THE BOND BUYER

Libor transition is a 2021 SEC priority for the muni market

By

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Published

January 13, 2021, 2:33 p.m. EST

Rebecca Olsen, director of the Office of Municipal Securities, said Wednesday the development of any other priorities will have to await the appointment of a new SEC chairman. ***U.S. Securities and Exchange Commission***

The 2021 priorities for the Office of Municipal Securities at the Securities and Exchange Commission are the transition away from Libor and improving the timeliness of financial disclosures.

Rebecca Olsen, director of the Office of Municipal Securities, highlighted the Libor transition in a presentation Wednesday in which she noted that the addition any other priorities will have to await the appointment of a new SEC chairman.

Gary Gensler, the former chairman of the Commodity Futures Trading Commission, has been widely reported as President-elect Joe Biden's expected choice. Whoever is nominated by Biden will require Senate confirmation and could be weeks away from taking office.

Olsen's office, meanwhile, is moving ahead on the Libor transition and issued a detailed advisory Friday to the municipal securities market.

Olsen told members of the Government Finance Officers Association Debt Committee on Wednesday that the new advisory is focused "on both municipal issuers and municipal advisors."

"According to a statement released by the Alternative Reference Rate Committee last March, there is approximately $44 billion with outstanding publicly-offered municipal securities that are Libor based," Olsen said.

Olsen added that "all-new municipal issuers may be exposed in many other ways, including private equity funds, notes, bank loans, derivatives and other credit agreements or financial instruments that use Libor as a reference rate."

The SEC advisory highlights how the discontinuation of Libor could have a significant impact on the municipal securities market, stating that its discontinuation "may present a material risk for many issuers of municipal securities and other obligated persons."

The advisory said municipal obligors should consider whether any state laws constrain their ability to replace Libor with an alternative reference rate. They also should consider the tax consequences of the transition and its impact on hedge floating-rate investments. They also should consider whether they are familiar with the process by which any of their outstanding debt obligations referencing Libor can be amended and if those amendments are reasonably feasible within the timeframe anticipated for the Libor transition.

"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,'' the SEC's Office of Municipal Securities said. "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."

The advisory “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.”

For new contracts, the SEC advises using an alternative reference rate, or if Libor usage is continued, to include fallback language published by the Alternative Reference Rates Committee or the International Swaps and Derivatives Association (ISDA).

During Wednesday’s GFOA Debt Committee meeting, Richard Li, public debt specialist for the City of Milwaukee, pointed out to Olsen that there are minors differences in the fallback language released by ARRC and ISDA.

“The differences potentially introduce basis risk if you have a hedge transaction,” Li said.

“I don't know that the SEC has a view,” responded Olsen. “I haven't spoken with anyone about it.” Olsen said she would check on what the SEC’s position might be.

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