Staff Statement on LIBOR Transition

Division of Corporation Finance, Division of Investment Management, Division of Trading and Markets, and Office of the Chief Accountant[1]

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LIBOR[2] is an indicative measure of the average interest rate at which major global banks could borrow from one another. LIBOR is quoted in multiple currencies and multiple time frames using data reported by private-sector banks.[3] LIBOR is used extensively in the U.S.[4] and globally as a "benchmark" or "reference rate" for various commercial and financial contracts, including corporate and municipal bonds and loans, floating rate mortgages, asset-backed securities, consumer loans, and interest rate swaps and other derivatives. It is expected that a number of private-sector banks currently reporting information used to set LIBOR will stop doing so after 2021 when their current reporting commitment ends, which could either cause LIBOR to stop publication immediately or cause LIBOR's regulator to determine that its quality has degraded to the degree that it is no longer representative of its underlying market.[5] As regulators and market participants seek to avoid business and market disruptions resulting from the expected discontinuation of LIBOR, implementing alternative reference rates in advance of the discontinuation has taken on urgency. As described in more detail below, the U.S. and other countries are currently working to replace LIBOR with alternative reference rates.

The expected discontinuation of LIBOR could have a significant impact on the financial markets and may present a material risk for certain market participants, including public companies, investment advisers, investment companies, and broker-dealers. The risks associated with this discontinuation and transition will be exacerbated if the work necessary to effect an orderly transition to an alternative reference rate is not completed in a timely manner.[6] The Commission staff is actively monitoring the extent to which market participants are identifying and addressing these risks.

Alternative Reference Rates

Working groups have been formed in each of the United States, the United Kingdom, the European Union, Japan, and Switzerland to recommend an alternative rate to LIBOR for its respective currency. In the U.S., the Alternative Reference Rates Committee ("ARRC"), a group convened by the Federal Reserve Board and the Federal Reserve Bank of New York, is comprised of a diverse set of private-sector entities, each with an important presence in markets affected by USD LIBOR, and a wide array of official-sector entities, including the Commission, banking regulators, and other financial sector regulators, as non-voting ex-officio members. The ARRC has identified the Secured Overnight Financing Rate ("SOFR") as its preferred alternative rate for USD LIBOR. SOFR is a measure of the cost of borrowing cash overnight, collateralized by U.S. Treasury securities, and is based on directly observable U.S. Treasury-backed repurchase transactions. This is a liquid market with daily volumes regularly in excess of $800 billion.[7] Some market participants are also considering other USD reference rates for certain instruments. The Commission does not endorse the use of any particular reference rate. The Commission staff is monitoring whether the adoption of a variety of replacement rates for USD LIBOR instead of the emergence of a dominant successor could limit the effectiveness of all replacement benchmarks.

In addition to the five jurisdictions noted above, other jurisdictions may be working to replace or strengthen the reference rates utilized for their currencies. Although this document focuses on LIBOR, market participants should also consider examining their exposures to other reference rates undergoing transitions. The work

being performed globally to address reference rate transition risk is ongoing and evolving. Market participants should seek to stay informed as this work progresses.

While not all issues related to alternative reference rates have been resolved,[8] the Commission staff encourages market participants who have not already done so to begin managing their transition away from LIBOR. For many market participants, waiting until all open questions have been answered to begin this important work likely could prove to be too late to accomplish the challenging task required.

Managing the Transition from LIBOR

Existing Contracts

The Commission staff encourages market participants who have not already done so to begin the process of identifying existing contracts[9] that extend past 2021 to determine their exposure to LIBOR. Many legacy contracts have interest rate provisions referencing LIBOR that, when drafted, did not contemplate the permanent discontinuation of LIBOR and, as a result, there may be uncertainty or disagreement over how the contracts should be interpreted. In addition, in circumstances where the contractual interpretation is clear, the adjustment may be inconsistent with expectations of the affected parties. In certain cases, for example, a floating rate obligation may become a fixed rate obligation. There are rarely quick fixes to these types of issues and the Commission staff encourages market participants to focus on them now to avoid business and market disruptions after 2021. In particular, the Commission staff encourages market participants to consider questions along the lines of the following as they seek to understand and mitigate the risks related to the transition from LIBOR.

