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ARRC Recommends Loan Conventions and Best Practices for Use of Forward-Looking SOFR Term Rate to Accelerate the Transition Away from LIBOR

In anticipation of the Alternative Reference Rates Committee's (ARRC) impending formal recommendation of the forward-looking Secured Overnight Financing Rate term rates (SOFR Term Rates) produced by the CME Group, the ARRC is announcing conventions and use cases for how best to employ the SOFR Term Rates to successfully transition away from U.S. dollar (USD) LIBOR. The ARRC's formal recommendation will complete the last step in making the SOFR Term Rates widely available, and is expected to follow shortly after the July 26 move of interdealer trading conventions to SOFR.

"Market participants now have the tools and necessary guidance to support use of the SOFR Term Rate in transitioning away from LIBOR." said Tom Wipf, ARRC Chairman and Vice Chairman of Institutional Securities at Morgan Stanley. "Once the SOFR First swaps convention switches on July 26th and the ARRC formally recommends the SOFR Term Rates, market participants should have what they need to use SOFR in all its forms across financial markets, including the use of the SOFR Term Rates for business loans."

In its recommended best practices, the ARRC has highlighted particular areas where use of the SOFR Term Rates will be helpful to support a smooth transition away from USD LIBOR, taking into account feedback from a broad set of stakeholders. The SOFR Term Rates will be especially helpful for the business loans market—particularly multi-lender facilities, middle market loans, and trade finance loans—where transitioning from LIBOR to an overnight rate has been difficult. The Best Practice Recommendations also support the use of SOFR Term Rates in end-user facing derivatives that hedge cash instruments linked to the Term Rates, and certain securitizations with underlying assets that are themselves tied to SOFR Term Rates.

To help further facilitate the use of the SOFR Term Rates and SOFR Averages in advance, the ARRC has published recommended conventions for these rates in the business loans market. The ARRC has previously released recommended conventions for the use of SOFR In Arrears using both daily simple SOFR average and a compounded SOFR average.

Today's announcement builds on the ARRC's term rate principles, term rate market indicators and Request for Proposals update—which together provide clear guidance that would allow the ARRC to recommend a SOFR-based term rate shortly after the July 26 SOFR First convention switch.

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 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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