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Written Testimony  
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**House Financial Services Subcommittee on Investor Protection, Entrepreneurship, and  
Capital Markets**

**“The End of LIBOR: Transitioning to an Alternative Interest Rate Calculation for  
Mortgages, Student Loans, Business Borrowing, and Other Financial Products”**

April 15, 2021

Chairman Sherman, Ranking Member Huizenga, and distinguished members of the Subcommittee, thank you for the opportunity to appear at today’s hearing.

My name is Dan Coates. I serve as the Senior Associate Director of Risk Analysis and Modeling in the Federal Housing Finance Agency’s (FHFA) Division of Federal Home Loan Bank Regulation. I have over 30 years of experience in the federal government and today marks my first time testifying before Congress.

FHFA regulates and oversees Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System – together, the regulated entities. Since 2008, FHFA has also served as conservator of Fannie Mae and Freddie Mac – together, the Enterprises.

I lead an office of economists and financial analysts who support a range of topics including financial analysis, credit risk modeling, and market risk modeling for our examination, supervision, and regulation of the Federal Home Loan Banks (FHLBanks). Since the 2017 announcement of London Interbank Offered Rate’s (LIBOR) future discontinuation, I have overseen FHFA’s response to emerging issues stemming from the LIBOR transition. I established the Agency’s ten working groups, involving 89 FHFA staff working on the LIBOR transition alongside other duties. These working groups were organized to monitor – and in some cases direct – the regulated entities as they move away from LIBOR to more robust reference rates. I established and serve as Chair of the Agency’s Reference Rate Transition Steering Committee to provide oversight to those working groups. I also serve as the FHFA representative to the Alternative Reference Rates Committee (ARRC).

LIBOR has been the world’s most widely used interest rate benchmark. The LIBOR transition is the largest financial infrastructure change to date, surpassing in size and complexity the conversion to the Euro and the Y2K conversion. Preparing for this transition has been and will continue to be an enormous undertaking with a variety of implications for all participants in the global financial system. FHFA and its regulated entities have been leaders in this effort and I am proud of what has been accomplished to date.

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As Director Calabria has made clear, FHFA's efforts to transition away from LIBOR are guided by the same core objectives that direct all the Agency's work: ensuring the safety and soundness of our regulated entities, supporting liquidity and resilience in our nation's housing finance markets, and protecting homeowners and renters. While important work remains, I am confident that we will meet our goal of fully transitioning the Enterprises and FHLBanks away from LIBOR by the end of 2021.

Although the date of the LIBOR cessation has been extended for most U.S. Dollar LIBOR products until June 30, 2023, FHFA is continuing to execute our timeline as planned. FHFA's actions to prepare for this transition are consistent with the guidance issued on November 30, 2020, by the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation stating their concerns that continued new LIBOR use after the end of 2021 would constitute a safety and soundness threat.

FHFA's regulated entities have been working diligently to transition away from LIBOR. We have a reasonable expectation that there will be an orderly transition with minimal disruption to the financial markets upon the cessation of LIBOR thanks to the efforts of the Federal Reserve, the Federal Reserve Bank of New York, the ARRC, and the International Swaps and Derivatives Association (ISDA). However, if enough market participants fail to prepare for the transition away from LIBOR, there could be considerable systemic consequences upon its discontinuation. In addition, there are a number of contracts that did not contemplate the permanent cessation of LIBOR. Disputes over the interpretation of those contracts will likely be lessened with the passage of federal legislation to provide clarity about the transition.

One of the most significant challenges has been the development of new products and markets focused on non-LIBOR products. Here, FHFA's regulated entities have led the transition by being the first and most significant issuers of Secured Overnight Financing Rate-indexed (SOFR) debt and by developing SOFR-based alternatives to their existing LIBOR products. Thanks to FHFA's leadership, the FHLBanks and the Enterprises have stopped purchasing and issuing LIBOR-based products, with only limited exceptions.

Of all the LIBOR-indexed products owned, guaranteed, or issued by its regulated entities, FHFA has been particularly focused on ensuring a seamless transition away from LIBOR for those with adjustable-rate mortgages (ARMs). While these products represent a small fraction of the LIBOR exposure of FHFA's regulated entities, they are among the most consumer-facing. We have been and continue to work with the Consumer Financial Protection Bureau (CFPB), the Federal Reserve, and others in the regulatory community, along with the Consumer Products Working Group of the ARRC which includes representatives of consumer groups with the goal of assuring that those with LIBOR indexed ARMs do not suffer a payment shock at the time that LIBOR goes away.

