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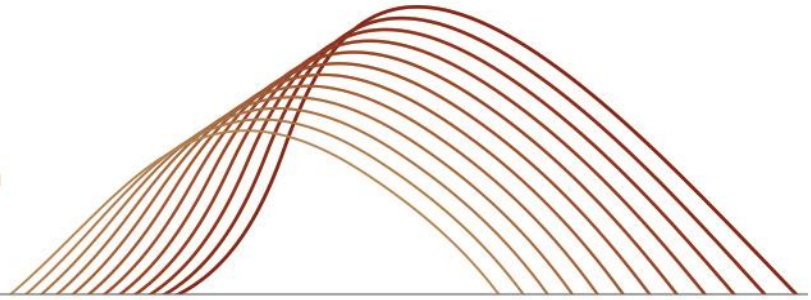

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ARRC Releases Supplemental Consultation on LIBOR-to-SOFR Spread Adjustment Methodology

By Joyce Sophia Xu, Michael Spafford, Diona Park, Daren Stanaway & Matthew Smith

On May 6, 2020, the Alternative Reference Rates Committee (the "ARRC") issued a supplemental consultation seeking market feedback on certain technical issues relating to the U.S. dollar ("USD") LIBOR-to-SOFR spread adjustment methodology for cash products (the "Supplemental Consultation").[1] The Supplemental Consultation provides a summary of market participant feedback that the ARRC received in response to its original January 2020 consultation regarding spread adjustment methodologies (the "Original Consultation") and poses follow-up questions for the market's view on two outstanding technical details.[2]

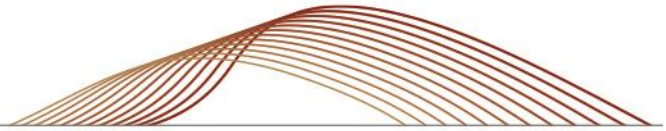
I. Background

The ARRC's spread adjustment methodology is intended for use in cash products referencing USD LIBOR that have incorporated the ARRC's recommended hardwired fallback language or for legacy USD LIBOR contracts where a spread-adjusted Secured Overnight Financing Rate ("SOFR") can be selected as a fallback. In response to the feedback that it received to its Original Consultation, the ARRC announced in April 2020 that it is recommending a spread adjustment methodology based on a historical median over a five-year lookback period calculating the difference between USD LIBOR and SOFR, with a one-year transition period applicable only to consumer products.[3] The ARRC's recommended spread adjustment methodology for cash products aligns with the spread adjustment methodology recommended by the International Swaps and Derivatives Association, Inc. ("ISDA") for derivatives. The ARRC has stated that it intends to work with a to-be-announced third-party vendor to publish its recommended USD LIBOR-to-SOFR spreads and spread-adjusted rates and will release a more detailed final recommendation of its recommended spread adjustment methodology as part of this process.[4] Additionally, since the ARRC's initial recommendations, ISDA recently announced that it would include a pre-cessation trigger in the amended 2006 ISDA Definitions and in a single protocol for legacy trades bringing fallbacks for derivatives closer in line with cash products.[5]

II. The Supplemental Consultation

A. Matching ISDA's Spread Adjustment Methodology vs. ISDA's Spread Adjustment Value

Using the ARRC's recommended hardwired fallback language, floating rate notes, securitizations, and syndicated and bilateral business loans would fall back to a forward-looking term SOFR rate ("Term



SOFR") if the ARRC has recommended one, or, if Term SOFR has not been recommended or if the parties to the relevant contract prefer not to use Term SOFR, a compound average of SOFR either in arrears or in advance (depending on the preferences of the parties to the relevant contract). Because five years of historical data may not be available for Term SOFR at the time of the transition away from USD LIBOR, the Original Consultation sought market feedback on how the Term SOFR spread adjustment should be calculated in those circumstances and proposed a few options for market participants to consider. After reviewing market feedback to the Original Consultation, the ARRC identified another potential option: using ISDA's spread adjustment *value* for a given LIBOR tenor, instead of ISDA's spread adjustment *methodology*, across the different fallback rates of the same tenor, regardless of whether sufficient rate history for any particular fallback rate exists. The Supplemental Consultation now seeks feedback on market participants' preferences in this regard.

B. Spread Adjustment Timing for Pre-Cessation Event

While the Original Consultation sought feedback on the potential timing for when the recommended spread adjustment could be set in the event of a pre-cessation trigger, the ARRC notes that, with ISDA's recent announcement for applying pre-cessation fallback triggers, it is possible that ISDA may elect to set its spread adjustment at a different time than the time that the ARRC had considered. Consequently, the Supplement Consultation now seeks the market's views on whether the timing of the fixing of the ARRC's spread adjustment upon the occurrence of a pre-cessation trigger should match the timing ISDA ultimately selects.

III. Conclusion

The full text of the Supplemental Consultation can be found here. Market participants may submit responses to the consultation questions by email to the ARRC no later than June 8, 2020.

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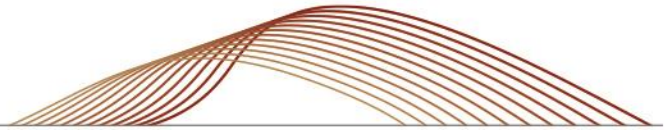

[1] "ARRC Issues Supplemental Consultation on Spread Adjustment Methodology," available here.

[2] "Summary of Feedback Received in the ARRC Spread-Adjustment Consultation and Follow-Up Consultation on Technical Details," available here [hereinafter "Supplemental Consultation"].

[3] "ARRC Announces Recommendation of a Spread Adjustment Methodology for Cash Products," available here. For more information on the ARRC's announcement, please see our recent publication, "ARRC Announces Recommended Spread Adjustment Methodology for Cash Products," available here.

[4] *See* Supplemental Consultation.

[5] "ISDA Announces Preliminary Results of Consultation on Pre-cessation Fallbacks for LIBOR," available here. For more information on ISDA's pre-cessation fallbacks for LIBOR, please see our recent publication, "ISDA Announces Preliminary Results of LIBOR Pre-cessation Fallbacks Consultation," available here.