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## *LSTA Releases Final Draft of Simple SOFR Concept Credit Agreement*

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On July 13, 2020, the Loan Syndications & Trading Association (“LSTA”) circulated to its Primary Market Committee a final draft of its concept credit agreement (the “LSTA Credit Agreement”) describing a term loan referencing daily simple Secured Overnight Financing Rate (“SOFR”) or daily compounded SOFR.<sup>1</sup> The LSTA Credit Agreement has been developed to offer an illustrative example for new originations of SOFR-referencing loans and provide an additional tool for market participants as they transition away from LIBOR. The LSTA previously released a concept credit agreement referencing a compounded average of daily SOFRs calculated in arrears<sup>2</sup> and a concept credit agreement using just the simple average of daily SOFRs.<sup>3</sup> The LSTA Credit Agreement supports the Alternative Reference Rates Committee (“ARRC”) recommended LIBOR fallback language for syndicated loans published on June 30, 2020, which only updates the hardwired fallback approach and includes daily simple SOFR as the second replacement rate in the waterfall.<sup>4</sup> The highlights of the LSTA Credit Agreement are as follows:

1. **Flexibility for Daily Simple SOFR and Daily Compounded SOFR:** The LSTA Credit Agreement allows the lenders and loan parties to elect daily SOFR rate calculated either on a simple basis (“Daily Simple SOFR”) or compounded basis (“Daily Compounded SOFR”). In choosing between Daily Simple SOFR and Daily Compounded SOFR, market participants must balance the ease, speed, and certainty of Daily Simple SOFR with the accuracy in reflecting time value of money and allowance for more accurate hedging provided by Daily Compounded SOFR.<sup>5</sup>
2. **Daily Compounded SOFR – “Compound the Balance”:** Under the LSTA Credit Agreement, Daily Compounded SOFR is calculated using the “compound the balance” method wherein SOFR is applied to principal and all accrued, unpaid interest (excluding any margin) on a daily basis on Business Days. Another approach in calculating Compounded SOFR is to “compound the rate,” which applies a calculated rate of daily compounded interest to the principal outstanding. The latter may be challenging to utilize in the syndicated loan context given principal fluctuations that may occur within an interest period related to prepayments or trading in the secondary markets.<sup>6</sup> The ARRC is still reviewing this calculation approach in its Business Loans Working Group, and the LSTA will address the “compounding the rate” approach in a separate concept document in due course.<sup>7</sup>
3. **Term SOFR:** The LSTA Credit Agreement also includes Term SOFR provisions that can be incorporated at the parties’ election based on feedback from LSTA members supporting such transition. Market participants should carefully consider automatic transition to Term SOFR

upon achievement of certain milestones, particularly considering potential timing delays and uncertainty about the availability of Term SOFR for syndicated loans.<sup>8</sup>

The LSTA has indicated they expect to publish the final version of the LSTA Credit Agreement following the ARRC's publication of its recommended conventions for business loans.<sup>9</sup> They will also be developing forms of amendments designed for amending LIBOR-referencing loans with the "amendment approach" fallback language as well as forms of notice of conforming changes that can be used in connection with the "hardwired approach" fallback language based on current ARRC waterfall rates.<sup>10</sup> There are still many moving pieces in LIBOR transition for the syndicated loan market, including waiting for the readily available reporting of an IOSCO-compliant forward-looking term SOFR<sup>11</sup> and final agreement by the ARRC on the methodology for calculating a compounded SOFR for use in loans. In the interim, market participants should start considering which SOFR-based rate and methodology they prefer and how best to move forward implementing SOFR in their loans and other financial products.

With the ARRC's best practices' recommendation to begin exclusively using the hardwired approach for LIBOR-referencing syndicated loans looming (officially September 30, 2020),<sup>12</sup> the time has come to begin using SOFR based rates for loans and operationalizing SOFR (whether using the LSTA's model or otherwise). The LSTA Credit Agreement not only provides a benchmark for market participants entering into new SOFR-referencing loans but also offers guidance in considering which fallback language to incorporate into their LIBOR-referencing credit agreements. Such proactive and forward-thinking market participants will be best prepared for a smooth transition from LIBOR (hopefully well in advance of the ultimate LIBOR deadline of December 31, 2021).

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<sup>1</sup> "Going Daily! Final Draft of Simple SOFR Concept Document Released," available [here](#) [hereinafter, "LSTA's Announcement"]

<sup>2</sup> "Flashforward: LSTA Releases Draft SOFR "Concept Credit Agreement," available [here](#) and "LSTA Distributes Revised Draft of Compounded SOFR Concept Document," available [here](#).

<sup>3</sup> "LSTA Releases Initial Draft of Simple SOFR Concept Document," available [here](#).

<sup>4</sup> ARRC Releases Updated Recommended Hardwired Fallback Language for Syndicated Loans," available [here](#).

<sup>5</sup> See, the ARRC's "A User's Guide to SOFR," available [here](#). For more information, please see our publication, "ARRC Release White Paper Regarding SOFR – The New U.S. Dollar LIBOR Alternative," available [here](#).

<sup>6</sup> For more information on calculating compounded SOFR, please see the ARRC's "SOFR "In Arrears" Conventions for Syndicated Business Loans," available [here](#).

<sup>7</sup> See, the LSTA's Announcement.

<sup>8</sup> See, the ARRC's "2020 Objectives," available [here](#), which addresses challenges around publishing and operationalizing a forward-looking term SOFR rate.

<sup>9</sup> See, the LSTA's Announcement.

<sup>10</sup> "SOFR Amendment Forms: Tools for Transition," available [here](#).

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- <sup>11</sup> See, the LSTA's "LIBOR: The Future of Forward Looking Term SOFR," available [here](#); the Federal Reserve currently publishes indicative forward-looking Term SOFR (See, the Federal Reserve's "Indicative Forward-Looking SOFR Term Rates," available [here](#)).
- <sup>12</sup> Please see our recent publication, "ARRC Recommends Best Practices for Completing LIBOR Transition," available [here](#).