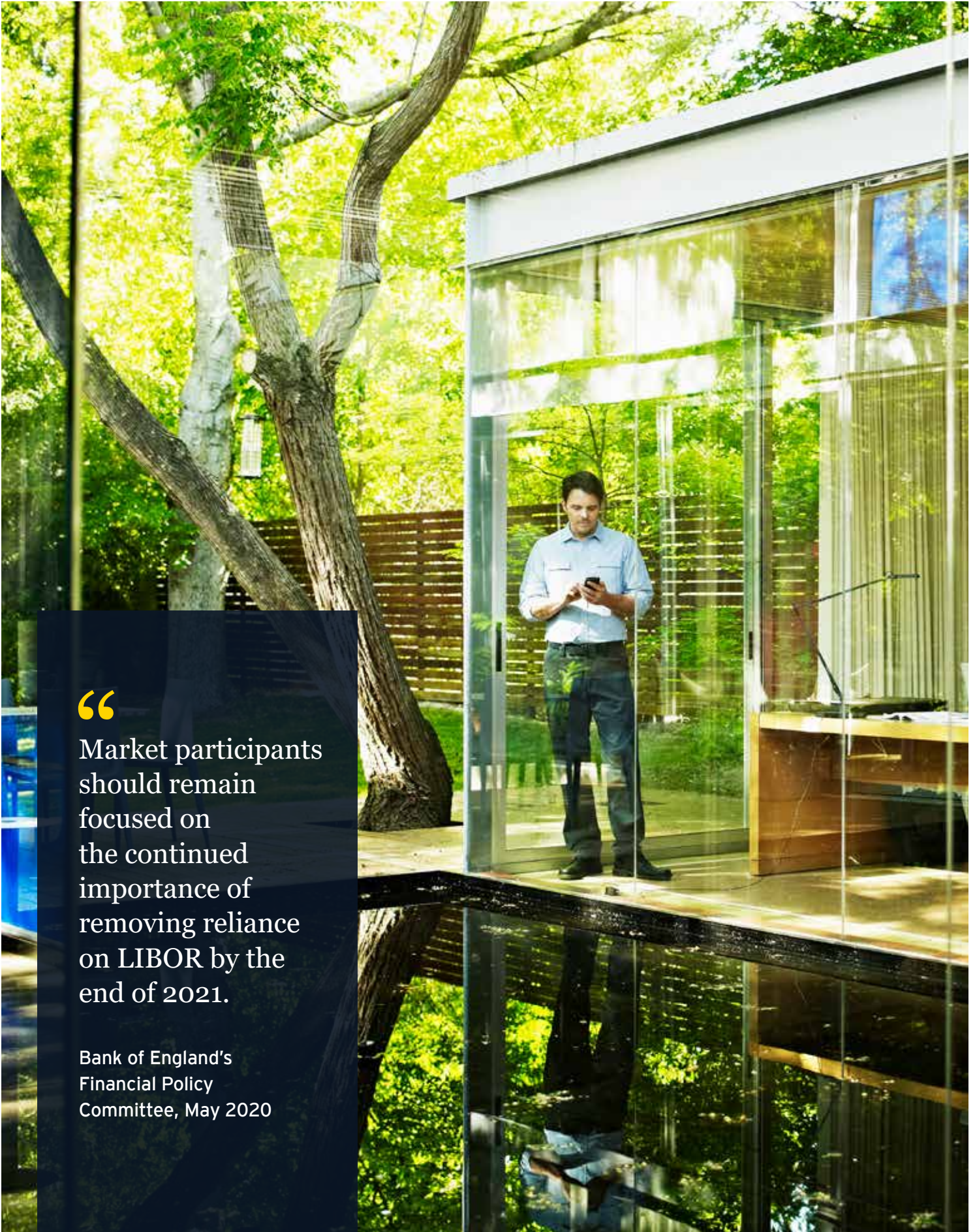


# Key considerations for boards assessing LIBOR transition readiness

A LIBOR transition guide for boards of  
directors



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Market participants should remain focused on the continued importance of removing reliance on LIBOR by the end of 2021.

