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SEC Staff Issues Statement on LIBOR Transition with Key Considerations for Market Participants

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On December 7, 2021, the SEC staff issued a statement to remind issuers, investment professionals and other market participants of their obligations related to the LIBOR transition. The publication of non-U.S. dollar-based LIBOR rates was discontinued after December 31, 2021, and the publication of U.S. dollar-based LIBOR rates will cease after June 30, 2023. The Secured Overnight Financing Rate (SOFR) has been identified as the preferred alternative reference rate in place of U.S. dollar-based LIBOR. Among other things, the SEC staff noted that the transition to SOFR may have an impact on recommending to customers LIBOR-linked securities or investment strategies using LIBOR as a benchmark. Furthermore, the SEC staff highlighted several obligations of which broker-dealers, registered investment advisers and funds should be aware with regard to the transition.

With respect to broker-dealers, the SEC staff noted that under Regulation Best Interest (Reg BI), a broker-dealer that recommends to a retail customer LIBOR-linked securities or investment strategies involving those securities must have a reasonable basis, based on considerations of a security's or strategy's risks, rewards and costs, to believe that the recommendation is in the customer's best interest. In this regard, the staff stated that broker-dealers should ensure that LIBOR-linked securities or strategies have robust fallback language in offering documents that clearly defines the replacement reference rate that will take effect upon the discontinuation of LIBOR, and consider the impact that the proposed replacement rate may have on the expected performance of any LIBOR-linked security or strategy.

With respect to registered investment advisers and funds, the SEC staff noted the following:

- Advisers generally should consider whether any advice regarding LIBOR-linked investments and risks related to those investments is consistent with their clients' goals in light of the fiduciary duties advisers owe their clients. This includes considering whether recommended investments or related contracts have robust fallback language to implement an alternative

reference rate when LIBOR is discontinued and whether the transition to an alternative reference rate may create economic differences that could cause the investment to depart from a client's strategy or risk tolerance.

- Registered funds, including BDCs, and private fund advisers should be aware of disclosure obligations related to the LIBOR transition. For example, a fund that invests significantly in LIBOR-linked investments may have principal risks related to the discontinuation of LIBOR and the volatility, valuation and liquidity it may have on its portfolio holdings.

- Advisers, funds and fund boards should be aware of valuation risks associated with the discontinuation of LIBOR and the transition to an alternative reference rate as well as the effect these developments may have on valuation inputs and assumptions

- Advisers should monitor and manage potential conflicts of interest related to the LIBOR transition. For example, an adviser that charges performance fees subject to a hurdle rate tied to LIBOR or an index containing LIBOR-linked securities should consider disclosing that it may be easier to earn the performance fee after the transition to an alternative reference rate.

- Finally, advisers and funds should consider whether they or their key service providers need to make changes to operational processes and IT systems in connection with the LIBOR transition, which could take a significant amount of time to complete.

The SEC staff statement is available here.

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