

Bond Case Briefs

Municipal Finance Law Since 1971

Office of Municipal Securities Staff Statement on LIBOR Transition in the Municipal Securities Market[1]

1. Managing the Transition from LIBOR in the Municipal Securities Market

The expected discontinuation of LIBOR[2] could have a significant impact on the municipal securities market and may present a material risk for many issuers of municipal securities and other obligated persons[3] (collectively, “municipal obligors”). Municipal obligors should consider the potential actions available to mitigate these risks, including the repercussions of not taking the steps necessary to effect an orderly and timely transition, in anticipation of LIBOR’s discontinuation.[4] Risks that could arise in connection with the LIBOR transition are also relevant to other municipal securities market participants, including those who advise municipal obligors. As such, when advising their municipal obligor clients on issuances of municipal securities and municipal financial products that reference LIBOR (or that may otherwise be materially affected by the transition from LIBOR), municipal advisors should be aware of and, to the extent relevant, should take into consideration the issues arising from the LIBOR transition.[5]

This statement focuses on issues specifically relevant to the municipal securities market. For additional information and context, municipal market participants should also review the Commission staff’s statements with regard to the broader securities market.[6]

a. Existing Contracts

OMS staff urges municipal obligors to identify existing contracts that extend past 2021 to determine their exposure to LIBOR. Potentially affected contracts include, but are not limited to, municipal bonds, notes, bank loans, derivatives, leases, installment sales agreements, other credit agreements and financial instruments, commercial contracts (e.g., contracts with vendors, suppliers, service providers, other contractors, employees and others), and investments held by municipal obligors. To avoid unanticipated risks, municipal obligors should consider taking appropriate steps in connection with any existing LIBOR-based contracts to resolve potential issues arising from LIBOR’s discontinuance as soon as practicable.[7]

OMS staff believes that consequences of any unanticipated changes in the financial terms of an instrument can be particularly impactful in circumstances where the instrument has an extended maturity or termination date, or where another financial arrangement has previously been entered into as a hedge against, or otherwise in anticipation of, an existing LIBOR-based instrument. OMS staff acknowledges there are rarely quick fixes to these types of issues and encourages market participants to focus on them now to avoid financial, operational, and market disruptions after 2021.

OMS staff believes that the following questions also may be relevant for municipal obligors:

1. **State Laws.** Do state laws constrain municipal obligors’ ability to replace LIBOR with an alternative reference rate (e.g., do any debt or investment authorization statutes limit interest rate structures or permissible reference rates, thereby constraining the ability of municipal obligors to effectively implement a transition)?

2. **Hedging Strategies.** For long-dated derivative contracts referencing LIBOR used to hedge floating-rate investments or obligations (which may extend for periods beyond those more typically seen in other segments of the financial markets), what effect will the discontinuation of LIBOR have on the effectiveness of the party's hedging strategy?[8]
3. **Tax Consequences.** Would a potential change in financial terms of an instrument resulting from a transition from LIBOR risk material tax consequences for the municipal obligor or investors in its debt obligations? What actions may be needed to avoid negative tax consequences?[9]
4. **Amending Outstanding Debt Instruments.** Are municipal obligors familiar with the process by which their outstanding debt obligations referencing LIBOR can be amended, and are such amendments reasonably feasible within the timeframe anticipated for the LIBOR transition? What would be the repercussions to municipal obligors if such amendment(s) occur?

b. New Contracts

Municipal obligors also should consider whether contracts entered into in the future should reference an alternative rate to LIBOR (e.g., SOFR) or, if a municipal obligor determines to enter into new contracts referencing LIBOR notwithstanding the risks identified herein, whether such contracts include effective fallback language. Municipal obligors should understand the potential impacts if such fallback provisions are triggered under their contracts, such as any potential change in interest rate levels or behavior under different market conditions resulting from the new rate structure as compared to the original LIBOR-based structure.

i. ARRC Fallback Language

The Alternative Reference Rates Committee ("ARRC") has published recommended fallback language for new issuances of a variety of debt instruments, some of which may be used in the municipal securities market.[10] Such fallback language seeks to provide interest rate provisions that will function upon discontinuation of LIBOR and promote consistency in defining key terms such as benchmark transition events, benchmark replacement, and benchmark replacement adjustments.[11]

ii. ISDA Fallback Language

ISDA has been leading an industry effort to implement fallback language for derivatives contracts. Specifically, on October 23, 2020, ISDA released the (i) "IBOR Fallbacks Supplement" and (ii) "IBOR Fallback Protocol."