Bank of England's  
Financial Policy  
Committee, May 2020

# Is your firm prepared to transition away from LIBOR?

Financial services organizations are preparing for an enormous and transformational migration from the London Interbank Offered Rate (LIBOR) and other Interbank Offered Rates (IBORs) to new alternative reference rates (ARRs). Boards of directors can and should play an active role in shaping their firms' LIBOR transition programs by providing guidance and credible challenges to help management successfully navigate this critical migration.

Significant progress has been made to prepare for the transition to Alternative Reference Rates (ARRs), such as the US dollar Secured Overnight Financing Rate (SOFR), ARR that is meant to replace IBORs. Public-private working groups have been focused on facilitating the transition through the selection of ARRs, developing derivative and cash market ARR product conventions, and building the market structure to support the development of liquidity in ARRs-based products. Despite this progress, substantial work remains, and firms are at varying levels of preparedness.

LIBOR transition is a complex and transformational challenge given the pervasiveness and volume of LIBOR exposures. LIBOR serves as the floating rate index across a wide scope of products including commercial and consumer loans, derivatives, securities, and deposits. The scale of the reform is vast and not just limited to the G5 LIBOR currencies, as several other IBORs are also transitioning to new, more robust ARRs. The multijurisdictional nature of the transition adds to the scale and complexity of the implementation efforts for many firms. The need to manage the massive disruption from COVID-19 further complicates the task of transition. But the cessation dates are not likely to change, so banks and other financial services organizations must move forward.

Given the vast and varied challenges and opportunities that IBOR transition presents, it is critical that boards are actively engaged and ask management the right questions about the transition. This article highlights the challenges that boards should be aware of and the specific questions they can raise to assess their firm's readiness across seven key areas:

- 1. Governance and program management**
- 2. Risk management**
- 3. Product and business strategy**
- 4. Legacy contracts remediation**
- 5. Conduct and communications**
- 6. Infrastructure and operational readiness**
- 7. Sector and industry engagement**



## COVID-19 will not stop or slow the transition

**Firms must prepare for the inevitable transition.**

The Financial Conduct Authority (FCA), which, along with the Bank of England oversees the submission of LIBOR, has stated that firms cannot rely on LIBOR being published after the end of 2021. This central assumption “has not changed” despite the market turmoil resulting from COVID-19.<sup>1</sup> Similarly, the Financial Stability Board has also made clear that the benchmark transition remains a priority despite the pandemic, that firms cannot rely on LIBOR being produced after 2021, and that benchmark transition will help strengthen the global financial system.<sup>2</sup>

# 01 Governance and program management



Firms should have a robust LIBOR transition governance framework that includes accountable senior executives to oversee the implementation of the firm's transition strategy. The breadth of impact and complexity of change necessitates close engagement with senior leadership across multiple lines of business and functions. Regular and effective communication of progress, readiness and risks to successful transition is critical.

A full impact analysis across the enterprise – covering products, clients, contracts, systems, models and processes – should be the foundation for planning. Execution itself should be predicated on sound transition road maps that weigh business priorities (e.g., new product offerings) with risk appetites and internal and external dependencies. Lastly, as with any large-scale initiative, sufficient budgeting and resourcing are critical to success; allocation decisions should be backed by strong business cases and rationalized across the organization to scale efficiencies.

Key questions for boards:

- ▶ **Accountability and oversight.** Is the right senior leadership in place to drive the transition across business lines?
- ▶ **Transition risks.** Have transition risks (e.g., reputational, financial, operational, conduct) been assessed and mitigation plans formed?
- ▶ **Strategic priorities.** How will the transition impact the firm's strategic priorities and performance targets?
- ▶ **Budgeting and resourcing.** Has the firm ensured transition teams have access to adequate funding, resourcing and skill sets throughout the transition?

# Risk management

## 02



There are many financial and non-financial risks associated with IBOR transition. Financial risks include the potential for value transfer resulting from the difference in cash flows of LIBOR floating rate resets as compared with replacement fallback rates, the basis risks between ARR and LIBOR rates, and the changes to the depth of markets in IBOR products and the development of market liquidity in ARRs. Non-financial risks include the vast operational risks of implementing significant new end-to-end firmwide infrastructure and the ability to process new fallbacks upon LIBOR cessation as well as reputational or conduct risks associated with trading customers fairly during transition.

Firms should inventory all qualitative and quantitative transition risks and comprehensively map them to enterprise risk taxonomies. Further, firms should conduct detailed risk assessments to understand how key risks manifest under different transition scenarios and market conditions. Transition risks should be incorporated into stress testing models.

