How to approach your (L)IBOR transition programme

A programme manager's guide to commencing a reference rate reform programme

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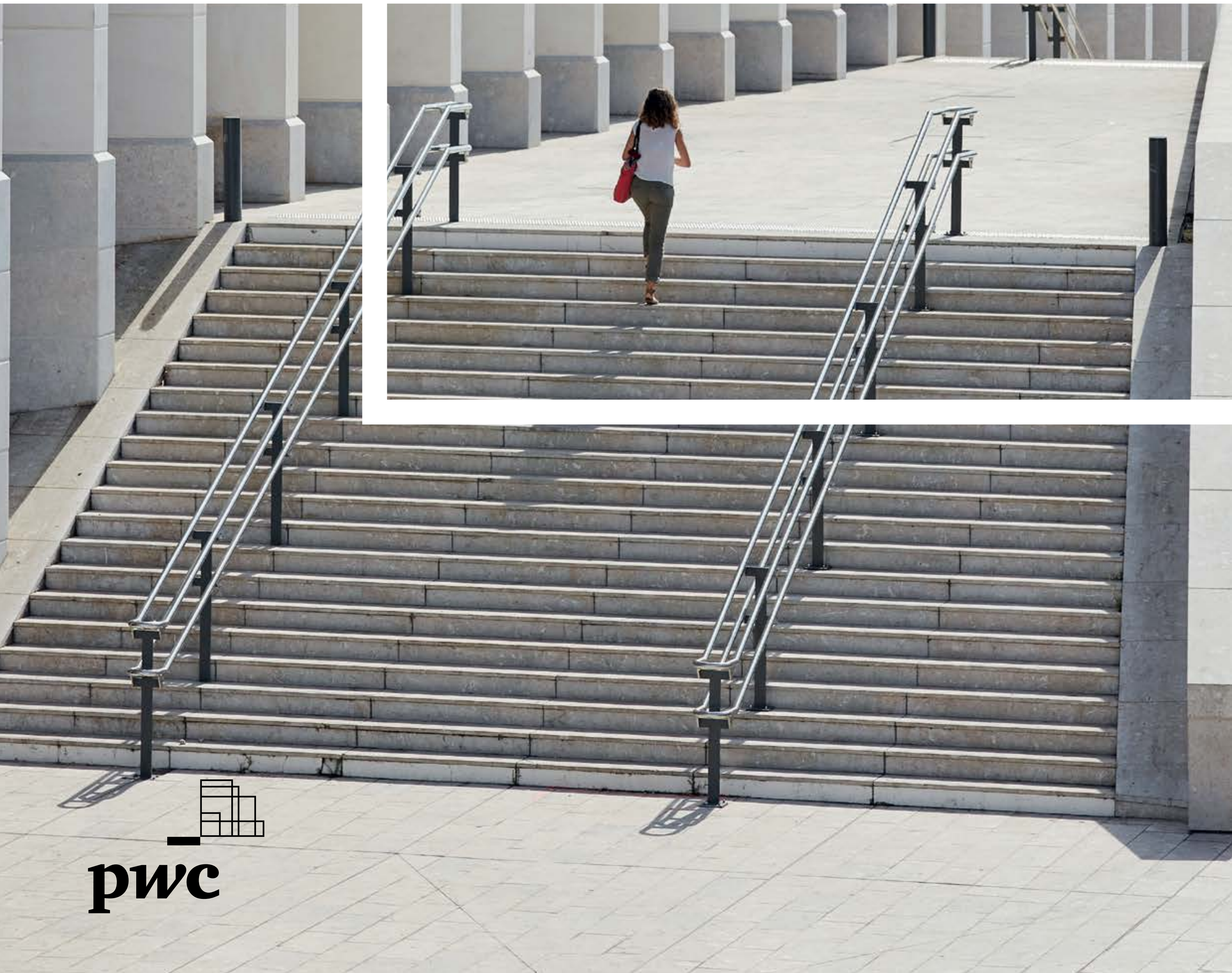

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Table of content

Executive summary

LIBOR will be replaced by the end of 2021

Given the announcements of the UK's Financial Conduct Authority (FCA) in 2017, **the future of LIBOR is not guaranteed and banks will no longer be compelled to submit to LIBOR after December 2021.** Therefore, alternative risk-free rates (RFRs), rate-based products, derivatives, liquidity pools and clearing capabilities need to evolve as part of an overall programme transition timetable. Global coordination across currencies and asset classes is critical, as transactions are highly interlinked and relationships between assets in a portfolio must also be addressed and handled in order to avoid any disruption. In Switzerland, the main activities surrounding LIBOR were tackled in the SNB working groups. Most banks have been postponing the setup of transformation projects into 2019/20.

