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Before the U.S. House of Representatives Committee on Financial Services
Subcommittee on Investor Protection, Entrepreneurship and Capital Markets

Hearing: "The End of LIBOR: Transitioning to an Alternative Interest Rate Calculation for Mortgages, Student Loans, Business Borrowing, and Other Financial Products"

April 15, 2021

Chair Sherman, Ranking Member Huizenga and Members of the Subcommittee:

I appreciate the opportunity to testify before you today on behalf of the Division of Corporation Finance of the Securities and Exchange Commission ("SEC" or the "Commission")[1] about the transition away from LIBOR[2] and the Securities and Exchange Commission staff's efforts to monitor the transition.[3]

The announced discontinuation of LIBOR will have significant impacts on the financial markets and market participants. LIBOR's discontinuation and transition to an alternative reference rate may present material risks for public companies, investment advisers, investment

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[1] The views expressed in this testimony are those of the author and do not necessarily represent the views of the SEC, the Commissioners, or other members of the SEC staff.

[2] Formerly an acronym for the London Interbank Offered Rate, LIBOR is common parlance for its current official name ICE LIBOR. For further information about the current state of the transition, see Federal Financial Institutions Examination Council, *Joint Statement on Managing the LIBOR Transition* (Jul. 1, 2020), *available at* https://www.ffiec.gov/press/pr070120.htm.

[3] For further information, see Division of Corporation Finance, Division of Investment Management, Division of Trading and Markets and Office of the Chief Accountant, *Staff Statement on LIBOR Transition* (Jul. 12, 2019) [hereinafter "Staff Statement on LIBOR Transition"], https://www.sec.gov/news/public-statement/libor-transition; SEC Office of Compliance, Inspections and Examinations, *Risk Alert: Examination Initiative: LIBOR Transition Preparedness* (Jun. 18, 2020) [hereinafter "EXAMS Risk Alert"], *available at* https://www.sec.gov/exams; SEC Office of Municipal Securities, *Staff Statement on LIBOR Transition in the Municipal Securities Market* (Jan. 8, 2021) [hereinafter "OMS Staff Statement"], https://www.sec.gov/municipal/oms-staff-statement-libor-transition-municipal-securities-market. These statements represent the views of the staffs of the respective Divisions and Offices. They are not rules, regulations, or statements of the Commission. The Commission has neither approved nor disapproved their content. These statements, like all staff statements, have no legal force or effect: they do not alter or amend applicable law, and they create no new or additional obligations for any person.

companies, broker-dealers, and, ultimately, investors. Those risks will be greater if an orderly transition is not completed in a timely manner—including important work to be done this year, and work still to be finished. A cross-agency team of Commission staff collaborates regularly on LIBOR transition matters, and the staff is actively monitoring the extent to which market participants are identifying and addressing these risks in preparing for the transition.

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. The Commission's three-part mission is to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation. We will be pursuing each part of that mission during the LIBOR transition. The Division of Corporation Finance ("CF") has encouraged public companies to plan for the LIBOR transition and to consider their disclosure obligations, control systems, and risks to their businesses that the transition may present. Areas in which existing rules or regulations may require disclosure related to the discontinuation of LIBOR include disclosure of risk factors,[4] management's discussion and analysis,[5] board risk oversight,[6] and financial statements.[7] To meet their disclosure obligations, companies also may need to adjust their information technology systems, internal controls, and related policies and procedures to reflect the transition. CF has encouraged companies to keep investors informed about the progress toward risk identification and mitigation and any anticipated material impact, and also has issued guidance for companies to consider in deciding what disclosures are relevant and appropriate.[8]

The Division of Trading and Markets ("TM") has been monitoring the impact that the discontinuation of LIBOR will have on broker-dealers, central counterparties, and exchanges. These entities may need to consider transition-related impacts due to: issuing instruments, or being a party to a transaction, referencing LIBOR; making investments that reference LIBOR; making a market in instruments that reference LIBOR; or underwriting, placing, or advising on the issuance of instruments referencing LIBOR. In addition, broker-dealers should be especially mindful of their sales practice obligations. In particular, broker-dealers are subject to Regulation

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[4] Item 105 of Regulation S-K and Item 3.D of Form 20-F require companies to provide a discussion of the material factors that make an investment in the company or offering speculative or risky and, in making these disclosures, to explain concisely how each risk affects the company or the securities being offered.

[5] 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 are reasonably likely to have a material favorable or unfavorable impact on net sales or revenues or income.

[6] 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.

[7] Changes in the reference rate included in financial instruments resulting from the expected discontinuation of LIBOR may affect a company's accounting for financial assets and financial liabilities thereby affecting its financial statements.

