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LIBOR Successor Rate Provisions in the Syndicated Loan Market

*David I. Schrodt**

In anticipation of the LIBOR sunset, the United States syndicated loan market is modifying its standard approach to the unavailability of LIBOR by including terms that establish rules for pricing loans at successor rates. The syndicated loan market has not, however, settled on a single accepted or favored convention for such terms. Instead, there are currently a number of alternative—and conflicting—approaches for establishing a successor rate. This article raises certain issues presented by these approaches and provides a list of sample language that is appearing in recent credit agreements in the syndicated loan market.

Andrew Bailey, the CEO of the United Kingdom's Financial Conduct Authority (the "FCA"), has announced that the FCA and the panel banks whose submissions are used to determine the London Interbank Offered Rate ("LIBOR") will only sustain LIBOR until the end of 2021. The FCA is declining to provide a successor rate, but Mr. Bailey did assert the need for legacy contracts, those contracts with maturities extending beyond 2021, to either switch to a new successor rate or include a fallback mechanism if no successor rate to LIBOR is available. Prior to this announcement, credit agreements in the United States syndicated loan market typically addressed the risk of LIBOR becoming unavailable by establishing fallback pricing at an alternative base rate.

In anticipation of the LIBOR sunset, the United States syndicated loan market is modifying this standard approach to the unavailability of LIBOR by including terms that establish rules for pricing loans at successor rates. The syndicated loan market has not, however, settled on a single accepted or favored convention for such terms. Instead, there are currently a number of alternative—and conflicting—approaches for establishing a successor rate. This article raises certain issues presented by these approaches and provides a list of sample language that is appearing in recent credit agreements in the syndicated loan market.

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ISSUES IN THE WAKE OF THE ANNOUNCED LIBOR SUNSET

The inevitable LIBOR sunset has created pressure to establish, prior to the end of 2021, a successor rate to LIBOR for U.S. Dollar loans and other U.S. Dollar financial products that include LIBOR as a material term. Indeed, the Federal Reserve Bank of New York, in cooperation with the Treasury Department's Office of Financial Research, plans to begin publishing a Broad Treasury Repo Financing Rate ("BTFR") to serve as the successor rate to LIBOR with respect to such loans and financial products. At the same time, as currently proposed, the BTFR would require additional methodology to be a truly comparable rate to LIBOR as BTFR is a secured rate while LIBOR is an unsecured rate.

Many of the successor rate provisions appearing in the syndicated loan market alter the accepted syndicated loan market conventions that (i) required lenders must approve modifications to interest rate related provisions and (ii) all affected lenders must approve any interest rate reductions. Other recent credit agreements with successor rate provisions are ambiguous with respect to these amendment and voting conventions; these credit agreements include successor rate provisions in the definitions section or the change in circumstances section of the agreement, while also having amendment and waiver provisions that, without qualification, include the above-referenced required lender and affected lender approval requirements. Most, but not all, of the new provisions subject the successor rate, or the process for choosing it, to market and reasonableness conditions. Those credit agreements that authorize a successor rate without any such limits mark a significant shift from the above-referenced market conventions. Further, even credit agreements that do require the successor rate to be market sometimes do not address the risk that there may not be a market standard successor rate.

New loans now have maturity dates beyond the LIBOR sunset, and while not all new credit agreements include successor rate provisions, the trend in the syndicated loan market favors including such provisions. This is understandable. The alternative base rate is more expensive than LIBOR, and the rationale for this alternative pricing, prior to the announcement of the LIBOR sunset, has been that it would be useful to include as a temporary rate, not as a replacement for LIBOR. Participants and arrangers would be well served to consider the alternative approaches available when considering the addition of successor rate provisions. Lenders that are participating in the syndicated loan market should carefully review the definitions, change in circumstances, and amendment sections in credit agreements as successor rate provisions may appear in each of

these sections and, as the market matures with respect to this issue, lenders risk being tied to early precedents.

ALTERNATIVE APPROACHES—LIST AND SAMPLES

The market is currently unsettled on what may later be a preferred approach for successor rate provisions, and the following list of approaches is informative but not exhaustive. Likewise, the detailed successor rate provisions in any specific credit agreement may vary from the samples provided. Borrowers will likely continue to prefer adding successor rate provisions in their credit agreements due to the unfavorable pricing provided by the alternative base rate, and lenders should monitor the syndicated loan market regarding this issue as it evolves.