The pressure on Swiss financial institutions increased in December 2018 when FINMA issued Guidance 03/2018, outlining the risks of the potential replacement of Libor and addressing the importance of the issue for banks, asset managers and insurance companies. In January/February 2019, FINMA issued a self-assessment questionnaire to selected financial institutions, giving them time until April 2019 to report on their progress with regard to their Libor replacement initiatives and asking them about their LIBOR exposure.

The LIBOR replacement reform will impact financial institutions along their value chain

Libor replacement will affect all financial institutions on a company-wide level and has direct and potentially significant impacts on commercial, F2B operational and technical aspects and client engagement. **Trading, finance and accounting, valuation and risk modelling, trading and execution, legal and client management will be particularly affected.**

The right timing is key

Several large financial institutions have already started to set up programmes to deal with the Libor transition. Programme governance models may either be centralised or decentralised – either way, the right timing is of key importance. Making an early start in alternative reference rates, even though clarity is limited and liquidity is lacking, will just create unnecessary sunk cost; while starting a Libor replacement programme too late could have significant business impacts.

We believe that, given the timeframe of the regulation and the status of implementation of the various reference rates, Q2/Q3 2019 is a good time to kick off the (L)ibor transformation project for most institutions that have not already done so. Given the complexity and continued uncertainty surrounding a Libor replacement programme, we recommend **clients start with a small, cross-functional team that conducts an initial impact assessment.** PwC has developed an approach, supported by templates and tools, that covers the entire subject matter across the following areas:

1. Risk management and valuation
2. Products
3. Legal documents
4. Clients and counterparties
5. Processes and systems
6. Strategy and roadmap

The results of this work will provide a holistic picture of the impact of (L)ibor reform on the financial institution and help determine the scope and resources for the replacement programme.

Figure 1: Overview on LIBOR impact areas

Introduction to the LIBOR reform

Background and reasons for a LIBOR reform

To determine the LIBOR, every day the Intercontinental Exchange (ICE) surveys a pool of banks to estimate an average interest rate for intra-bank funding. The results of the survey are published daily in the form of an unsecured interest rate, with different maturities across five different currencies (USD, GBP, EUR, CHF, JPY) – the LIBOR.

LIBOR rates have existed since the eighties, and they represent one of the most important benchmark rates used globally by financial institutions.

With the transaction volume in the market on the decline, however, **LIBOR has been based increasingly on expert judgement.** After the revelation of collusive actions by several banks contributing to LIBOR in 2012, doubts started to arise on the reliability of such judgement, and the LIBOR moved into the spotlight. A slow but inevitable transformation had begun, which reached a turning point **in November 2017 when the UK's Financial Conduct Authority (FCA) announced** in agreement with central banks and regulatory authorities that it would **no longer persuade, or compel, banks to submit to LIBOR beyond 2021.**

