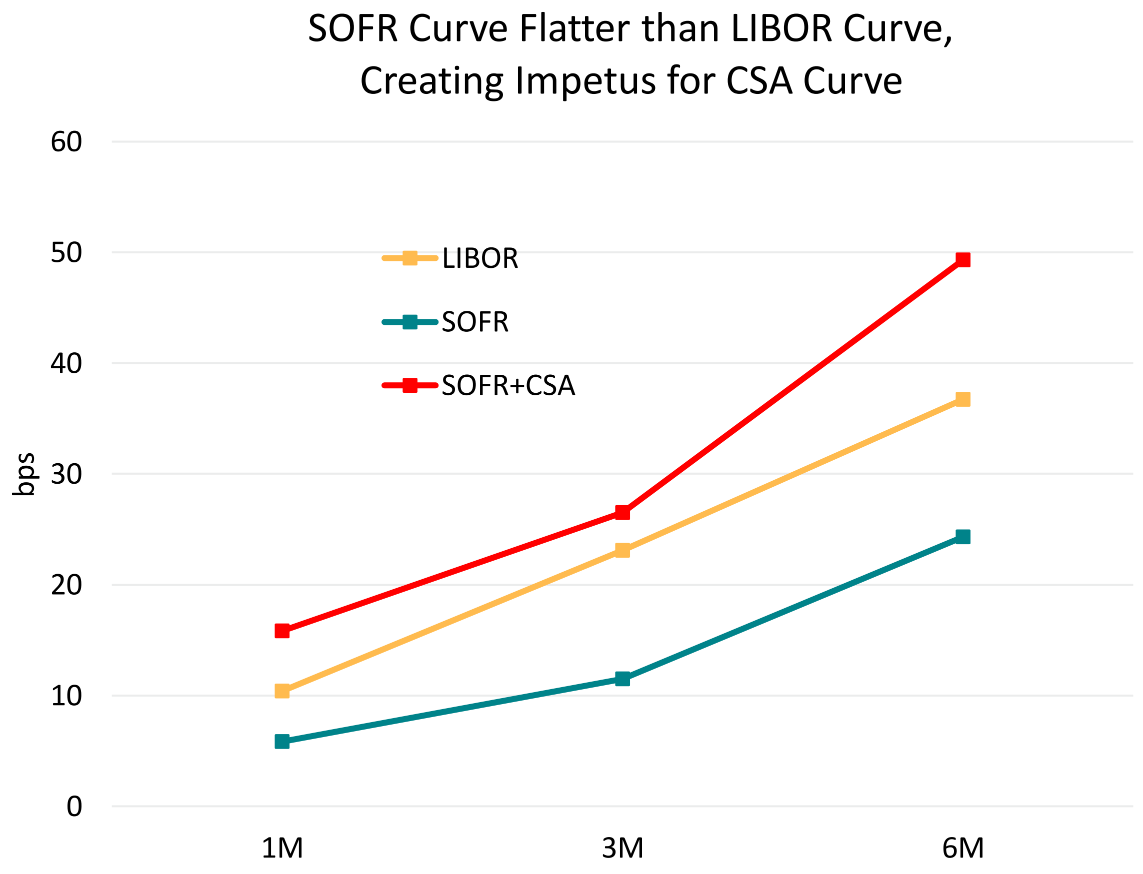


- LIBOR and SOFR both respond to interest rate policy
- Between 1998 and 2021, the difference between LIBOR & SOFR was between 5 and 30 bps 70% of the time
- However, the difference is not constant and LIBOR can widen materially in periods of market disruption (like 2008 or March 2020)

Source: LSTA, Wells Fargo, Bloomberg, FRBNY

Economics: Why the SOFR CSA Curve? Other Approaches?

- The SOFR curve is lower and flatter (green curve)
- The LIBOR curve is higher and steeper (e.g., 3M LIBOR tends to be higher than 1M LIBOR (yellow curve))
- To maintain a higher "reference rate" for longer interest rate contracts, many SOFR loans include a "Credit Spread Adjustment (CSA)" Curve of 10 bps for 1M/15 bps for 3M/25 bps for 6M (red curve)
- Some transactions have a flat CSA for all tenors
- Other transactions might pull the CSA into a wider margin itself
- Still others might use an "Adjusted SOFR", which would be SOFR+a fixed spread adjustment
- There are strengths and weaknesses of each approach
- Review your documents to know what you have!