- Do you have or are you or your customers exposed to any contracts extending past 2021 that reference LIBOR? For companies considering disclosure obligations and risk management policies, are these contracts, individually or in the aggregate, material?
- For each contract identified, what effect will the discontinuation of LIBOR have on the operation of the contract?
- For contracts with no fallback language in the event LIBOR is unavailable, or with fallback language that does not contemplate the expected permanent discontinuation of LIBOR, do you need to take actions to mitigate risk, such as proactive renegotiations with counterparties to address the contractual uncertainty?
- What alternative reference rate (for example, SOFR) might replace LIBOR in existing contracts? Are there fundamental differences between LIBOR and the alternative reference rate – such as the extent of or absence of counterparty credit risk – that could impact the profitability or costs associated with the identified contracts? Does the alternative reference rate need to be adjusted (by the addition of a spread, for example) to maintain the anticipated economic terms of existing contracts?
- For derivative contracts referencing LIBOR that are utilized to hedge floating-rate investments or obligations, what effect will the discontinuation of LIBOR have on the effectiveness of the company's hedging strategy?
- Does use of an alternative reference rate introduce new risks that need to be addressed? For example, if you have relied on LIBOR in pricing assets as a natural hedge against increases in costs of capital or funding, will the new rate behave similarly? If not, what actions should be taken to mitigate this new risk?

New Contracts

Market participants also should consider whether contracts entered into in the future should reference an alternative rate to LIBOR (such as SOFR) or, if such contracts reference LIBOR, include effective fallback language. The ARRC has published recommended fallback language for new issuances of floating rate notes,[10] syndicated loans,[11] bilateral business loans,[12] and securitizations.[13] The ARRC's recommended fallback language seeks to provide interest rate provisions that will function upon the expected discontinuation of USD LIBOR and promotes general consistency in defining key terms such as benchmark transition events, benchmark replacement, and benchmark replacement adjustments.[14]

In addition, the International Swaps and Derivatives Association ("ISDA"), which maintains industry standard swaps and derivatives documentation, has been leading an industry effort to implement robust fallback language for derivatives contracts since 2016, at the request of the Financial Stability Board's Official Sector Steering Group.[15] Fallback language that ISDA is currently developing with industry feedback will apply to derivatives entered into on ISDA documentation after the date of adoption. Additionally, if counterparties consent per a standard protocol, this fallback language will be applied to outstanding obligations of consenting counterparties.

Other Business Risks

An impact assessment of the discontinuation of LIBOR extends beyond identification, evaluation, and mitigation efforts related to existing or new contracts. The Commission staff encourages market participants to also identify, evaluate, and mitigate other consequences the discontinuation of LIBOR may have on their business, such as on strategy, products, processes, and information systems. For example, market participants may wish to ensure that their information technology systems are able to incorporate new instruments and rates with features that differ from LIBOR. Depending on a market participant's exposure to LIBOR, prudent risk management may necessitate the establishment of a task force to assess the impact of financial, operational, legal, regulatory, technology, and other risks. Each market participant should examine its individual circumstances and consider whether it faces risks beyond those identified in this Staff Statement.

The ARRC is supported by various working groups that are considering additional issues beyond those discussed in this document. For example, the ARRC's Operations/Infrastructure Working Group is collaborating with key vendors of software and technology that are critical to operationalizing the transition from USD LIBOR. Market participants should stay informed regarding the progress of the various ARRC working groups.

Division Specific Guidance

Below, each of the Divisions of Corporation Finance ("CF"), Investment Management ("IM"), and Trading and Markets ("TM"), and the Office of the Chief Accountant ("OCA"), details how the discontinuation of LIBOR may impact specific registrants and provides staff guidance on how registrants might respond to this risk. Registrants may find guidance provided by a division or office, other than the one they view as their primary Commission staff contact, insightful with respect to certain of their circumstances. Thus, we encourage registrants and their advisors to evaluate this entire document.

