Chairman Brown, Ranking Member Toomey, and members of the Committee. I am honored to be here today on behalf of the Alternative Reference Rates Committee (or ARRC) to testify on the need for Federal legislation to address the LIBOR transition for legacy products and support the efforts of this committee to bring that to fruition.

The ARRC is comprised both of a broad set of private-sector firms and associations representing a range of perspectives on the LIBOR transition as well as a broad set of U.S. agencies, including the Federal Reserve, the CFTC, the SEC, Treasury, the OCC, the FDIC, and FHFA, who provide oversight to our work.[1] We were convened by the Federal Reserve Board and Federal Reserve Bank of New York in 2014 in order to help address the financial stability risks that the Financial Stability Oversight Council had publicly identified concerning the use of LIBOR in the financial system.

Over time, LIBOR had grown to be a pervasive part of our economy; it has been referenced in nearly every floating rate business and consumer loan, floating rate debt and securitization contract, in nonfinancial corporate contractual agreements, and in a staggering amount of derivatives. The ARRC has estimated that U.S. dollar LIBOR is referenced in over $200 trillion financial contracts alone, roughly ten times the size of the annual U.S. gross domestic product. But despite the fact that so much of the financial system depended on LIBOR, few if any bothered to understand what this rate was based on, and in fact we now understand that it was based on very little. LIBOR had both a weak and opaque governance structure and was based on what had become a very thin market. As a result of these shortcomings, LIBOR was in danger of failing, and the official sector had to step in to prevent a sudden and disruptive end to it and instead has sought an orderly winddown. The ARRC was convened to help facilitate a smooth transition and was asked to identify a robust alternative to U.S. dollar LIBOR, one that was appropriate to base trillions of dollars of contracts on, and to address risks to legacy LIBOR contracts. I believe that the ARRC is a truly successful example of public-private sector cooperation, but it is important to understand that all of the ARRC's recommendations are voluntary; no one is required to follow them, and no one is required to use the ARRC's recommended rate, the Secured Overnight Financing Rate, or SOFR.

SOFR is based on overnight borrowing transactions in the U.S. Treasury repo market, the largest interest rates market in the world, a key source of secured financing for a broad range of financial market participants, and a key component of overall Treasury markets in the United States. The ARRC selected SOFR after several years of work examining all potential alternatives and public consultation. The ARRC selected SOFR as its recommended alternative

[1] Reflecting the importance of its work, the ARRC's *ex officio* members include the Commodity Futures Trading Commission, Consumer Financial Protection Bureau, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, Federal Reserve Bank of New York, Federal Reserve Board, National Association of Insurance Commissioners, New York Department of Financial Services, Office of Financial Research, Office of the Comptroller of the Currency, U.S. Department of Housing and Urban Development, U.S. Securities and Exchange Commission, and the U.S. Treasury. As the ARRC has explained, this "structure facilitates collaboration between the market and the official sector" and "allows the group to have diverse participation across financial services."

based on the fact that it is by far the most robust alternative to LIBOR available – there will always be a U.S. Treasury repo market both in good times and bad – and based on the widespread support from a broad range of market participants including end users and borrowers.

The ARRC believes that SOFR is an appropriate rate for new use in products that have historically referenced LIBOR, and that it is robust enough to ensure that we do not recreate the problems that we have had to deal with in LIBOR. We expect that many market participants will in fact choose to use SOFR, and many have already done so or are actively preparing to. However, we also support choice, and we have been clear since our inception that our recommendations are voluntary. At the end of the day, the market will determine which rates are used.

For many legacy products things are much less simple and will create additional challenges and considerations. The ARRC's Second Report, published in March 2018, provided a survey of contractual fallbacks in various cash products referencing LIBOR and noted that many of these contracts did not envision the possibility that LIBOR might permanently cease or had fallbacks that would not be economically appropriate if such an event occurred. Unlike derivatives, which are covered by standardized documentation and have developed efficient mechanisms allowing for contractual amendments, many cash instruments, such as floating rate bonds and securitizations, have fallback language that is difficult or impossible to change after they have been issued.

