Surveillance: Supporting the LIBOR Transition

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Regulatory focus

Global regulators are focused on the implications of transitioning away from LIBOR to a new risk free rate by end-2021. Over 40 years, LIBOR has deeply embedded itself across market infrastructure – over US$400 trillion of assets reference LIBOR as the underlying rate. The transition away from this critical benchmark is a complex issue with ambitious timelines.

The LIBOR benchmark has been shrouded with controversy over the past decade and the current determination process is still heavily reliant on the expert judgment of panel banks. This has been a significant driver of the push towards an alternative.

The Financial Stability Board's Official Sector Steering Group along with other regulators have set targets for the industry to develop solutions to move away from LIBOR to risk-free rates. Working groups for the LIBOR currencies have defined replacement rates. However, there is still great uncertainty on the challenges which lie ahead and further technical guidance is required for some areas.

Why is surveillance necessary?

Conduct risk in relation to the transition is an identified concern for the industry and regulators. The surveillance function has an important role to play in ensuring customers are treated fairly throughout the transition process and protecting firm's from potential conduct breaches.

Mis-selling lessons from history

Firms must apply the lessons from previous industry scandals involving PPI and IRD, ensuring a fair transition when migrating their customers to new products. Surveillance teams need to learn and embed learnings from past events in order to avoid the repeat of historical issues.

Value transfer

Firms will need to demonstrate that they have treated customers fairly.
Surveillance can be used to detect cases where communications with customers is not in a manner consistent with the firm's conduct principles.

Evolving transition landscape

The size and scope of this transition and the constantly evolving landscape makes this is a challenging issue for the industry to get right.
Surveillance needs to be part of the risk management conversation, and firms should consider reviewing and updating their detection mechanisms to reflect the changing conduct risk profile.

Market abuse

LIBOR was historically tained by rigging scandals, and as it now bows out, firms cannot risk leaving further market conduct risks unmarked.

Confidential information regarding the timing and transition of customers could give rise to market abuse scenarios e.g. front running. Firms need an adequate control framework, including surveillance.

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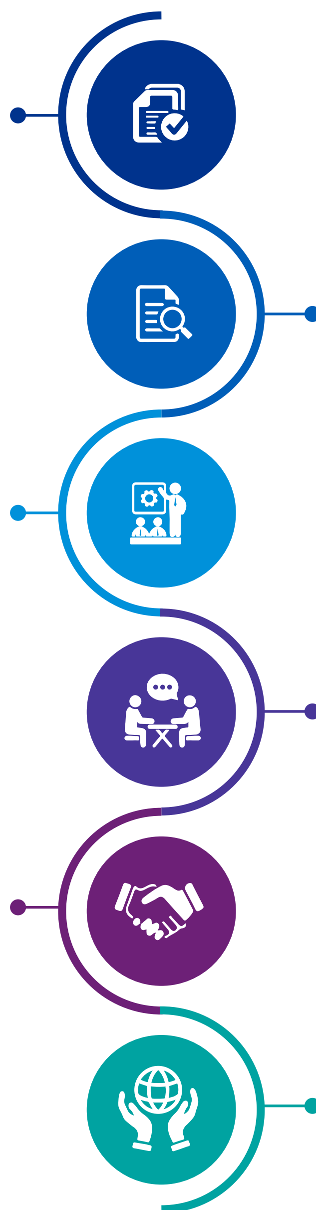
Practical steps for surveillance programs

In order to help mitigate and manage risks arising from this transition, surveillance functions need to assess whether their current scenarios and controls are fit for purpose. Below are several key areas that firms should consider when assessing the effectiveness of their surveillance arrangements during this transition:

Conflicts of interest assessment

The transition will create opportunities and incentives for businesses and individuals which give rise to potential conflicts of interest. Firms need to map the conflicts that could arise from the transition and implement controls, including effective monitoring as mitigation.



Conduct risk scenarios

Using different transition paths to flag up where conduct risk is likely to be most acute:

— Is the bank treating customers fairly?
— Is there evidence of mis-selling, front running, etc?
— Are incentives creating poor behaviours?

Governance

Surveillance has an important role to play and should be part of the firm's transition program governance. The existing conduct risk framework can be leveraged.

Communications surveillance

Update people in scope to include those individuals in high-risk transition roles, such as relationship managers. Assess lexicon and searching methodologies to ensure coverage of transition conduct risk.

Trade surveillance

Run conduct scenarios through existing monitoring in order to ensure surveillance captures the new risk profiles. Surveillance should recalibrate thresholds and alert types where necessary considering inputs such as unusual PnL moves.

Training

Ensure surveillance analysts are aware of the conduct risk elements arising from the transition, as well as alert to the new risks relevant to surveillance.

Clearly, managing the conduct risk in the LIBOR transition is not a simple matter, especially given that there is still so much uncertainty surrounding all aspects of this seismic shift in historic market infrastructure. However, there are proactive steps firms can take to help manage the conduct risks that have already been identified and those that may arise in the future. Surveillance teams must make sure that the consideration and management of transition-related conduct risks is embedded into their business as usual (BAU) program and is responsive and flexible as the transition progresses.

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