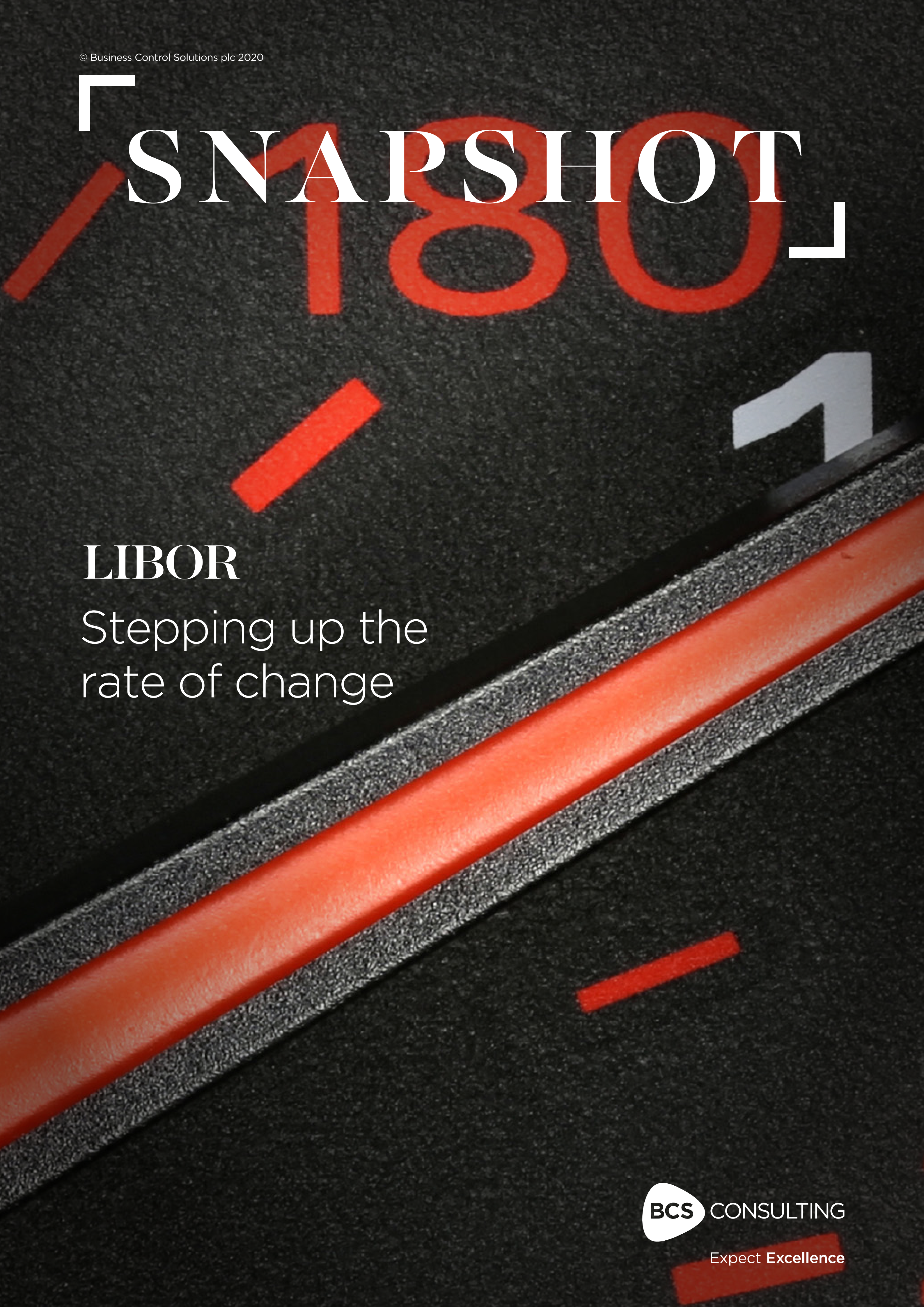
SNAPSHOT



LIBOR

Stepping up the rate of change

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Why has the LIBOR transition been introduced?

For more than 40 years the financial services industry has relied upon interbank offered rates (IBORs) as a reference rate for certain variable-rate financial instruments. This includes the London interbank offered rate (LIBOR), which is calculated based on daily submissions from selected panel banks, and provides a measure of the average rate at which banks are willing to borrow wholesale unsecured funds.

Whilst the historic compliance issues including charges of attempted manipulation and false reporting have been widely publicised, the more pressing problem relates to a decline in the liquidity of the interbank unsecured funding markets linked to the submissions, which is limiting the ongoing validity of LIBOR.