Firms should also develop mechanisms to oversee and monitor transition risks on an ongoing basis. A dedicated independent risk management team or function could cover LIBOR transition, but also handle ongoing

risk reporting, updates to risk management policies, procedures and limits.

### Key questions for boards:

- ▶ **Risk identification.** Has a formal assessment of transition-related material risks, including the identification of mitigation actions, been performed?
- ▶ **Exposure monitoring.** Are there processes in place to monitor and report aggregate LIBOR exposures across businesses?
- ▶ **Scenario design and stress testing.** Has the firm designed base-case and stress-case scenarios based on different assumptions across risk taxonomies?
- ▶ **Balance sheet risks.** Has the firm analyzed the impacts that value transfer and other losses may have on earnings and capital?
- ▶ **New product approval (NPA).** How are the firms NPA processes going to handle the volume and complexity of new ARR products?

# Product and business strategy

## 03



The transition to ARR presents firms with an opportunity to re-evaluate business strategies and improve positioning within their market segments. Firms may also take the opportunity to rationalize current LIBOR products and, in some cases, simplify those offerings.

As firms monitor the development of ARR-linked product conventions and prepare to offer and transact in ARR-linked products, they should review the profitability of existing products and consider rationalizing them across businesses. In addition, senior management should provide guidance to lines of business on setting dates to stop issuing IBOR-linked contracts and limit the maturity profile of IBOR exposures. These activities should drive the prioritization of transition plans.

There may be opportunities to increase or preserve market share for early movers on new ARR-linked products. Firms should proactively engage their customers to develop deeper cross-business relationships. Those that are slow to market may miss out on opportunities or risk losing market share. In addition, failing to address customer needs could result in damage to the brand.

The IBOR transition may also present an opportunity to standardize and improve pricing methodology and consistency. When defining pricing methodologies and tools, impacts to profitability, hedgeability and net interest income margin should be evaluated for each product under various market conditions. Increased standardization and governance will help mitigate conduct risk by making sure new products drive fair customer outcomes. They can also drive revenue growth as relationship managers will have a more systemic way to determine pricing.

### Key questions for boards:

- ▶ **Business strategy.** How can the transition help the firm create competitive advantage, increase revenue or gain market share?
- ▶ **Economic impact.** Has the firm forecasted the net interest margin and overall economic impact of transition appropriately?
- ▶ **Pricing strategy.** Has the firm established a consistent and economically viable framework for pricing new ARR-linked products?

# Legacy contract remediation



Contracts maturing after 2021 (“legacy contracts”) may not have fallback language to address a permanent LIBOR cessation or contain language that significantly changes the economics of the floating rate payments underlying the transactions in the event of LIBOR cessation. Large, global banks may have hundreds of thousands of contracts linked to LIBOR that mature post-2021. Therefore, legacy contract analysis and remediation will be one of the most substantial bodies of work for many firms. Contract remediation requires mobilization of significant resources to identify the full impacted population, digitize and analyze contractual fallback language provisions that will be triggered upon cessation of LIBORs, develop preferred remediation paths to address the risks associated with fallback language, and conduct client outreach and repapering and tracking of remediation efforts.

For many cash products (e.g., syndicated loans, floating rate notes and securitizations), amending existing contracts may require lengthy, complex negotiations given the potential for value transfer and consent provisions. Although many derivative positions may be amended via ISDA’s multilateral protocol mechanism or through changes to clearinghouse’s rule books, firms still must track and manage adherence to protocols and significant client engagement will likely be needed to address concerns with the proposed fallbacks and manage impacts for products where derivative products are hedges of linked cash products.

