IBOR transition

Managing the transition to new Risk Free Rates

kpmg.com/be

IBOR what is changing?

Interbank offer rates (IBORs) are systemically important benchmarks, underpinning many contracts within the financial sector globally (not only derivatives contracts, but any type of financial instrument in the market).

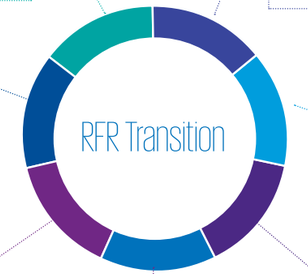
Following the Financial Stability Board (FSB) recommendations in 2014 to enhance the robustness of benchmark indices, the industry has been developing new risk free reference rates (RFRs). These RFRs have been designed to overcome the pitfalls of IBOR rates, in particular to minimize reliance on expert judgement and ensure a better reflection of the risk free rate.

In 2017 the FCA confirmed that it will no longer compel banks to submit data to LIBOR post 2021. For EU Member States, the European Commission adopted the "European Benchmark Regulation" in 2016. Both Euribor and Eonia were considered to be non compliant with this regulation and need to be reformed (or discontinued) by 1 January 2020.

US, UK, Swiss and Japanese Working Groups ('WG') have developed SOFR, reformed SONIA, SARON, TONAR. The market is initiating the transition towards these new rates.

ECB introduced ESTER, going live in Q3 2019, as replacement of EONIA. In parallel, Euribor is being reformed as a hybrid methodology (pending FSMA approval).

What are the key challenges?



Significant scale to the transition
- Impacts all clients participating in IBOR- related contracts
- US/UK/Euro currencies are likely to have different timelines
- Detailed transition timeline needed

Identifying all products impacted
- All existing & new contracts
- Derivatives, loans, bonds, and mortgages
- Key terms may not be easy to identify and vary on a contract per contract basis (fallback mechanisms may differ in hedged item and hedging instrument)

Operational & Conduct risk
- Introduces conduct risks with the changes in benchmark and spreads applied
- Large scale changes in legal documentation, models and curves introduces significant operational risk

Developing wider liquidity in new underlying market
- Liquidity needed in new SOFR/SONIA/ESTER - based products
- Momentum needed to drive the transition across the market

Accounting and hedge accounting impact
- Expected to impact forecast transactions
- Impact on hedge effectiveness tests (effectiveness of the hedging instrument after fallback or need for new instrument)
- Tax implications for transfer pricing

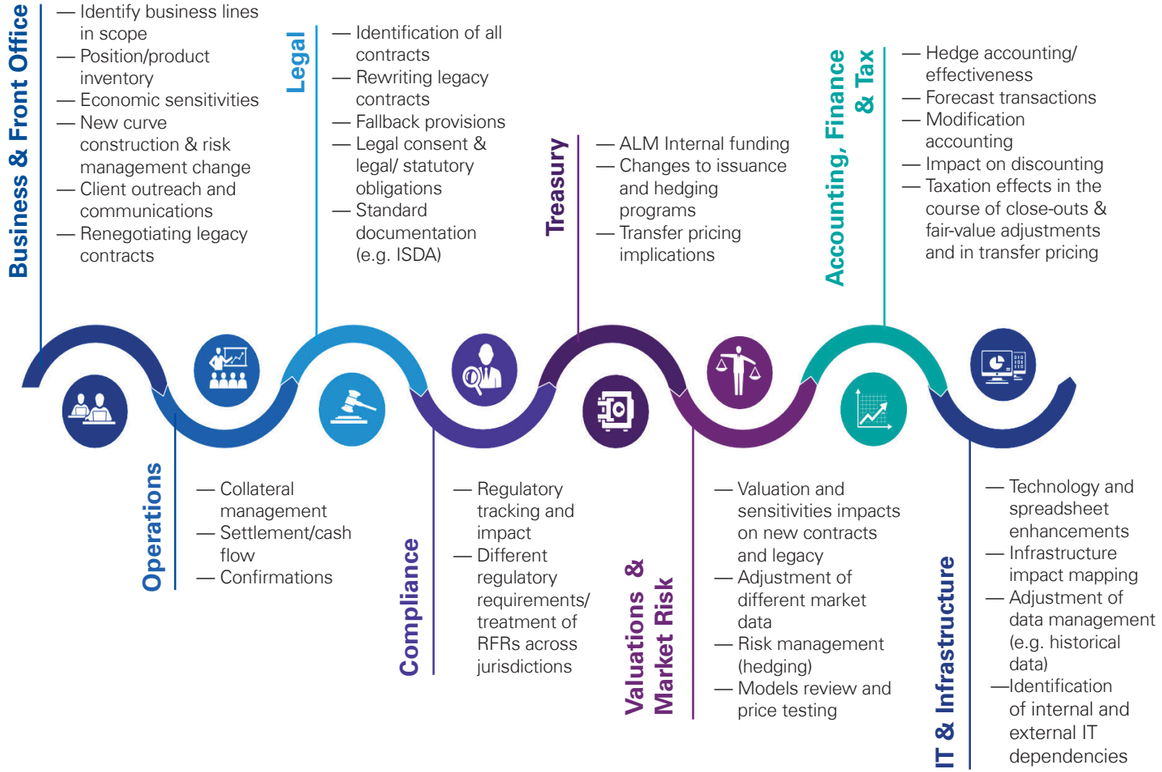
Client outreach
- Changes need to be communicated to customers
- Greater challenges for cash products versus derivatives

