ARRC

Recommended Scope of Use for SOFR Term Rates
ARRC Recommended Scope of Use – Legacy Contracts

The ARRC has issued recommended fallback language for LIBOR-based
  • floating rate notes
  • bilateral business loans
  • syndicated loans
  • securitizations
  • residential adjustable-rate mortgages
  • private student loans

The first step of the fallback waterfalls is a forward-looking, SOFR-based term. After the ARRC has recommended the term rates, if the relevant tenor exists, contracts with ARRC language would fall back to the SOFR Term Rate once the contractual LIBOR replacement date occurs.

The ARRC expects to make recommendations for the New York State legislation that are consistent with its existing recommended fallback provisions.
ARRC Recommended Scope of Use – New Contracts

The ARRC continues to recommend SOFR for all products, and as a general principle recommends that market participants use overnight SOFR and SOFR averages given their robustness, particularly in markets where we have seen that there can be successful adoption of these rates such as:

- floating rate notes
- consumer products such as adjustable-rate mortgages and student loans
- most securitizations

The ARRC also recommends the use of overnight SOFR and SOFR averages in cases where a party wishes to hedge in the most efficient and transparent manner.
ARRC Recommended Scope of Use – New Contracts

However, the ARRC also supports the use of the SOFR Term Rate in areas where use of overnight and averages of SOFR has proven to be difficult.

Specifically:

- **The ARRC supports the use of SOFR Term Rate in addition to other forms of SOFR for business loan activity** — particularly multi-lender facilities, middle market loans, and trade finance loans—where transitioning from LIBOR to an overnight rate has been difficult and where use of a term rate could be helpful in addressing such difficulties.

- The ARRC also recognizes that the SOFR Term Rate may also be appropriate for certain securitizations that hold underlying business loans or other assets that reference the SOFR Term Rate and where those assets cannot easily reference other forms of SOFR.
The ARRC does not support the use of the SOFR Term Rate for the vast majority of the derivatives markets, because these markets already reference SOFR compounded in arrears and transitioning derivatives markets to the more robust overnight risk-free rates (RFRs) is essential to ensure financial stability as emphasized by the Financial Stability Board.

The ARRC recommends that any use of SOFR Term Rate derivatives be limited to end-user facing derivatives intended to hedge cash products that reference the SOFR Term Rate. This limitation is intended to avoid use that is not in proportion to, or materially detracts from, the depth of transactions in the underlying derivatives markets that are essential to the construction of the SOFR Term Rate over time.