LIBOR at the 11th Hour
Time for Passengers to Drive
In 2020, Accenture conducted a new LIBOR survey (see About the Research) to focus on the fast-evolving and intricate landscape of the LIBOR transition.

As market dynamics continue to shift and the 2021 deadline runway shortens, firms from the sell side, buy side and corporates need to refocus their thinking, energy, and resources on executing and delivering their transition programs. Just as critically, they need to get their operations ready to support new business as well as the transition to a post-LIBOR world.
Our survey indicates many firms continue to underestimate the operational demands of the transition and the challenges ahead.

This despite the directives and encouragement of the Financial Conduct Authority (FCA), European Banking Authority (EBA), the Federal Reserve Board (FRB), and other agencies to transition swiftly and commence planned cessation notices. With respondents still showing degrees of overconfidence in their ability to scale delivery at pace, without fully thinking through the operational capacity and required changes, we see a need to move quickly to reduce risk exposure and meet target financial outcomes.

With the November 30, 2020 ICE Benchmark Administration (IBA) consultation announcement, the end game for institutions is becoming increasingly complex. For interest rate product participants, December 2021 remains a target for enterprise and client readiness for all GBP, EUR, CHF, and JPY LIBOR rates, while the end dates for USD LIBOR have changed. This may tempt participants to slow or redirect readiness efforts for the remaining USD tenors to take advantage of the June 2023 target date which we discourage. This bifurcation of target dates only adds complexity for the sell side, buy side, and corporates, as each reassesses and refactors its current situation in light of the December 31, 2021 deadline for ending the origination of LIBOR-based products.
Drivers and passengers have different challenges for transition

In the 2019 Accenture LIBOR survey, the results clearly indicated that respondents fell into one of two groups, each with a different mindset and approach to the transition. The first group was made up of firms with mature plans that were investing heavily to complete their transition on time and consisted mainly of the large sell-side investment banks and capital market participants who set and trade benchmark rates. These firms were actively “driving” their remediation and transition programs.

The second group consisted of “passenger” types who were approaching the transition with more caution and hesitancy and were more likely to believe that the transition deadline would be delayed.

This group is characterized by buy-side and corporate firms who are more likely to be users of benchmark rates, and thus more likely to approach the transition with less commitment.

These sentiments continue to be apparent in our latest survey, but in light of the November 30, 2020, IBA consultation announcement, it is important to assess if “driver” and “passenger” firms now have more flexibility in how they plan and implement the transition, and also if they have greater ability to design and deploy new products. Do corporates and the buy sides become the drivers to the sell side in product design, or does this extension simply create greater demands and complexity for all market participants?
What this means for the sell side

Issuing banks and other institutions that originate loans, credits and other LIBOR-based transaction contracts have already invested substantial effort focused on operational readiness and client transition in the lead-up to the June 2023 announcement, whereas the sell-side institutions were “pushing” their agenda onto their corporate and consumer clients, who were slow to move forward with the transition.

Operational readiness initiatives span process, system, data, people, and fallback readiness activities for both legacy LIBOR exposures as well as Alternative Reference Rate (ARR) products for new origination. Prior to the shift in the USD transition deadline, sell-side institutions were “pulling” along corporate clients and counterparties who have been slow to move independently, and driving readiness to operationalize fallbacks, reprioritize technology and establish budgets to be able to update financial systems and adopt the new ARR curves.

We have observed that with the early Sterling Overnight Interbank Average Rate (SONIA) and Secured Overnight Financing Rate (SOFR) outreach, sell-side firms and issuers underestimated the magnitude of effort needed to equip their front office and agents to effectively and confidently cover the range and the technical nature of key messages to be delivered. Oversimplified technology and product solutions that rely heavily on legacy LIBOR workflows and controls need updating to reflect the changes in risk as well as to provide sufficient scalable capacity. This is also critical to maintaining the required resilience to concurrently perform current business as usual (BAU) tasks, new product BAU activity and the interim workarounds.

Nearly six in ten sell-side respondents mentioned operational readiness and conduct risk as a top challenge in their transition efforts.
With a longer timeframe, sell-side firms can reconsider transition scenarios based upon a basic or reduced level of understanding when it comes to the new ARR mechanics, as well as the interest rate risk levers to be reassessed and recalibrated, and new solutions defined with enhanced monitoring and controls. The longer timeframe can also help sell-side firms educate their corporate and buy-side clients on the financial complexities of the transition and provide precious time to discuss enhanced and tailored product options. Additional focus on communications training including strategy shifts in handling of BAU renewals, annual reviews and potentially difficult legacy client contract scenarios should also be a priority given the new timeline and may result in reprioritizing outreach efforts. However, the potential for compliance and control issues emerging from unintended conduct and miscommunication actions increases with the longer runway to resolve legacy back book LIBOR contracts.