[8] *See* Staff Statement on LIBOR Transition, *supra* note 3.

Best Interest when recommending LIBOR-linked securities to retail customers, which requires the broker-dealer, among other things, to understand the potential risks, rewards, and costs associated with the recommendation and to have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile. This consideration may include whether the investments or related contracts at issue have clear fallback language providing for an alternative rate when LIBOR is discontinued and whether any replacement rate has economic differences that make the investment less compatible with their retail customer's investment objectives or risk tolerance. Regulation Best Interest also requires broker-dealers to make relevant disclosures and address conflicts of interest. Finally, TM has encouraged its regulated entities to analyze how the LIBOR transition will impact them, including their business, systems, models, processes, risk management frameworks, and clients.[9] Regulated entities should respond accordingly in order to mitigate the impacts, including disclosure where appropriate.

The Division of Examinations ("EXAMS") has engaged in efforts to assess the impact that the discontinuation of LIBOR will have on registered entities subject to SEC oversight, including investment advisers, investment companies, broker-dealers, transfer agents, municipal advisors, and clearing agencies, and has encouraged early preparation among registered entities. Last year, it launched an examination initiative to assess industry preparation efforts and identify challenges confronting the industry in transition efforts.[10] EXAMS also issued a risk alert highlighting to the financial services industry issues to consider to facilitate a successful transition.[11] As part of its LIBOR transition preparedness initiative, EXAMS has thus far conducted approximately 75 examinations of a wide range of registrants. EXAMS is continuing its examinations, focusing on retail advisers, and continuing to message the importance of preparation.

The Division of Investment Management ("IM") is focused on general preparedness and risk management among advisers and funds related to the discontinuance of LIBOR. IM has encouraged investment advisers to consider the effect the discontinuation of LIBOR will have on LIBOR-based investments when recommending them to clients or monitoring them for clients. This consideration may include whether the investments or related contracts at issue have clear fallback language providing for an alternative rate when LIBOR is discontinued and whether any replacement rate has economic differences that make the investment less compatible with their client's risk strategy or tolerance. Another key aspect of preparing for the transition involves updating systems and operational processes. Among other things, advisers and funds that transact in LIBOR-based investments will need to make sure that their systems are able to handle the ongoing calculation of interest accruals and payment calculations for instruments tied to replacement rates for LIBOR, and to accommodate alternative rate instruments so that they can transact in them as they become available. IM has provided guidance on fund disclosures, including encouraging affected funds to provide disclosures tailored based on the fund's investment objective, holdings, investment strategies, and structure. Disclosures should address

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[9] *See id*.
[10] *See* EXAMS Risk Alert, *supra* note 3.
[11] *See id*.

all material risks associated with LIBOR-linked instruments in offering documents and other communications so that investors can make informed investment decisions.[12]

The Office of the Chief Accountant ("OCA") continues to monitor the activities of preparers, auditors, standard-setters, and other regulators to address financial reporting issues that might arise in connection with a transition from LIBOR to alternative benchmark reference rates. OCA staff has encouraged ongoing discussion and analysis of questions in this area in interactions with various stakeholders, including the Financial Accounting Standards Board and the International Accounting Standards Board. Both boards have updated their accounting standards to address potential accounting implications arising from the anticipated transition away from LIBOR, and continue to monitor this area for other potential accounting and financial reporting implications that may need to be addressed through standard setting. In addition, through continued engagement with stakeholders, OCA staff have supported efforts to raise awareness of the potential accounting considerations and to encourage disclosure of potential material impacts of, and issuer progress relating to, the transition.[13]

The Office of Municipal Securities ("OMS") has encouraged municipal issuers and municipal advisors to focus on issues specifically relevant to the municipal securities market, including with respect to existing and new contracts with LIBOR exposure, the need to keep investors informed through primary and secondary municipal security market disclosures, and municipal advisors' preparation for the transition away from LIBOR.[14] Municipal issuers have exposure primarily through their debt obligations, derivative transactions, and investment portfolios, although some may additionally be exposed to LIBOR through their services, supply and other commercial contracts. OMS staff has actively engaged in industry outreach with key market participants on the need to take appropriate steps proactively to deal effectively with the LIBOR transition. In addition to moderating a LIBOR transition discussion during last year's municipal market disclosure conference hosted by OMS, this year the OMS director has discussed LIBOR transition issues and outlined material disclosure issues arising from the LIBOR transition with municipal market participants in meetings and at conferences.

Thank you for the opportunity to discuss the SEC staff's work related to the LIBOR transition.

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[12] *See* Staff Statement on LIBOR Transition, *supra* note 3.
[13] *See id*.
[14] *See* OMS Staff Statement, *supra* note 3.