The "IBOR Fallbacks Supplement" amends ISDA's standard definitions for interest rate derivatives to incorporate robust fallbacks for derivatives linked to certain IBORs, effective on January 25, 2021 (after this date, all new cleared and non-cleared derivatives that reference these definitions will include the new fallbacks).[12] The "IBOR Fallbacks Protocol" is a template agreement that allows market participants to incorporate the revised definitions and fallbacks of the "IBOR Fallback Supplement" into their legacy non-cleared derivatives trades with other willing counterparties. Counterparties may enter the "IBOR Fallbacks Protocol" immediately, and similar to the "IBOR Fallbacks Supplement," it becomes effective on January 25, 2021.[13]

iii. IBA Announcement and Regulatory Response

On November 30, 2020, IBA announced that it planned to consult on its intention to cease the publication of one-week and two-month LIBOR on December 31, 2021, and the overnight, one-month, three-month, six-month and 12-month LIBOR tenors on June 30, 2023.[14]

That same day, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (together, the "agencies") jointly responded to IBA's announcement.[15] First, the agencies encouraged banks to stop writing

contracts referencing LIBOR as soon as possible (and in any event by the end of 2021, subject to certain limited exceptions), stating that entering into new contracts that use LIBOR as a reference rate after December 31, 2021 and failing to prepare for disruptions to LIBOR (including operating without robust fallback language that includes a clearly defined alternative reference rate) could cause significant issues if not addressed.[16] Second, the agencies noted that extending the publication of certain LIBOR tenors until June 30, 2023 would allow most legacy LIBOR contracts to mature before LIBOR experiences disruptions.[17] Former Commission Chairman Jay Clayton, the ARRC, and the United Kingdom's Financial Conduct Authority supported these announcements through their own statements.[18]

Municipal obligors and market participants acting as counterparties to, or advising, municipal obligors should closely review the IBA announcement and the subsequent regulatory response. In particular, municipal obligors should carefully analyze all new contracts entered into with banks or any other counterparties to determine whether they should continue to reference LIBOR, paying particular attention to those contracts into which municipal obligors would enter after December 31, 2021.[19] If they do continue to reference LIBOR in new contracts, municipal obligors should determine whether the contracts include robust fallback language to mitigate against risks identified herein and by the agencies.

2. Disclosure Related to LIBOR Transition

Former Commission Chairman Clayton and OMS Director Rebecca Olsen recently observed that, “[w]hile there are significant differences between our corporate capital markets and our municipal securities markets, the importance of high quality disclosure, particularly in times of uncertainty, is consistent.”[20] The Commission has previously stated that, particularly in connection with “... complex and sophisticated derivative and other municipal products ... investors need a clear understanding of the terms and the particular risks arising from the nature of the products.”[21] Consistent with this observation, OMS staff believes that municipal obligors should consider the need to make appropriate disclosures regarding the material risks related to the expected discontinuation of LIBOR, and mitigating actions taken in response.

a. Primary Market

In the primary market, the official statement for a new issue affected by LIBOR (whether it is the rate borne by the securities or applies to derivatives or other financial arrangements that secure, hedge or otherwise have a material impact on the new issue) should include appropriate disclosures regarding the material risks related to the expected discontinuation of LIBOR, mitigating actions taken or expected to be taken in response, and any fallback language governing the interest rate provisions after the discontinuation of LIBOR.

b. Secondary Market

In the secondary market, it is important to keep investors informed, either through disclosures required under continuing disclosure undertakings or by voluntary disclosure, about the progress toward risk identification and mitigation, and the anticipated impact on the municipal obligor, if material. OMS staff encourages municipal obligors to provide investors with forward-looking information regarding the potential future impact of the LIBOR transition on their outstanding municipal securities, relevant derivatives positions, hedging strategies, investments and other contracts, and their overall financial and operating conditions.