<p>Approach: Agent is Authorized to Choose the Successor Rate</p>
<p>“LIBOR Rate’ means . . . the rate per annum equal to the London Interbank Offered Rate (“LIBOR”) or a comparable or successor rate which rate is approved by the Agent . . . ; provided that (i) to the extent a comparable or successor rate is approved by the Agent in connection with any rate set forth in this definition, the approved rate shall be applied in a manner consistent with market practice; provided, further that to the extent such market practice is not administratively feasible for the Agent, such approved rate shall be applied in a manner as otherwise reasonably determined by the Agent.”</p>
<p>Approach: Agent is Authorized to Select the Successor Rate in Consultation with Borrower</p>
<p>“If the Agent reasonably determines after the Closing Date that LIBOR has been discontinued, the Agent shall select a comparable successor rate in its reasonable discretion (in consultation with the Borrower), and will promptly so notify each Lender.”</p>
<p>Approach: Agent and Borrower are Together Authorized to Approve the Successor Rate</p>
<p>“If the LIBOR Rate cannot reasonably be determined by the Agent in accordance with the foregoing sentences, then the Agent may utilize a comparable or successor rate (as approved by the Agent and the Borrower) as the LIBOR Rate.”</p>
<p>Approach: Required Lenders and Borrower Together Approve the Successor Rate</p>
<p>“If the LIBOR Rate is not available, any amendment or waiver which relates to providing for another benchmark rate to apply in place of the LIBOR Rate (or which relates to aligning any provision of a Loan Document to the use of that other benchmark rate) may be made with the consent of the Required Lenders and the Borrower.”</p>

Approach: Agent and Borrower are Authorized to Determine the Successor Rate, With Required Lenders Given Negative Consent Rights

“Provided that to the extent a comparable or successor rate is approved by the Agent in connection herewith, the approved rate shall be applied in a manner consistent with market practice; provided, further, that to the extent such market practice is not administratively feasible for the Agent, such approved rate shall be applied in a manner as otherwise reasonably determined by the Agent in consultation with the Borrower; provided, further, that if such rate is not available at such time for any reason, then the ‘LIBOR Rate’ for such Interest Period shall be (a) a comparable successor or alternative interbank rate for deposits in Dollars that is, at such time, broadly accepted as the prevailing market practice for syndicated leveraged loans of this type in lieu of the ‘LIBOR Rate’ and is reasonably acceptable to the Borrower and the Agent or (b) if no such broadly accepted comparable successor interbank rate exists at such time, a successor or alternative index rate as the Agent and the Borrower may reasonably determine and which successor or alternative index rate described in this clause (b), at the discretion of the Agent, may be posted to the Lenders not less than five (5) Business Days before effectiveness thereof and, if the Required Lenders shall not have objected to such successor or alternative index rate within five (5) Business Days after posting, then the Required Lenders shall be deemed to have agreed that such successor or alternative index rate is reasonable and to have consented to the effectiveness of such successor or alternative index rate.”

Approach: Agent, Required Lenders and Borrower Together Agree to the Successor Rate

“If the Borrower notifies the Agent that the Borrower requests an amendment to the provisions of this Agreement and each other relevant Loan Document to replace the LIBOR Rate (and related provisions hereof and thereof) with an alternative rate of interest for periods following the last date on which the LIBOR Rate is determinable (a “LIBOR Replacement Amendment”) (or if the Agent notifies the Borrower that the Required Lenders request a LIBOR Replacement Amendment or if the Agent shall have determined that adequate and reasonable means do not exist for ascertaining the LIBOR Rate), regardless of whether any such notice is given before or after such date, then notwithstanding any other provision of this Agreement or any other Loan Document to the contrary, the Agent, the Borrower and the Lenders shall promptly negotiate in good faith a LIBOR Replacement Amendment in form and substance reasonably satisfactory to the Borrower and the Required Lenders, and such LIBOR Replacement Amendment shall become effective upon the execution and delivery thereof by the Required Lenders, the Administrative Agent and the Borrower (and, for the avoidance of doubt, without the need for consent of any other party) for periods following the last date on which the LIBOR Rate is determinable.”