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What Experts Are Warning About Change From Libor.

WASHINGTON - Financial institutions are getting a jump on moving away from a longtime key benchmark index and into a new one, a move that could cause problems for some municipal interest rate swaps and other derivatives.

Bank officials, investors, and other experts weighed in Tuesday on the need to move quickly away from using the London Interbank Offered Rate, or Libor as a benchmark and migrating to the SOFR, the Secured Overnight Financing Rate. Speaking on a panel at the Securities Industry and Financial Markets Association's annual meeting, these experts stressed the increasing inevitability of the loss of Libor and the need to begin moving away from it before it is actually retired in about three years.

Libor is the average rate at which major banks can obtain unsecured funding from each other. It has been used in trillions of dollars of derivatives transactions globally and was at the center of a series of scandals in which banks and bankers were charged with manipulating it for financial gain. The Financial Conduct Authority in London, announced last year that it will abandon Libor by the end of 2021.

Libor has been widely used in the tax-exempt bond market. Examples include bank loans involving floating rate notes or bonds that have rate resets based on Libor and interest rate swaps tied to muni bonds that have been publicly offered.

SOFR is published by the Federal Reserve Bank of New York, which describes it as "a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities."

New York's Metropolitan Transportation Authority issued the municipal market's first tax-exempt transaction linked to SOFR last month.

Libor "is no longer a viable reference," said Christian Rasmussen, global head of liability creation structuring & flow management and global co-head of repo trading at UBS.

Jason Manske, senior managing director and head of global derivatives and liquid markets at MetLife (MET), stressed superiority of SOFR as a transaction-based rate rather than one like Libor which is set artificially.

"Do you want a rate that's based on actual transactions, or do you want a made-up rate?" Manske asked. "You can't put this off. You have to start the baby steps now."

The panel particularly discussed the need to include "fallback language" in the contracts governing transactions tied to a reference rate, so that there will be clarity about what happens to those deals in a post-Libor world.

Ann Battle, assistant general counsel at the International Swaps and Derivatives Association, said ISDA is working to help its member institutions move toward SOFR.

"We're doing a lot to facilitate adoption of SOFR going forward," she said.

Absent regulatory relief, a switch from Libor to SOFR could create tax issues for municipal debt, such as reissuance. If floating rate bonds based on Libor switch to another benchmark rate, the switch may be considered a material change to the bonds that causes them to be considered newly reissued. A reissuance would make the bonds subject to the latest tax laws and rules and could even make them taxable. A Treasury Department official announced last month that Treasury and the Internal Revenue Service will try to provide some relief with regard to this issue, but could not say when that project will be done.

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