### **Background**

According to the ARRC, LIBOR is referenced in \$223 trillion in financial contracts in the United States, with 96 percent of that exposure estimated to reside in derivatives contracts. According to its administrator, ICE Benchmark Administration (IBA), "the LIBOR methodology is

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designed to produce an average rate that is representative of the rates at which large, leading internationally active banks with access to the wholesale, unsecured funding market could fund themselves in such market in particular currencies for certain tenors.”

However, the number of actual unsecured borrowing transactions backing the quotes that panel banks submit has fallen over the years as firms increasingly rely on other sources of funding. As a result, panel banks have increasingly relied on “expert judgement” as a basis for their submissions to the LIBOR administrator.

In the summer of 2017, Great Britain’s Financial Conduct Authority (FCA) Chairman Andrew Bailey, regulator of the LIBOR administrator, announced that he had secured the commitment of LIBOR panel banks to continue submitting quotes that are the basis for LIBOR until December 31, 2021. The FCA would not compel panel banks to submit quotes after that date. In subsequent speeches, Mr. Bailey warned that LIBOR could be stopped outright or declared unrepresentative soon after that date.

FHFA’s regulated entities have referenced LIBOR in many of their previously issued products. For example, the FHLBanks used to offer LIBOR-indexed floating rate advances, issue debt in cash or synthetic forms that were indexed to LIBOR, invest in LIBOR-based floating rate securities, and engage in swaps and other derivatives tied to LIBOR. The Enterprises used to purchase floating rate single- and multifamily mortgages and securitize those assets with LIBOR-based interest rates. The Enterprises used to create collateralized mortgage obligations (CMOs) with interest rates tied to LIBOR. The Enterprises’ credit risk transfer (CRT) products were similarly tied to LIBOR. While the Enterprises no longer issue debt tied to LIBOR, they continue to engage in derivative transactions tied to LIBOR. However, we expect that activity to decline as liquidity in SOFR derivatives increases.

On November 17, 2014, the Federal Reserve convened the ARRC with the support of the U.S. Department of the Treasury, the U.S. Commodity Futures Trading Commission, and the Office of Financial Research. The ARRC was convened to identify a set of alternative U.S. dollar reference rates that are more firmly based on transactions from a robust underlying market than U.S. dollar LIBOR and that are compliant with standards such as the International Organization of Securities Commissions’ (IOSCO) *Principles for Financial Benchmarks*. The ARRC issued a number of recommendations to facilitate the voluntary acceptance and use of these alternative reference rates.

### **Transition to the Secured Overnight Financing Rate**

On June 22, 2017, the ARRC identified SOFR as the U.S. recommended replacement for LIBOR. SOFR is derived from overnight repurchase agreement contracts where the collateral posted is U.S. Treasury securities. Since SOFR first was published in April 2018, daily transaction volume in the markets underlying SOFR has averaged more than \$980 billion. Transaction volume often has exceeded \$1 trillion and it has never been less than \$700 billion. Importantly, SOFR is compliant with IOSCO principles developed as a set of “best practices” for reference rate production to ensure reference rates used in the future would be based on actual

market transactions in a transparent manner by an unbiased administrator subject to regular audits.

Since choosing SOFR as its recommended successor to LIBOR, the ARRC was reconstituted in 2018 to facilitate the smooth transition to SOFR. The ARRC established a number of guiding principles and regularly reminds its members of the voluntary nature of its recommendations. The ARRC regularly publishes the minutes of its meetings, and requests public comment on its proposed recommendations. The Federal Reserve Bank of New York and the Federal Reserve established the ARRC and serve as its Secretariat. Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, through the FHLBank of New York, serve as voting members of the ARRC.

### **FHFA's Work to Transition from LIBOR**

FHFA recognized the need for our regulated entities to prepare for the likelihood of a LIBOR cessation. We established our Agency's Reference Rate Transition Steering Committee and started the work to ensure our regulated entities prepared for the transition. FHFA was invited to join the ARRC in late 2017, and we have been participating as a non-voting "ex officio" member since the ARRC was reconstituted in early 2018.