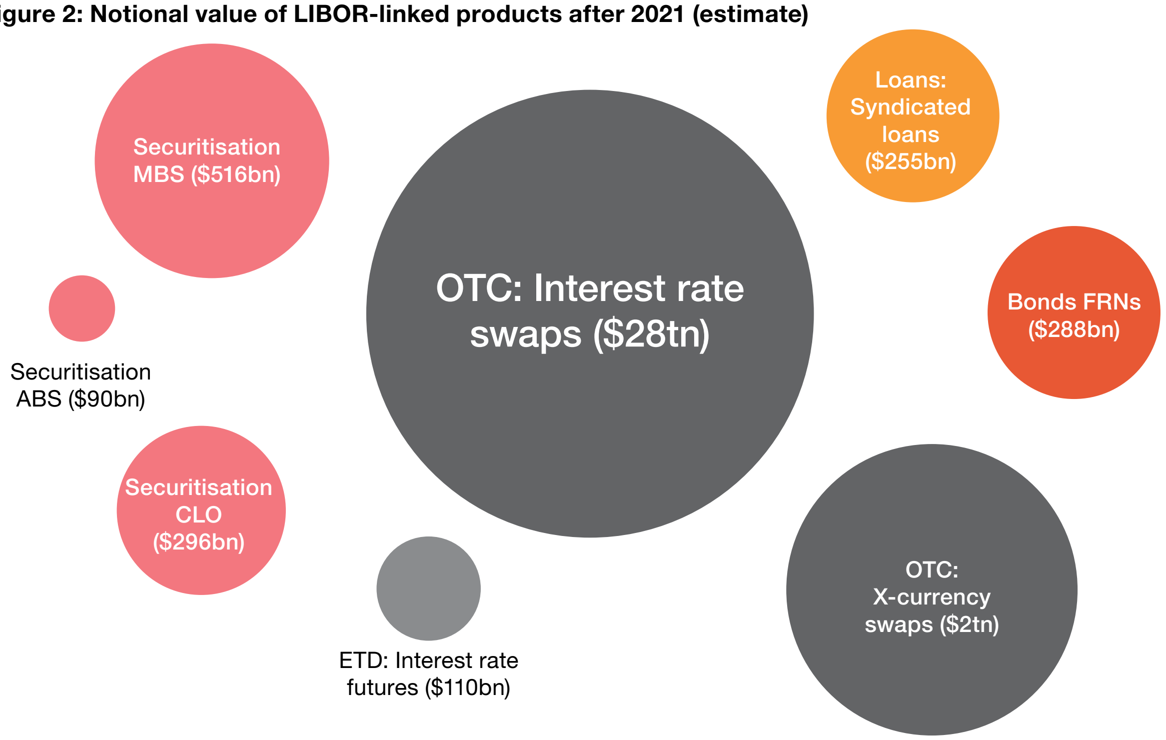
Importance of LIBOR in financial markets

LIBOR is deeply embedded in today's financial markets – and **in Switzerland, the CHF LIBOR is even one of three elements of Swiss National Bank (SNB) monetary policy,** which sets a target range for the three-month CHF LIBOR.

To further illustrate the extent to which LIBOR-related instruments are embedded in today's financial markets, consider the following:

- There are approximately **US$200 trillion in LIBOR-linked contracts** (> US$35 trillion currently have maturities beyond the 2021 cut-off date), requiring significant effort for remediation.
- As of 2016, LIBOR-referenced contracts accounted for **72%** of the **OTC derivatives market, 71%** of **syndicated loans, 82%** of **floating rate notes** and substantial proportions of the securitisation and loan markets.
- Looking at the projected remaining notional product value linked to LIBOR after 2021, Figure 2 gives an indication of how strongly embedded the LIBOR is as a reference rate:

Figure 2: Notional value of LIBOR-linked products after 2021 (estimate)



Current view on alternative reference rates

Various working groups are currently evaluating different alternative reference rates (ARR) that are to replace LIBOR but currently still lack homogeneity with regard to collateralisation (see graph below). As these discussions are still ongoing, **uncertainty persists with respect to the LIBOR transition.**

Given the importance of LIBOR, many alternative reference rates have been analysed, and many countries have set up working groups to address the consequences of a possible disappearance of the LIBOR. First steps on the journey away from LIBOR are depicted in Figure 3. To guide the transition to an adequate new benchmark, the International Organization of Securities Commissions (IOSCO) also published a set of principles for financial benchmarks in 2013.

