

April 8, 2020

ARRC Announces Recommendation of a Spread Adjustment Methodology for Cash Products

At its April meeting, the Alternative Reference Rates Committee (ARRC) agreed on a recommended spread adjustment methodology for cash products referencing U.S. dollar (USD) LIBOR. The ARRC's recommended methodology is for market participants' voluntary use, to produce spread adjustments intended for USD LIBOR contracts that have incorporated the ARRC's recommended hardwired fallback language, or for legacy USD LIBOR contracts where a spread-adjusted Secured Overnight Financing Rate (SOFR) can be selected as a fallback.

Following its consideration of [feedback received](#) on its [public consultation](#), the ARRC is recommending a spread adjustment methodology based on a historical median over a five-year lookback period calculating the difference between USD LIBOR and SOFR. For consumer products, the ARRC is additionally recommending a 1-year transition period to this five-year median spread adjustment methodology. The five-year median spread adjustment methodology matches the methodology recommended by the International Swaps and Derivatives Association (ISDA) for derivatives and would make the ARRC's recommended spread-adjusted version of SOFR comparable to USD LIBOR and consistent with ISDA's fallbacks for derivatives markets. The inclusion of a transition period for consumer products was endorsed by many respondents, including consumer advocacy groups.

"This announcement of a recommended spread adjustment methodology provides important clarity that should encourage those who have not already done so to begin using the ARRC's fallback language," said Tom Wipf, ARRC Chair and Vice Chairman of Institutional Securities at Morgan Stanley. "The ARRC believes that the use of hardwired language that clearly sets out the replacement for LIBOR is best practice and I urge everyone to use ARRC's recommended fallback language in their contracts now."

The ARRC made this initial recommendation after [conducting](#) an extensive [public consultation](#), during which more than [60 responses](#) were received from consumer advocacy groups, asset managers, corporates, banks, industry associations, government-sponsored entities, among others.

In the coming weeks, the ARRC will release a more detailed final recommendation of the spread adjustment methodology for cash products. The ARRC has committed to making sure its recommended spread adjustments and the resulting spread-adjusted rates are published and will work with potential vendors to make sure that these spreads and spread-adjusted rates are made publicly available.

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

ALTERNATIVE REFERENCE RATES COMMITTEE

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 the 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 the 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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Contact for ARRC Chair Tom Wipf

[Paige Mandy](#)

Morgan Stanley

Contact for the ARRC's Outreach/Communications Working Group

[Andrew S. Gray](#)

JPMorgan Chase

Contact for the Federal Reserve Board

[Darren Gersh](#)

Contacts for the Federal Reserve Bank of New York

[Suzanne Elio](#) and [Betsy Bourassa](#)