At FHFA, our approach has been straightforward. We have worked to ensure our regulated entities adequately account for their LIBOR exposures across all of their business lines. We have also worked to ensure the entities have adequate governance structures in place to manage the transition. And we have evaluated the entities' transition plans.

We are actively involved in supervising our regulated entities' transitions away from LIBOR. We have established ten working groups across FHFA. While the Enterprise working groups have a more direct role than the FHLBank working groups owing to the Enterprises being in conservatorship, the underlying goal is the same: to ensure that each regulated entity transitions away from LIBOR in a safe and sound manner.

As an example of the type of reviews we have been engaged in, when we review the regulated entities' transition plans we evaluate a number of factors: the entities' exposures to LIBOR, their transition governance and reporting structure, their budgets and staffing related to the transition, and their evaluation of the fallback provisions in contracts binding on the institution. In addition, we evaluate the entities' own operational readiness including, but not limited to, readiness of their own systems and those of their vendors. We also review the entities' plans to reduce their LIBOR exposures, their outreach to counterparties, and their communications plans for any products affecting their customers and other counterparties.

To facilitate our review and supervision and to direct the entities under conservatorship, we have deployed an exposure template for each entity to use when reporting to us on a quarterly basis. This exposure template ensures we receive information in a form that allows us to compare one entity's exposure to another's.

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We continue to have regular meetings with the Enterprises to ensure the transition moves forward. We have working group level meetings regularly, and I meet with the executives in charge of the LIBOR transition team at each Enterprise. I also have regular meetings with the Chief Risk Officer at each Enterprise.

### **Fannie Mae and Freddie Mac's Transition from LIBOR**

FHFA has worked to ensure that the Enterprises provided leadership to the ARRC's Consumer Products Working Group in areas related to mortgages. This is appropriate given their significant role in mortgage purchases and securitization. FHFA has worked with the CFPB, the Federal Reserve, and the ARRC to ensure consumer groups have had a seat at the table and that their views have been heard. We have joined meetings of the ARRC Consumer Products Working Group hosted by the CFPB and the Board, and we have hosted an ARRC Consumer Products Working Group and other meetings with consumer groups. Director Calabria opened one of those meetings and stressed the importance of consumers' views.

Our work with the Enterprises was carefully sequenced. First, we worked to get more updated and transparent language for new LIBOR products that would fully anticipate the end of LIBOR. Second, we ensured new replacement products were developed in time to be ready and on the market prior to LIBOR's demise. Third, we cut off the purchase and production of LIBOR products as the new SOFR-based products came online. Since then, we have been working on issues related to the transition away from LIBOR of previously issued, or "legacy," LIBOR products.

One of our first transition projects was to ensure the Enterprises provided leadership in developing new "fallback language" supporting new ARMs. This language describes more clearly how the coupon rate on the mortgage would be switched to a replacement rate should the coupon rate no longer be produced or be deemed unrepresentative. This was a critically important improvement to achieve first in order to reduce the uncertainty around newly issued LIBOR ARMs. The Enterprises and FHFA worked closely with consumer groups, other regulators, lenders, servicers, and investors in developing this more modern contract language, which has been required for single-family uniform ARM instruments that closed on or after June 1, 2020.

The second major step took place in 2019 when the Enterprises and FHFA worked with members of the ARRC Consumer Products Working Group to develop parameters of an adjustable rate mortgage that would be acceptable to *all* market participants, including groups representing consumers, other regulators, lenders, servicers, and investors. This resulted in an ARRC white paper that explained the basic structure of future ARMs based on SOFR. The Enterprises then built the systems to purchase and securitize SOFR-indexed ARMs. On April 1, 2020, the Enterprises published additional details about their new SOFR-based ARM products and announced they would begin purchasing SOFR-indexed ARMs in the second half of 2020.

During the summer of 2019, FHFA instructed the Enterprises to stop purchasing LIBOR-indexed ARMs that were issued more than six months earlier. On February 5, 2020, the Enterprises

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announced that they would no longer purchase LIBOR-indexed single-family and multifamily ARMs with application dates beyond September 30, 2020. They also announced their intention to no longer purchase any LIBOR-based single-family and multifamily ARMs after December 31, 2020.

