

# The IBOR challenge



Retiring IBORs will impact many bank areas necessitating an urgent plan

## Banks *must* transition to RFRs

The Financial Services Board (FSB) established a steering group to reform interest rate benchmarks in favour of risk-free reference rates, overnight or term RFRs, and stated (July 2018) “there needs to be a transition to new reference rates”.

Industry Associations inc ISDA, AFME, ICMA and SIFMA have estimated the total outstanding notional exposure to IBORs at over \$370 trillion, of which 18% mature after 2021.

The range of instruments referencing LIBOR (and other IBORs) include derivatives, syndicated loans, securitisations, business and retail loans inc mortgages, floating-rate notes (FRNs) & deposits.

Transition to SONIA (GBP), ESTER (EUR), TONA (JPY), SOFR (USD) and SARON (CHF) RFR rates

poses a number of commercial, operational, financial, legal and risk obstacles. Transition will take an extended timetable and present a significant transformation challenge.

In September 2018 the Bank of England/FCA/PRA wrote a “Dear CEO” letter to large UK banks and insurers obliging them undertake a comprehensive risk assessment of the impacts according to a range of scenarios. The firms must deliver a report to the BoE/regulators summarising quantified risk assessment and transition plans by 14 Dec 2018.

Given the complexity and scope of the impact any change programme requires a detailed scoping, impact assessment and transition plan to clearly define governance, impacts, risk and roadmap.

## Impacts and challenges

A range of conflicting options pose complex challenges for financial institutions. The number of alternative RFRs are proliferating with various bodies competing for the regional/global standard. In addition the introduction of multiple RFRs by product or industry create further difficulties in identifying the optimal replacement choice. The varying calculation methodologies and terms (O/N to 3 months) will result in significant variations to payments under existing contracts. The transition will require firms to review, assess and analyse changes to a number of critical operating functions including:

- Market risk profiles
- Risk models
- Valuation tools
- Product design
- Hedging strategies

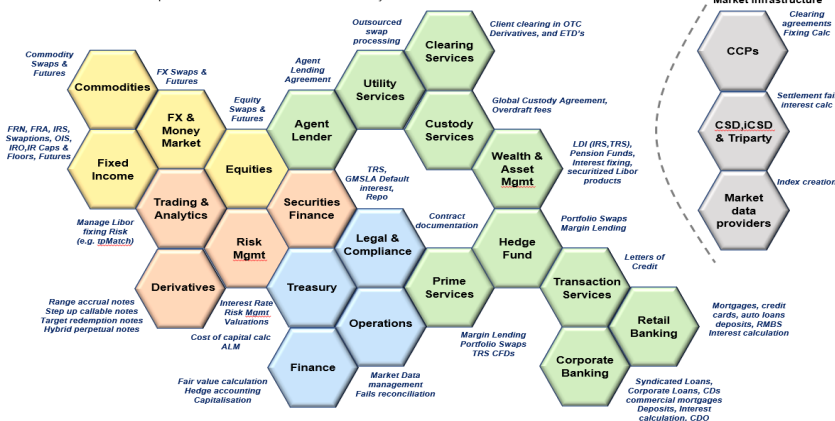
In the UK the adoption of SONIA will require analysis of the following to catalyse adoption:

- Futures – SONIA reference contract
- New RFR term structure
- Decide criteria for term vs O/N reference rates
- Legacy product conversion
- EU Benchmark Regulation impact (ESTER)
- Alternative RFR market development
- Tax and accounting alignment
- Hedge accounting impacts – GAAP and IFRS
- Fair market valuation esp during parallel run period
- Basis risk
  - Cash products vs derivatives differences
  - Cash product term reference vs derivatives o/n
  - Cross currency swaps – RFR timing
- Positions and holding roll-off timing
- Non –cleared margin impact of new RFRs
- Client re-papering by product

