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What is Happening to My LIBOR Now? Simplification of the ARRC's Hardwired Approach

On March 25, 2021, the Alternative Reference Rates Committee (the "ARRC") issued supplemental guidance to its recommended hardwired fallback language for U.S. dollar LIBOR denominated syndicated and bilateral business loans. The ARRC's supplemental guidance provides a more streamlined version of the fallback language for syndicated business loans (which the ARRC issued in June 2020) and bilateral business loans (which the ARRC issued in August 2020). The ARRC's supplemental guidance comes on the heels of the March 5, 2021 announcements made by the ICE Benchmark Administration¹ (the "IBA") and the UK's Financial Conduct Authority (the "FCA") formally announcing LIBOR's cessation. The ultimate goal of the ARRC's supplemental guidance—made possible given the certainty on fallback timing and the applicable spread adjustments in the wake of the March 5, 2021 announcements—is the simplification of the 2020 hardwired fallback language to further support an orderly transition from USD LIBOR to the Secured Overnight Financing Rate ("SOFR").

SIMPLIFICATIONS TO THE HARDWIRED APPROACH

The ARRC's supplemental guidance does not replace or supersede the ARRC's prior hardwired fallback language issued in 2020. Instead, the ARRC's supplemental guidance offers a simplified approach to arrive at the same substantive result as the 2020 hardwired fallback language. This section describes in some detail the primary simplifications that the ARRC incorporated into its recommended hardwired fallback language, but the general takeaway for market participants is that the ARRC's supplemental guidance is more accessible and transparent.

First, given the clarity on fallback timing as a result of the March 2021 announcements by the IBA and the FCA (which announcements constituted the occurrence of a "Benchmark Transition Event" under the 2020 hardwired fallback language), the replacement of USD LIBOR is now addressed in an operative provision that is separate from the provisions addressing the replacement of future benchmarks. Previously,



the definitions for “Benchmark Transition Event” and “Benchmark Replacement Date” described the trigger event and the effective date of the transition from USD LIBOR to the fallback reference rate. The supplemental guidance now addresses USD LIBOR through an operative provision referencing the March 2021 announcements by the IBA and the FCA and provides for a transition effective date on the earlier of (1) the date that the IBA ceases to support all tenors of LIBOR or the FCA announces in a public statement that LIBOR is no longer representative and (2) the Early Opt-In Effective Date. The supplemental guidance continues to include provisions addressing the potential occurrence of future “Benchmark Transition Events” for reference rates other than USD LIBOR. For those market participants who nevertheless plan to use the 2020 hardwired fallback language, the ARRC’s supplemental guidance is a reminder that, as a result of the announcements from the IBA and FCA, a “Benchmark Transition Event” has occurred as of March 5, 2021, and those market participants should revise the 2020 hardwired fallback language to acknowledge the occurrence of the “Benchmark Transition Event”.

Second, the spread adjustments for LIBOR fallback have been hardcoded into the definition of “Benchmark Replacement” because, following the March 2021 announcements by the IBA and FCA, these spread adjustments have been published by Bloomberg and are fixed as of March 5, 2021 for all US Dollar, Euro, Sterling, Swiss Franc and Japanese Yen LIBOR settings.² As a result, the ARRC was able to remove the “Benchmark Replacement Adjustment” mechanics which previously addressed the then-unknown spread adjustments.

Finally, the supplemental guidance sets forth a two-step waterfall to determine the successor rate to be used: (1) Term SOFR plus a hardcoded adjustment (as described above) or (2) Daily Simple SOFR plus the spread adjustment selected or recommended by the Relevant Governmental Body for the replacement of the tenor of USD LIBOR with a SOFR-based rate having the same length as the applicable interest payment period. The second step of the waterfall reflects a refinement by the ARRC in light of recognition that Daily Simple SOFR is a daily rate (rather than Term SOFR or USD LIBOR, which feature tenors) and therefore an interest payment is required frequency (i.e., monthly or quarterly) and the applicable spread adjustment is a function of such interest payment frequency.

We further note that the two-step waterfall is designed to address an as-of-yet unknown variable affecting LIBOR transition: while the ARRC reiterated its intention to recommend a forward-looking term SOFR for use as a fallback rate, it is uncertain whether an IOSCO-compliant benchmark³ that is also acceptable to the ARRC will be available prior to June 30, 2023 (the scheduled cessation date for the remaining USD LIBOR tenors). If the ARRC is unable to conclude that an IOSCO-compliant forward-looking SOFR term rate is available, then the second step in the fallback waterfall continues to be Daily Simple SOFR. Despite the ARRC’s intention to recommend a forward-looking term SOFR for use as a fallback rate, the ARRC has acknowledged that it will not be in a position to make such a recommendation by mid-2021 because, among other reasons, liquidity in SOFR derivatives markets may not have developed sufficiently. The ARRC has encouraged market participants to continue to transition from LIBOR, without waiting for a forward-looking term SOFR, by using a non-forward-looking rate such as Daily Simple SOFR (i.e., the second level in the fallback waterfall). In fact, borrowers who intend to enter into interest rate swaps may find it advantageous to consider removing the option for Term SOFR and thereby falling back to Daily Simple SOFR (or, as an alternative to the ARRC’s recommendation, Daily Compound Simple SOFR) in order to align the replacement reference rate more closely with the International Swap and Derivatives Association’s selected fallback rate and the floating rate option for “SOFR”.

CONCLUSION

In light of the increased certainty on the timing of LIBOR cessation and the applicable spread adjustments, the ARRC’s supplemental guidance offers greater transparency and more user-friendly provisions to market participants. The ARRC previously recommended that all market participants adopt hardwired fallback language by December 31, 2020, and the supplemental guidance provides a simplified and streamlined approach that is designed to facilitate the discussion and



adoption of hardwired fallback language by those market participants who have not yet adopted the hardwired fallback language in preparation for LIBOR's cessation.

For more information regarding the transition away from LIBOR, please see:

[What Happened To My Interest Rate? Planning Now To Avoid Value Transfer And Other Risks Upon The Demise Of U.S. Libor](#), [What Happened to My Interest Rate? A Deep Dive into Hardwiring Predictability and Fairness for LIBOR Transition in Loans, Derivatives and other Contracts](#), [Is My Libor Back?](#), [Can't We All Just Get Along? Four Key Areas of Dispute in the Evolving Landscape of LIBOR Cessation Litigation](#), [What Happened to My Interest Rate? Fed Intensifies Scrutiny of Lenders' SOFR Transition Efforts](#) and [And So it Begins: What Recent Announcements Mean for the Future of LIBOR](#)

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¹ The IBA is the Financial Conduct Authority-regulated and authorized administrator of LIBOR.

² The spread adjustment values for each currency and tenor are available at: https://assets.bbhub.io/professional/sites/10/IBOR-Fallbacks-LIBOR-Cessation_Announcement_20210305.pdf.

³ The International Organization of Securities Commissions, the international body comprising the world's securities regulators.



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