In areas not as visible to consumers, the Enterprises started offering SOFR-indexed CMOs for settlement in July 2020. Additionally, under the guidance of FHFA, Freddie Mac and Fannie Mae have since ceased taking on new LIBOR-indexed CMO exposure. The Enterprises ceased LIBOR-indexed CRT transactions after 2020 and now offer SOFR-indexed CRTs. Freddie Mac issued three SOFR-indexed single-family CRTs in the fourth quarter of 2020 and issued three SOFR-indexed single-family CRTs and one SOFR-indexed multifamily CRT in the first quarter of this year. Fannie Mae is now operationally ready to do so. Each Enterprise has adopted the “ISDA protocol,” a set of industry-adopted amendments aimed at an orderly transition to SOFR upon any LIBOR cessation for derivatives contracts.

The Enterprises have been providing leadership in the transition since Fannie Mae issued the first SOFR-based debt in July 2018. Freddie Mac and the FHLBanks soon followed, and the FHLBanks are now the largest issuers of SOFR-based floating-rate debt.

On May 28, 2020, the Enterprises jointly produced a “Playbook” describing the steps they were planning to take in the transition away from LIBOR. They also jointly produced a “Frequently Asked Questions” document. Those documents have been updated on a monthly basis since.

The Enterprises have helped lead the ARRC’s Consumer Products Working Group devoted to determining a path forward for legacy ARMs. One of the Enterprise’s staff serves as a co-chair for that working group. FHFA, the U.S. Department of the Treasury, CFPB, the Federal Reserve, and other regulators have worked with this working group to ensure that representatives of consumer groups were active participants in finding a solution to the legacy LIBOR products. The result of this effort was the final spread-adjusted rate recommendations for consumer products, which we expect the ARRC to announce soon.

We also expect the Enterprises to make announcements about the successor rates for all of their legacy LIBOR products this year.

### **The Federal Home Loan Banks’ Transition from LIBOR**

The FHLBanks have been working to educate their members on the LIBOR transition. They have been offering their members SOFR-indexed loans, known as advances, for some time now. However, the number of members taking such advances has been limited to date, potentially reflecting the downward trend in members asking for advances in a time of sustained low interest rates and a strong base of deposits.

We have been hard at work ensuring that the FHLBanks are prepared for the upcoming transition. We requested their transition plans and offered feedback on those plans. We sent them a Supervisory Letter in September 2019 instructing them that as of December 31, 2019,

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they must cease purchasing LIBOR-linked investments with maturities beyond December 31, 2021. The Letter also requested that as of March 31, 2020, they cease all other transactions involving LIBOR with maturities beyond December 31, 2021. Due to the COVID-19 pandemic, we extended the March deadline to June 30, 2020.

The most important exception to this instruction pertains to collateral. As the FHLBanks' mission involves providing liquidity to its members so they can accomplish their housing finance roles, FHFA has left it up to each Bank to determine its approach to LIBOR-based collateral from their members. We asked the FHLBanks to request additional information from their members about their LIBOR collateral so that they could understand their potential exposures and adjust their valuations and lending values based on such collateral as the market for LIBOR-based collateral changes.

We also took the unusual step to make the 2019 Supervisory Letter publicly available. We did this in a manner that revealed no supervisory information about the FHLBanks, but did reveal to their members, vendors, and other market participants that FHFA was serious about ensuring that the FHLBanks move away from LIBOR. We sent this letter in our role as prudential supervisor and regulator of the FHLBanks: in our view, exposure to LIBOR beyond 2021 represents a significant risk to the FHLBanks and the letter represents our best supervisory judgment for ensuring the FHLBanks transition away from this risk in a safe and sound manner.

FHFA and the FHLBanks continue to prepare transitioning away from LIBOR. Last fall, we sent the FHLBanks a letter urging them to sign the ISDA protocol for resolving LIBOR derivatives. We similarly made this letter public. All of the FHLBanks have signed the ISDA protocol.

### **Conclusion**

At FHFA, we continue to look for ways we can enhance awareness of the importance of this transition. In addition to our work with the regulated entities, we have established a [LIBOR transition page](#) on FHFA's website. We look forward to continuing our work with the CFPB, the Fed, the other ex officio members of the ARRC, and the ARRC's Consumer Products Working Group and representatives from consumer advocacy groups to ensure all parties are given sufficient information to ensure their concerns are addressed as we move forward with this large and complex financial infrastructure transition.

I will be glad to answer your questions.

Thank you.