THE BOND BUYER

Regulatory guidance on Libor transition welcomed

By

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The municipal bond industry will have a window of more than two years to adjust to the phase out of Libor under the proposed transition regulations announced by Treasury and the IRS.

The long-awaited rules announced Tuesday and published Wednesday in the Federal Register are subject to public comment through Nov. 25.

But the sections pertaining to public finance can be implemented immediately.

Those are among the reasons bond experts gave for their positive reaction to this proposal for helping issuers avoid adverse tax consequences from changing the terms of debt, derivatives, and other financial contracts to alternative reference rates.

An alternative reference will not trigger a reissuance if the new rate produces the same fair market value within 25 basis points.

There are two safe harbors for achieving that:

One involves looking at the historical average values of both reference rates and, if necessary, making an adjustment payment.

Johnny Hutchinson, a partner at Squire Patton Boggs in Houston and chair of NABL's Tax Law Committee.

The second safe harbor allows the issuer and bondholder to simply agree that the fair market value is the same if they are unrelated to each other.

That second instance "is almost always going to be the case in the public finance world," said said Johnny Hutchinson, a partner at Squire Patton Boggs in Houston and chair of the Tax Law Committee of the National Association of Bond Lawyers. "That particular safe harbor is going to be very helpful to people in the public finance world."

Hutchinson said Treasury and the IRS "should be applauded for getting this to all come together and getting it out."

"It's a project that touches all sorts of different areas of federal income tax law far beyond our little corner of the world in public finance," he said.

Libor, an acronym for the London Inter Bank Offered Rate, is being phased out by the end of 2021 at the recommendation of the Alternative Rates Reference Committee created by the U.S. Federal Reserve Board and the Federal Reserve Bank of New York.

Hutchinson commended the Treasury and IRS for allowing "a very broad list of other indices" to be used as a replacement for Libor instead of limiting the alternative solely to the Secured Overnight Financing Rate (SOFR) published by the Federal Reserve Bank of New York.

Although he labeled the proposed regulations "a little dense," Hutchinson said that "from an initial read" they "give issuers of bonds fairly broad latitude to replace rates in their current bond documents and in their current swap documents."

The Government Finance Officers Association also welcomed the proposed regulations.

Matthias Edrich, a tax partner at Kutak Rock in Denver and a former chair NABL's Tax Law Committee

"We are especially glad to see that the IRS is providing clarity around the tax issues relating to converting outstanding trades, such as an interest rate swap contract, in order to alleviate any costly and unproductive disruption for issuers," said Emily Brock, director of the federal liaison center at GFOA.

Matthias Edrich, a tax partner at Kutak Rock in Denver and a former chair NABL's Tax Law Committee, often serves as tax counsel for banks on their bond financings.

The absence of IRS guidance has hindered banks from determining the right approach to putting alternative rate language in bond documents.

"My estimate is that banks will start using the approaches that are in the regulations, and will start implementing changes to their alternative rate language now that there's more certainty as to what the ultimate IRS approach will be," Edrich said.

Both NABL and GFOA plan on sending comments to Treasury and the IRS on possible improvements to the proposed regulations.

"I know our members well and I am sure we will have some members who will come up with ways that they can be improved," said Hutchinson.