## 04

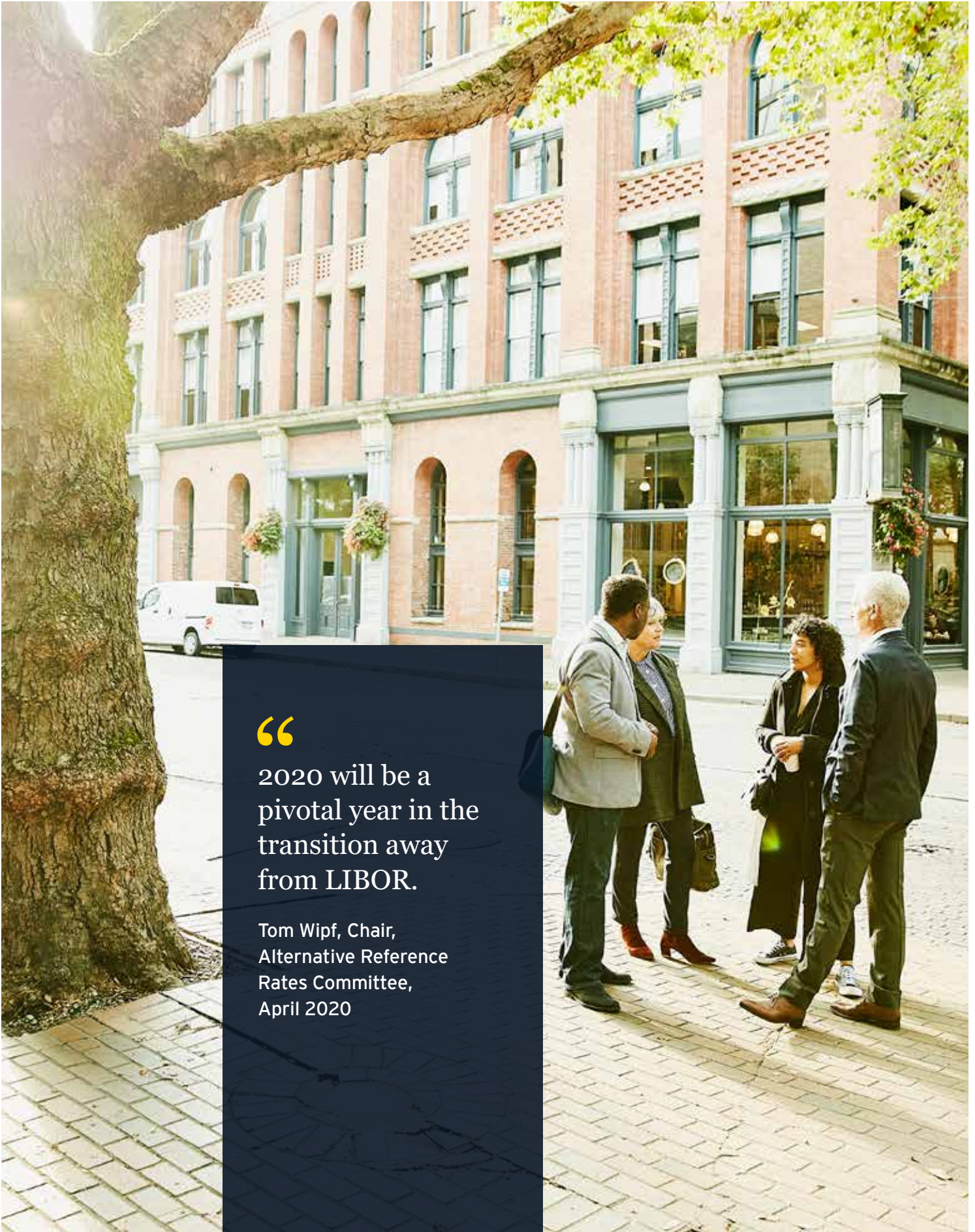


Firms should also consider whether these IBOR transition work efforts can be strategically used as a launchpad for broader firm-wide contract management enhancements given the relevant stakeholders, technology platforms and contract types will be in scope for this initiative.

### Key questions for boards:

- ▶ **Contract discovery.** How is the firm identifying the complete population of impacted contracts, including those with indirect IBOR exposure?
- ▶ **Remediation and repapering strategy.** Has the firm identified preferred remediation approaches across the different contract types?
- ▶ **Contract management tools.** Is the firm deploying technology to efficiently digitize and extract relevant contractual terms and manage the repapering process?
- ▶ **Legal risk.** Has the firm adequately assessed its exposure to litigation risk given the breadth of contracts impacted and potential for various outcomes?





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2020 will be a pivotal year in the transition away from LIBOR.

Tom Wipf, Chair,  
Alternative Reference  
Rates Committee,  
April 2020

# Conduct and communications

## 05

An effective enterprise communication strategy is critical to successful transitions. Firms must deliver consistent messaging across internal and external stakeholder groups, enhance client awareness and reduce legal, reputational and conduct risks.