Division of Corporation Finance

The federal securities laws are designed in part to elicit disclosure of timely, comprehensive, and accurate information about risks and events that a reasonable investor would consider important to an investment decision. A number of existing rules or regulations may require disclosure related to the expected discontinuation of LIBOR, including rules and regulations related to disclosure of risk factors,[16] management's discussion and analysis,[17] board risk oversight,[18] and financial statements.[19]

As companies consider the questions in the section above entitled "Managing the Transition from LIBOR" and address the risks presented by LIBOR's expected discontinuation, it is important to keep investors informed about the progress toward risk identification and mitigation, and the anticipated impact on the company, if material. In deciding what disclosures are relevant and appropriate, CF encourages companies to consider the following guidance.

- The evaluation and mitigation of risks related to the expected discontinuation of LIBOR may span several reporting periods. Consider disclosing the status of company efforts to date and the significant matters yet to be addressed.
- When a company has identified a material exposure to LIBOR but does not yet know or cannot yet reasonably estimate the expected impact, consider disclosing that fact.
- Disclosures that allow investors to see this issue through the eyes of management are likely to be the most useful for investors. This may entail sharing information used by management and the board in assessing and monitoring how transitioning from LIBOR to an alternative reference rate may affect the

company. This could include qualitative disclosures and, when material, quantitative disclosures, such as the notional value of contracts referencing LIBOR and extending past 2021.

At this stage in the transition away from LIBOR, we note that companies most frequently providing LIBOR transition disclosure are in the real estate, banking, and insurance industries. We also note that, based on our reviews to date, the larger the company, the more likely it is to disclose risks related to LIBOR's expected discontinuation. However, for every contract held by one of these companies providing disclosure, there is a counterparty that may not yet be aware of the risks it faces or the actions needed to mitigate those risks. We therefore encourage every company, if it has not already done so, to begin planning for this important transition.

Division of Investment Management

The Division of Investment Management is actively monitoring the impact that the expected discontinuation of LIBOR will have on investment companies ("funds") and advisers, particularly those that invest in instruments referencing LIBOR, such as floating rate debt, bank loans, LIBOR-linked derivatives, and certain asset-backed securities. The discontinuation of LIBOR may impact the functioning, liquidity, and value of these investments. The extent of this impact will depend on the specific types of investments, as well as the terms of those investments. For example, investments without fallback language, or with fallback language that does not contemplate the discontinuation of LIBOR, could become less liquid and/or change in value as the date approaches when LIBOR will no longer be updated. Further, the interest rate provisions of these investments may need to be renegotiated. Funds should consider assessing any impact on the liquidity of their investments, including how those investments are classified and whether this could alter the effectiveness of their liquidity risk management programs, to ensure compliance with Rule 22e-4 under the Investment Company Act of 1940.

Even funds that do not invest in instruments linked to LIBOR could be impacted by the discontinuation of LIBOR. For example, closed end funds and business development companies that engage in direct lending may need to renegotiate the terms of contracts extending past 2021 that do not address the discontinuation of LIBOR. In addition, funds that have received exemptive orders that reference LIBOR (such as certain interfund lending orders) should consider evaluating possible implications for terms and conditions of their relief.

Funds and advisers should consider whether the impacts discussed above, and other consequences of the discontinuation of LIBOR, are risks that they should disclose to investors.[20] Whether disclosure is appropriate, and the content of such disclosure, will depend on the nature and significance of any investments or agreements that are linked to LIBOR. Some funds have begun incorporating in their prospectuses tailored risk disclosure on how the transition could affect their specific investments, while other funds have included more generic disclosure that division staff believes is generally less helpful to investors. IM encourages affected funds to provide investors with tailored risk disclosure that specifically describes the impact of the transition on their holdings. In relation to instruments extending past 2021 and referencing LIBOR, advisers should consider the effect the discontinuation of LIBOR will have on these instruments when recommending them to clients or monitoring them for clients.