This has resulted in global regulators proposing that LIBOR, as well as other IBORs, are replaced by alternative reference rates (ARRs) by the end of 2021. The Financial Conduct Authority (FCA) has stated that it will not compel banks to submit LIBOR quotations after 2021 and that market participants must transition to alternative rates before this date.

How is the industry responding?

The transition to new ARRs affects banks, asset managers, insurers and corporates who manage contracts underpinned by LIBOR. The regulator has been clear that "all firms need to plan for the cessation of LIBOR", including ceasing issuance of cash products linked to sterling LIBOR by end-Q3 2020. Firms will need to undertake a detailed impact assessment of their operating models to identify their exposure to LIBOR, which will likely extend well beyond their asset and liability structures, to a wide range of applications and infrastructure used for valuation, pricing, performance evaluation and risk management.

Appetite to progress transition plans is being hampered by the uncertainty surrounding the transition to new rates. Whilst the panel banks will no longer have to submit rates beyond 2021, the regulator has not been specific about what will happen to LIBOR after this point, leaving firms to voluntarily begin executing against their transition plans in the absence of strong guidance or a best practice approach.

The collaboration of market participants, trade associations and regulatory bodies will be key to success, not only to clearly establish a way forward, but also to ensure that there is an appropriate financial ecosystem in place to support transactions on the new rates. A number of industry working groups have been initiated across all impacted currencies to support the direction and decision making related to the transition, though ultimately the roadmap will depend on the availability and subsequent demand of ARR-linked products, and the readiness of market infrastructure to support these transactions.

Responses to a 'Dear CEO' letter published by the regulator in 2019 showed that firms most advanced in their transition journeys have already undertaken detailed impact and risk assessments. These go beyond just balance sheet exposure, and address pricing, valuation, booking infrastructure and consider a broad range of risks including the prudential and conduct risks connected to the transition. These firms have taken a proactive and risk-averse approach to their solutions by developing scenarios based on the demise of LIBOR in 2021, which includes starting to transact using ARRs, allowing them to begin reducing their exposure to LIBOR.

What is the BCS view on it, and how can we help?

The transition away from LIBOR will require complex change to be delivered against a backdrop of uncertainty. At this point in time, all firms should have mobilised a transition programme and be executing against a high-level roadmap. Those that haven't, run the risk of being unable to transition to ARRs in line with regulator expectations.

If you want to have greater confidence in your ability to transition away from LIBOR, BCS Consulting recommends taking the following actions today:

1. Mobilise a LIBOR transition programme: Given the uncertainty and complexity of the LIBOR transition, it is crucial to mobilise a transition programme with dedicated staff, senior sponsors and a steering committee. The FCA expect firms, where appropriate, to identify the Senior Manager responsible for overseeing the transition and detail this in their Statement of Responsibilities, in accordance with the UK Senior Managers and Certification Regime (SM&CR).

2. Undertake an assessment of existing LIBOR exposure: Firms should assess their exposure to LIBOR in existing contracts that extend beyond 2021 and, if possible, develop capabilities to report on this going forward. There are 3rd party vendor solutions available in the market that can expedite the discovery of LIBOR linked contracts.

3. Identify and evaluate existing fallback language: In the majority of cases, existing fallback language was not written to contemplate permanent benchmark cessation. It was written to provide an interim path forward should a rate be temporarily unavailable, and thus minimise legal and business risk. Once contract scope is determined, firms should identify and evaluate existing fallback language in agreements to determine if amendments are required.

4. Deliver training to client facing staff: Firms should ensure that relevant client facing staff have adequate knowledge and competence to understand the implications of LIBOR ending and are able to respond to client queries appropriately. This is important to mitigate potential conduct risk and increase demand for new ARR linked products once they become available.

5. Engage with industry bodies: There are still a number of industry-wide unknowns regarding the LIBOR transition. Firms should actively engage with industry bodies to understand market direction on key topics and advocate its viewpoints on them. Firms should ensure they have reviewed the latest guidance (16 Jan 2020) from the Risk Free Rate Working Group (RFRWG), which is endorsed by the Bank of England and Financial Conduct Authority, on its priorities and roadmap for 2020 and plan accordingly.

BCS Consulting can use our delivery and regulatory change expertise to help mobilise, plan and deliver your LIBOR transition programme. We have supported many transformation programmes in the past and can leverage this capability to ensure a smooth transition away from LIBOR for your firm.

Who should you speak to about it?

To find out more about how BCS Consulting can help with your LIBOR transition, please get in touch with one of our key contacts listed below.

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