Remarks by Acting Comptroller of the Currency Michael J. Hsu at the Alternative Reference Rates Committee (ARRC) Symposium

October 26, 2021

Good afternoon and thank you for having me here at this Alternative Reference Rates Committee (ARRC) symposium. Libor cessation and replacement is an incredibly important issue facing the global financial system and it is an honor and a privilege to be here.

I was appointed as Acting Comptroller of the Currency this past May. In my time as Acting Comptroller, I have focused on several priorities, including the importance of building trust in the banking system and guarding against complacency. These two imperatives anchor and inform my approach to bank supervision. Both are also highly relevant to the issue of Libor cessation and replacement.

Building trust is central to the nature and work of the ARRC. The ARRC is a collaborative effort among borrowers and lenders, industry groups and the official sector, all working together to promote a smooth transition away from Libor, preserving and promoting safety and soundness in the financial system.

As the banking sector has weathered the pandemic with relatively healthy balance sheets, it may be tempting for bank management to become complacent about continued and emerging risks such as Libor replacement. This complacency can have a profound negative effect on bank operations, safety, and soundness. Let's face it, there are still people out there who believe that some way, somehow Libor will not be discontinued but will survive as a "synthetic Libor," or as some have called it, a "zombie Libor." Let me clear, the federal financial regulators have said no new Libor exposures – zombie or otherwise – after December 31, 2021, and we mean it.

I think complacency also may be a temptation in some quarters where folks believe that

they simply don't have any Libor exposure at all. We know that OCC-supervised institutions use or are exposed to Libor in many different ways. The largest banks we supervise rely heavily on Libor in their lending, derivatives activities, and market-making capacities. Banks of all sizes, however, must look outside these activities to determine whether they have Libor exposures in other contexts. For example, a bank may own a Libor-based loan participation interest, or may hold an instrument for the bank's investment or liquidity portfolio that pays Libor-based income or otherwise reflects Libor exposures. If the bank is using a third-party vendor to provide financial valuation updates, asset/liability management modeling, or cash flow analysis of borrower collateral or bank assets, the vendor may be employing discounting methods using Libor-based rates. Even if none of these considerations currently present issues for the bank, management should still be screening new investments and activities for embedded Libor.

The OCC has consistently advocated for thoughtful and timely preparedness on the part of the banks we supervise when considering the cessation of Libor. We developed a phased approach to govern our expectations for banks while they prepare for the transition. We focused our efforts in 2019 on making banks aware of the transition and encouraging them to carefully inventory their exposures and become familiar with our supervisory expectations. In 2020, the OCC emphasized bank preparedness, and in 2021, we have turned our attention to banks that may need additional support or assistance for a smooth transition. At this point in the timeline, the OCC expects every bank to be executing upon a comprehensive plan to address the effects of Libor cessation that is tailored to the bank's particular exposure to Libor under its current business model, risk profile, and strategic plan. We recognize that this process may present operational challenges that banks will need to address depending on each bank's available

resources, the scope of the exposure, and the relative financial sophistication of the bank's borrowers.

The OCC has stressed – and I want to reinforce today – the importance of successfully executing transition plans before new use of LIBOR stops and Libor ceases to be reported. Banks have it within their power to avoid year-end market disruptions. Now is the time to pick up the pace. No excuses.

Let me say a few words about replacements for Libor. What should be guiding us is a simple principle: never again. Never again should we need to revisit this issue of an unreliable and untrustworthy rate. The rates used to replace Libor should be robust.

On September 8, 2021, the International Organization of Securities Commissions (IOSCO) issued a statement on credit sensitive rates, reiterating the importance of transitioning to robust alternative financial benchmarks and reminding benchmark rate administrators that demonstrating compliance with the IOSCO principles is not a one-time exercise. The IOSCO specifically highlighted Principles 6 and 7, calling on benchmark rate administrators to assess whether benchmarks are based on active markets with high volumes of transactions and whether such benchmarks are resilient during times of stress. The IOSCO cited concern that some of Libor's shortcomings may be replicated through the use of credit sensitive rates that lack sufficient underlying transaction volumes. The Financial Stability Board, weighing in from a macroprudential perspective, similarly noted that "to ensure financial stability, benchmarks which are used extensively must be especially robust."

The OCC shares these concerns. Last week, we issued a Bulletin[1] reiterating our expectations that banks demonstrate that their Libor replacement rates are robust and appropriate for their risk profile, nature of exposures, risk management capabilities, customer and funding needs, and operational capabilities. The IOSCO noted that the Secured Overnight Financing Rate (SOFR) provides a robust rate suitable for use in most products, with underlying transaction volumes that are unmatched by other alternatives. To this end, OCC supervisory efforts will initially focus on non-SOFR rates.

In addition to complacency, there are two other "C" words that come to mind with respect to Libor replacement: complexity and confusion.

Libor has been ubiquitous in financial markets for decades, and the work to replace it has indeed been complex. And complex issues can crop up in unexpected places. For instance, we have seen a growing groundswell in commercial lending toward so-called "Term SOFR." Term SOFR is a rate derived from observable activity in the SOFR derivatives markets and can be set in advance and paid in arrears which appeals to many commercial entities. Term SOFR is the intellectual property of the Chicago Mercantile Exchange, or CME, and any use of it, any at all, requires a license from the CME. The license doesn't cost anything, but it is necessary

The ARRC and its many members, working through a host of sub-committees and workstreams, have been wrestling with many of the complexities at no small expense to themselves, for years. The general population will never know just what a herculean effort this has been, but on their behalf, I want to take this opportunity to compliment everyone

[1] See: OCC Bulletin 2021-48, LIBOR Transition: Joint Statement on Managing the LIBOR Transition | OCC

involved and to thank you for your service.

Lastly, that other "C" word I mentioned, confusion. The regulatory community has worked hard to minimize confusion throughout this process via coordinated communications. The OCC has been actively working with our supervised institutions since 2018 to promote their preparation for the cessation of Libor. The FFIEC recently published a joint statement on Libor transition. The FDIC, the Fed, and the OCC published a joint statement about "no new Libor exposures after the December 31, 2021 deadline" last November with only four specific carve-outs. In case there is lingering confusion around that deadline, let me clear that up now: no new exposures means no new contractual obligations entered. If there is an existing contractual obligation whose term extends beyond the December 31, 2021 date, even if it is undrawn, that is not a new exposure. But a new Libor contract would include any agreement that creates additional Libor exposure for a supervised institution or extends the term of an existing Libor contract. Of course we anticipate that most Libor exposures will sunset by June 2023.

Let me conclude by reiterating that Libor cessation and replacement is an incredibly important issue facing the global financial system. It has been and continues to be a complex and at times confusing process. The work of the ARRC in meeting these challenges has been critically important and tremendous.