Figure 3: Proposed LIBOR alternatives

Existing rate	Proposed alternative	Borrowing type
EURIBOR / EUR LIBOR	ESTER	Unsecured
USD LIBOR	SOFR	Secured
GBP LIBOR	Reformed-SONIA	Unsecured
CHF LIBOR	SARON	Secured
JPY LIBOR / TIBOR	TONAR	Unsecured

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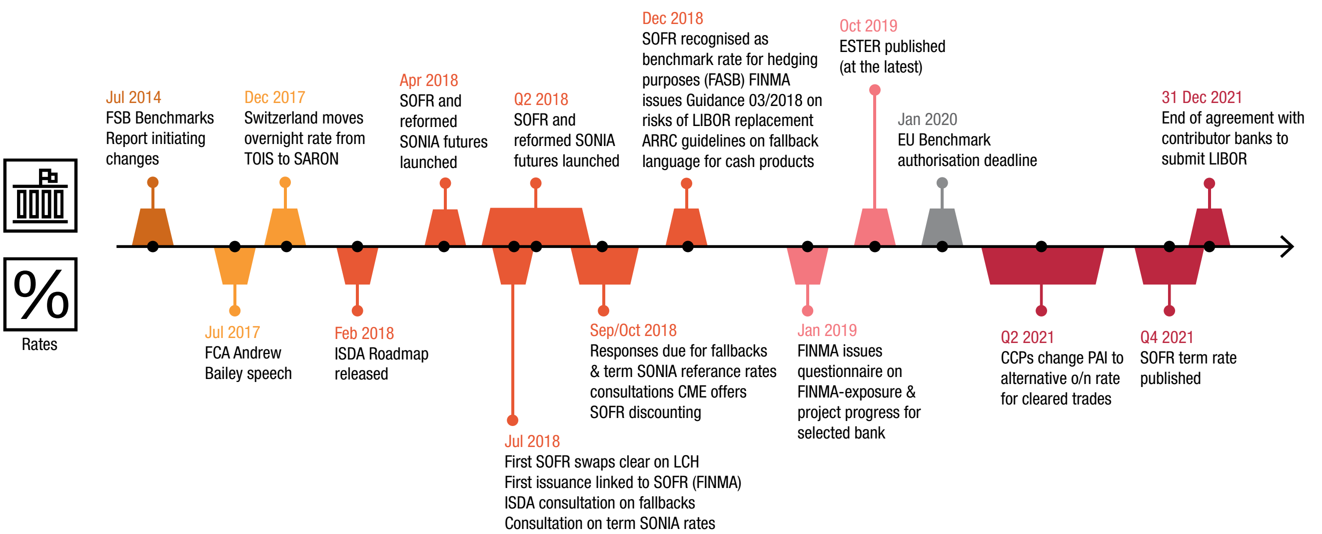
Figure 4: LIBOR reform timeline



Initial scoping and impact assessment

Scoping

Even though January 2022 may still seem far away, leaving plenty of time to prepare and implement, we strongly suggest that change programme actions for the short-, medium- and long-term be initiated in Q2/Q3 2019 (if they have not already been started) and we urge project managers to commence a LIBOR programme.

Setting up a programme on such a scale can be a complex assignment, as it has impacts across various functions of a financial instituion. Moreover, the impact of transitioning from LIBOR to a new ARR will be different for each organisation and is often unclear before conducting an assessment. We believe **a small and agile LIBOR task force should be established as early as possible** in order to drive an initial impact assessment. This impact assessment should then form the basis of further mobilisation steps.

The 6 pillars of our initial impact assessment

PwC has developed a 6 Pillar Impact Assessment Approach enabling a comprehensive view of the impact of LIBOR replacement across a financial institution's business functions.

Figure 5 illustrates the following high-level steps of this impact assessment approach in more detail:

1. Risk management and valuation
2. Products
3. Legal documents
4. Clients and counterparties
5. Processes and systems
6. Strategy and roadmap

For each pillar, project managers should carefully evaluate the implications and assess the impact to the workstream's objective. PwC has defined questions a project manager should consider. Furthermore, PwC has accelerators and can provide experienced staff, who can manage, lead or serve as a sparring partner during the impact assessment. Sample questions for each pillar are given in Figure 5 on the right.

Our ready-to-implement PwC Accelerators (i.e. C3 suite, product analysis template, documents detection, contract extraction and clustering tool, and process and system analysis template) are designed to **increase project quality and simultaneously reduce project cost,** because, as the saying goes, you don't have to reinvent the wheel. Moreover, these accelerators can be tailored to an institution's requirements in order to increase their relevance to the project in question. Within a few days, our C3 suite makes it possible to analyse your LIBOR exposure for the upcoming years at contract level.