Based on the ARRC's work, we know that many legacy nonfinancial corporate contracts referencing LIBOR have no workable fallback language or no fallback language whatsoever and that many financial contracts have fallbacks that would require parties to poll an unnamed set of banks in an attempt to recreate LIBOR, which we believe would be both burdensome and unsuccessful, or refer only to the last published value of LIBOR, effectively converting what were intended to be floating rate instruments to fixed-rate instruments.

The ARRC established several working groups to work with market participants to develop more robust fallback language and publish consensus recommendations on such language. ARRC working groups have involved more than 300 different institutions, including lenders, borrowers, investors, and consumer advocacy groups. Recognizing the single importance of clarity and certainty with respect to fallbacks for consumer contracts, the ARRC published a separate set of Guiding Principles specifically designed for its work on consumer products. The ARRC's work on fallback recommendations included numerous consultations with market participants, each of which is publicly available. Many new issuances now contain ARRC-recommended fallback language thanks to this work.[2]

[2] Following the work of each working group and the consultations, the ARRC published recommended contractual fallback language for floating rate notes, syndicated and bilateral loans, securitizations, consumer adjustable rate mortgages, and student loans.

While developing recommended fallback language that could be adopted in new contracts referencing LIBOR, the ARRC also recognized that not all contracts can or will be amended by the time of LIBOR cessation and that there will be a significant amount of legacy contracts outstanding that will have no clear or effective reference rate when the main tenors of U.S. dollar LIBOR cease or become no longer representative immediately after June 30, 2023. To help to address this, the ARRC developed and promoted legislation for contracts governed by New York law to avoid the disruptions, market uncertainties, and confusion that would otherwise occur when LIBOR ends.

In March 2021, the New York State legislature passed legislation supported by the ARRC that provided clear fallbacks to any contract referencing LIBOR governed by New York law that otherwise has no effective fallback language, either because it is has no fallback or because it falls back to a LIBOR-based rate (or to a dealer poll to determine a LIBOR rate). The State of Alabama subsequently passed similar legislation. The passage of state legislation has been extraordinarily important in helping to address the risks of the LIBOR transition. In particular, many financial contracts are covered under New York law. However, we know that many nonfinancial corporate contracts, consumer loans, and securitizations are not covered by New York or Alabama state law. While the ARRC is prepared to advocate for similar legislation in other states, we cannot reasonably hope for comparable legislative solutions in all 50 states and the District of Columbia. Federal legislation can help to ensure an equal outcome for all Americans.

The legislative proposal that I understand members of this committee are working on and that a House committee passed earlier in the year would help to ensure that equal outcome. As with the legislation passed in New York and Alabama, the legislative proposal is purposefully narrow, intended only to address contracts that could not otherwise be changed. For contracts that already allow one party the right to choose a new rate, a feature of most consumer contracts referencing LIBOR, the proposed legislation does not alter the right of the designated party to determine the successor rate, but it does provide a safe harbor to encourage a choice based on SOFR, which has had the strong support of consumer advocacy groups in addition to lenders and investors. For contracts that do not grant a particular party the right to name a successor rate to LIBOR and have no fallback language or language that refers only to a poll of banks or some past value of LIBOR, the proposal recognizes that a unique successor rate must be named in order to avoid legal conflict and it names a successor rate based on SOFR for that purpose, but again only for those contracts that will not otherwise work in the absence of a legislative solution. The proposed legislation has no impact for contacts that already specify a non-LIBOR floating rate if LIBOR is unavailable, which is the case for most legacy business loans. Parties may also opt out of the legislation at any time.

As I have noted, the ARRC represents a very diverse set of participants. We have worked by consensus to develop recommendations to help ensure that the U.S. economy can successfully transition from LIBOR. ARRC members have for some time strongly held the consensus view that legislation addressing legacy LIBOR contracts is an important component of the transition. We support your efforts to introduce legislation in the Senate and, in conjunction with your counterparts in the House, urge you to pass it as expeditiously as possible. We thank you in advance for your consideration and stand ready to be a resource in any way we can.