Changing the basis
- No term structure as RFR overnight rates
- The legal mechanism for fallbacks being designed
- The credit spread mechanism at transition to be agreed

What do **banks** need to do?

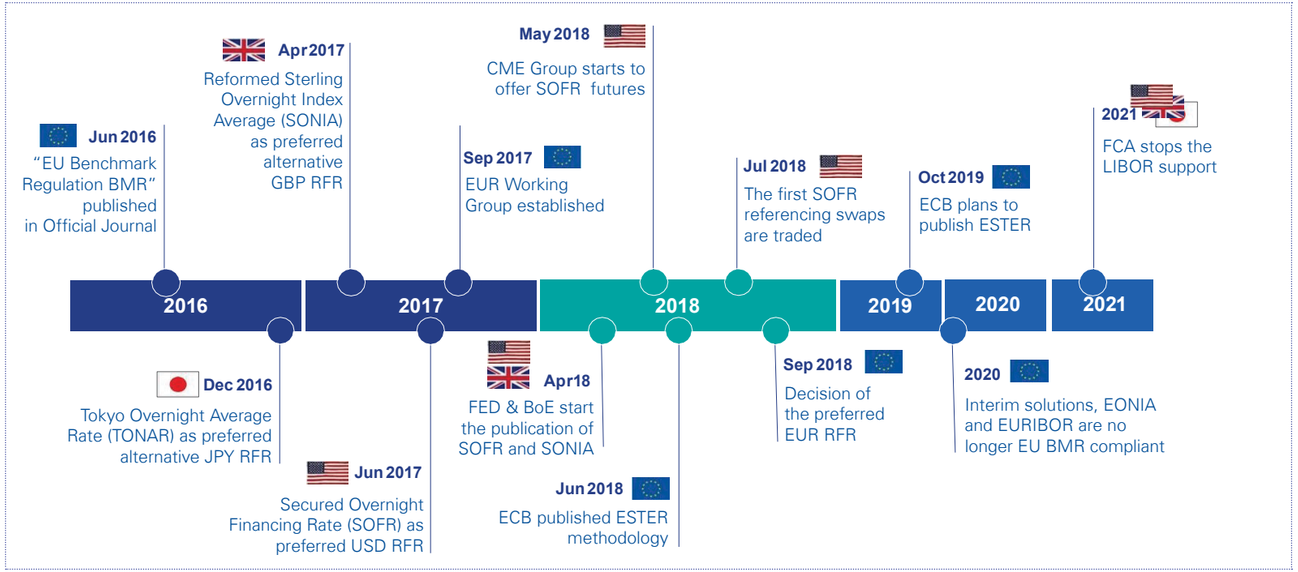
Firms need to assess the impact of the transition across their products, clients and infrastructure. While uncertainties on final (technical) details of the "future" benchmarks still exist, it is essential to prepare now in order to be ready for different scenarios and have a clear understanding on potential impacts of each scenario. The impact will not be limited to derivatives, but will also affect the way banks organize their daily operations. It is therefore key to consider this impact across the whole organization and to cover key functions: Sales & Trading, Operations, Risk & Valuations, Treasury, Legal and Compliance.