Notably, OMS staff believes that the discussion in the Municipal Market COVID-19 Statement under the heading “Important Considerations that Generally Weigh in Favor of Providing Updated

Investor-Oriented Disclosures that Discuss the Current and Anticipated Effects of COVID-19” with respect to liability concerns also would generally apply to voluntary disclosures relating to the potential implications of the LIBOR transition.[22]

OMS staff also notes that the Governmental Accounting Standards Board (“GASB”) issued Statement No. 93 revising certain GASB standards relating to references to LIBOR and certain hedge accounting issues implicated by replacing LIBOR with an alternative reference rate.[23] GASB encourages early application for municipal obligors for those portions that have not yet become effective.[24] If financial statements are included in the official statement or in continuing disclosures, the municipal obligor should be cognizant of, and seek to adhere to, applicable accounting standards with regard to the LIBOR transition.

3. Municipal Advisors’ Preparation for the LIBOR Transition

Municipal advisors should consider the impact of the LIBOR transition regarding both their own operations as well as their clients.

a. LIBOR Risk Alert

A recent “Risk Alert” from the Commission’s Division of Examinations[25] identified aspects of the LIBOR transition that may be relevant for municipal advisors and other regulated entities to consider when preparing to be examined by Commission staff,[26] including:

1. The exposure of the firm and its customers, clients and investors to LIBOR-linked contracts that extend past the current expected discontinuation date, including any fallback language incorporated into these contracts;
2. The firm’s operational readiness, including any enhancements or modifications to systems, controls, processes, and risk or valuation models associated with the transition to a new reference rate or benchmark;
3. The firm’s disclosures, representations, and/or reporting to investors regarding its efforts to address LIBOR discontinuation and the adoption of alternative reference rates;
4. Identifying and addressing any potential conflicts of interest associated with the LIBOR discontinuation and the adoption of alternative reference rates; and
5. Clients’ efforts to replace LIBOR with an appropriate alternative reference rate.[27]

b. Municipal Advisor Duties

Municipal advisors providing advice to municipal obligors regarding municipal securities or municipal financial products with LIBOR exposure should be aware of and, to the extent relevant, should consider the issues arising from the LIBOR transition in formulating their advice. Beyond such action, OMS staff reiterates the duties imposed upon municipal advisors by: (i) MSRB Rule G-42; and (ii) Exchange Act Section 15B(c)(1).

i. MSRB Rule G-42

The MSRB issued a statement related to the duties of municipal advisors and LIBOR. The MSRB noted that, under [MSRB Rule G-42](#), if a municipal advisor makes a recommendation of a municipal securities transaction (or a municipal financial product) involving LIBOR to a municipal entity or obligated person client, it must have a “reasonable basis to believe that the recommended municipal securities transaction or municipal financial product is suitable for the client, based on the information obtained through the reasonable diligence of the municipal advisor.”[28]

ii. Exchange Act Section 15B(c)(1)

Municipal advisors are reminded that Exchange Act Section 15B(c)(1)[29] imposes a fiduciary duty on municipal advisors when advising their municipal entity clients.

[1] This statement represents the views of staff of the U.S. Securities and Exchange Commission (“Commission”)’s Office of Municipal Securities (“OMS”). It is not a rule, regulation, or statement by the Commission. The Commission has neither approved nor disapproved its content. This statement does not alter or amend applicable law and has no legal force or effect. This statement creates no new or additional obligations for any person.

[2] Formerly an acronym for “London Interbank Offered Rate,” LIBOR is common parlance for its current official name, “ICE LIBOR.” See “ICE LIBOR,” ICE Benchmark Administration (“IBA”), available at <https://www.theice.com/iba/libor>. IBA is an independent subsidiary of Intercontinental Exchange, Inc., and is responsible for the end-to-end administration of the LIBOR benchmark.

[3] Obligated person is defined in 15 U.S.C. § 78o-4(e)(10) and 17 C.F.R. § 240.15c2-12(f)(10).

[4] See “Overview: The Future of LIBOR,” available at <https://www.theice.com/iba/libor> (providing a discussion of the LIBOR discontinuation scheduled to occur in 2021 and proposed possible limited exceptions thereto).

[5] While this statement focuses on municipal obligors and municipal advisors, other municipal securities market participants (including, but not limited to, investors, broker-dealers, investment advisers, commodity trading advisers, and their legal counsel) should understand the legal, financial, and operational implications of the LIBOR transition and the associated risks in connection with their activities in the municipal securities market.