Clear, fair and timely communications are an increasing area of focus for regulators. They have urged firms to promote consistent messaging well in advance of IBOR cessation to help clients make informed decisions about relevant products and risks. Multiple client communications may be necessary throughout the transition and require more effort than firms planned for.

Key elements of a robust communication framework include defining a process for identifying and refreshing an accurate list of impacted counterparties inclusive of up-to-date contact information, developing internal training materials and consistent, clear external messaging and implementing the proper distribution channels to facilitate mass outreach and client inquiries, while planning for unique tailored approaches for sensitive or less sophisticated client bases.

### Key questions for boards:

- ▶ **Regulatory requests.** Is the firm prepared to respond to rising requests from regulators?
- ▶ **External messaging and conduct.** Is the firm ensuring businesses are acting in the best interests of clients, such as through measures like presenting customers with transition options, including benefits, costs and risks?
- ▶ **Complaint and inquiry management.** Have existing complaint management processes been updated, and how will complaints be escalated to senior management?
- ▶ **Internal training.** Are employees adequately trained to engage with customers on complex and potentially higher risk issues associated with the transition?

# Infrastructure and operational readiness

## 06



Many end-to-end processes to price, capture, settle, account, report and manage LIBOR-based derivative and cash products will require significant changes. Specifically, supporting data, systems, models, curves and end-user computed tools all need updating. The infrastructure impact analysis and implementation timelines must account for internal systems development, external vendor dependencies, testing and model validation.

Systems and models need the capability to operationalize new ARR product conventions (e.g., compounding in arrears), as well as other market developments (e.g., transition to ARR funding and cleared derivative ARR discounting) and contract remediation efforts (e.g., operationalizing fallback language in systems of record). Systems and models need to be updated and tested in time to support new and transitioned products, while remaining flexible to address developments throughout the transition and handle “cut-over” and process fallback rates when triggered.

Key questions for boards:

- ▶ **Planning and timing.** Has the firm assessed the technology impacts, including vendor dependencies, that may impact transition timelines?
- ▶ **Models and end user computing tools.** Have all affected models (including vendor models) or end user computing tools been identified are they being updated in according with governance standards?
- ▶ **Interim manual workarounds.** Is the firm planning to use risk accepted manual workarounds as a contingency if strategic systems and models cannot be developed, tested and validated in time to support needed ARR-product demand?

# Sector and industry engagement

## 07



Engagement with sector and industry groups are critical to drive transition in line with market, firm and client interests. Recent regulatory announcements have signaled aggressive timelines for shifting to ARR product offerings in 2020. Active engagement with relevant regulatory bodies and industry working groups is especially important considering recent requests for detailed transition planning information and the likelihood of increased regulatory scrutiny as we move closer to the end of 2021.

Additional reasons to monitor or participate in regulatory and industry forums include receiving timely updates, which should be disseminated to stakeholders across the firm, ensuring plans and budgets are flexible to address evolving market and regulatory developments, and participating in shaping the ARR market structure through industry-wide consultations.

Key questions for boards:

- ▶ **Industry working group participation.** Which industry groups should the firm participate in or otherwise engage?
- ▶ **Regulatory engagement.** Is messaging consistent to regulatory and industry bodies?
- ▶ **Industry updates.** How is useful industry guidance and information shared across the firm?



## In summary

Given the vast and varied challenges and opportunities that IBOR transition presents, it is critical that boards are actively engaged and ask management the right questions about the transition. Among the key questions highlighted throughout this piece, chief among them are questions aimed at ensuring sufficient resources are deployed, that the program is aligned with business goals and strategy, and that clients are treated fairly throughout the transition.



The EY financial services teams continue to monitor developments. Check back in at [ey.com/ibor](https://ey.com/ibor) for our insights on the ongoing transition. Or connect with us at [fs.board.matters@ey.com](mailto:fs.board.matters@ey.com) for further insights.

