

MEMO# 33942

December 7, 2021

LIBOR Update: SEC Staff Issues Updated Guidance on LIBOR Transition

[33942]

December 8, 2021

TO: ICI Members
Investment Company Directors
LIBOR Transition Working Group SUBJECTS: Compliance
Disclosure
Distribution
Fund Accounting & Financial Reporting
Operations
Portfolio Oversight
Valuation RE: LIBOR Update: SEC Staff Issues Updated Guidance on LIBOR Transition

On December 7, staff of the US Securities and Exchange Commission issued guidance on key LIBOR transition considerations for market participants.[\[1\]](#) The guidance follows the staff's previously issued guidance issued in July 2019.[\[2\]](#)

The guidance provides general considerations for all market participants as well as specific guidance for funds and advisers and other regulated entities. Throughout the document, the SEC staff reminds market participants to consider their disclosure obligations and cautions investment professionals to consider their standards of care when recommending LIBOR-linked securities or investment strategies.

Highlights from the guidance are discussed below.

General Considerations for All Market Participants

The SEC staff recommends that market participants be mindful of the following considerations:

- **Fallback language:** The staff walks through examples of circumstances in which investments may or may not have fallback language applicable to providing an alternative reference rate when LIBOR is discontinued. They note that while the Alternative Reference Rates Committee (ARRC) has published recommended fallback language that can be used various types of products in anticipation of LIBOR cessation, "US issuers are not obligated to include any particular fallback language in

transaction documents for new issuances of LIBOR-linked securities."

- **Valuation:** The staff states that "even when the transaction documents contain robust fallback language, the value of LIBOR-linked securities—and consequently their potential returns—may experience material changes upon LIBOR's discontinuation." The staff notes the transition's potential impact on valuation measurements, including through the differences between LIBOR and alternative reference rates and through changes in market liquidity and trading volumes in all rates during the transition period.
- **Monitoring:** Market participants that have a duty to monitor their clients' or customers' existing holdings should consider the effect of LIBOR discontinuation on those holdings that are linked to LIBOR. Among other things, market participants should consider whether those investments have robust fallback language and consider the economic differences between LIBOR and the alternative rates.
- **Operations:** The staff notes operational complexities as a result of the transition may require market participants to update processes and IT systems. These updates include understanding how to handle accrual and payment calculations, updating systems to ensure that they are able to transact in alternative reference rates, undertaking systems upgrades, and considering communications to investors and other stakeholders.

Considerations for Funds and Investment Advisers

The SEC staff directs several recommendations to registered funds and advisers.

For registered funds, the SEC focuses on their disclosure obligations with respect to LIBOR transition. The staff states "[i]f a fund invests a significant portion of its assets in LIBOR-linked investments, it should disclose any principal risks related to the potential cessation of LIBOR, as well as the anticipated impact (and expected timing of that impact) on those investments, including with respect to volatility, value, and liquidity." Further, the staff advises funds to consider their disclosure and legal obligations regarding performance fees that may be linked to LIBOR.

The staff also reminds funds to consider any valuation risk or impact on valuation inputs and assumptions associated with LIBOR transition.

For investment advisers, the staff draws attention to advisers' fiduciary duty in providing investment advice and states "investment advisers should consider whether any advice regarding LIBOR-linked investments and applicable risks is consistent with their clients' goals." The staff recommends that advisers consider whether investments contain robust fallback language and consider any economic differences between LIBOR and an alternative replacement rate.

Considerations for Other Market Participants

The staff provides guidance for other types of market participants, including:

- **Broker-Dealers Providing Recommendations to Retail Customers:** The staff recommends that "broker-dealers should be especially mindful of their obligations when recommending LIBOR-linked securities or investment strategies involving LIBOR-linked securities to retail customers" given the standards of care established under Regulation Best Interest (RBI). Specifically, "[i]n light of the now-certain transition away from LIBOR, understanding the potential risks, rewards and costs is especially

important when recommending LIBOR-linked securities." The staff urges broker-dealers to understand whether an investment has robust fallback language and, in general, believes it would be difficult to satisfy RBI by recommending an investment with no fallback language.

- **Broker-Dealers Transacting in Municipal Securities:** The staff reminds broker-dealers of the Office of Municipal Securities guidance relating to LIBOR transition and other guidance.^[3] The staff notes that broker-dealers should consider the impact that the LIBOR transition may have in connection with other duties applicable to municipal securities activities, including underwriting offerings and making recommendations to retail customers.
- **Public Companies and Asset Backed Securities Issuers Making Disclosures:** The staff reminds market participants that a number of rules and regulations may require disclosure of the impact of LIBOR cessation, including rules covering the disclosure of risk factors, management's discussion and analysis, board risk and oversight, and financial statements, as well as Regulation AB. The staff recommends registrants make specific disclosures and consider making quantitative disclosure, when material. Specifically:
 - "[C]ompanies with material risk related to outstanding debt with inadequate fallback provisions should consider disclosing how much debt will be outstanding after the relevant cessation date and the steps the company is taking address the situation, such as renegotiating contracts or refinancing the obligations."
 - Companies assessing LIBOR exposure "should consider providing investors insight into what the company has done, what steps remain, and the timeline for further efforts."

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endnotes

^[1] SEC Staff Statement on LIBOR Transition - Key Considerations for Market Participants (Dec. 7, 2021), *available at* https://www.sec.gov/news/statement/staff-statement-libor-transition-20211207#_ftnref37.

^[2] SEC Staff Statement on LIBOR Transition (July 12, 2019), *available at* <https://www.sec.gov/news/public-statement/libor-transition>.

^[3] See SEC Office of Municipal Securities Staff Statement on LIBOR Transition in the Municipal Securities Market (Jan. 8, 2021) *available at* <https://www.sec.gov/municipal/oms-staff-statement-libor-transition-municipal-securities-market>.