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ARRC Releases Consultations on Fallback Contract Language for Floating Rate Notes and Syndicated Business Loans for Public Feedback

Draft Fallback Proposals Aim to Minimize Disruptions if LIBOR is No Longer Usable; ARRC Seeks Feedback before Publishing Final Recommendations for Market Participants' Voluntary Use

The Alternative Reference Rates Committee (ARRC) released consultations on U.S. dollar (USD) LIBOR fallback contract language for floating rate notes and syndicated business loans for public feedback. These consultations outline draft language for new contracts that reference LIBOR so as to ensure these contracts will continue to be effective in the event that LIBOR is no longer usable. Feedback should be submitted no later than November 8, 2018. This effort is part of the ARRC's mandate to help in addressing risks in contracts referencing LIBOR and builds on its work developing the Paced Transition Plan, which outlines the steps for an effective shift to the ARRC's recommended alternative reference rate, the Secured Overnight Financing Rate (SOFR). These are the first consultations on fallback language that the ARRC has released, and the ARRC expects to consult on proposals for other cash products, including securitizations, bilateral loans, and consumer products, in the future.

"The public and private sector share the recognition that there is a strong possibility that LIBOR may discontinue, and the associated risks are considerable. That's why these consultations for fallback contract language are a crucial development in creating a more resilient financial regime," said Sandra O'Connor, Chair of the ARRC and JPMorgan Chase & Co. Chief Regulatory Affairs Officer. "These consultations build on the ARRC's strong body of work to date and we encourage all market participants to share thoughtful feedback over the coming weeks, so that safer fallback language can be voluntarily incorporated into contracts as quickly as possible."

As described in the ARRC's guiding principles for fallback contract language, there are substantial benefits to consistency across products. Aligning fallback provisions across different types of products so that they would operate similarly during a LIBOR cessation reduces operational, legal, and basis risk. Recognizing that the products differ in critical ways, the ARRC's proposed provisions and language for fallbacks for floating rate notes and syndicated business loans are tailored to each specific product but seek general consistency in defining key terms, including:

- **Trigger events** – events that start the transition from LIBOR to a new reference rate;
- **A successor rate "waterfall"** – a provision specifying the priority of unadjusted rates that would replace LIBOR; and

- **A spread adjustment "waterfall"**— a provision specifying the priority of spread adjustments that would be applied to the successor rate because of differences between LIBOR and SOFR.

Floating Rate Notes

- The consultation on fallbacks for floating rate notes proposes one specific approach. This approach involves defining the events that would start the transition from LIBOR, outlining a clear waterfall for determining what rate would replace LIBOR in that situation and deciding how a spread adjustment to that rate would be calculated.

Syndicated Loans

The consultation on fallbacks for syndicated business loans proposes two different approaches for comment: a "hardwired approach" and an "amendment approach." The two approaches are:

- ***Hardwired Approach*** – This approach would provide certainty upfront and it is similar to the proposed fallback provision for floating rate notes described above. In the event that LIBOR is no longer usable, this approach would clearly specify which SOFR-based rate and which spread adjustment to use. Neither borrowers nor lenders would be able to make modifications to the replacement rate designated in the waterfall.
- ***Amendment Approach*** – This approach would provide a streamlined amendment mechanism for negotiating a replacement benchmark and could serve as an initial step towards a hardwired approach. It uses loans' flexibility to create a simpler, streamlined amendment process.

The proposals now being published for consultation were developed by consensus within the Floating Rate Notes and Business Loans/CLOs working groups of the ARRC, representing the collective work of more than 50 institutions, and have been approved by the ARRC. Cadwalader, Wickersham & Taft LLP assisted the working group efforts as drafting counsel. After full consideration of all comments received, the ARRC will issue final contract language recommendations for floating rate notes and syndicated business loans, for market participants' voluntary use in future LIBOR contracts.

Submitting Feedback about Consultations

The ARRC is seeking feedback on each proposed approach and on the key issues involved. The release of these consultations marks the start of a public comment period, during which the ARRC intends to work closely with end users to solicit and incorporate their input. The consultations include multiple questions about each aspect of the suggested fallback provisions. Comments should be sent to the ARRC Secretariat (arrc@ny.frb.org) no later than November 8, 2018. Comments will be posted on the ARRC's website as they are received without alteration except when necessary for technical reasons. Comments will be posted with attribution unless respondents request anonymity. Questions regarding the consultations should also be sent to the ARRC Secretariat (arrc@ny.frb.org) and will not be posted for attribution.

About the ARRC

The ARRC is a group of private-market participants convened by the Federal Reserve Board and Federal Reserve Bank of New York in cooperation with the Bureau of Consumer Financial Protection, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the Office of Financial Research, the Office of the Comptroller of the Currency, the Commodity Futures Trading Commission, the Securities and Exchange Commission and the U.S. Treasury Department. It was initially convened in 2014 to identify risk-free alternative reference rates for USD LIBOR, identify best practices for contract robustness, and create an implementation plan with metrics of success and a timeline to support an orderly adoption. The ARRC accomplished its first set of objectives and identified SOFR as the rate that represents best practice for use in certain new USD derivatives and other financial contracts. It also published its Paced Transition Plan, with specific steps and timelines designed to encourage adoption of SOFR. The ARRC was reconstituted in 2018 with an expanded membership to help to ensure the successful implementation of the Paced Transition Plan, address the increased risk that LIBOR may not exist beyond 2021, and serve as a forum to coordinate and track planning across cash and derivatives products and market participants currently using USD LIBOR.

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