Muni Market Awaits Fallback Language for Libor Phaseout.

WASHINGTON — Municipal and corporate bond issuers are awaiting the release of standardized fallback language for the eventual phaseout of Libor, market participants told a Securities and Exchange Commission's Fixed Income Market Structure Advisory Committee on Monday.

The phaseout of Libor, also known as the London Interbank Offered Rate, will affect municipal finance in not just the bond market but also in some legacy contracts with suppliers where Libor language is used, experts said. Fallback language is expected to be released before year-end by both the Alternative Reference Rates Committee (ARRC) convened by the Federal Reserve and the International Swaps and Derivatives Association (ISDA).

Pat McCoy, past president of the Government Finance Officers Association and finance director of the New York Metropolitan Transportation Authority, said ISDA's work "is going to be a critical piece of the work that ARRC undertakes."

"It will make more clear to the issuer community what they need to focus on with their existing legacy agreements and, obviously to the extent that they want to do new derivative agreements, what is available to them," McCoy told The Bond Buyer.

McCoy said the GFOA is encouraging municipal governments to consult with their municipal advisor and their counsel before deciding how to proceed.

Tom Deas of the National Association of Corporate Treasurers said at Monday's meeting that Libor language is contained in many supplier contracts.

McCoy said it's likely not as prevalent in municipal contracts, but it does occur.

"There's typically a fallback language in the documents," he said. "Obviously with derivatives there's fallbacks in that as well. That affects the municipal market as well as the corporate market."

There are about $1.8 trillion in outstanding floating-rate corporate and municipal bonds tied to Libor, the Fixed Income Market Structure Advisory Committee was told Monday.

Tom Wipf, who was named last week as the new chairman of ARRC and is vice chairman of municipal securities at Morgan Stanley (MS), told the panel that Libor is being phased out because "the underlying cash transactions that support Libor had really stopped taking place."

"Post the financial crisis, interbank lending pretty much grounded to a halt," Wipf said. "The 19 banks who report into the Libor panel really had no observable transactions to look at so they used what we call expert judgment."

The successor to Libor in the United States, the Secured Overnight Financing Rate known as SOFR, is based on the overnight Treasury repo, which has from $750 billion to $1 trillion in daily activity.

But Libor has a term component and a credit component while SOFR has neither of them.

Wipf said the ARRC is working on a way to bridge that. He described 2019 as “deep in the second act of a three act play” with the official phaseout of Libor coming in 2022.

He described standardized fallbacks and protocols as a “first step in risk management in putting us in a better position than we are today, but by no means are they the answer to all issues.”

Julian Potenza, a fixed income portfolio manager for Fidelity Management & Research Co., said he’s encouraged that the ARRC will soon publish recommended fallback language.

“We are hopeful that the publication of that language will give the buy side a common set of principles to rally around as we negotiate for terms that are friendly to investors in Libor-linked issuance,” Potenza said.

In terms of “legacy securities,” Potenza said his understanding is that it’s “unlikely that there is any regulatory Big Bang solution.”

“On the new-issue front, our preference is for the development of clear, consistent and investor-friendly fallback language across markets,” Potenza said. The investor-friendly components should include clear Libor succession triggers, minimal agent or issuer discretion and value neutral spread adjustments so there are no winners or losers, he said.

McCoy, in his presentation of the Fixed Income Market Structure Advisory Committee, said the New York MTA will have about eight transactions this year that will need to remarket using either SIFMA-based, Libor-based or SOFR-based floating-rate note or, alternatively, fixed-rate financing.

“While different market participants are coming together to make this as painless as possible, we know that it will be disruptive,” McCoy told the panel. “I think one of the keys to avoiding that disruption is early planning and early adoption to the degree that an entity can do that.”

By Brian Tumulty

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