ARRC Guiding Principles for More Robust LIBOR Fallback Contract Language in Cash Products

The goal of the ARRC is to publish one or more sets of suggested fallback language and it has developed these principles to guide the development of U.S. dollar LIBOR fallback language within its working groups. These principles are being shared publicly so that market participants may consider them as the ARRC works to reach consensus on suggested fallback language in new contracts in order to fulfill its mandate to help address risks in contract language and minimize disruptions associated with a potential end to LIBOR. 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 extent to which any market participant implements or adopts any suggested contract language is completely voluntary. Each market participant will make its own independent decision about whether or to what extent any suggested contract language is adopted. Similarly, these guiding principles are completely voluntary and market participants should make their own decisions about whether to adopt or implement these guiding principles when considering contract language.

Contract Language Evolution and Moving from Discretion to Specificity

- Market participants should look to minimize the time before more robust contract language is widely incorporated, which may involve being willing to change language over time rather than forgoing any improvements until the absolutely most robust language possible has been identified. Continuing to issue new deals without more robust replacement language will increase the size of the risk to the financial system.

- Efforts should evolve iteratively, utilizing market information and developments from other products to inform standard interest rate language in new agreements. Suggested contract language may initially include higher degrees of flexibility or discretion in order to facilitate quicker incorporation of more robust fallback language where none currently exists, but should be expected to evolve to more specific language that leaves less ambiguity as to how fallback rates and spread adjustments will be selected. This process will be facilitated by the longest possible parallel run between LIBOR and alternative fallback reference rates. Unnecessary variability in fallback language should be reduced as soon as market consensus emerges. This includes, without limitation, specific triggers, the successor rate, the spread adjustment mechanism, and the term structure.

- Where flexibility or discretion are incorporated, it should be done in the most limited manner possible to ensure ease of application and to minimize the potential for disputes, and it should not unduly preclude the mechanisms and outcomes thought likely to be included in future more specific language.

- Suggested contract fallback language should seek to minimize litigation risk as well as judicial and regulatory risks for all market participants.

Consistency Between Asset Classes as Appropriate

- Suggested contract language should bear resemblance to contract language in other asset classes and liabilities – including derivatives – as feasible and appropriate. To extent consensus does not exist across all asset classes, individual sectors should seek to maintain consistency of approach within their particular asset class.
- Market participants should strive to maintain alignment in outcomes and minimize basis risks between their products and any related loans and securities, securitizations, or hedges bearing in mind operational, tax, and accounting issues.
- Market participants should also seek an alignment of outcomes, where possible, with contract language in other jurisdictions in order to simplify transition and minimize value transfer in multi-currency facilities and minimize basis risks in other agreements or interrelated transactions involving multiple currencies.
- In order to promote consistent outcomes, market participants should seek to use SOFR, or a benchmark based on SOFR, as the primary basis for a replacement rate where this is considered appropriate and practicable.

Feasibility and Fairness of Implementation

- Suggested contract fallback language should be practicable and should go beyond the standard poll of banks that appears in many legacy documents' fallback provisions.
- Mechanics for determining successor rates, spread adjustments and term structures should be feasible from an operational perspective.
- Suggested contract fallback language should incorporate feedback from a broad range of market participants to, among other things, ensure that it is feasible and fair, does not advantage any market participant to the disadvantage of another, and could be implemented practically.
- Market participants should inform themselves so as to understand the ramifications of current fallback language and the potential ramifications of any proposed successor rates or other contractual details, including how any successor rate may behave relative to LIBOR in different stages of the economic cycle and in different economic conditions.
- Contract language should seek to minimize expected value transfer over the lifetime of the contract.
- To the extent that value transfer may occur, fallback language should be based on observable, objective facts and rules set forth in the contract.
- Contract language should contemplate additional disruptions and attempt to be future proof, including by addressing the potential cessation of the replacement rate.

- Contract fallback language should not impede, to the extent possible, any efforts towards voluntary transition that may be negotiated by contract parties independent of standardized contract fallback language.

Rate, spread and term structure adoption

- Suggested contract fallback language should explicitly allow for a spread adjustment to minimize valuation changes. Such language should provide adequate protections to the extent an Administrative Agent, Trustee, Collateral Agent or other party is responsible for making any determinations with respect to such adjustments.
- Suggested contract fallback language should include specific triggers that enact the shift to successor rate(s).
- The choice of successor rate, spread adjustment and succession timing and mechanics should be clear enough to be effectively communicated to borrowers and investors.