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ARRC Consults on Spread Adjustment

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Much of the thought in the LIBOR phase-out process has been on drafting contract terms that identify an agreed-upon replacement benchmark and then effecting the transition. One aspect that has received less attention is the necessary margin adjustment that should accompany a change in the benchmark. Because LIBOR is an unsecured interbank lending rate and SOFR, as the name suggests, is based on secured transactions, there inevitably exists a LIBOR-SOFR basis. Without an accompanying margin adjustment, the transition to SOFR would, under normal circumstances, result in a reduced interest rate on a loan.

The Federal Reserve's Alternative Reference Rates Committee (ARRC) is tackling the topic in its recently published ***ARRC Consultation on Spread Adjustment Methodologies for Fallbacks in Cash Products Referencing USD LIBOR.*** The publication provides an opportunity for market participants to comment on the appropriate methodology for determining the spread adjustment. Our colleagues at the *Cadwalader Cabinet* summarized the consultation **here**.