LSTA WEEK IN REVIEW

April 16, 2021

LSTA HIGHLIGHT: OPSCON Week 2 begins Tuesday with great new content. Click here for agenda!

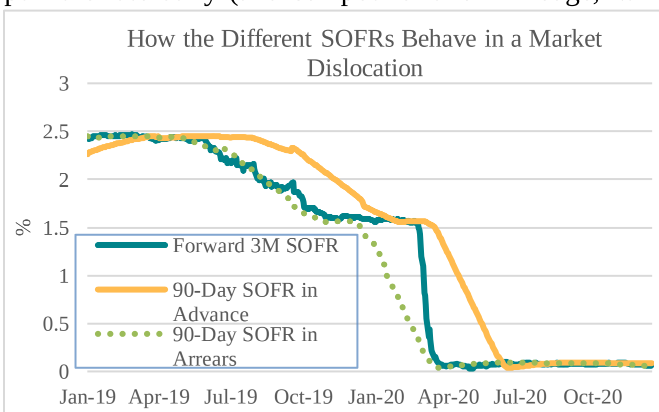
LIBOR: LIVING IN A MULTIRATE WORLD

On the Wednesday Ops panel, LIBOR experts confronted the reality that, by year-end, we'll be living in a "multirate" world, e.g., there will be loans priced over LIBOR, variations of SOFR and potentially Credit Sensitive Rates ("CSRs"). They answered the question, "How are we going to manage the **transition to the multirate world** and, once there, how will we function?"

The panel discussed the rates that could exist in the future and contrasted them to LIBOR (**Slide 4 of the presentation**). As readers likely know, the leading replacement contender has been SOFR, the "Secured Overnight Financing Rate". SOFR is a *daily* rate based off overnight Treasury repo; however, there are ways to create a 30- or 90-day rate, by either using an average of the daily rates or using a SOFR forward curve.

As Slide 4 shows, forward looking Term SOFR and Credit Sensitive Rates are most like LIBOR. They both have a natural term curve (i.e., 1- and 3-month tenors) and are known in advance of the interest period, thus their documentation and operations are very similar to LIBOR. However, an official forward looking Term SOFR is not yet recommended for use, and the CSRs generally are still in development. SOFR Compounded in Advance is calculated by looking *back* at the previous period (like 30 or 90 days), taking the compound average of the daily SOFR rates, and then locking that rate in at the beginning of the interest period. Because the rate is known "in advance" of the interest period, SOFR Compounded in Advance operationalizes and is documented much like LIBOR. However, because it looks backwards to the previous period, it reportedly can create asset-liability management issues, borrower arbitrage opportunities and temporal basis risk.

Daily Simple SOFR and Daily Compounded SOFR are least like LIBOR because the parties *don't* know the interest rate in advance and instead pull the rate daily (and compound it for Compounded SOFR) and calculate the interest rate during the interest period. The final interest rate is not known until the end of the interest period.



Source: FRBNY

So how do these slightly different rates perform? The COW demonstrates how the SOFRs behaved in the March 2020 market disruption. Because SOFR in Arrears calculates the rate on a "live" daily basis, it will begin pulling in the new rates as soon as they move, and hence will react first. Because SOFR in Advance locks the rate from the *prior* period, it reacts last. Forward Looking Term SOFR reacts only once the interest rates change, and the new rate is applied to interest periods *starting that day*; thus, Term SOFR's reaction speed is between SOFR in Arrears and SOFR in Advance.

So which rate "wins"? No one knows yet. Most lenders and borrowers say they want a rate known in advance of the interest period, which would bias the market toward Term SOFR, SOFR Compounded in Advance or a Credit Sensitive Rate. However, some borrowers say they want a cheap perfect hedge, which might bias them toward SOFR in Arrears (with a corresponding SOFR hedge). Moreover, it is clear that we *will* be living in a multirate environment starting late 2021 because banks must stop originating LIBOR loans (and thus will originate on SOFR or CSR), while legacy loans will still be on LIBOR. Ultimately, the panelists are preparing to live in a world that has LIBOR loans, SOFR loans and potentially CSR loans all at the same time. And they recommend that all market participants prepare for that too. (Please see the LSTA's **LIBOR transition** page, **Weekly LIBOR Q&A Call** and a series of helpful **Zoomcasts**.

