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ARRC Releases Consultations on Fallback Contract Language for Bilateral Business Loans and Securitizations for Public Feedback

ARRC Also Posts Comments by Market Participants on Similar Consultations for Floating Rate Notes and Syndicated Business Loans That Were Released for Input This Fall

The Alternative Reference Rates Committee (ARRC) released consultations on U.S. dollar (USD) LIBOR fallback contract language for [bilateral business loans](#) and [securitizations](#) 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 60 days from release of the consultations, or by February 5, 2019. 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). This is the second set of consultations on fallback language that the ARRC has released, and the ARRC expects to consult on proposals for fallback language in consumer products in the future.

The ARRC also posted over 60 comments received on its first set of consultations on fallback language for [floating rate notes](#) and [syndicated business loans](#). These consultations had been issued by the ARRC in September for market participants' review and the comments received reflect input from market participants and trade groups representing a broad cross-section of the markets that must address the risks associated with contracts referencing LIBOR. After full review of this market feedback, the ARRC expects to release final recommendations on fallback language in these contracts for market participants' voluntary use in early 2019.

"The risks associated with LIBOR publication ceasing or changing are clear, so it is critical that we continue to prepare for this eventuality," said Sandra O'Connor, Chair of the ARRC and JPMorgan Chase & Co. Chief Regulatory Affairs Officer. "A crucial part of this preparation is to stop adding to the associated financial stability risks, by developing and implementing robust contract language for products referencing LIBOR. We've received informative and robust feedback on our first two consultations. All of these consultations outline safer fallback language that can be voluntarily incorporated into contracts. We encourage all market participants to share feedback on them over the next two months."

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 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.

Bilateral Business Loans

Similar to the ARRC’s earlier consultation on syndicated business loans, the [consultation on bilateral business loans](#) proposes two different approaches for comment: a “hardwired” and an “amendment” approach.

- **Hardwired Approach** – This approach would offer a clear waterfall for selecting a replacement benchmark and spread adjustment that would apply if LIBOR is no longer usable.
- **Amendment Approach** – This approach would provide a streamlined amendment mechanism that provides flexibility in negotiating a replacement benchmark and spread adjustment.

The consultation also seeks comment on the relationship between loans that implement a replacement benchmark and related hedging arrangements that borrowers and lenders use to mitigate risks.

Securitizations

The [consultation on securitizations](#) proposes one specific hardwired approach regarding triggering events and the waterfall for rate determination. It also addresses the unique challenges presented by the securitization market’s asset and liability components.

The proposals now being published for consultation were developed through discussion within the Securitizations and Business Loans working groups of the ARRC, representing work of more than 70 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, following the 60-day comment period, the ARRC will issue final contract language recommendations for bilateral business loans and securitizations, 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 stakeholders in these markets, including issuers, intermediaries, and end users, to solicit and incorporate their input. The consultations include multiple questions about each aspect of the potential fallback provisions. Comments should be sent to the ARRC Secretariat (arrc@ny.frb.org) no later than February 5, 2019. Please coordinate internally and provide only one response per institution. Please attach your

responses in a PDF document and clearly indicate “Consultation Response” in the subject line of your email. Comments will be posted on the ARRC’s website after the close of the consultation period without alteration except when necessary for technical reasons. Comments will be posted with attribution unless respondents request anonymity. If your institution is requesting anonymity, please clearly indicate this in the body of your email and please ensure that the PDF document you submit is anonymized. 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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