[6] See “Staff Statement on LIBOR Transition” (July 12, 2019), available at <https://www.sec.gov/news/public-statement/libor-transition>.

[7] For example, depending on their individual facts and circumstances, parties to existing LIBOR-based contracts could resolve their LIBOR references by negotiating a new reference rate, or agreeing upon new fallback language, as described herein in connection with new contracts.

[8] As discussed below, the International Swaps and Derivatives Association (“ISDA”) proposed fallback language in connection with the LIBOR transition that, if counterparties consent, could be applied to existing contracts. ISDA is a global association of market participants, key components of the derivatives market infrastructure, as well as law firms, accounting firms, and other services providers. ISDA works to promote sound risk management practices and policies in the derivative space (such as developing the ISDA Master Agreement, the standard document regularly used to govern over-the-counter derivatives transactions). See “About ISDA,” available at <https://www.isda.org/about-isda>.

[9] In October 2019, the Internal Revenue Service (“IRS”) published proposed regulations providing guidance on the tax consequences of the LIBOR transition. Although not yet finalized, OMS staff understands that the proposed regulations are intended to allow municipal issuers to replace LIBOR with an alternate reference rate without causing a reissuance, provided that the issuer complies with certain conditions. See Guidance on the Transition From Interbank Offered Rates (“IBORs”) to Other Reference Rates, 84 FR 54068 (Oct. 9, 2019). Pending finalization of these proposed regulations, the IRS has provided interim guidance that the adoption of certain fallback language recommended by the ARRC and ISDA (described herein) for contracts with terms referencing IBORs

will not impact the tax status of municipal securities. See “IRS Rev. Proc. 2020-44,” (Oct. 9, 2020), available at <https://www.irs.gov/pub/irs-drop/rp-20-44.pdf>.

[10] These include, among others, floating rate notes (see “ARRC Recommendations Regarding More Robust Fallback Language for New Issuance of LIBOR Floating Rate Notes,” (Apr. 25, 2019), available at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/FRN_Fallback_Language.pdf), securitizations (see “ARRC Recommendations Regarding More Robust Fallback Language For New Issuances Of Libor Securitizations,” (May 31, 2019), available at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/Securitization_Fallback_Language.pdf), and syndicated loans (see “ARRC Recommendations Regarding More Robust Fallback Language For New Originations Of Libor Syndicated Loans” (Apr. 25, 2019), available at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/Syndicated_Loan_Fallback_Language.pdf).

[11] See “ARRC Releases Recommended Fallback Language for Floating Rate Notes and Syndicated Loans” (Apr. 25, 2019), available at <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/ARRC-Apr-25-2019-announcement.pdf>.

[12] See “ISDA 2020 IBOR Fallbacks Supplement” (Oct. 23, 2020), available at <http://assets.isda.org/media/3062e7b4/23aa1658-pdf>.

[13] See “ISDA 2020 IBOR Fallbacks Protocol” (Oct. 23, 2020), available at <http://assets.isda.org/media/3062e7b4/08268161-pdf>. Notably, the ARRC published its support of the “IBOR Fallbacks Protocol,” encouraging market participants to adhere to it before its January 25, 2021 effective date. See also “ARRC Supports Forthcoming ISDA IBOR Fallbacks Protocol and Encourages Adherence” (Oct. 22, 2020), available at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Press_Release_ISDA_Protocol.pdf.

[14] See “ICE Benchmark Administration to Consult on Its Intention to Cease the Publication of One Week and Two Month USD LIBOR Settings at End-December 2021, and the Remaining USD LIBOR Settings at End-June 2023” (Nov. 30, 2020), available at <https://ir.theice.com/press/news-details/2020/ICE-Benchmark-Administration-to-Consult-on-Its-Intention-to-Cease-the-publication-of-One-Week-and-Two-Month-USD-LIBOR-Settings-at-End-December-2021-and-the-Remaining-USD-LIBOR-Settings-at-End-June-2023/default.aspx>. IBA expects to conclude its consultation for feedback by the end of January 2021. *Id.*

[15] See “Statement on LIBOR Transition” (Nov. 30, 2020), available at <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20201130a1.pdf>.

