

May 31, 2019

**ARRC Releases Recommended Fallback Language for Bilateral Business Loans  
and Securitizations**

***ARRC Encourages Use of this Language in New Contracts, Which Aims to Minimize Market  
Disruptions if LIBOR is No Longer Usable***

The Alternative Reference Rates Committee (ARRC) today released recommended contractual fallback language for U.S. dollar (USD) LIBOR denominated [bilateral business loans](#) and [securitizations](#). This follows the release of the ARRC's recommended contractual fallback language for [floating rate notes](#) and [syndicated loans](#) in April. These provisions are for market participants' voluntary use in new contracts that reference LIBOR and were developed with the goal of reducing the risk of serious market disruption in the event that LIBOR is no longer usable.

These recommendations are part of the ARRC's mandate to help address risks in contracts referencing LIBOR. They build on the ARRC's work to develop the [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). The ARRC also expects to consult with a broad range of stakeholders on proposals for fallback language in consumer products in the future.

"It is imperative that market participants stop writing contracts that do not account for the discontinuance of LIBOR. Both today's fallback language and the set issued last month provide essential tools for writing robust contracts," said Tom Wipf chair of the ARRC and Vice Chairman of Institutional Securities at Morgan Stanley. "It's time that all market participants transition their products away from U.S. dollar LIBOR where possible and we encourage the use of SOFR now, but those that continue to use LIBOR need to make sure they have very strong fallbacks in place."

The final recommended language was prepared after consideration of all comments received—over 50 in total—on the fallback language consultations for [bilateral business loans](#) and [securitizations](#). These provisions were endorsed by the ARRC and represent a consensus of its Business Loans and Securitizations working groups. Together, these working groups represent the collective work of more than 80 institutions and trade groups, including more than 300 individuals. Cadwalader, Wickersham & Taft LLP assisted the working group efforts as drafting counsel.

As described in the ARRC's [guiding principles for fallback language](#), there are substantial benefits to aligning fallback provisions across different products so that they would operate similarly in the event that LIBOR is no longer usable. Recognizing, however, that financial

products differ in critical ways, the ARRC's recommended fallback language is designed for specific products but seeks general consistency in defining key terms, including:

- **Benchmark Transition Events:** the trigger events that start the transition away from LIBOR;
- **Benchmark Replacement:** the successor adjusted rate that would replace references to LIBOR throughout the contract following a Benchmark Transition Event; and
- **Benchmark Replacement Adjustment:** the spread adjustment component of the Benchmark Replacement that is applied to the successor rate to make it more comparable to LIBOR.

### **Bilateral Business Loans**

Similar to the ARRC's recommended fallback language for [syndicated loans](#), the recommended language for [bilateral business loans](#) includes two different approaches: a "hardwired" and an "amendment" approach.

- **Hardwired Approach:** This approach provides a clear waterfall for selecting a replacement benchmark and spread adjustment that would apply if LIBOR is no longer usable.
- **Amendment Approach:** This approach provides a streamlined amendment mechanism that offers flexibility in selecting a replacement benchmark and spread adjustment.

The fallback language also provides an option that acknowledges the relationship between loans that implement a replacement benchmark and related hedging arrangements that borrowers and lenders use to mitigate risks.

### **Securitizations**

The ARRC's recommended fallback language for [securitizations](#) proposes a hardwired approach regarding triggering events and the waterfall for rate determination. It also addresses the unique challenges presented by the securitization market's asset and liability components.

### **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 Consumer Financial Protection Bureau, 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 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](#)

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[Plan](#), with specific steps and timelines designed to encourage 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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