Along with the operational re-calibration needed, sell-side firms should also carefully navigate regulators’ expectations to actively transition and begin originating new ARR products. UK and US banking and capital market regulators have made it clear that they plan to formally examine and exert regulatory oversight on the progression, risks and remediation impacts of LIBOR.

The combination of greater complexity driven by the additional transition time for the majority of USD LIBOR tenors and mounting regulatory pressures sets the stage for new winners and losers. The sell-side firms who have invested in reusable contract extraction tools and automation now have repeatable processes, analytical tools, and richer data to innovate new products, better manage the transition and compete post LIBOR. They are also better prepared and positioned to thrive in a dual operating model environment.

Over half of sell-side respondents indicated that client outreach was a top transition challenge.
Prior to the IBA consultation, we observed that many USD sell-side participants did not have sufficient capacity to develop other ARR products beyond SOFR given the dependency on vendors, growing client demand and challenges in mobilizing their operating models. Many additional product innovations for the American Interbank Offered Rate (Ameribor®), new prime products and others were prioritized for post-December 2021. Given the addition of the new IBA timeline, these participants now have time to offer better suited, more-tailored products to clients. This opportunity needs to be reassessed and strategies re-evaluated.

This situation can lead to a more confident posture during the outreach negotiations as well as shifts in a firm’s market position to capture the expected system-wide attrition.

Ultimately the IBA consultation now aligns external market/regulator expectations with the internal challenges to balance the cost to operate versus resilience in a dual mode transition and post June 2023 operating environment.

Firms that are more operationally ready for a dual operating environment can respond with greater agility and at a lower cost. New products and an evolving transition strategy can be developed and introduced even when confronted with additional regulatory guidance.
Are buy-side firms passengers in the transition?

With the IBA consultation, buy-side firms and institutional participants acting in an investor capacity are now in the forefront of the transition, along with corporates.

While understanding financial impacts is key, we are observing that areas such as functionally preparing the firm to operationalize fallbacks, having a data driven and “scalable factory” operating model to understand the impacts of each issuer’s offer, and being able to maintain compliance with investment mandates and contractual covenants are not progressing sufficiently. The consultation and the new timelines for a portion of the LIBOR positions provide opportunities to reassess and understand how ARRs beyond SOFR might be a better mandate fit.
According to our latest LIBOR Survey, buy-side firms were still in the early stages of transition.

According to our clients, no fewer than 13 different incoming issuer outreach pathways need to be prepared for buy-side firms to commence the transition. Having analyzed contracts and comparison indices for performance benchmarking, infrastructure changes is an immense undertaking that requires progress beyond exposure identification and readiness to both discontinue offering legacy LIBOR products before the end of December 2021 and to transition the back book by 2023.

Finally, even though the consultation has shifted the transition towards bank clients and a demand-driven event, buy-side firms still have to manage portfolio performance. This can result in banks operating concurrent and parallel operating models over the next two years or so, far longer than originally planned and exposing them to additional risks and challenges. Controls, client awareness of investment products, and the coordination of middle and back-office functions are expected to generate additional complexity as both the old and new BAU operate in parallel while compromising economies of scale.
Are corporates falling behind?

Prior to the June 2023 IBA proposed timeline, large corporates had planned their 2021 change agendas, architectures, and financials transition so that in 2022 and beyond they could resume focus on strategic growth initiatives.

Finance and accounting impacts and investment/trading product operations are the focus of functional, operational and technology change for the corporates. With LIBOR and new benchmark rates offered across multiple currencies, including the European Union Benchmarks Regulation (BMR) and third-country currencies, Accenture’s LIBOR survey reveals that the financial and operational risk from adopting new interest rate curves and preparing for new ARR financing is far-reaching and requires significant testing and quality assurance.

Corporates that have exposure in multiple currencies would have to operate with more than one deadline, with possible impacts to their capital and funding. Given that these multiyear and other projects have already been built on the back of requirements and designs needed to support ARR adoptions, sudden shifts and retroactive step backs in solutions may introduce more resiliency risk and potential disruption of core business. The need to balance this cost with potential delay has significant consequences for processes that do not directly serve the corporates’ customers.

Figure 1 on page 11 offers a top-line view of the expected impact of the LIBOR transition on organizations.

Similar to buy-side investors, corporate clients need to improve their operational readiness. Our research shows they lag their peers with only 36% having entered the design and build phases of their transition.
### Figure 1. How LIBOR transition is expected to impact organizations

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<th>Potential Impacted Functions</th>
<th>Overview of Impacts</th>
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| **Counterparty Contracts**   | • Counterparty master agreements should be updated for LIBOR replacement rates  
• Equipment and property leases are indexed to LIBOR |
| **Trading**                  | • Large option positions use interest rate (IR) swaps for hedging  
• Securities linked to LIBOR  
• Lease agreements may have penalties tied to LIBOR |
| **Risk Management**          | • Physical interest rate curves may be discounted at LIBOR  
• Credit simulations may require LIBOR replacement for PFE models  
• Price forecasting may model LIBOR correlations  
• Global VaR models use of LIBOR for funding considerations |
| **Treasury and Finance**     | • Estimated 10 billion commercial paper market  
• Credit facilities lending at LIBOR +/- basis  
• Interest rate swaps to manage interest rate from risk debt issuance  
• Intercompany and joint venture (JV) lending may be tied to LIBOR |
| **Accounting**               | • Forward lease obligations reported in the financial statements, discounted to present value  
• Interest rates swaps to convert fixed or floating rate obligations fall under hedge accounting  
• IFRS 9 exception reporting |

Source: Accenture, February 2021
Are passengers becoming drivers?