[16] *Id.* (“Given consumer protection, litigation, and reputation risks, the agencies believe entering into new contracts that use USD LIBOR as a reference rate after December 31, 2021, would create safety and soundness risks and will examine bank practices accordingly”). Various provisions of federal law require banks to operate in a safe and sound manner. See, e.g., 12 U.S.C. 321-338a, 1467a(g), 1818(b), 1844(b), and 3101 et seq.

[17] *Supra* note 15.

[18] See “Statement on Developments Related to the LIBOR Transition” (Nov. 30, 2020), available at <https://www.sec.gov/news/public-statement/clayton-libor-2020-11-30>; “ARRC Applauds Major Milestone in Transition from U.S. Dollar LIBOR” (Nov. 30, 2020), available at

https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Press_Release_Applauds_Milestone_Transition_US_Dollar_LIBOR.pdf; “FCA Response to IBA’s Proposed Consultation on Intention to Cease US\$ LIBOR” (Nov. 30, 2020), available at <https://www.fca.org.uk/news/statements/fca-response-iba-proposed-consultation-intention-cease-us-dollar-libor>.

[19] While IBA is considering proposals that could extend LIBOR (subject to certain limited exceptions) beyond 2021, there is at this time no certainty that such extension will occur and therefore OMS staff’s discussion of the LIBOR transition herein reflects the current IBA deadlines.

[20] See Jay Clayton, Chairman, Commission, and Rebecca Olsen, OMS Director, “The Importance of Disclosure for our Municipal Markets” (May 4, 2020), available at <https://www.sec.gov/news/public-statement/statement-clayton-olsen-2020-05-04> (“Chairman Clayton and OMS Director Olsen Statement”).

[21] See “Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and Others,” 59 FR at 12752 (Mar. 17, 1994). The Commission further stated therein that “... investors need to be informed about the nature and effects of each significant term of the debt ... [and] should be aware of their exposure to interest rate volatility, under all possible scenarios.”

[22] See Chairman Clayton and OMS Director Olsen Statement. While the safe harbors for forward looking statements that are available to certain corporate issuers are not available to issuers of municipal securities, OMS staff notes that a municipal issuer’s approach to forward-looking disclosures should be informed by the judicially developed “bespeaks caution” doctrine. For a description of the “bespeaks-caution” doctrine developed by the federal courts of appeals, see generally Robert A. Fippinger, *The Securities Law of Public Finance*, §8:3.4[B] (3d. ed. 2019).

[23] GASB Statement No. 93, *Replacement of Interbank Offered Rates* (Mar. 2020). Not all municipal obligors are subject to GASB standards. For those municipal obligors that are subject to standards set by the Financial Accounting Standards Board (“FASB”), see FASB Accounting Standards Update (“ASU”) 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting* (Mar. 2020). Municipal obligors that are subject to accounting standards other than GASB or FASB should consider the extent to which they should follow the guidance set forth in GASB Statement No. 93 or FASB ASU 2020-04, as appropriate.

[24] Most changes became effective after June 15, 2020. However, GASB Statement No. 93 provides for a later effective date for the removal of LIBOR as an appropriate benchmark interest rate, with such removal to become effective for reporting periods ending after December 31, 2021. GASB has postponed effectiveness of portions of GASB Statement No. 93 relating to lease modifications until June 15, 2021 due to the COVID-19 pandemic. See GASB Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance* (May 2020).

[25] Division of Examinations (then known as the Office of Compliance Inspections and Examinations) Risk Alert, *Examination Initiative: LIBOR Transition Preparedness* (June 18, 2020), available at https://www.sec.gov/files/Risk%20Alert%20-%20OCIE%20LIBOR%20Initiative_1.pdf (“LIBOR Risk Alert”).

[26] While the LIBOR Risk Alert is directed toward regulated entities, other municipal securities market participants (including, but not limited to, municipal obligors) may wish to consider the issues raised in the LIBOR Risk Alert.

[27] See LIBOR Risk Alert.

[28] See “LIBOR Transition Information,” available at <http://www.msrb.org/Regulated-Entities/Resources/LIBOR-Information>.

[29] 15 U.S.C. § 78o-4(c)(1) (2019).