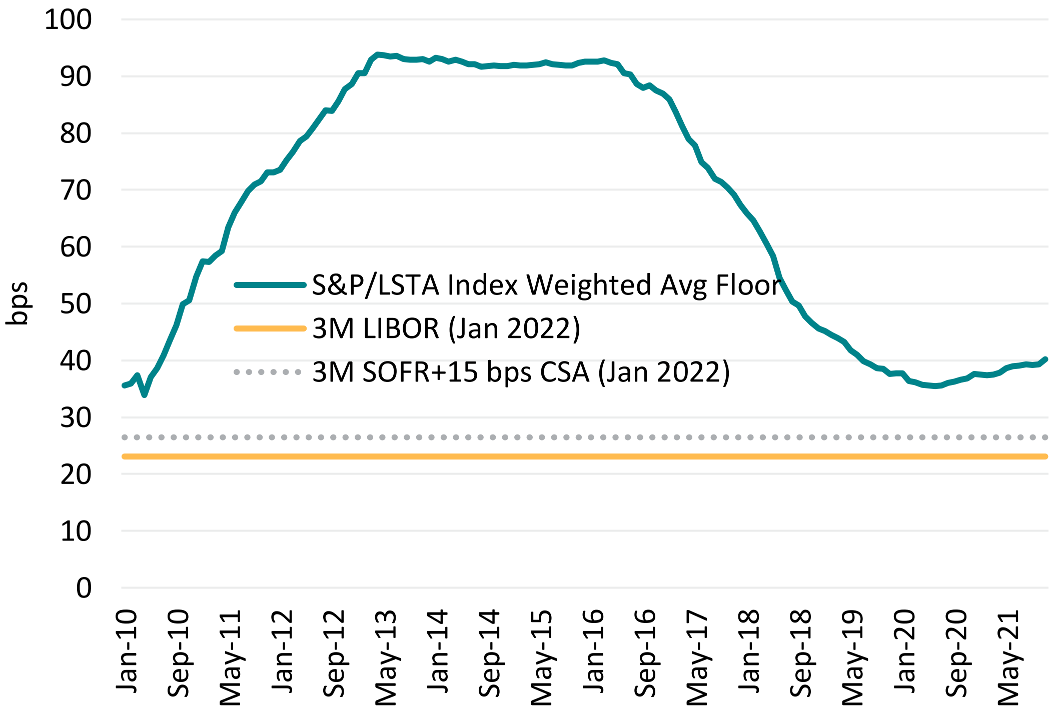


Source: LSTA, CME Group, WSJ

Economics: An Interest Rate Floor Can Address Economics, Ease Transition *if it is Still Applicable at Transition*

- There are questions about whether new SOFR loans or loans that flip from LIBOR to SOFR may pay less
- LIBOR floors can mitigate this risk if they are still applicable at transition
- Roughly half the loans in the S&P/LSTA Leveraged Loan Index (and nearly all new BSL institutional loans) have a LIBOR floor
- The average floor is 75 bps on Index loans and 60 bps on new issue loans; both <u>*currently*</u> are above either LIBOR or the typical SOFR+CSA
- An interest rate floor that reduces economic mismatches between LIBOR and SOFR, and also could ease transition frictions (***assuming your floor is high enough and also ports over to SOFR during transition…)***

Weighted Average Floor Level in S&P/LSTA Loan Index vs LIBOR, SOFR+CSA



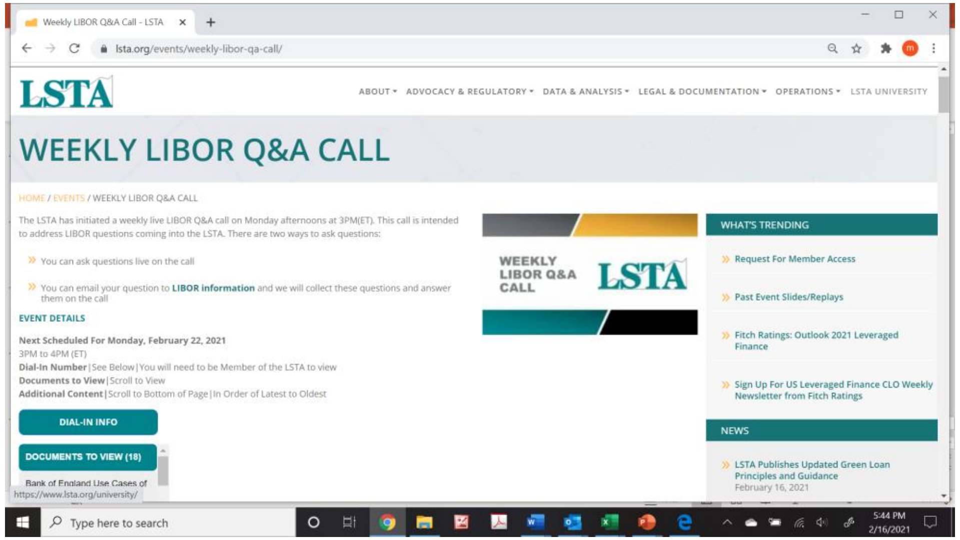
Source: S&P/LSTA Index, LCD, CME Group, WSJ, LSTA Calculations