Another PwC Accelerator for LIBOR is our legal document detection tool. It ensures that all relevant legal documents referencing LIBOR are detected and adjusted according to agreed legal language. Potential impacts on specific clients and counterparties can be derived quickly, and transition mechanisms or potential repapering efforts can be automated based on agreed procedures. These are just a few of the benefits this tool offers.

Starting a LIBOR replacement programme with an impact assessment and leveraging PwC Accelerators will significantly lower a financial institution's implementation costs.

Initial impact assessment roadmap

Depending on the complexity and size of the organisation, our experience shows that an institution should plan **2–6 weeks** for the impact assessment that will provide a comprehensive view of the impact of LIBOR replacement. Critical drivers determining the duration of the impact assessment are the institution's size and exposure to LIBOR and the type of product it offers.

Figure 6 shows a high-level overview of an impact assessment roadmap, which, however, could potentially alter depending on the project's scope and complexity.

Figure 5: The six pillars of PwC's impact assessment approach

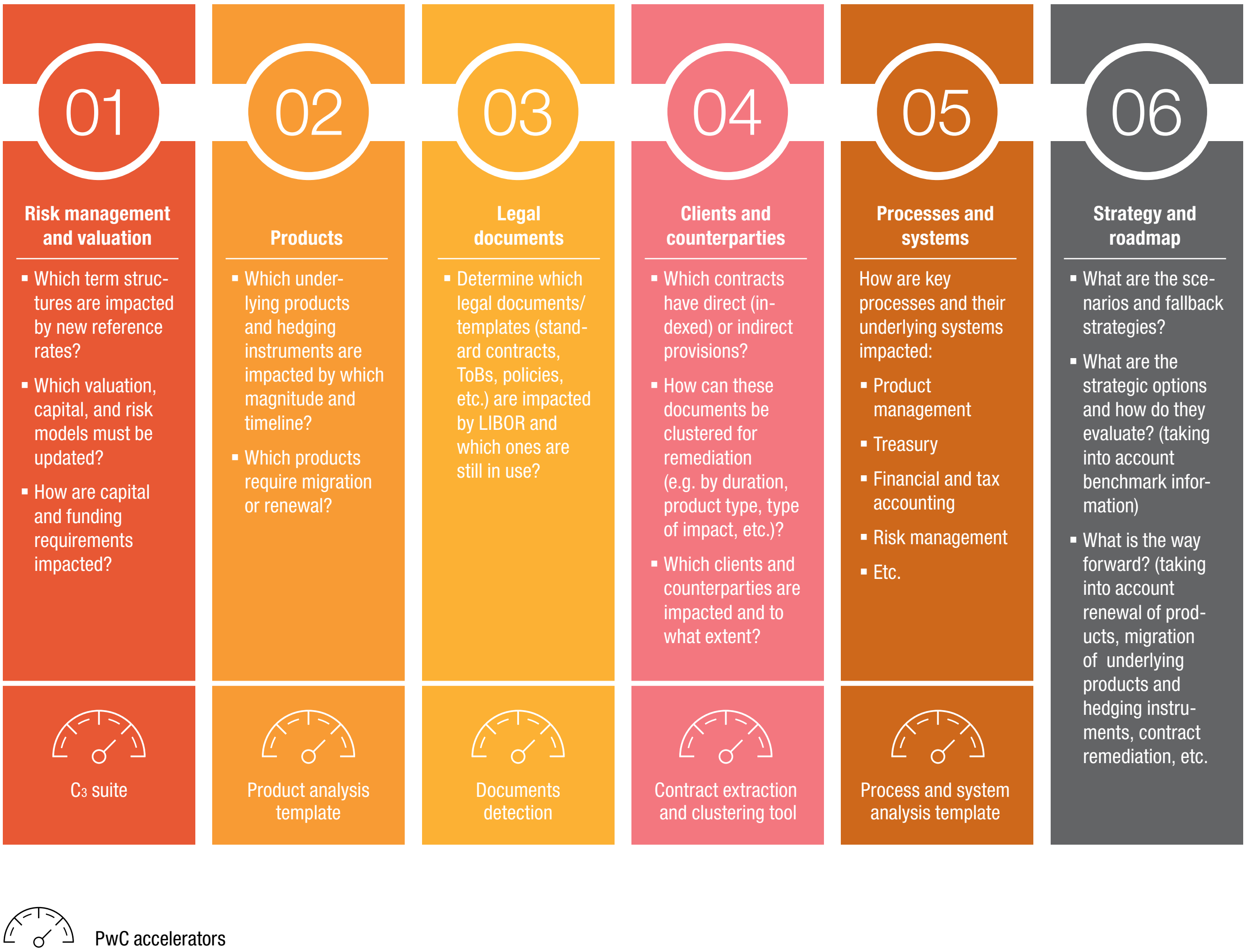
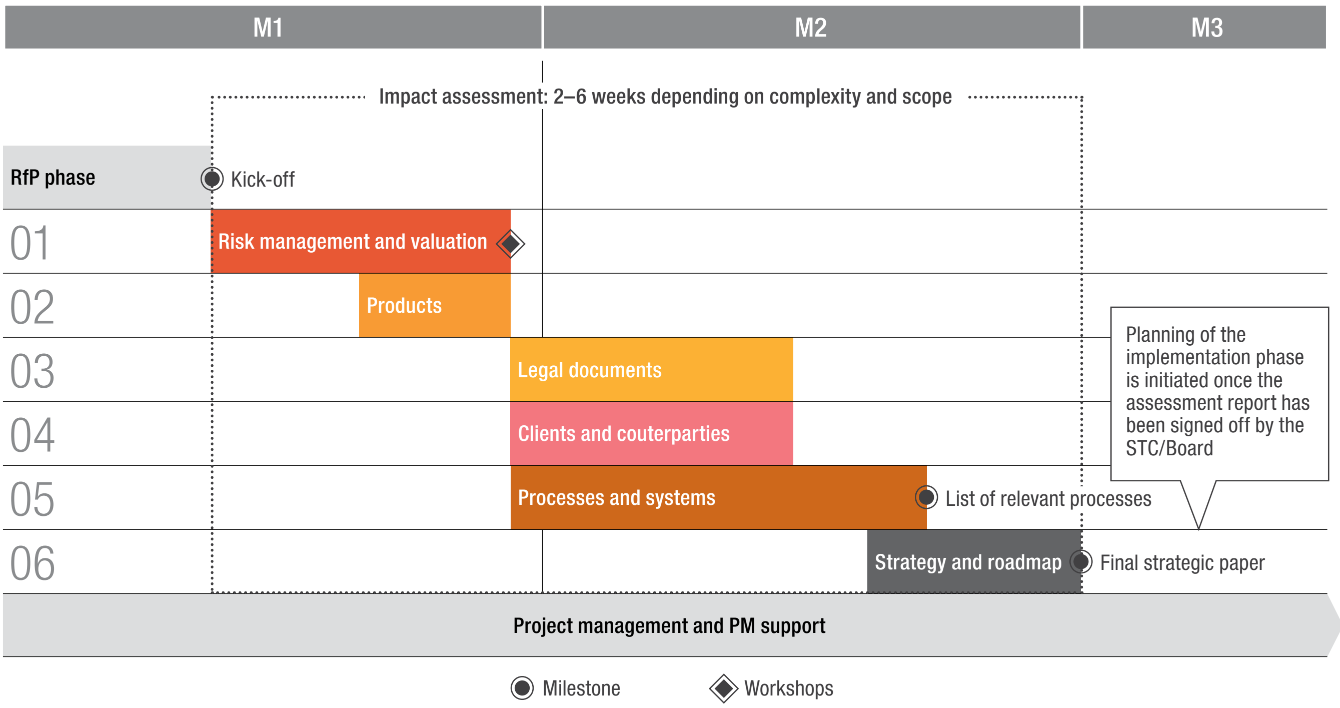


