PARKER FITZGERALD
TRANSFORMING FINANCIAL SERVICES

IBOR Transition

Developing a strategic response

London New York Paris Zurich

Executive Summary

Interbank Offered Rates (IBORs) have been on the international regulatory agenda since 2008 and headlined since 2012, when the first high-profile LIBOR manipulation settlements were agreed. These systemically important benchmarks, underpinning a market of over $370tn,[1] were proven to be vulnerable to manipulation.

In 2014, the Financial Stability Board (FSB) report recommended improvements to the robustness and governance of existing IBOR methodologies, in line with IOSCO principles and the development of "near risk free" alternative reference rates (ARRs). Significant progress has been made to date. ARRs have been selected for all major currencies: SONIA (GBP), SOFR (USD), TONA (JPY) , SARON (CHF) and ESTER (EURO).

However, many challenges remain while monetary policy and new capital adequacy rules have continued to reduce the transactions in the unsecured interbank funding market. This prompted the FCA to announce in July 2017 that it would no longer persuade or compel banks to make LIBOR submissions from the end of 2021. In July 2018, both the FCA and CFTC were unequivocal in reemphasising the urgency to act and the inevitability of the discontinuation date. With the deadline for transition to ARRs set, firms must now define their strategy for mobilising and executing the transition.

IBOR Transition could create considerable conduct, reputational, and legal risks. This presents significant challenges for market participants, the greatest of which being the scale of change across all core business lines and functions. A wait-and-see approach to IBOR Transition is not an option.

Challenges and Impacts

Early estimates are that the cost of IBOR Transition could be comparable to that of MiFID II. While there is awareness of the issues, there has been surprisingly little tangible progress made with only 12% of firms having developed a preliminary plan. [2]

For institutions with large IBOR-linked exposures, the risks of the transition are vast. There is very limited time to undertake high-risk changes across front, middle and back office activities, systems and processes which may impact hundreds of thousands of contracts. The identification of those activities and contracts alone represents a substantial challenge. Significant unknowns and divergent timelines remain around the maturity of ARRs, but regulators are clear that this does not justify inactivity.

One such unknown is the availability of forward-looking term structure which many deem critical to certain cash products. Firms have a valuable opportunity now to engage with regulators and industry bodies to help shape the transition process, outcomes and the ARRs.

Future risks aside, the ongoing transition creates considerable conduct, reputational and legal risks in the here and now. For example, writing long-dated business extending beyond 2021 triggers mis-selling risk.

In short, the challenges and impacts of IBOR Transition are deep and far-reaching and are moving rapidly towards the top of the management agenda.

Functions	Governance	Policies & controls	Models & analytics	Documentation	Data & systems	Business processes	Key challenges and immediate priorities
Front Office	High	High	High	High	High	High	- Management of pricing and associated economic impacts - Detailed product, customer and counterparty transition plans
Treasury & Finance	Medium	Medium	High	Medium	High	Medium	- Forecasting of funding and balance sheet impacts - Development of term structures based on ARRs
Risk	Medium	Medium	High	Medium	Medium	Low	- Re-calibration of traded market and counterparty credit risk models - Historical time series data and proxies
Legal	Low	High	Low	High	Low	Medium	- Major dependencies on the maturity of fall-back provisions in contracts - bi-lateral negotiations with front office functions
Technology	Low	Medium	Low	Low	High	Medium	- Identification and change of impacted systems - Managing capacity and minimising disruption during transition phase
Compliance & Op Risk	High	High	Low	High	Low	Medium	- Redevelopment of policies e.g. suitability and appropriateness - Evidencing decision governance and minimising conduct risk

Impacts: Low Medium High

[1] ISDA, IBOR Global Benchmark Survey: 2018 Transition Roadmap, February 2018.
[2] ISDA, IBOR Global Benchmark Transition Report, June 2018.

Shaping your response

IBOR Transition requires a strategic and urgent response. While the impacts and associated risks cut across all functions of a bank, they predominantly sit with the front office and treasury due to their integral roles in business activities.

Rather than being managed by compliance and risk functions as with the case of MiFID II and other regulatory programmes, the accountability for IBOR Transition should sit with the business.