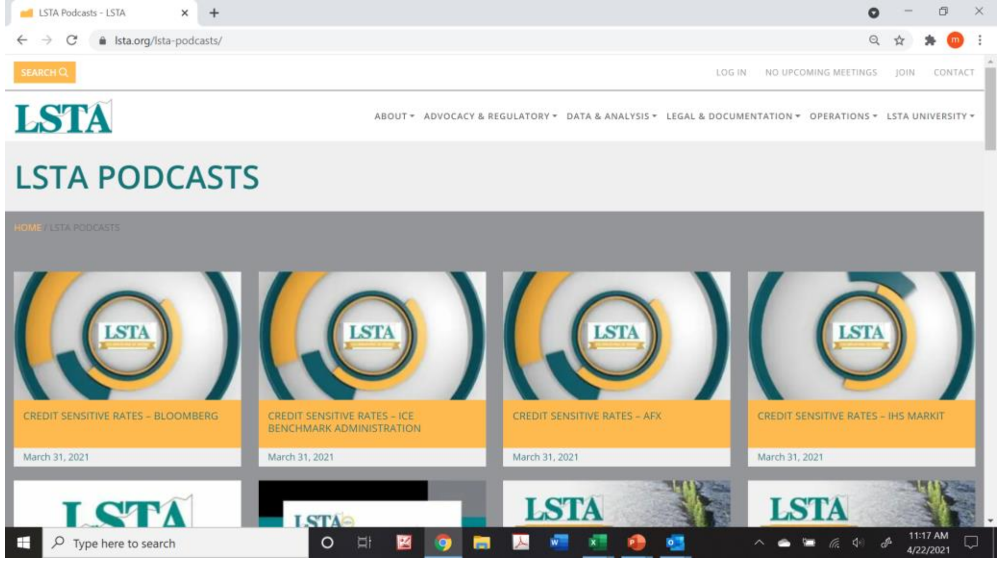
Now That We Survived 12.31.21…Where to Now?

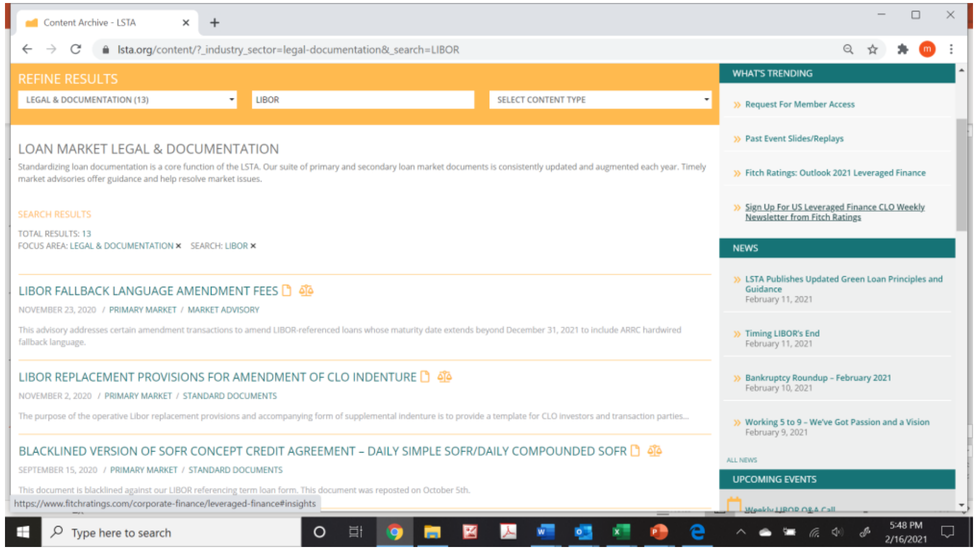
- Why are there some LIBOR loans still?
  - Loans underwritten in 2021 and sold in 2022
  - Some private credit transactions may continue on LIBOR for a period of time
  - Incrementals/fungible add-ons that are contemplated under pre-existing contracts remain a gray area
- Are you ready for all new SOFR loans?
  - Do you have your CME Term SOFR License?
  - Are your systems able to handle CSAs, CSA Curves?
  - Look at the LSTA Term SOFR Concept Credit Agreement to understand SOFR loan doc structure - https://www.lsta.org/content/term-sofr-concept-document/
  - Look at LSTA LIBOR Transition Checklist to see forms that SOFR and CSAs can take - https://www.lsta.org/news-resources/advisory-libor-transition-checklist/
- Prepare for many loans falling back from LIBOR to SOFR well before June 2023
  - Do you have a remediation plan in place?
  - LSTA is working on a universal fallback amendment, which may streamline Early Opt In transitions
  - Be prepared to watch for – and quickly vote on! – 51% negative consent transition amendments

