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ARRC Welcomes and Highlights Messages from Recent FSOC Principals Meeting

Leadership from Across the Official Sector Urges a Speedy Transition off of LIBOR and Highlights SOFR's Strengths

The Alternative Reference Rates Committee (ARRC) welcomes and highlights the key points made during the Financial Stability Oversight Council (FSOC) Principals Meeting last Friday, June 11. Convened by Treasury Secretary Janet Yellen, this meeting included a discussion about the importance of accelerating the transition from LIBOR and using sufficiently robust reference rates—like the ARRC-recommended Secured Overnight Financing Rate (SOFR)—for derivatives and capital markets products.

The full recording of the open session is available here and the Treasury Department's readout is available here.

"Official sector leaders presented a united front in underscoring the transition's urgent importance for financial stability," said Tom Wipf, ARRC Chairman and Vice Chairman of Institutional Securities at Morgan Stanley. "As they made clear: LIBOR is going away very soon so transition efforts must accelerate, we don't ever want do this again so choose wisely when moving off of LIBOR, and SOFR is a robust, proven reference rate that can truly anchor this transition."

Key excerpts from published remarks during the session include:

Randal Quarles, Vice Chairman of the Federal Reserve Board
"The broad range of private-sector market participants who constitute the ARRC constructed and chose SOFR as their preferred rate precisely because of this stable structure. It rests on one of the deepest and most liquid markets in the world and is therefore likely to remain available even when other financial markets are disrupted. It is transparently calculated, engendering market confidence. And within weeks there will be a term rate based on SOFR, supporting the pricing of a range of market products. For all these reasons, the ARRC did not recommend rates other than SOFR in capital markets or for derivatives, and market participants should not expect such rates to be widely available. For non-capital markets products, our supervisory guidance clearly notes that lenders and borrowers are free to choose among rates that meet their needs, but there are benefits of SOFR for these products, and thus—particularly with the development of term rates—SOFR will play a role in these markets as well."

Janet Yellen, Secretary of the Treasury
"The decisions made now around the selection of alternative rates will determine whether some of LIBOR's shortcomings may be replicated through the use of alternative rates that lack sufficient underlying transaction volumes. I am concerned about recent use, and potential future growth in use, of these rates in derivatives… The most critical step in the transition is the move toward truly robust alternative rates, like SOFR, which can mitigate the need for future transitions. A failure to adopt robust alternative rates would leave us continuing to face the same risks and challenges that we face today."

Gary Gensler, Chairman of the Securities and Exchange Commission

"As Hans Christian Andersen wrote in his famous folktale, 'The Emperor's New Clothes': The emperor had no clothes. Because few transactions underpinned LIBOR, the people responsible for determining this benchmark tended to use their own judgment in setting it. That was not the only challenge. On top of that, LIBOR was easy to game. When I was at the Commodity Futures Trading Commission, the excellent staff did a remarkable job uncovering many cases of manipulative conduct at large banks. Finally, somebody had pointed out that the emperor had no clothes… That's why I believe the Secured Overnight Financing Rate (SOFR), which is based on a nearly trillion-dollar market, is a preferable alternative rate."

Rostin Behnam, Acting Chairman of the Commodity Futures Trading Commission

"There is broad consensus among all market participants, and not just the dealer banks, of the urgency to shift away from LIBOR… To avoid the conduct and stability risks that emerged when LIBOR became disconnected from actual activity, we must rely on a benchmark that is both representative of transactions and proportional to the depth and breadth of products that rely upon it. SOFR demonstrates that fitness for the derivatives markets."

Michael Hsu, Acting Comptroller of the Currency

"… we are at an important juncture in the LIBOR transition. There are important financial stability implications for this body and the financial system. Importantly, over the long run financial stability is a critical interest of all stakeholders whatever their size and market participation. The Secured Overnight Financing Rate (SOFR) is a robust replacement rate that has been carefully developed and will be reliably produced in a wide range of market conditions. The widespread adoption of SOFR in derivatives and other markets will promote financial stability for all participants in the financial system. SOFR enjoys broad applicability and already has a proven track record. We expect every bank, regardless of size, to demonstrate that its replacement rate selections are appropriate for the bank's products, funding needs and operational capacities. In particular, we want to emphasize the importance of banks considering the strength of the fallback provisions they employ."

About the ARRC

The ARRC is a group of private-market participants convened by the Federal Reserve Board and Federal Reserve Bank of New York in cooperation with the Commodity Futures Trading Commission, the Consumer Financial Protection Bureau, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the National Association of Insurance Commissioners, the New York Department of Financial Services, the Office of Financial Research, the Office of the Comptroller of the Currency, the U.S. Department of Housing and Urban Development, the U.S. Securities and Exchange Commission, and the U.S. Treasury Department. It was initially convened in 2014 to identify risk-free alternative reference rates for USD LIBOR, identify best practices for contract robustness, and create an implementation plan with metrics of success and a timeline to support an orderly adoption. The ARRC accomplished its first set of objectives and identified the SOFR as the rate that represents best practice for use in certain new USD derivatives and other financial contracts. It also published its Paced Transition Plan, with specific steps and timelines designed to encourage adoption of the SOFR. The ARRC was reconstituted in 2018 with an expanded membership to help to ensure the successful implementation of the Paced Transition Plan, address the increased risk that LIBOR may not exist beyond 2021, and serve as a forum to coordinate and track planning across cash and derivatives products and market participants currently using USD LIBOR.

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