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ARRC Releases Recommendations for Contracts Linked to the USD LIBOR ICE Swap Rate

The Alternative Reference Rates Committee (ARRC) today released recommendations for contracts linked to USD LIBOR ICE Swap Rates (USD LIBOR ISR). The recommendations recognize that these contracts are not covered by federal LIBOR legislation and that counterparties may need to take proactive steps to address the end of the USD LIBOR ISR. Contracts referencing the USD LIBOR ISR include USD LIBOR swaptions, USD LIBOR Constant Maturity Swap (CMS)-linked derivatives, and certain debt instruments. To avoid disruption to these contracts, the ARRC developed a set of recommendations including a suggested fallback formula that can be used for USD LIBOR ISR fixings after 3-month USD LIBOR has been discontinued or becomes non-representative.

"These recommendations are yet another important ARRC tool for ensuring everyone is prepared well ahead of next year," said Tom Wipf, ARRC Chairman and Vice Chairman of Institutional Securities at Morgan Stanley. "We encourage market participants to assess their USD LIBOR ISR exposures and fallback provisions, proactively address the impact of those legacy positions where possible, and consider the ARRC's suggested fallback formula in determining a successor rate where needed."

In particular, the ARRC makes the following recommendations:

- Market participants should inventory their contracts tied to the USD LIBOR ISR and identify the fallback provisions that they contain. For contracts whose primary fallback is a dealer poll, particular attention should be paid to the secondary fallback, i.e. the fallback that would apply if the dealer poll(s) were to fail.

- Where practical, market participants should take proactive steps to address the impact of the cessation of USD LIBOR ISR on their legacy positions (e.g. USD LIBOR swaptions, USD LIBOR CMS-linked derivatives and debt instruments) by:
    - Converting these positions to their SOFR or SOFR ISR equivalent, or
    - Incorporating hardwired fallbacks consistent with the approach suggested by the ARRC and included in the prevailing version of the ISDA Definitions, or
    - Considering calling or buying back debt instruments with problematic fallback provisions.

- If a legacy position cannot be proactively converted to SOFR or the SOFR ISR and its contractual fallbacks cannot be amended:
    - The ARRC believes that, once 3-month USD LIBOR has ceased to be published as a representative rate, the fallback formula suggested would accurately represent the at-the-money rates of standard interest rate swaps which are tied to it and which incorporate the fallback provisions introduced in the ISDA 2020 IBOR Fallbacks Protocol.
    - As a result, if the contractual fallbacks involve calculation agent determination, the ARRC recommends that calculation agents consider the ARRC's suggested fallback formula in determining a successor rate.

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 Commodity Futures Trading Commission, the Consumer Financial Protection Bureau, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the National Association of Insurance Commissioners, the New York Department of Financial Services, the Office of Financial Research, the Office of the Comptroller of the Currency, the U.S. Department of Housing and Urban Development, the U.S. 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 it recommends 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 support the voluntary 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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