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Key Principles to Guide the ARRC as it Considers the Conditions it Believes are Necessary to Recommend a Forward-Looking SOFR Term Rate

The ARRC recommends the use of SOFR as a replacement for USD LIBOR given its robustness, and recommends that the vast majority of new contracts directly reference averages of overnight SOFR rates—including compounded SOFR averages, simple averages of SOFR, and the SOFR Averages and Index published by the New York Fed. These averages of overnight SOFR rates can be used in advance (set at the beginning of the interest period) or in arrears (set at or shortly prior to the end of the interest period).

The ARRC has long recognized that the use of a forward-looking SOFR term rate may be a useful supporting tool, but for a limited set of use cases such as fallbacks for certain legacy cash products referencing LIBOR, and only once sufficient liquidity exists in SOFR derivatives.[1] This is because forward-looking SOFR term rates would be based on derivatives transactions, not the financing transactions that back overnight SOFR rates. Therefore, any ARRC recommended forward-looking SOFR term rate should meet the criteria for alternative reference rates that the ARRC set, similar to SOFR itself.[2]

The following principles will continue to guide the ARRC as it considers the conditions it believes are necessary to recommend a forward-looking SOFR term rate.

The key principles for an ARRC-recommended forward-looking SOFR term rate, are that this rate should:

1. ***Meet the ARRC's criteria for alternative reference rates*****,** similar to SOFR itself;

2. ***Be rooted in a robust and sustainable base of derivatives transactions over time,*** to ensure that its use as a reference rate is consistent with best practices and the ARRC's own standards; and,

3. ***Have a limited scope of use,*** to avoid (i) use that is not in proportion to the depth and transactions in the underlying derivatives market or (ii) use that materially detracts from volumes in the underlying SOFR-linked derivatives transactions that are relied upon to construct a term rate, making the term rate itself unstable over time.

[1] ARRC User's Guide to SOFR (April 2019); FSB Interest rate benchmark reform – overnight risk-free rates and term rates
[2] ARRC Interim Report and Consultation