LIBOR Transition: Trigger Warnings (!)

October 11, 2018 - As LSTA followers hopefully know, LIBOR cessation is a major issue facing the loan market. As a member of the ARRC Committee, the LSTA has been working to ease LIBOR transition, and one of the first steps is to develop ARRC recommendations on “LIBOR fallbacks” – in other words, to what rate your loan would fall back if LIBOR were to cease. The first step in developing fallback language is to develop a robust “trigger”, in other words, an event that precipitates the transition from LIBOR to a new reference rate. As we detail below, robust fallback triggers are specific, objective and known to all market participants - and we’ve tried to develop them in the ARRC’s Proposed LIBOR Fallback Consultation.

Mandatory Triggers

Five mandatory triggers have been identified in the ARRC’s syndicated loans proposals – two ISDA triggers and three “pre-cessation triggers” – which are found in the definition of “Benchmark Discontinuance Event” in each of the fallback language proposals. (See pages 7-8 of consultation and minutes 12:35-16:07 of webcast.) We now take each of these in turn. The ISDA triggers are intended to match the LIBOR permanent cessation triggers that will be included in standard ISDA documentation. These triggers cover announcements by ICE Benchmark Administrator or relevant regulators that LIBOR has ceased or will permanently cease. While it is crystal clear that LIBOR nonexistence must be a trigger event it is not as clear that it is the only necessary trigger event. For instance, it is conceivable that LIBOR may deteriorate or the FCA, the regulator for LIBOR, may declare that LIBOR may no longer be used. The three “pre-cessation” triggers aim to cover the scenarios that the ARRC Business Loans working group believed would be important to the loan market, namely an unannounced stop to LIBOR (trigger 3), a material change in the quality of LIBOR (trigger 4), or a regulator’s statement that LIBOR is no longer representative or may no longer be used (trigger 5). These triggers have been included for market consideration and are the subject of Consultation Questions 2 and 4. Question 2 is a three-part question that focuses on whether respondents support inclusion of any of the pre-cessation triggers (Question 2(a)), whether respondents have concerns about including triggers that differ from those that will be included in standard ISDA documentation (Question 2(b)), and, if the pre-cessation triggers are not included, how respondents intend to manage the risks those triggers address (Question 2(c)). Additionally, Question 4 asks respondents if there are any other trigger events that should be considered instead of/in addition to the pre-cessation triggers.

Early Opt-in Triggers

In addition to the mandatory triggers described above, which are common to both loan proposals (and the FRN proposal), the business loans and CLOs working group included an early “opt-in” trigger in both loan proposals (which is found in clause (B) of the “Benchmark Transition Determination” definition). The purpose of the “opt-in” trigger is to allow market participants to reduce the number of LIBOR-based loans before LIBOR ceases, which should reduce the risks inherent in transitioning a large number of loans simultaneously. This trigger would be available in certain circumstances even though LIBOR is still being published and none of the mandatory triggers have been met. (See pages 8-9 of consultation and minutes 12:36-18:29 of webcast.) While both loan proposals include this feature, the trigger itself differs. The amendment approach allows a transition away from LIBOR if the administrative agent or required lenders determine that new or amended loans are incorporating a LIBOR replacement. This ability is subject to affirmative consent by required lenders. The hardwired approach, by contrast, allows for a narrower “opt-in” trigger: the administrative agent (on its own or as advised by the borrower) notifies the borrower and lenders that at least two publicly available loans refer to Term SOFR (a forward-looking term rate endorsed by the ARRC) plus the Replacement Benchmark Spread (an ARRC selected or ISDA selected spread adjustment, as applicable). Recognizing that this would be a voluntary transition, the hardwired proposal contemplates a higher level of lender involvement for the market’s consideration - required lender or supermajority lender affirmative consent. Several consultation questions are dedicated to the “opt-in” triggers. Question 3 asks respondents whether such a trigger is appropriate to include and, if so, which of the proposed triggers (amendment vs. hardwired) is preferred. Question 15(b) and Question 16(b) ask respondents about the appropriate level of lender consent in the context of the amendment approach “opt-in” and hardwired approach “opt-in”, respectively. (Any additional feedback respondents wish to offer on this topic can be included in response to Question 4.)

Make your voice heard!

The results of this consultation will inform the ultimate recommended language published by the ARRC. We remind all loan market stakeholders (borrowers, agents, lenders) that responding to this consultation is your best opportunity to influence a future LIBOR transition. Feedback to arrc@ny.frb.org is requested by Thursday, November 8th (one response per institution; anonymity available upon request).

This note on fallback triggers is the first in a series of spotlights on the ARRC’s Syndicated Loans Consultation. Click here for a high-level summary of the entire consultation and here for our consultation webcast.