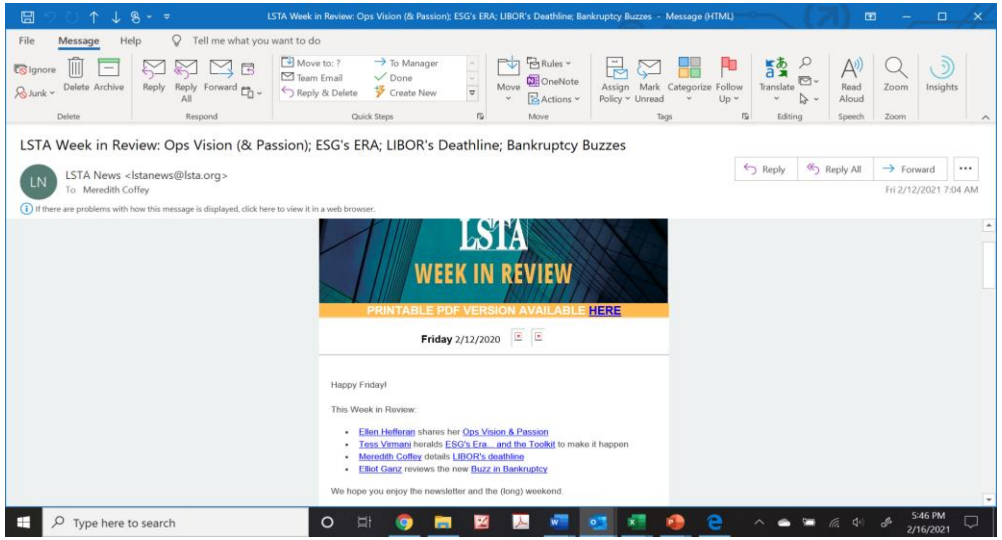
Appendix: Resources, ARRC Recommended Spread Adjustments for Fallbacks

LSTA Resources: LIBOR Call, Podcasts, Documents & News









Economics: ARRC Spread Adjustments on Legacy Loans vs Market CSAs on New Loans

- ARRC spread adjustments (11 bps for 1M, 26 bps for 3M) are specifically and explicitly for contracts that fallback from LIBOR to SOFR using hardwired fallback language.
- They were not intended to be used in new contracts.
- See ARRC Spread Adjustment Public Consultation, which stated:
  - *It is important to emphasize that any ARRC-recommended spread adjustments are intended for use in LIBOR contracts that have incorporated the ARRC's recommended hardwired fallback language or for legacy LIBOR contracts in which parties are able to and choose to select an ARRC recommended spread-adjusted rate as a fallback. The recommended spread adjustments would not and are not intended to apply to new contracts referencing SOFR.*
- The ARRC Fallback Spread Adjustment reflects the results of two public consultations, and was set as the 5-year historical median difference between LIBOR and SOFR on the date that the FCA announced LIBOR's cessation (March 5, 2021).
- The ARRC has said that ***it would not reconsider*** the spread adjustment as it went through a robust consultation process; an ex-post change would disrupt a long-anticipated approach.