



Transitioning from LIBOR to alternative Risk Free Rates

May 2019

KPMG Board Leadership Centre



The end of 2021 is fast approaching - and marks when the London Interbank Offered Rate (LIBOR) may cease to exist. Now is the time to assess whether your organization will be ready for this seismic shift.

The breadth of LIBOR's impact expands across many critical aspects of an organisation. It touches on financing and transactions, clients and contracts, operations, systems, models, processes, and accounting. As firms start to look closely at the impact, more interrelated issues continue to emerge.

In this paper we provide an overview of some of the challenges that lie ahead and how firms can start to plan and manage the transition successfully in preparation for the 2021 deadline. One thing is clear, the pace of change is rapidly accelerating and firms must plan and assess what the transition means for them and their business – whether that be product innovation, infrastructure or customers.

Are firms prepared for the transition?

LIBOR is hardwired into all manner of financial activity, such as risk management, valuation, performance modelling and commercial contracts. But, despite the 2021 deadline, a large number of firms with exposure to LIBOR are yet to start making preparations for its discontinuation and many firms have not yet started negotiating replacement language in their contracts to reflect the change.

A recent survey by [JCRA and Travers Smith LLP](#), which focused on derivatives users and covered over 100 firms including investment funds, asset managers, property developers, social housing associations, infrastructure developers, corporates and banks, found that 83 percent of companies are yet to start making changes to their contracts, with 15 percent in the early stages of this process and only two percent having completed the project.

Who is impacted?

- Most financial services firms, energy companies and other corporates:
- Banks (Investment, commercial and retail)
- Asset Managers, Hedge Funds, Institutional Investors, mutual funds and pension funds
- Corporate Treasury/Energy firms
- Clearing houses

What's impacted?

- All transactions referencing LIBOR including derivatives, loans, bonds and mortgages.
- All other processes using LIBOR (Discounting, Tax, Accounting, financial modelling, collateral, coupon payments)
- Unlike other regulatory changes there are potential economic losers and winners. Customer and conduct/reputation is important

What should the board be aware of?

Reputation

- Risk of reputational damage with global regulators such as the Bank of England and the US Federal Reserve
- Businesses need to be seen to be supporting the transition
- Larger banks and selected insurers have responded to the FCA's '[Dear CEO letter Dec 2018](#)'

Finance

- Profit and loss implications
- Tax implications
- Transition costs

Customers

- Client franchise risk
- Treating customers fairly

Issue	Points to consider
Risk exposure	<ul style="list-style-type: none"> — Have all primary and second order LIBOR risks been identified and assessed? — While primary LIBOR risks can be readily identified, second order risks are harder to locate. Also, grouping unstructured data can be difficult. — Investment banks are likely to find it easier to extract data than retail banks and corporates. — The Swiss Financial Market Supervisory Authority (FINMA) have been driving exposure quantification in Switzerland. — The FCA's 2018 Dear CEO letter has accelerated the transition for UK entities.
Conduct risk	<ul style="list-style-type: none"> — Firms are concerned about conduct risk – there are lessons to be learnt from PPI mis-selling, Interest Rate Derivative mis-selling scandals. — Likely economic transfer of value for existing contracts. There should be no competitive advantage to be sought through the transition.
Budgeting	<ul style="list-style-type: none"> — Is there clarity on how the transition will be budgeted for? — Many firms have not yet developed a full business case. — Unlike other regulatory changes where the timelines are clear, here there is uncertainty and firms are unsure how fast to move.
Transition awareness	<ul style="list-style-type: none"> — Is there a communications plan (both internal and external) in place to raise awareness of how you will be managing the transition and the impacts on customers and products? — Are external stakeholders clear on what is required of them?
Operational challenges	<ul style="list-style-type: none"> — Contract change – AI can assist with the challenging scale of contract discovery and contract change needed. — It can be difficult to find where LIBOR is coded into operational bank processes – for large organisations code scanning could be employed.
Fall backs and term rates uncertainty	<ul style="list-style-type: none"> — Have fall backs been defined for all products? They may be difficult to implement for certain legacy products (e.g. Floating Rate Notes). — There is still some debate on the need for term rates for the new RFRs (e.g. finding a balance between business needs and thorough understanding of the implications).
Scenario development	<ul style="list-style-type: none"> — One off effects – e.g. the shock of hard cut over to RFR in 2021; risks on ongoing business franchise (like stress testing); basis risk; failed hedge accounting from mismatched timing of cut over.

Transition planning checklist

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| <ul style="list-style-type: none"> <input checked="" type="checkbox"/> Have you seen your firm's assessment of key risks related to LIBOR discontinuation and the details of actions your firm plans to take to mitigate those risks? | <ul style="list-style-type: none"> <input checked="" type="checkbox"/> Has your firm performed the necessary due diligence? <ul style="list-style-type: none"> – Do you know what you've got in terms of Libor exposures? – Have you looked at your inventory contracts, models, systems and processes? – Which of your clients are impacted and have they been risk assessed and prioritised? – Have potential scenarios been developed with contingency plans? |
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