OPS & (UN)COMMON SENSE

The LSTA Operations Conference kicked off with Steve Connolly (JPMorgan), Brian O'Neill (Bank of America), David Lee (Fidelity) and Elaine Mahon (Invesco) using common sense to **connect the dots between Agent Bank and Buyer** perspectives

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and suggested the following optimal settlement and servicing practices and workflows (with a little nudging from the LSTA's Ellen Hefferan):

- Buyers should submit KYC and tax documentation to Agent Banks and counterparties prior to entering or sub-allocating a trade. Similarly, KYC compliance and tax teams should perform their analysis promptly to avoid settlement delays. All parties should follow the *LSTA Guidance: Know Your Customer Considerations for Syndicated Lending and Loan Trading* to ensure that they meet – but do not unnecessarily exceed – legal requirements. In addition, there needs to be a better understanding of the rationale for and timing of tax "refreshes" which cause significant delays. (Note: An LSTA committee will be formed to review tax issues causing delays and unnecessary withholdings.) And if you want faster onboarding, utilize either the LSTA/LMA Administrative Detail Form or IHSMarkit's Form.
- A new buyer cannot become a lender of record without the prior written consent of the Borrower, which in most Credit Agreements is deemed given 10-15 Business Days after the request has been made. Borrowers rarely consent; therefore, the period must elapse. A 5-day deemed consent period is enough time for a Borrower to object but won't drag settlement on for a month.
- When new money is added to existing deals, it is either pursuant to a new facility (requiring a new CUSIP) or an addition to an existing facility (utilizing the existing CUSIP). This information must be communicated to the buyers at the time of allocation. Should such facility "funge" into existing debt at the time of funding, at that point, the new facility (new CUSIP) can be terminated but the separation initially is needed. It may be cleaner to settle primary allocations and pre-trigger/post-trigger trades prior to merging the facilities.
- Perhaps the easiest way to avoid having the Agent "pull trades" is to check off on SDC as a Seller, only when one has the position in inventory to sell, and as a Buyer, only when one has the cash to purchase and has posted an affiliate letter or obtained Borrower's Consent, if necessary. Employing settlement certainty when settling primary allocations may be worth exploring.
- From the buyer perspective, there is no need to provide interest and principal notices, including rate information for the next interest period, before the day prior to the actual payment and commencement of new contract period. Amending notice provisions in Credit Agreements could significantly decrease the vast number of days that settlements are "on hold".
- Can we really say that time spent quibbling over pennies is time well spent? Add a tolerance of $1.00 to payments made and commitments transferred on assignment agreements and focus on more important issues!

All the action points above fall under the category of "common sense" fixes. If we can agree on these common sense fixes – and encourage vendors to support the data transparency and connectivity that support these fixes – what can't we do?!

LIBOR: CSR INSERT

The LSTA has published an **advisory** which addresses adding a "credit sensitive rate" option as part of the LIBOR fallback language included in syndicated loan and bilateral loan documentation. This advisory provides sample language developed by the LSTA in collaboration with a working group of its sell-side and buy-side members to facilitate the use of credit sensitive rates in hardwired fallback language for members who are interested in incorporating a credit sensitive rate option. The LSTA is providing this language in light of the **interest shown by a significant number of LSTA members in credit sensitive rates that are emerging** and member requests for documentation that can account for and accommodate such rates, as well as the opportunity credit sensitive rates now have to develop as viable replacements for LIBOR given that June 30, 2023 is the expected cessation date for the most widely used tenors of USD LIBOR for legacy transactions. The LSTA remains committed to facilitating the implementation and use of all viable fallback rate options and its provision of this language complements the LSTA's previous work to operationalize and implement SOFR-based variants.

SOCIAL LOAN PRINCIPLES

The LSTA, LMA and APLMA have released the **Social Loan Principles (SLP).** The SLP aim to create a high-level framework of market standards and guidelines, providing a consistent methodology for use across the social loan market, whilst allowing the loan product to retain its flexibility and preserving the integrity of the social loan market while it develops.

The SLP build on and refer to the Social Bond Principles (SBP) administered by the International Capital Markets Association (ICMA), with a view to promoting consistency across markets.

They have been developed by an experienced working party consisting of representatives from leading financial institutions and law firms active in the global loan markets, with a view to promoting the development and integrity of the innovative social loan product.

The SLP comprise voluntary recommended guidelines, to be applied by market participants on a deal-by-deal basis, based around the following four core components: 1) Use of Proceeds, 2) Process for Project Evaluation and Selection, 3) Management of Proceeds and 4) Reporting. The LSTA will produce an SLP Guidance document soon.

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