Client Alert

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ARRC Releases Recommended LIBOR Fallback Language

As many corporate borrowers and their treasury professionals are aware, the US Dollar LIBOR will cease to exist at the end of 2021 (at which time banks will no longer be compelled to submit LIBOR). Borrowers, lenders and their legal advisors have been anticipating LIBOR discontinuation and many proactively incorporated language into credit agreements to try to address replacement of the popular interest rate benchmark. There are nuances to the replacement of LIBOR that have proven challenging to drafters and therefore news that the Alternative Reference Rates Committee (the ARRC) released recommended LIBOR fallback language that it had developed with the help of the Loan Syndications and Trading Association (the LSTA), on April 25, 2019, was welcomed.

The ARRC released two approaches to LIBOR fallback language for new originations of LIBOR-referenced US dollar-denominated syndicated business loans: (1) the “Amendment Approach” and (2) the “Hardwired Approach.” Each approach contains two major components: first, a “trigger,” which is one of several events that initiates the transition from LIBOR to a successor rate (e.g., a benchmark administrator, or governing body with authority over such administrator, announcing that it will no longer provide LIBOR or the parties choosing early opt-in) and, second, a “Benchmark Replacement” rate, which is the alternative interest rate benchmark that replaces LIBOR together with a spread adjustment to make the alternative rate more comparable to LIBOR.

The Amendment Approach is specific as to fallback trigger events and objection rights for “Required Lenders” (typically a majority of the lenders), but all decisions about the specific new benchmark rate and the mechanics for adjustments to the successor rate are determined by the borrower and the administrative agent at the time of the trigger event pursuant to a process outlined in the fallback language. In short, upon the occurrence of a trigger event, the parties amend the credit agreement by negative consent, such that Required Lenders have five days to object to the proposed successor rate and spread adjustment to which the borrower and the administrative agent have agreed before the amendment takes effect.

The Hardwired Approach, like the Amendment Approach, contains specific fallback trigger events. However, unlike the Amendment Approach, the Hardwired Approach contains a waterfall of specific successor rates in order of decreasing priority. The successor rate is expected to be the secured overnight financing rate, or “SOFR,” published daily by the Federal Reserve Bank of New York. The highest priority in the waterfall is the “Term SOFR,” which is expected to be the forward-looking term rate based on SOFR, followed by the “Compounded SOFR,” which is a compounded average of daily SOFRs if the Term SOFR does not exist. SOFR is expected to be lower than LIBOR, so a spread adjustment mechanism is built into this approach as well. If none of the specific successor rates are available at the time of the triggering event, the Hardwired Approach defaults to the Amendment Approach.

Many practitioners believe that once a reliable Benchmark Replacement is chosen and suitable spread adjustment mechanics are established, the Hardwired Approach will become the market standard. However, until that time, the Amendment Approach may be the best way for corporate borrowers to maintain some degree of control and flexibility in the still uncertain LIBOR replacement process. Despite drawbacks inherent in each approach, it is nonetheless instructive for the corporate borrowers and lenders to have this new guidance from the ARRC.

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The full report from the ARRC can be accessed here.

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