Figure 6: Indicatives timeline for an impact assessment



Formal programme mobilisation

Strategy for a centralised or decentralised programme setup

Based on the results of the initial impact assessment, institutions will need to formally mobilise their Libor transition programme. In most organisations, programme managers will be expected to provide a detailed roadmap covering the duration of the programme along with a programme budget at this point. They will also be expected to set up formal governance for the programme. **Most organisations are familiar with two types of programme governance model: centralised and decentralised types.**

Centralised programme governance features central control and ownership. This drives consistency across the firm and also helps to leverage knowledge of teams in different business areas. Given that a great deal of uncertainty is still attached to the Libor transition, many companies will favour a centralised model to ensure close coordination between business areas. However, they need to put measures in place to counter the common shortcomings of centralised programme set-ups, like lack of ownership in divisions or functions.

In a **decentralised governance model, execution ownership resides with the respective divisions and functions.** This ensures a higher degree of ownership, and many companies find this to be effective in terms of the cost, quality and timeliness of their programmes. A small central team (e.g. at group level) typically coordinates the activities, aligns roadmaps, supports knowledge sharing and provides consolidated status reporting and monitoring.

Companies should base their decision about which model to use on the **impact of LIBOR replacement on the organisation** as identified in the initial impact assessment, as well as on the organisation's **existing structures and experiences.**

Next steps and conclusion

Next project execution steps

Once the initial impact assessment and programme mobilisation have been completed, a LIBOR transition progamme can be launched. Among the various important action points for a programme manager, the following three topics are considered to be vital.

Programme plan and roadmap
Programme management should commence the LIBOR transision programme by drafting a programme plan as well as a roadmap for the entire duration of the programme. During preparation of the programme plan, **management can leverage the results of the impact assessment** in order to estimate a stream's effort complexity and time period. Given the ongoing uncertainty with respect to alternative reference rates (see above), **institutions should wait before applying changes** (e.g. system changes to handle the new rates), where this is feasible. **'Reverse planning'** can be applied, working backwards from the end date of 31 December 2021 (the end of the agreement with contributor banks to submit to LIBOR) or an earlier date if the institution plans to implement new products earlier. In either case, the expected timelines for making changes and dependencies with other workstreams need to be considered.

Since regulators and the global industry have not yet reached a final conclusion on future reference rate policy, **institutions will have to monitor critical decisions** through direct communication with the regulators, various working groups and peer players in the industry.

Detailed formal assessment
Building upon the initial impact asssessment, a detailed impact assessment should follow to define comprehensive goals and requirements for each identified stream. In contrast to the initial impact assessment, PwC suggests that **the detailed impact assessment be conducted at stream level rather than by a centralised project team** and according to the timelines applicable to the respective workstreams. Each stream should be encouraged to define its own scope and deliverables and take ownership and responsibility within the boundries set by programme management. Results of the detailed assessment can feed back into the programme plan and roadmap.

Communication plan and change management
Consistent internal and external communication will be a vital success factor for the programme and should be defined in a communication plan and carried out for the entire programme lifespan. An **internal communication plan** should cover communication to all internal stakeholders (e.g. regular steering committee update meetings, project status update meetings between programme management, project management and stream leads) as well as **change manangement** with all relevant functions within the institution. An **external communication plan** entails ongoing exchanges with regulators, industry peers, clients and media.

Conclusion

Even though the referance rate reform seems like it is a regulatory change on the distant horizon, **banks and other institutions with exposure to LIBOR have to act now** in order to permit an orderly and successful transition to the new reference rates.

To enable a cost-efficient and timely transformation, we recommend that financial instititutions validate the optimal timing for starting the programme impact assessment. In our view, Q2/Q3 2019 seems an ideal timeframe for small and medium-sized institutions to start, so that the risks and total cost of transformation can be optimised. Postponing the mobilisation of a LIBOR replacement programme into 2020 increases **the risk that the institution will not be able to implement all the changes** in time. Plus, getting such a late start may prevent inititutions from benefitting from earlier-mover or smart-adopter advantages.

How PwC can help

With our know-how in supporting impact assessments for banks, asset managers and insurance companies and leveraging tried-and-tested approaches, we are happy to share our thoughts on managing the reference rate reform, serve as sparring partners for your experts or provide a support package tailored to your specific needs. We would welcome the opportunity to be of assistance.

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