



Tick tock... the end of LIBOR

Regulators have stipulated that firms should transition away from the London Interbank Offered Rate (LIBOR) to alternative overnight risk-free rates (RFRs), a move that may impact financial institutions worldwide. Abbas Basrai stresses why the scale and complexity of this change should not be underestimated.

Inter Bank Offered Rates (IBORs) have a key role in financial markets and underpin trillions of dollars in financial products. However, regulators globally have signaled that firms should transition away from LIBOR to alternative overnight RFRs before December 2021. Financial institutions, industry working groups, and regulators around the globe are now working against the clock to manage and implement this almost inevitable transition.

LIBOR's decommissioning may affect—and pose risks to—most business and support functions of financial institutions. To put the magnitude of the change in context, it is estimated that nearly USD 400 trillion worth of contracts are linked to LIBOR across the spectrum of financial instruments.¹³ RFRs have been designed to overcome the



pitfalls of these rates, from minimizing reliance on expert judgment and ensuring a better reflection of the risk-free rate, to avoiding certain past LIBOR rate-related malpractice or misdemeanors.

LIBOR currently supports a vast range of financial products and valuations across multiple jurisdictions — from loans, mortgages and leases to bonds and securitizations, derivatives and more. In the UAE, it is estimated that about one-quarter of all financial products in banks reference LIBOR. A large GCC bank recently noted in its annual report that approximately one-third of its contracts reference LIBOR. Global regulators have indicated that the current construct underpinning LIBOR is likely to be unsustainable and a potential threat to global financial stability. Across the GCC, regulators are preparing

for the transition away from LIBOR. In January 2020, the Central Bank of Bahrain released a “Dear CEO” letter requesting banks to identify their exposures and develop an implementation roadmap for new RFRs. Other GCC regulators are also establishing working groups to discuss the challenges. It is unclear yet how regulators will deal with regional IBORs, such as in the Emirates (EIBOR), Saudi Arabia (SAIBOR) and Bahrain (BHIBOR).

What should banks do next?

On an international level, banks may find it challenging to navigate a largely uncertain environment and the transition’s potential impact on their products, infrastructure, services, customers — and reputation. This creates an imperative to identify individual LIBOR-based references, decipher problematic

legal language, and develop a solution on time. Navigating the IT changes to major applications alone could take several months. Beyond internal preparation for the transition and, how effectively they communicate those changes to the market could be critical.

Given their exposure to LIBOR-based products, banks in Europe and the US could be leading with the implementation of their transition programs. Banks in the UAE could therefore leverage the approach taken by their international counterparts. The transition path adopted has been similar across jurisdictions and has three initial steps.

First, an internal working group could be established that includes key stakeholders from across the bank. Working groups in most banks are being championed by either the Finance or Treasury function, and may include representatives from Risk, Legal, Operations, and IT, as well as customer-facing business lines such as Retail and Corporate. Most banks have formed a separate internal project management office (PMO) to help coordinate the project with internal and external stakeholders.

Second, banks can plan to undertake an initial impact assessment to identify where LIBOR exposures may exist on the balance sheet, irrespective of their size. This could be segmented in different ways (by geography, product and customer for example), and could extend to trading book activities that reference LIBOR.

In addition to the contracting and customer impact, banks may also have references to LIBOR in other non-customer facing activities such as procurement contracts, models, accounting processes and spreadsheets that will need to be identified and included in the change

program. For example, banks will need to consider changes with respect to their trading books on instruments that reference LIBOR. Another consideration is how accounting teams will contend with the significant potential effect of LIBOR reform on both internal and external financial reporting.

Third, after all impacts have been identified, banks could develop a transition roadmap that articulates how and when these impacts will be managed.

A framework for banks

Before offering non-LIBOR rates to customers, banks are likely to first develop capabilities to be able to transact and book in the new RFRs. Beyond identifying LIBOR exposures, banks could focus on developing their customer communication strategy, consider how they will amend customer contracts, and identify all internal processes that reference LIBOR. All this needs to be completed before the fast-approaching December 2021 deadline!

Automation as a solution to the LIBOR challenge likely promises ongoing business benefits and advantages that go beyond identifying contracts and required changes. Digital capabilities unlocked by a smart LIBOR solution is likely to enable financial institutions to access the applicability of Artificial Intelligence (AI) in key areas such as risk management, compliance, operational resilience and more.


Time is running out

Experience tells us that we are not generally seeing what is considered an appropriate sense of urgency in the global banking sector, despite the formidable task ahead and its tight timeline. In the UK, for example, financial regulators recently noted their surprise over the “very different

states of readiness for dealing with the transition and associated risks demonstrated by plans submitted.” They also urged banks not to take a “wait-and-see” approach.

But sector players are not entirely to blame for allegedly being slow off the mark on this complex journey. They can unfortunately face troubling circumstances given the number of dependencies associated with the transition, the necessity of clarifying guidance from standard setters, and the need for potential intervention from both regulators and legislative bodies to address significant hurdles. However, banks should not further delay taking action: there is no time to lose. Tapping into AI is likely to give organizations a fast and reliable solution to today’s—and tomorrow’s—business challenges.

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LIBOR transition framework- phases