Making the accountable executive business-aligned will enable the banks to effectively mitigate the risks associated with IBOR Transitions and to align the programme with long-term business strategies.

That said, change of this scale (and with regulatory drivers) will demand active involvement and collaboration from compliance and risk functions.

Ensuring the right programme governance and representation from key functions will be critical to responding to issues that will arise during the transition.

One immediate risk is around the suitability and appropriateness of products being sold. As the IBOR Transition accelerates, banks must ensure they can evidence consideration of the impacts on their clients and that they have explained these impacts clearly, taking into account the complexity of the product and the sophistication of the client.

As the transition begins, risks will exist around both new and existing businesses. While litigation and financial risks will surround legacy products, liquidity and hedging risks will exist for new business in light of enhanced regulation and guidance around benchmark activities including IOSCO and EU Benchmark Regulation.

Transition timetable and key activities

Planning	2019 Transition	2021 Post-Transition
- Understand / influence policy making and implementation timetable - Determine economic, client and operational impacts - Identify all relevant IBOR referenced products, clients, contracts and terms - **Determine a strategic response**	- Client outreach and bi-lateral contract negotiations - Infrastructure design / valuation and risk model recalibration - Amendment of contracts, terms and product marketing - Suitability and appropriateness controls	- **LIBOR submission compulsion ceases** - Management of legacy roll off - Litigation risk tracking and remediation - Managing IBOR discontinuation risk

A strategic response plan

To help clients understand their exposure and business impacts of IBOR Transition, we have developed a unique assessment approach, supported by a number of purpose built accelerators, to help senior management develop their strategic response.

At the completion of this process, senior management will have clarity on the key economic and operational impacts of IBOR Transition, certainty over the "cost to achieve" and a robust plan and delivery strategy to minimise the overall impact on clients.

Strategic Response

Formalisation of Programme Governance

- Develop response and programme structure
- Creation of business case to secure initial funding

IBOR Document e-Discovery

- Identify impacted contracts, terms, templates
- Definition of required amendments and updates

Transition Strategy and Planning

- Cash and Derivative products
- Operations and Infrastructure (Risk, IT, Finance)

Assessment of Client and Enterprise Impacts

- Construction of inventory and analysis framework
- Determination of economic and operational impacts

Principles for success

A successful programme should adhere to the following principles to maximise the predictability of outcomes and minimise execution risk throughout the delivery:

- ✓ **Ensure senior accountability** - appoint a senior accountable executive (preferably a member of the board)
- ✓ **Comprehensive understanding of scope** - build a complete inventory of IBOR referenced products
- ✓ **Leverage existing knowledge and experience** – particularly from benchmark and regulation including BMR and IOSCO
- ✓ **Engage proactively with industry and regulators** - to ensure you are able to shape and influence transition policy
- ✓ **Integrate legal effort at outset** - collaboration with legal counsel will accelerate impact analysis and reduce execution risk
- ✓ **Be proactive in adopting ARRs** - launch new products referencing ARRs as soon as possible to reduce tail risk (2021+)
- ✓ **Implement robust fall back provisions** – to ensure financial instruments and contracts can transition seamlessly
- ✓ **Robust planning** - design of high-level roadmap and transition plan to support ongoing dialogue with the supervisor

Our expert team

Following the Global Financial Crisis, Parker Fitzgerald has been instrumental in assisting clients to shape and execute their response to the challenges posed by new market infrastructure regulations including Benchmark Regulation (EUBR) and MIFID II.

Our practitioner-led approach, in-depth understanding of capital markets and direct experience leading the implementation of market infrastructure regulations for the world's largest financial institutions make us your ideal partner for IBOR Transition.

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- 20 years' experience in Capital Markets
- Expert in Cash and Derivatives trading
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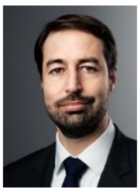

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About Parker Fitzgerald

Parker Fitzgerald is a strategic advisor and consulting partner to the world's leading financial institutions.

We provide independent advice, assurance and market-leading solutions to help our clients navigate their most critical issues, reduce complexity and improve their overall risk-adjusted performance.

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