The differences in approach and timing across the US, UK and Europe will require a well coordinated program of activities to ensure changes are aligned.



Developing a clear timeline

There is a clear impetus to make the change up to 2020/2021. Timelines are being developed, but there are going to be variations across jurisdictions. It is key to ensure that internal timelines are aligned with regulatory timelines.



2018

Mobilization & Preliminary Study

- Project initialization
- Identification of impacts and requirement analysis
- Planning of implementation period

2019-2020

Implementation

- Contract adjustments and customer contact
- IBOR Change Program

Post 2020

Product Conversion & Functionality

- Sequencing of product change
- Assessment of project progress
- Testing and assessment of functionality and need for adjustments

We can support you in this process

We can guide you through this process and help you in each phase of the transition plan. Typical support includes:

— Creation of a project governance and structuring of work streams according to leading practices
— Gap analysis and impact assessment supported by our technical experts in front to back processes of your business
— Review of contractual details and required amendments by our experts in financial law
— Project management and PMO by our experts in large transformation projects
— Development of tools and artificial intelligence algorithms (e.g. involvement of Machine Learning, experts and tools for automatization of analyzing of contracts)

You can benefit from our international network of member firms

— A global working group on "IBOR Reform" is in place, piloted by our UK and US member firms, and supplies us with leading practices and market insights from ongoing projects
— The reforms within the US and UK have already taken the next step since alternative benchmarks have been completely defined – we therefore use the experience of our global colleagues

Approach tailored to your needs and your exposure to IBOR (from "quick scans" requiring only limited budget to detailed impact assessment on your whole value chain and definition/implementation of transition plans).

KPMG Publications

Evolving LIBOR series: Dear CEO letter

The PRA and FCA has written to the CEOs of large banks and insurance companies.

Evolving LIBOR series: Moving with the change

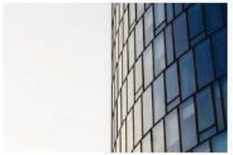
The shift from LIBOR to alternative RFRs is set to redraw the landscape for global financial services.

Evolving LIBOR series: Planning the transition to new Risk Free Rates

Is your firm ready for the transition to new global risk-free rates?

Evolving LIBOR series: Euro risk free rate transition

ECB recently conducted a public consultation on the assessment of candidate euro risk-free rates.



Evolving LIBOR series: Regulatory round-up

The pace of change.

Evolving LIBOR series: Moving with the change

Planning and preparing a move toward alternative reference rates (LIBOR).

The IBOR reform

The time pressured transition to alternative risk-free rates.

Evolving LIBOR series: Moving with the change

Planning and preparing a move toward alternative reference rates (LIBOR).

Key contacts

KPMG Belgium

Koen De Loose
Partner
Risk Consulting
KPMG Advisory

E kdeloose@kpmg.com
T +32 2 708 43 17

Isabelle Blomme
Partner
Financial Law
Kratos Law

E iblomme@klaw.be
T +32 2 708 40 66

Julien Thiry
Manager
Risk Consulting
KPMG Advisory

E jthiry@kpmg.com
T +32 2 708 42 10

KPMG Global

Stefano Hartl
Partner
Advisory
KPMG Germany

E stefanohartl@kpmg.com
T +49 89 9282 4982

James Lewis
Director
Risk & Compliance
KPMG in the UK

E james.lewis@kpmg.co.uk
T +44 20 7311 4028

Chris Long
Principal
Financial Services Advisory
KPMG in the US

E chrislong@kpmg.com
T +1 973 912 4826

kpmg.com/be