Division of Trading and Markets

The Division of Trading and Markets is actively monitoring the impact that the expected discontinuation of LIBOR will have on broker-dealers, central counterparties, and exchanges. For example, entities may:

- issue instruments or be a party to transactions, including derivative transactions, referencing LIBOR;
- own investments that reference LIBOR or make a market in instruments that reference LIBOR;
- have LIBOR-based hedges in place;
- underwrite, place, or advise on the issuance of instruments referencing LIBOR;
- recommend securities that reference LIBOR, including in relation to retail investors; and
- have listing and clearing standards that do not contemplate new benchmarks.

TM encourages these entities to analyze how this change will impact them – their business, systems, models, processes, risk management frameworks, and clients – and to respond accordingly. They also should

consider whether their clients and the markets should be informed of risks related to this change.

Office of the Chief Accountant

An interest rate benchmark can have a pervasive impact on a company's financial reporting. Transitioning from one benchmark rate to another benchmark rate can also have a significant impact on a company's accounting. The Office of the Chief Accountant is actively monitoring the activities underway among preparers and auditors of financial statements, standard setters such as the Financial Accounting Standards Board ("FASB"), and other regulators, to address financial reporting issues that might arise in connection with any transition from LIBOR to an alternative benchmark rate.

These issues could span a number of different areas, including for example, the accounting and financial reporting for:

- modifications of terms within debt instruments;
- hedging activities;
- inputs used in valuation models; and
- potential income tax consequences.

Some participants throughout the financial reporting structure, including preparers, auditors, and regulators, have begun to address some of these potential accounting considerations and related disclosures. OCA encourages the ongoing discussion and analysis of questions in this area and is available to address any related pre-filing consultations.[21] OCA staff has previously provided views relating to the impact of the expected discontinuation of LIBOR on the application of hedge accounting.[22]

With regard to standard-setting, the FASB[23] added a project to its agenda to address potential accounting and reporting implications relating to the expected discontinuation of LIBOR. In addition, the FASB issued an Accounting Standards Update that allows for the Overnight Index Swap ("OIS") rate based on SOFR (collectively, "SOFR OIS") to be designated as a benchmark interest rate for hedge accounting purposes.[24]

The International Accounting Standards Board ("IASB") recently published an Exposure Draft, Interest Rate Benchmark Reform, which addresses various hedge accounting issues in the period leading up to the replacement of an existing interest rate benchmark.[25] We encourage constituent participation in the standard-setting process as both the FASB and the IASB will benefit from the active engagement and involvement of the various parties involved in the financial reporting ecosystem.

Contact

The Commission staff welcomes discussion on this issue. What issues are you thinking about and what challenges are you facing? Your feedback can help highlight other issues and challenges related to this important transition. General feedback can be sent to LIBOR@sec.gov. You can contact CF at (202) 551-3100 or CFORS@sec.gov. You can contact IM at (202) 551-6921 or IMDRAO@sec.gov. You can contact TM at (202) 551-5777 or TRADINGANDMARKETS@sec.gov. You can contact OCA at (202) 551-5300 or OCA@sec.gov.

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[1] This statement represents the views of the staffs of the Divisions of Corporation Finance, Investment Management, and Trading and Markets, and the Office of the Chief Accountant. It is not a rule, regulation, or statement of the Securities and Exchange Commission ("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.

[3] LIBOR is quoted in five currencies – U.S. dollar ("USD"), British pound sterling, euro, Japanese yen, and Swiss franc – and for seven different maturities – overnight, one week, one month, two months, three months,

six months, and 12 months. This combination of currencies and maturities amounts to 35 different LIBOR rates reported each business day.

[4] An estimated $200 trillion in notional transactions reference USD LIBOR in the cash and derivatives markets with more than $35 trillion extending past 2021. See Second Report of the Alternative Reference Rates Committee (Mar. 5, 2018), available at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-Second-report.com.

