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Progress on the Transition to Risk-Free Rates

Remarks by

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and

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at

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I am pleased that we have this opportunity to meet with many of the institutions active in helping to achieve a transition from LIBOR to the risk-free rates identified by working groups in each of our jurisdictions. The Financial Stability Board (FSB) has coordinated the international effort to reform interest rate benchmarks at the direction of the G-20. This is an important effort across the globe, but nowhere is it of more importance than in the jurisdictions relying on LIBOR.

Let's review the reasons that we are here. By the time of the financial crisis, much of the global financial system had come to rely on LIBOR. And yet LIBOR was a very poorly structured rate; contributing banks were asked to submit quotes without any requirement of evidence of transactions or other facts to back them up, which made them susceptible to manipulation. Thanks to subsequent reforms, contributors now provide this type of evidence where possible, but LIBOR is based on an underlying market with so few transactions that there is relatively little direct evidence they can provide. Many submitting banks are uncomfortable with this situation, and some sought to stop their participation. As a result, the official sector has had to step in to support LIBOR by securing a voluntary agreement with the remaining banks to continue submitting through 2021. At the same time, the official sector has convened national working groups to help develop alternative risk-free rates and navigate a very complicated transition.

Many people have used reference rates with little thought. The experience with LIBOR should teach us that this has to change and that we cannot risk making this kind of mistake again. Banks should conduct at least as much due diligence on the reference rates that they use as they conduct on the creditworthiness of their borrowers. The national working groups convened by many of the FSB member authorities have performed that type of diligence with the Secured Overnight Financing Rate, or SOFR, and the risk-free rates identified in other jurisdictions. That effort has been a clear and positive example of public-private sector cooperation. These alternative risk-free rates have been created or substantially reformed to ensure that robust, transaction-based rates that accurately represent well-defined underlying markets and are consistent with internationally-recognized standards are available.

I want to thank the many institutions here today, and the many more that have played equally constructive roles, for their efforts in this process. This month marks the one-year anniversary of SOFR and is close to the one-year anniversary of the other new risk-free rates. Over that year, we have seen the establishment of new futures markets, cleared swap markets, and debt markets based on these new rates. SOFR futures, which did not exist a year ago, have seen more than $7 trillion in cumulative notional volumes. This has been a crucial development for market liquidity and is helping to spur the growth of SOFR swaps and other derivative markets. And SOFR is being used in cash products, with $81 billion in SOFR-linked debt issued over the past year.

New markets do not arise overnight--in normal circumstances they can often take decades to develop. What has been accomplished over the past year is remarkable. At the same time, we have only a little over two and a half years until the point at which LIBOR could end, and the transition needs to continue to accelerate. The private sector needs to take on this responsibility, and we expect you to do so. The Federal Reserve's supervisory teams are including the transition away from LIBOR in their monitoring discussions with large firms. The Federal Reserve will expect to see an appropriate level of preparedness at the banks it supervises. As the Alternative Reference Rates

Committee (ARRC) continues to make progress on industry-led approaches to the transition, the transition paths away from LIBOR will become clearer for banks of all sizes.

While we expect you to take on this responsibility, we in the public sector must also recognize our need to help. The FSB has supported this transition globally, and, in the United States, the Financial Stability Oversight Council has supported the ARRC's work. It is important that we continue to do so, and I want to thank you all today for the thoughts you have shared with us on this transition and what is needed to make it succeed.