# G5 currency ARR replacements for the five IBORs

Alternative reference rates associated with the five major IBORs<sup>3</sup>

Currency	IBOR(s)	ARR	ARR secured vs. unsecured	Rate administrator	Tenor considerations
USD	USD LIBOR	Secured Overnight Financing Rate (SOFR)	Secured	Federal Reserve Bank of New York (FRBNY)	<ul style="list-style-type: none"> <li>▶ <b>Overnight:</b> based on the cost of borrowing cash overnight collateralized by Treasury securities.</li> <li>▶ <b>Averaged:</b> FRBNY publishes SOFR overnight rates daily as well as 30-day, 90-day and 180-day averages and a SOFR index to facilitate compounding in arrears term payment conventions.</li> <li>▶ <b>Forward term rates:</b> anticipated to be published by the end of 2021, pending buildup of liquidity in the SOFR futures and over-the-counter derivative markets.</li> </ul>
GBP	GBP LIBOR	Sterling Overnight Index Average (SONIA)	Unsecured	Bank of England	<ul style="list-style-type: none"> <li>▶ <b>Overnight:</b> based on the average of interest rates that banks pay to borrow sterling overnight unsecured from other financial institutions.</li> <li>▶ <b>Averaged:</b> the Bank of England is seeking feedback from market participants on publishing a daily SONIA compounded index along with a simple set of compounded SONIA period averages. Publication is anticipated to commence by the end of July 2020.</li> <li>▶ <b>Forward term rates:</b> industry trade associations are working on the development of Term SONIA to be made available in the first half of Q3 2020.</li> </ul>
EUR	EUR LIBOR/ EURIBOR/ Euro OverNight Index Average (EONIA)	Euro Short-Term Rate (ESTR)	Unsecured	European Central Bank	<ul style="list-style-type: none"> <li>▶ <b>Overnight:</b> based on the weighted average of the individual transactions in the European monetary market.</li> <li>▶ <b>Averaged:</b> a daily ESTR compounded index has not been published to date.</li> <li>▶ <b>Forward term rates:</b> the working group is also looking into ESTR-based term rates that may serve as fallbacks for EURIBOR for some products.</li> </ul>



Currency	IBOR(s)	ARR	ARR secured vs. unsecured	Rate administrator	Tenor considerations
CHF	CHF LIBOR	Swiss Average Rate Overnight (SARON)	Secured	SIX Swiss Exchange	<ul style="list-style-type: none"> <li>▶ <b>Overnight:</b> based on the overnight interest rate of secured funding for the Swiss franc in the Swiss repo market.</li> <li>▶ <b>Averaged:</b> SIX publishes a one-, three- and six-month compounded SARON in arrears beyond the overnight tenor.</li> <li>▶ <b>Forward term rates:</b> a forward-looking term structure is not anticipated.</li> </ul>
JPY	JPY LIBOR/ Tokyo Interbank Offered Rate (TIBOR)/ Euroyen TIBOR	Tokyo Overnight Average Rate (TONAR)	Unsecured	Bank of Japan	<ul style="list-style-type: none"> <li>▶ <b>Overnight:</b> based on unsecured overnight interbank borrowings for Japanese yen deposits.</li> <li>▶ <b>Averaged:</b> the development of an overnight compounded TONAR rate was the least preferred methodology based on the consultation published in November 2019.</li> <li>▶ <b>Forward term rates:</b> like SONIA, although a forward-looking term structure is anticipated, its use may be restricted to certain cash products. Unique transition challenges remain arising from the negative interest rate environment and the resulting lack of liquidity. Term rates are expected to be developed by mid-2021.</li> </ul>



## Further reading



[Seven conduct risk drivers for firms to manage in the IBOR transition](#)



[How IBOR transition is both an opportunity and a threat](#)



[How IBOR migration can serve as a technology springboard](#)

Looking for more? Access additional information and thought leadership at [ey.com/ibor](https://ey.com/ibor) and for board content visit [ey.com/boardmatters](https://ey.com/boardmatters).

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1 <https://www.fca.org.uk/news/statements/impact-coronavirus-firms-libor-transition-plans>

2 <https://www.fsb.org/work-of-the-fsb/addressing-financial-stability-risks-of-covid-19/>

3 Other currency areas outside of the five major currency areas are also reforming major interest rate reference rates (such as the Bank Bill Swap Rate (BBSW), the Canadian Dollar Offered Rate (CDOR) or the Hong Kong Inter-bank Offered Rate (HIBOR)) and have achieved varying levels of progress to date.