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Alternative Reference Rates Committee Releases Principles for Fallback Contract Language
Guiding Principles Mark a Key Milestone in Meeting the ARRC's Mandate

The Alternative Reference Rates Committee (ARRC) has released guiding principles for the development of fallback language for new financial contracts for cash products to ensure they will continue to be effective in the event that U.S. dollar (USD) LIBOR ceases to be produced. These principles mark a key milestone in meeting the ARRC's mandate to help address risks in contract language and minimize disruptions associated with a possible end to LIBOR. They also build on the ARRC's 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 principles are primarily aimed toward newly issued cash products including business loans, securitizations, and floating rate notes referencing LIBOR; other considerations beyond these principles may be warranted in considering contract language for consumer products.

The guiding principles are intended for market participants' voluntary use, to help them as they begin to reformulate potential contract language for cash products. They include broad guidelines related to usage of successor rates, spread adjustments, and trigger events; encourage consistency of terms and conditions across asset classes; and ask practitioners to consider feasibility and fairness of implementation. These guiding principles are designed to deal with new contracts that reference LIBOR, as most contracts for cash products do not adequately account for the possibility that LIBOR might cease to be produced. The UK Financial Conduct Authority has made clear that continued production of LIBOR is not guaranteed beyond 2021.

"These voluntary guiding principles released today by the ARRC are a meaningful step to allow market participants to consider the most appropriate LIBOR fallback language for new contracts to address the risk that LIBOR may permanently cease to be produced," said Sandra O'Connor, Chair of the ARRC and Chief Regulatory Affairs Officer at JPMorgan Chase and Co. "It is critical that the ongoing work of the ARRC is a transparent and open effort to support a smooth and orderly transition from U.S. dollar LIBOR should it be necessary."

The Federal Reserve convened the ARRC 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. After accomplishing its first set of objectives, it 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.

As part of its reconstitution, the ARRC has formed dedicated working groups that are continuing to develop specific language by product for consideration. These working groups include a broad range of market participants and will build on the framework of these guiding principles to provide additional specificity by product.

Upcoming ARRC Roundtable

The guiding principles will be among the topics discussed at a public roundtable hosted by the ARRC on July 19th. This forum will also provide an opportunity for the ARRC to report on its overall progress since it was reconstituted, and will be a starting point in the ARRC's public consultation and education process regarding contract robustness in instruments referencing LIBOR. The event will feature panel discussions around developments in contract language for floating rate notes, corporate loans, securitizations, and derivatives. It will be on-the-record, open to press, and available via webcast. Additional details and registration information can be found on the ARRC website.

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 the 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 the 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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