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SEC Office of Municipal Securities Issue Staff Statement on LIBOR Transition: Mayer Brown

On January 8, 2021, the staff of the US Securities and Exchange Commission's ("SEC") Office of Municipal Securities ("OMS Staff") issued a statement focusing on the impact of the discontinuation of LIBOR on the municipal securities markets. The statement highlights considerations for issuers of municipal securities and other "obligated persons" and municipal advisors to address the fact that the expected discontinuation of LIBOR "could have a significant impact on the municipal securities market and may present a material risk" for market participants.

The statement discusses considerations for remediating contracts with exposure to LIBOR, ongoing disclosure requirements, and the duties of municipal advisors in light of the December 31, 2021 discontinuation of LIBOR.

Remediation of existing and new contracts

OMS Staff urged municipal market participants to take action with respect to existing and new contracts that may have exposure to LIBOR, which may include 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.

Existing contracts may contain reference to LIBOR and require remediation. OMS Staff has requested that market participants identify existing contracts that extend past 2021 to determine exposure to LIBOR, noting that the 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 noted that firms should specifically consider: (1) potential constraints of state law upon replacing LIBOR, (2) the impact of LIBOR discontinuation on a firm's hedging strategies, (3) potential tax consequences of replacing LIBOR, and (4) operational capabilities to amend outstanding instruments.

Further, OMS Staff noted that municipal obligors should consider whether contracts entered into in the future should reference an alternative rate to LIBOR or include "fallback language" that triggers a replacement rate. The statement calls attention to three major initiatives by industry groups to facilitate the transition away from LIBOR:

- 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.
- The International Swaps and Derivatives Association ("ISDA") has led development of fallback language for derivatives contracts, including updates to ISDA standard definitions for new contracts, the 2020 IBOR Fallbacks Protocol for legacy contracts, and a template form of bilateral

agreement to facilitate the transition away from LIBOR.
- ICE Benchmark Administration ("IBA") announced a consultation on its intention to cease the publication of one-week and two-month USD LIBOR (as well as all other key LIBOR currencies) on December 31, 2021, and the overnight, one-month, three-month, six-month and 12-month USD LIBOR tenors on June 30, 2023, in order to allow most legacy LIBOR contracts to mature prior to LIBOR's discontinuation. This consultation garnered general support from U.S. banking regulators, former SEC Chairman Jay Clayton, the ARRC, and the United Kingdom's Financial Conduct Authority. The consultation closed in late January 2021 and an announcement from IBA of the results of the consultation is expected any day but regulators have made clear that the target cessation date for use of LIBOR in new contract originations remains December 31, 2021.

Disclosures related to the LIBOR transition

OMS Staff noted 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.

In the primary market, the official statement for a new issue affected by LIBOR 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.

OMS Staff also recognized the importance of secondary market disclosures, 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 encouraged 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.

How can municipal advisors prepare for LIBOR discontinuation?

The statement highlighted pertinent parts of the SEC's Division of Examinations' (formerly, the Office of Compliance Inspections and Examinations) Risk Alert on LIBOR transition considerations for municipal advisors.1 In particular, OMS Staff noted that municipal advisors should take into account and address:

- 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;
- 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;
- The firm's disclosures, representations, and/or reporting to investors regarding its efforts to address LIBOR discontinuation and the adoption of alternative reference rates;
- Any potential conflicts of interest associated with the LIBOR discontinuation and the adoption of alternative reference rates; and
- Clients' efforts to replace LIBOR with an appropriate alternative reference rate.

OMS Staff also specifically reminded municipal advisors of their duties under the Municipal Securities Rulemaking Board ("MSRB") Rule G-42, which creates a suitability requirement for recommendations by a municipal advisor, and Section 15B(c)(1) of the Exchange Act, which imposes a fiduciary duty on municipal advisors when advising municipal entity clients.

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Market participants continue to be encouraged by applicable regulatory authorities to cease new originations of LIBOR contracts prior to December 31, 2021. Firms should be prepared to handle not only their own LIBOR transition, but also to deal with the wide range of LIBOR exposure that may arise from other sources, such as relationships with clients, counterparties, or vendors.

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