[5] See Andrew Bailey, CEO, UK Financial Conduct Authority (regulator of the administrator of LIBOR) (July 12, 2018), "When I spoke about LIBOR in July last year, I made clear the need to transition away from LIBOR before end-2021. The importance of doing so has not changed . . . I hope it is already clear that the discontinuation of LIBOR should not be considered a remote probability 'black swan' event. Firms should treat it is as something that will happen and which they must be prepared for." Available at https://www.fca.org.uk/news/speeches/interest-rate-benchmark-reform-transition-world-without-libor.

[6] Randal K. Quarles, Vice Chair for Supervision, Federal Reserve Board, Chair of the Financial Stability Board (June 3, 2019), "With only two and a half years of further guaranteed stability for LIBOR, the transition should begin happening in earnest. I believe that the [Alternative Reference Rates Committee] has chosen the most viable path forward and that most will benefit from following it, but regardless of how you choose to transition, beginning that transition now would be consistent with prudent risk management and the duty that you owe to your shareholders and clients." Available at https://www.federalreserve.gov/newsevents/speech/quarles20190603a.htm.

[7] For additional information regarding ARRC and SOFR, see ARRC's Frequently Asked Questions document at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/ARRC-faq.pdf.

[8] For example, SOFR is an overnight rate, and additional work is being undertaken to develop a SOFR term structure that will facilitate the transition from term-based USD LIBOR rates. In addition, USD LIBOR incorporates a credit risk premium whereas SOFR is a secured rate. Methodologies are being developed to determine fair spreads between the two rates.

[9] Potentially affected contracts are not limited to financial instruments and credit agreements but also may include other commercial contracts, such as contracts with customers, vendors, and employees.

[10] See https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/FRN_Fallback_Language.pdf.

[11] See https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/Syndicated_Loan_Fallback_Language.pdf.

[12] See https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/Bilateral_Business_Loans_Fallback.pdf.

[13] See https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/Securitization_Fallback_Language.pdf.

[14] See https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/ARRC-Apr-25-2019-announcement.pdf.

[15] Market participants with derivative contracts should be aware of ISDA's work in this area, including two consultations published on May 16, 2019. See https://www.isda.org/2019/05/16/isda-publishes-two-consultations-on-benchmark-fallbacks/.

[16] Item 105 of Regulation S-K and Item 3.D of Form 20-F require companies to disclose the most significant factors that make an investment in the company speculative or risky and, in making these disclosures, to avoid "boilerplate" disclosure and instead provide disclosures that are tailored to the company's facts and circumstances.

[17] Item 303 of Regulation S-K and Item 5 of Form 20-F require companies to identify, among other items, known trends or known demands, commitments, events, or uncertainties that will result or that are reasonably likely to result in a material increase or decrease in liquidity, and to describe any known trends or uncertainties

that have had, or that a company reasonably expects may have, a material favorable or unfavorable impact on income.

[18] Item 407(h) of Regulation S-K requires companies to disclose the extent of its board's role in the risk oversight of the company, such as how the board administers its oversight function and the effect this has on the board's leadership structure.

[19] Risks related to the expected discontinuation of LIBOR, and mitigating actions taken in response, may have broad impact on a company's financial statements. See the section below entitled "Office of the Chief Accountant."

[20] See Item 4(b) of Form N-1A and Item 8(3) of Form N-2.

[21] See https://www.sec.gov/page/oca-registrant-accounting-matters.

[22] See Rahim M. Ismail, Professional Accounting Fellow, Remarks before the 2018 AICPA Conference on Current SEC and PCAOB Developments (Dec. 10, 2018), available at: https://www.sec.gov/news/speech/speech-ismail-121018.

[23] Pursuant to Section 108 of the Sarbanes-Oxley Act of 2002 (amending Section 19(b) of the Securities Act of 1933), the Commission has affirmed the status of the FASB as a designated private-sector standard setter. As a result, accounting standards established by the FASB are recognized as "generally accepted" for purposes of the federal securities laws. See Commission Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter, Release No. 33-8221 (Apr. 25, 2003), available at https://www.sec.gov/rules/policy/33-8221.htm.

[24] FASB Accounting Standards Update ("ASU") 2018-16, Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes.

[25] See https://www.ifrs.org/-/media/project/ibor-reform/ed-ibor-reform-may-19.pdf.