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ARRC Announces Recommended Spread Adjustment Methodology for Cash Products

By Paul Hastings LIBOR Transition Task Force

On April 8, 2020, the Alternative Reference Rates Committee (the "ARRC") announced that it had agreed on a recommended spread adjustment methodology for cash products referencing the U.S. dollar London Interbank Offered Rate ("USD LIBOR").[1] With the anticipated cessation of LIBOR at the end of 2021, the ARRC previously endorsed the Secured Overnight Financing Rate ("SOFR") as its recommended alternative to USD LIBOR and has developed recommended fallback language for use in various cash products that reference LIBOR.[2] For legacy contracts in which a spread-adjusted SOFR can be selected as a fallback, the ARRC's recommended spread adjustment methodology is intended to be used to determine the spread that can be added to SOFR, such that the spread-adjusted SOFR would be comparable to USD LIBOR.

The ARRC recommends a spread adjustment methodology based on a historical median over a five-year lookback period calculating the difference between USD LIBOR and SOFR. This overall spread adjustment methodology is consistent with the methodology recommended by the International Swaps and Derivatives Association, Inc. for derivatives products and therefore would align the spread-adjusted SOFR used in cash products with any related hedging positions. The ARRC additionally recommends a one-year transition period for consumer products to mitigate a "cliff effect" that could result from the LIBOR transition.

Tom Wipf, the ARRC's Chair, stated that the ARRC's announcement "provides clarity that should encourage those who have not already done so to begin using the ARRC's fallback language."[3] Mr. Wipf also noted that "the use of hardwired language that clearly sets out the replacement for LIBOR is best practice" and encouraged all market participants "to use the ARRC's recommended fallback language in their contracts now."[4]

The ARRC's recommendation is based on the extensive feedback that it received in response to its public consultation on spread adjustment methodologies.[5] The ARRC will release additional details regarding its recommended spread adjustment methodology for cash products in the coming weeks and has committed to ensuring that the LIBOR-to-SOFR spread adjustments and resulting spread-adjusted rates are published and made publicly available.[6]

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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[1] "ARRC Announces Recommendation of a Spread Adjustment Methodology for Cash Products," available here [hereinafter "ARRC Announcement"].

[2] An overview of the ARRC's recommended fallback language for various cash products is available here.

[3] *See* ARRC Announcement.

[4] *Id.*

[5] The ARRC received more than 60 responses from market participants, including consumer advocacy groups, asset managers, corporations, banks, industry associations, government-sponsored entities, and others. For more information on the ARRC's consultation, please see our recent publication, "ARRC Releases Consultation on LIBOR-to-SOFR Spread Adjustment Methodologies," available here.

[6] *See* ARRC Announcement.