

MEMO# 32448

May 7, 2020

LIBOR Update: ARRC Issues Best Practices for Vendor Readiness, Supplemental Consultation on Spread Adjustments for Cash Products, and Statement on the Use of the SOFR Index

[32448]

May 7, 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 Issues Best Practices for Vendor Readiness, Supplemental Consultation on Spread Adjustments for Cash Products, and Statement on the Use of the SOFR Index

We wanted to alert you to recent activity from the Alternative Reference Rate Committee (ARRC) in anticipation of the discontinuation of USD LIBOR and the use of the ARRC's recommended replacement rate, SOFR.

I. ARRC Best Practices for Vendor Readiness

On May 7, 2020, the ARRC issued a timeline for third-party technology and operations vendors to prepare for USD LIBOR discontinuation.[\[1\]](#) The ARRC recommends that vendors relevant to LIBOR transition should complete all necessary enhancements to support SOFR by the end of the year, and provides the following product-based recommended timelines:

- Floating rate notes: Vendors should complete all necessary enhancements by to support SOFR by June 30, 2020;
- Business loans: Vendors should complete all necessary enhancements by to support SOFR in new issuance business loans with maturities after December 31, 2021 and in consumer loans by September 30, 2020; and
- Securitizations: Vendors should complete all necessary enhancements by to support SOFR by December 31, 2020.

The ARRC continues to discuss additional recommendations for best practices for other market participants.

II. ARRC Summary of Consultation Responses and Supplemental Consultation on Spread Adjustments for Cash Products

Last month, the ARRC recommended a methodology for calculating the spread adjustment between USD LIBOR and SOFR for cash products using a historical median over a five-year lookback period, consistent with the methodology ISDA will use for derivatives.^[2] On May 6, 2020, the ARRC provided supplemental information and a summary of the feedback it received on that spread adjustment methodology.^[3]

The ARRC notes that its recommended hardwired fallback language^[4] for floating rate notes, securitizations, and business loans would use a forward-looking term SOFR rate, if available, and compounded average of SOFR in arrears or in advance if the term rate is not available. Given this contingency, the ARRC anticipates that it will recommend spread adjustments for these three types of SOFR. As a result, the ARRC requests comment on whether it should apply the same spread adjustment methodology or the same spread adjustment value to these three rates.

The ARRC also seeks feedback on whether its timing to set its spread adjustments should match ISDA's in the event of a pre-cessation event. "Pre-cessation" refers to a potential time period during which LIBOR may continue to be published, but because fewer panel banks are submitting rates, the UK Financial Conduct Authority would no longer consider LIBOR to be representative. ISDA will include a pre-cessation trigger in its fallback language for derivatives contracts, and the ARRC notes that ISDA may also use such an event to set its spread adjustment.

The ARRC is requesting feedback by email to the ARRC Secretariat (arrc@ny.frb.org) no later than June 8, 2020.

III. ARRC Statement on Using the SOFR Index for Floating Rate Notes

On May 6, 2020 the ARRC Floating Rate Notes Working Group issued information about using the Federal Reserve Bank of New York's daily published SOFR Index for floating rate notes.^[5] The SOFR Index measures the cumulative impact of compounding the SOFR over custom time periods.^[6] To assist the transition from USD LIBOR, the ARRC provides sample key terms for floating rate notes, including how to reference the SOFR Index, and sample fallback language.

Bridget Farrell
Assistant General Counsel

endnotes

^[1] See ARRC Recommended Best Practices for Vendors on Completing the Transition from LIBOR (May 7, 2020), *available at* <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC-Vendor-Recommended-Best-Practices.pdf>.

^[2] See ICI Memorandum No. 32386, *available at* https://www.ici.org/my_ici/memorandum/memo32386.

[3] See Summary of Feedback Received in the ARRC Spread-Adjustment Consultation and Follow-Up Consultation on Technical Details (May 6, 2020), *available at* https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Spread_Adjustment_Consultation_Follow_Up.pdf.

[4] 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>.

[5] See ARRC Floating Rate Notes Working Group Statement on the Use of the SOFR Index (May 2020), *available at* https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/Statement_on_SOFR_Index.pdf.

[6] See Additional Information about the Treasury Repo Reference Rates, *available at* <https://www.newyorkfed.org/markets/treasury-repo-reference-rates-information>; *see also* ICI Memorandum No. 32270, *available at* https://www.ici.org/my_ici/memorandum/memo32270.

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