One thing is certain: On January 1, 2022 we expect LIBOR transition winners and losers.

In our view, the transition represents an opportunity for bold firms to use this exceptional situation to reshape their books of business and business models and position themselves for sustainable future growth. This complexity is leading to some surprising outcomes as the buy side and corporate “passengers” become “drivers” and thus force the sell side to focus on client demand for new products.

The finish line is approaching. With “hard” product issuance and trading deadlines set, the pressure is mounting as there is now further clarity on interim dates for various products. While sell-side firms have had the advantage of leading the market in product issuance, with the 2023 IBA extended deadline for certain products the buy side is demanding more, and starting to drive the process as they become more cognizant of providing what clients want in a timely manner. Corporates are now analyzing scenarios to understand potential impact to house cash, treasury, and funding functions. A coordinated and controlled communication strategy to manage client expectations is becoming critical, while understanding product maturity is key to client retention and protecting firms’ financial and reputational integrity. As buy side and corporate “drivers” focus on their transition and exit legacy positions, the demand for new products is expected to increase, with the sell side providing them.

76% of all survey respondents agree/strongly agree that regulatory uncertainty/lack of clarification is holding back their remediation efforts.
While extraordinary developments such as a global pandemic and recession constituted the greatest hindrances for over 65% of all LIBOR Survey respondents with regards to their LIBOR transition progress, 42% of firms were also challenged by the lack of global regulatory coordination. Though regulators have reiterated that there should be no relief to timelines, 73% of all respondents believe that, given the regulatory uncertainty, regulators will provide relief and guidance to their organizations, with ample time to react in terms of fallback language, capital treatment and term methodology.

Despite significant external headwinds, firms are also struggling internally to execute on the capabilities required for transition. A majority of surveyed organizations believe innovative technologies such as automation, analytics, artificial intelligence and blockchain are of great value in accelerating their transition and driving more efficiencies and effectiveness. Yet, 75% of organizations surveyed plan to do only the minimum to transition away from LIBOR. Unfortunately, the LIBOR transition is not an isolated group of projects or an unwelcome fire drill. If the transition is not properly executed, firms can expose their business to greater risk and disruption, including Black Swan events, while undermining their competitive position.

As the window to an effective transition closes, important choices should be made with an eye to ‘optimizing’ capital, liquidity, products, pricing, and technology post transition.

Of all survey respondents agree/strongly agree that they are responsive and reactive when it comes to their LIBOR transition activities.
The following are actions firms can take now to transition to a post-LIBOR world
As the December deadline quickly approaches, and regulators continue to announce product issuance and trading deadlines throughout 2021, firms should focus on multiplying controls to manage operational risk and should balance the scaling of risks between strategic and tactical solutions to maintain business continuity and operational readiness.

To address these risks and be effective in transitioning client exposures as well as legacy products, firms should enact immediate actions. Planning should be done with military-grade precision to provide ready, sophisticated solutions while developing stabilizing interim and tactical actions and initiatives to address critical operational risks. Firms should pivot to execution and stop managing in silos to improve collaboration across internal teams and transition alliances.

Accessing the relevant skills and the necessary alliances and vendors is essential to an effective transition. Firms should secure resources and have access to key skills across business lines and functions for transition activities. Vendor selection for transition activities, including trading platform technology vendors and legal third-party alliances, should be initiated and a robust onboarding process implemented.

Firms should also develop industrial strength integrated solutions across business lines, people, process, and technology to maintain operational resiliency in legacy, transition, and new business activities. Budgets have to be committed to implement all of these activities and solutions in a timely manner. Financial firms on the sell side, the buy side, as well as corporations should expect to increase their spend as the transition becomes more challenging and demanding due to the prolonged timelines. And with costs escalating, a sentiment shared by our survey interviewees, this is not the time for half measures.
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About the Research

Accenture has been tracking and surveying how financial services firms and corporates are progressing on their LIBOR transition effort. Our first LIBOR survey was completed during the Summer of 2019 with the follow-up quantitative survey conducted in May and June of 2020. We interviewed 200 senior executives involved in LIBOR decision making from the banking, capital markets, asset management, insurance and corporates sectors across North America, Europe and Asia Pacific. To supplement our findings and insights we conducted in-depth interviews with twenty senior financial services executives.

References


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