Oral Statement

of

Kevin P. Walsh
Deputy Comptroller for Market Risk Policy
Office of the Comptroller of the Currency

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and Capital Markets
of the
Committee on Financial Services
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Chairman Sherman, Ranking Member Huizenga, and members of the Subcommittee, thank you for the opportunity to discuss the OCC’s work to ensure the large, midsize, and community banks we supervise are prepared for the cessation and replacement of the London Interbank Offered Rates or LIBOR.

I am Kevin Walsh, Deputy Comptroller for Market Risk Policy. I am the OCC’s ex-officio member of the Alternative Reference Rate Committee, oversee the agency’s representation on other committees associated with LIBOR’s cessation, and oversee the development and interpretation of policy and guidance related to market risk facing the federal banking system.

The OCC has worked closely with the institutions we supervise to ensure their preparedness since 2018. To avoid the risk of market disruptions, prolonged litigation, and adverse financial impacts, the OCC has stressed to banks we supervise the importance of adequate transition planning and successfully executing those plans before LIBOR ceases to be reported.
The OCC’s mission is to ensure that the institutions we charter and supervise operate in a safe and sound manner and treat all customers fairly. Rather than endorse any specific replacement rate—including the Secured Overnight Financing Rate or SOFR—we want to ensure that banks have the flexibility to determine LIBOR’s successor rate or rates as may be most appropriate for the continued operation of their business model and risk appetite and the function that rate supports, in a safe and sound manner.

Starting in 2018, as part of our ongoing outreach sessions with bank CEOs, CFOs, Chief Risk Officers, and Bank Directors, we included discussions of LIBOR’s cessation and encouraged them to consider their exposures, risk tolerances, and mitigation plans. We first mentioned the need for LIBOR transition plans in our Semiannual Risk Perspective that year. Since then, we have published several bulletins and guidance documents that set forth our expectations for bank transition activities.

In November 2020, the OCC published a joint letter with the Federal Reserve and the FDIC that reiterated that a bank may use any reference rate it determines to be appropriate for its business model and customer needs. That month, the OCC and other banking regulators clarified expectations that banks must stop creating new LIBOR exposures by the end of 2021, with few exceptions.

Recently, the OCC published a self-assessment tool that includes a series of questions related to bank exposure assessment and planning, consideration of replacement rates, fallback language, and the bank’s overall LIBOR cessation preparedness. The tool will help bank management evaluate, identify, and alleviate
transition risks. To date, more than 95 percent of the institutions we supervise have gone through the process to quantify their exposures.

For smaller community banks that engage in LIBOR-based lending, such as commercial or residential real estate lending or small business loans, the transition process may present operational challenges that banks will need to address based on their resources, the scope of their exposures, and the relative financial sophistication of their borrowers. OCC is working closely with these banks to assist them in mitigating these challenges.

OCC examiners are also supporting the regional and largest banks address their LIBOR-based exposures and are actively monitoring the adequacy of their planning and implementation of their mitigation strategies. My testimony describes how new ISDA protocols and a recently enacted New York state law have significantly reduced the risk of market disruption in the derivatives market.

Mitigating risks within consumer loan products and securities portfolios will be more complex given the nature of those instruments. Loans are typically negotiated between parties and the applicability of a variety of state laws can make negotiations more complicated. Securities, notably securitized exposures, are complicated by the diverse investor bases that need to provide agreement to make changes to the rates. Banks continue to work on preparing these portfolios for the transition, and the OCC is closely monitoring their efforts.

To further assist with the transition, the OCC appreciates Congress’ efforts to clarify contracts that do not have a fallback provision or a new rate as designated in the draft Adjustable Interest Rate (LIBOR) Act of 2021. Legislation could be helpful in
addressing systemic risks associated with the LIBOR cessation by incentivizing financial counterparties to agree to an appropriate reference rate or otherwise designating SOFR as the replacement rate. The OCC has provided comments to staff and looks forward to working with the Subcommittee to perfect the legislation.

Thank you again for inviting me to appear today. I will be happy to answer questions.