

MEMO# 32386

April 13, 2020

LIBOR Update: ARRC Recommended Spread Adjustment and SOFR-Based Pricing in Federal Reserve Term Asset-Backed Securities Loan Facility

[32386]

April 13, 2020 TO: Accounting/Treasurers Committee

Derivatives Markets Advisory Committee

LIBOR Transition Working Group

SEC Rules Committee

Securities Operations Advisory Committee

Security Valuation Operations Committee RE: LIBOR Update: ARRC Recommended Spread Adjustment and SOFR-Based Pricing in Federal Reserve Term Asset-Backed Securities Loan Facility

We wanted to alert you to recent activity from the Alternative Reference Rate Committee (ARRC), and the Federal Reserve Board concerning LIBOR.

I. ARRC Recommended Spread Adjustments for Cash Products

On April 8, 2020, the ARRC recommended a methodology for calculating a spread adjustment between USD LIBOR and SOFR for cash products.[\[1\]](#) The ARRC issued its recommendations for voluntary use in legacy contracts that have incorporated the ARRC's recommended hardwired fallback language[\[2\]](#) or otherwise contain fallback language permitting the use of SOFR-based rates. The ARRC previously stated its intent to recommend a spread adjustment methodology that would minimize the expected change in the value of contracts as a result of the change from USD LIBOR to SOFR.[\[3\]](#)

Specifically, the ARRC recommended a spread adjustment methodology based on a historical median over a five-year lookback period calculating the difference between USD LIBOR and SOFR. The ARRC stated that its methodology recommendation is consistent with that of the International Swaps and Derivatives Association (ISDA) for fallbacks in the derivatives markets.[\[4\]](#)

The ARRC announced that it would release a more detailed final recommendation of its spread adjustment methodology for cash products shortly. It also committed to publishing its recommended spread adjustments and the resulting spread-adjusted rates through

vendors.

II. Federal Reserve Board Uses SOFR as the Reference Rate for Certain Loans Under the TALF Program

On April 9, 2020, the Federal Reserve Board updated its term sheet for the Term Asset-Backed Securities Loan Facility (TALF), which is a credit facility to support the issuance of securities backed by private student loans, auto loans and leases, consumer and corporate credit card receivables, loans guaranteed by the Small Business Administration, and other assets.^[5] Among other provisions, the Federal Reserve permits borrowers in the facility to use certain collateralized loan obligations (CLOs)^[6] as eligible collateral. The Federal Reserve has determined to use SOFR as the reference rate for loans backed by eligible CLO collateral; specifically, the Fed has set the interest rate for those loans as 150 basis points over the 30-day average of SOFR.

Bridget Farrell
Assistant General Counsel

endnotes

[1] ARRC Announces Recommendation of a Spread Adjustment Methodology for Cash Products (Apr. 8, 2020), *available at* https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Spread_Adjustment_Methodology.pdf; see also ICI Memorandum No.32166, *available at* https://www.ici.org/my_ici/memorandum/memo32166.

[2] In the event that LIBOR is no longer usable, hardwired fallback language approach would specify which SOFR-based successor rate and spread adjustment would apply. See ARRC Releases Recommended Fallback Language for Floating Rate Notes and Syndicated Loans (Apr. 25, 2019), *available at* <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/ARRC-Apr-25-2019-announcement.pdf>.

[3] See ARRC Consultation on Spread Adjustment Methodologies for Fallbacks in Cash Products Referencing USD LIBOR (Jan. 21, 2020), *available at* https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Spread_Adjustment_Consultation.pdf.

[4] See Summary of Responses to the ISDA Consultation on Final Parameters for the Spread and Term Adjustments (Nov. 15, 2019) *available at* <https://www.isda.org/a/935TE/2019.11.15-ISDA-Final-Parameters-Consultation-Report.pdf>.

[5] See Term Asset-Backed Securities Loan Facility (effective Apr. 9, 2020), *available at* <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200409a1.pdf>. For a description of the TALF, see ICI Memorandum No. 32369, *available at* <https://www.ici.org/covid19/resources/trading/memo32369>.

[6] The term sheet noted that commercial real estate CLOs will not be deemed to be eligible collateral but that static pool CLOs would be eligible.

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