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Opening Statement
Full Committee Hearing: The Libor Transition: Protecting Consumers and Investors
November 2, 2021 at 10:00 AM

Thank you, Mr. Chairman.

The London Interbank Offered Rate – or LIBOR – has long been the most widely used U.S. dollar-denominated benchmark interest rate across all types of financial contracts. LIBOR is the rate at which large banks report they can borrow from one another in the interbank market on a short-term, unsecured basis.

At the end of 2020, over $223 trillion in contracts referenced LIBOR, including loans, bonds, derivatives, and securitizations. In 2013, the G20 launched a global review of interest rate benchmarks after cases of misconduct in the reporting of LIBOR rates by a small number of banks and the significant decline in interbank lending volume.

As the breadth and depth of interbank loan market liquidity greatly diminished, it became clear that alternative rates with greater volume and a larger number of market participants would be more appropriate than LIBOR. In the United States, the Federal Reserve Board and the New York Fed convened the Alternative Reference Rates Committee – or ARRC – to identify an alternative to LIBOR.

In 2017, the ARRC identified the Secured Overnight Financing Rate – or SOFR – as its recommended alternative to LIBOR. SOFR measures the cost of overnight, or short-term, borrowing collateralized by U.S. Treasury securities.

In 2020, daily volumes underlying SOFR were consistently above $1 trillion. Last year, the Fed, FDIC, and OCC directed banks to stop entering into new LIBOR contracts as soon as possible and no later than the end of 2021.

Earlier this year, the administrator of LIBOR announced that it will stop publishing all LIBOR settings by June 30, 2023. Although most existing contracts referencing LIBOR will mature by that date, a number of contracts will not, and lack fallback language to replace LIBOR with a non-LIBOR rate. As a result, many have called for federal legislation to address these so-called “tough legacy contracts.”

I agree banks should stop writing new LIBOR contracts as soon as possible, and federal legislation is likely needed to address tough legacy contracts. The unique and anomalous circumstances related to the LIBOR transition require action by Congress to amend contracts between private parties. Such congressional action should be a last resort.

As we consider this measure, any legislation that addresses tough legacy contracts must be very narrowly tailored, not change the equities of these contracts, and not affect any new contracts.

In July, the House Financial Services Committee approved a bill that would replace LIBOR in tough legacy contracts with a Fed-selected, SOFR-based benchmark. This bill takes a reasonable approach, and the Senate should carefully review it. In doing so, we should consider targeted amendments, such as ensuring that qualified non-SOFR benchmark rates are not disfavored in future contracts.

While it’s appropriate to mandate a SOFR-based index for this relatively small universe of tough legacy contracts, for new contracts banks must have the option to choose among qualified benchmark rates – including credit-sensitive rates – as appropriate for their business models. Risk-free rates like SOFR may work well for derivatives contracts and institutions active in the Treasury repo market, but they may not be well-suited for loans or certain community or regional banks.

The funding costs for such banks typically increase relative to SOFR during periods of stress, which could create an asset-liability mismatch if loans were required to reference SOFR. The Fed, FDIC, and OCC have previously acknowledged this problem. They have said the use of SOFR is voluntary and a bank may use “any reference rate for its loans that the bank determines to be appropriate for its funding model and customer needs.”

An even broader group of regulators said, in the context of bank lending, that “supervisors will not criticize firms solely for using a reference rate (or rates) other than SOFR." However, I am concerned this is exactly what Biden administration financial regulators are now seeking to do.

Just last week, the Acting Comptroller of the Currency said the OCC's supervisory efforts will "initially focus on non-SOFR rates." This suggests that the OCC may apply heightened supervisory scrutiny to non-SOFR rates. And last month, a senior New York Fed official said that banks that use a non-SOFR rate must do "extra work" to ensure that the bank is "demonstrably making a responsible decision."

SEC Chair Gensler has been even more explicit. On multiple occasions, he has criticized one particular credit-sensitive rate. These statements raise serious concerns that regulators are pressing all banks to use SOFR without any transparency or public input. If a bank wants to price its loan off a rate it believes is a better reflection of its cost of funding or customer needs than SOFR, regulators should not prohibit the bank from doing so.

This pressure, however, pales in comparison to the preferred approach of President Biden's nominee to lead the OCC. Professor Saule Omarova has written that widely used benchmark rates should either be pre-approved by the government or, worse, subject to "utility-style regulation." In other words, the government – not the market – would have a direct role in actually setting benchmark rates as it deems appropriate.

This is just one example of the many radical ideas that Professor Omarova has proposed that demonstrate a clear aversion for democratic capitalism, and a clear preference for an administrative state where decisions are made by technocrats who think they know more than the market.

Regulators should never disfavor qualified rates, and banks should have the choice to use any rate that meets well-established criteria for benchmark rates.

I hope to hear from today's witnesses about the transition from LIBOR, the potential for targeted federal legislation to address tough legacy contracts, and ways to preserve benchmark rate choice.