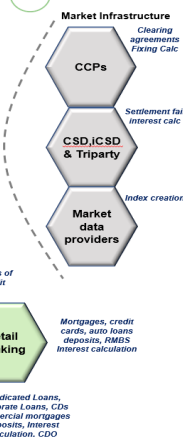
## LIBOR Impact

Retiring of the Libor rate will impact many areas of a full service bank

Below is an indicative list of products and services that use Libor today

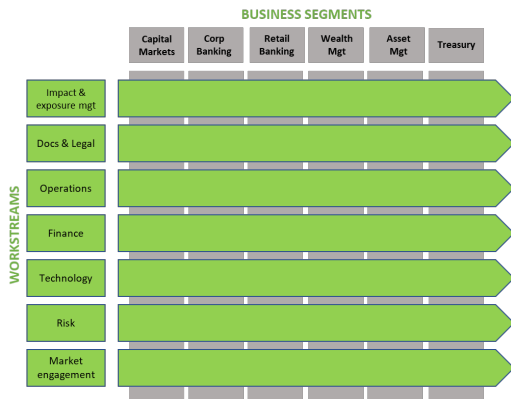


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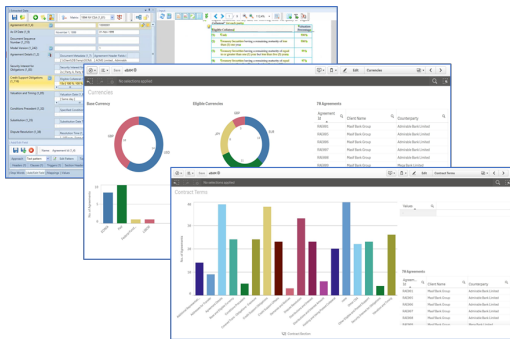
Impact analysis conducted by The Field Effect indicates IBOR transition is a wide reaching, complex challenge impacting many business segments within banks

## 1. Establish Governance



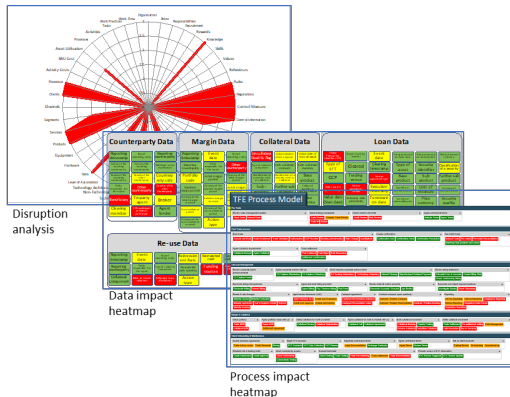
- **Requirement** - firms must design and establish clear accountability and responsibilities (consistent with the Senior Managers Regime) for designing & executing the transition
- **Challenge** - planning governance across multiple business segments, geographies, client groups and products will be complex; especially when matrixed against delivery work streams; mobilisation will take time and focus
- **Approach** - TFE has significant stakeholder engagement and communication experience; and expertise in programme design and mobilisation
- **Tooling** - as part of the “TFE-Modus” suite, TFE has developed a unique road-mapping tool that supports scenario-based planning of programme building blocks and dependencies, supported by techniques such as RACI for stakeholder mapping

## 2. Analyse legal documentation



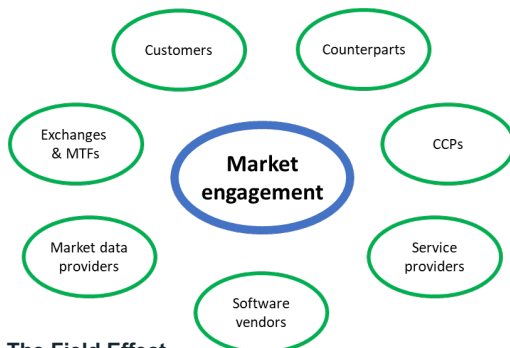
- **Requirement** - in order to assess risk, firms must identify & understand all agreements by product, by client, by jurisdiction...
- **Challenge**: it is impossible to analyse thousands of complex agreements manually – firms must automate the process of documentation analysis
- **Approach** - TFE provides a service for automatic agreement analysis covering multiple agreement types that helps banks identify which agreements are impacted, and the semantics of the impact
- **Tooling** - TFE designed and developed electronic business agreement management tooling (eBAM) for PWC, and works with PWC to offer a client service for rapid documentation analysis

## 3. Assess ops & IT impact



- **Requirement** - in order to complete their risk assessment and roadmap, firms must identify the impact of IBOR-replacement on their operational processes and technology
- **Challenge** - it is difficult for most banks to form an consistent, integrated view of process and technology impacts across business segments and geographies
- **Approach** - TFE has in-depth expertise analysing and visualising operating model impacts through a 7-dimension meta-model spanning products, geography, process, data, technology, controls and people roles
- **Tooling**: TFE has developed unique proprietary tooling (TFE-Modus) that analyses & visualises operating model impacts and implementation roadmap

## 4. Engage the market



- **Requirement** - firms must engage numerous third parties
- **Challenge**: firms will need a coordinated approach to understand how third parties will react, to align strategy and transition timescales
- **Approach** - TFE has conducted numerous projects to coordinate industry ecosystem impacts and communication programmes, and specifically to conduct “voice of client” surveys

### The Field Effect

The Field Effect is an independent consultancy specialising in **accelerating change** for financial services organisations. Our experience includes OTC, collateral, wealth management, custody, securities services and securities finance, equities, fixed income, FX, cards, payments and regulatory transformation. Find out how we can help your organisation. Contact us at [info@thefieldeffect.co.uk](mailto:info@thefieldeffect.co.uk)