Overcoming the challenges of Business Process and System Change in the LIBOR Transition

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The context

The journey to RFRs

As from the end of December 2021, financial institutions will no longer be compelled to submit LIBOR rates, as the market transitions fully to RFRs such as SONIA, and that's just the last of several LIBOR deadlines. The Bank of England has also said that by the end of Q3 2020, lenders should be in a position to offer non-LIBOR linked products to their customers – after that, they should include clear contractual arrangements in all new and re-financed LIBOR-referencing loan products to facilitate conversion to RFRs. Plus, all issuance of sterling LIBOR-referencing loans expiring after end-2021 should end by the close of Q1 2021.

To avoid disruption and the commercial challenge of participating in an increasingly illiquid LIBOR market, all banks, insurers, asset and wealth managers need to meet these deadlines, and remove all remaining dependencies on LIBOR by the end of 2021. It's a tight timeframe. The transition has many impacts that must be dealt with across your business – and regulators have consistently stressed that the final deadline will not be pushed back.

Pervasive implications for business processes…

Overall, LIBOR reform represents the largest and most complex change that has faced FIs since the introduction of the Euro.

The LIBOR reference rate is pervasive within your FI's infrastructure, across both the operating architecture and also IT systems and applications. This means that even an apparently small business process change to accommodate the switch to RFRs has major implications along the entire value chain.

In terms of business process change, it's important to establish where and how processes will be impacted by reference rate reform, and then organise how these changes will be made. As well process remediation, the changes will also have knock-on impacts such as a need to amend existing policy/procedure documentation and controls, as well as systems impacts. Some of these business changes will be simple to remediate. But the potentially large scale of the task means the organisation must prepare to allocate significant resources, and – in some cases – consult with functions such as Risk and IT, or even with third-party vendors.

In addition, whatever changes need to be made will require people to be informed, made aware, or even trained, depending on their roles and responsibilities. So there is a need for a comprehensive communications and training strategy to ensure the business changes are properly embedded into business-as-usual (BAU). Fundamentally, this is an opportunity for FIs to rethink their operating model and make strategic choices and changes, thinking about how they leverage technology, consolidate systems, and build in further efficiencies.

…and every system that touches them

Alongside the changes centred on business processes, all technology systems that reference LIBOR will need to be made operation-ready for a post LIBOR world. This is a challenging undertaking. Many FIs' IT estates are a complex mix of ageing in-house legacy and third-party vendor systems, and introducing new calculation engines to factor in risk free rates will face multiple issues. There are challenges in new rate ingestion, building calculation engines, supporting new curves, enhancing data models, pricing models, generation of new cash ladders based on RFR calculations, changes in collateral management, valuation models, etc. Additionally, third party systems require enhancements from vendors to incorporate these significant changes which is often a time consuming and long process. It is, hence, vital for FIs to carry out a thorough assessment of your technology estate to understand both the extent and degree of impact across the stack. It is also essential to start engaging with external vendors early. Indeed, to meet the end-2021 timeline, organisations would also need to consider implementing certain tactical solutions for the back-book while developing longer-term strategic solutions in parallel.

Once the required changes to all systems have been identified and analysed, detailed transition planning, design and testing will be required before embedding the changes into BAU.

How we can help

We can help you tackle the business process and system changes required for the transition from LIBOR to RFRs by combining a proven business-led approach, our differentiated point of view on systems-related enhancements, deep understanding of third-party vendor systems, and access to the right specialist expertise at the right stage. We will also advise you both on tactical changes to meet the regulatory timeline, and also on longer-term strategic actions. What's more, there is an opportunity to use your LIBOR programme as a vehicle for transformational change, which should be ascertained as you come to understand the level and impact of change, and take steps to future-proof your enterprise for the post-LIBOR world. It's an opportunity we urge you to seize. And we have the right capabilities to help you do this.

LIBOR reform demands the creation of a fit-for-purpose operating and systems infrastructure

The LIBOR reference rate is typically pervasive within the infrastructure of a financial services organisation, across both the operating architecture and also IT systems and applications. This means that even an apparently small business process change to accommodate the switch to RFRs has major implications along the entire value chain.

The remediation of a LIBOR product to one referencing RFRs impacts the front-office product engine, the cashflow and pricing calculations, the risk scenarios and models, and P&L attributions/FTP as well the back-office processes. So a single product enhancement requires changes to your front office, middle office and back-end systems. As depicted below, changes in products, contracts, risk and valuation, financial reporting and tax need to factor in the underlying process and systems changes.

Given the scale and scope of these impacts, it's vital to ensure your infrastructure is fit for a post-LIBOR world. In terms of **operating infrastructure,** all business processes impacted by the switch to RFRs must be re-architected. And with **technology infrastructure,** every system and application that touches these processes must be enhanced and tested – whether these systems are in-house or third-party vendor systems. You'll also need a mechanism to ensure current transaction and trades in flight can land post cessation, possibly using tactical remediation solutions to meet the regulatory timelines.

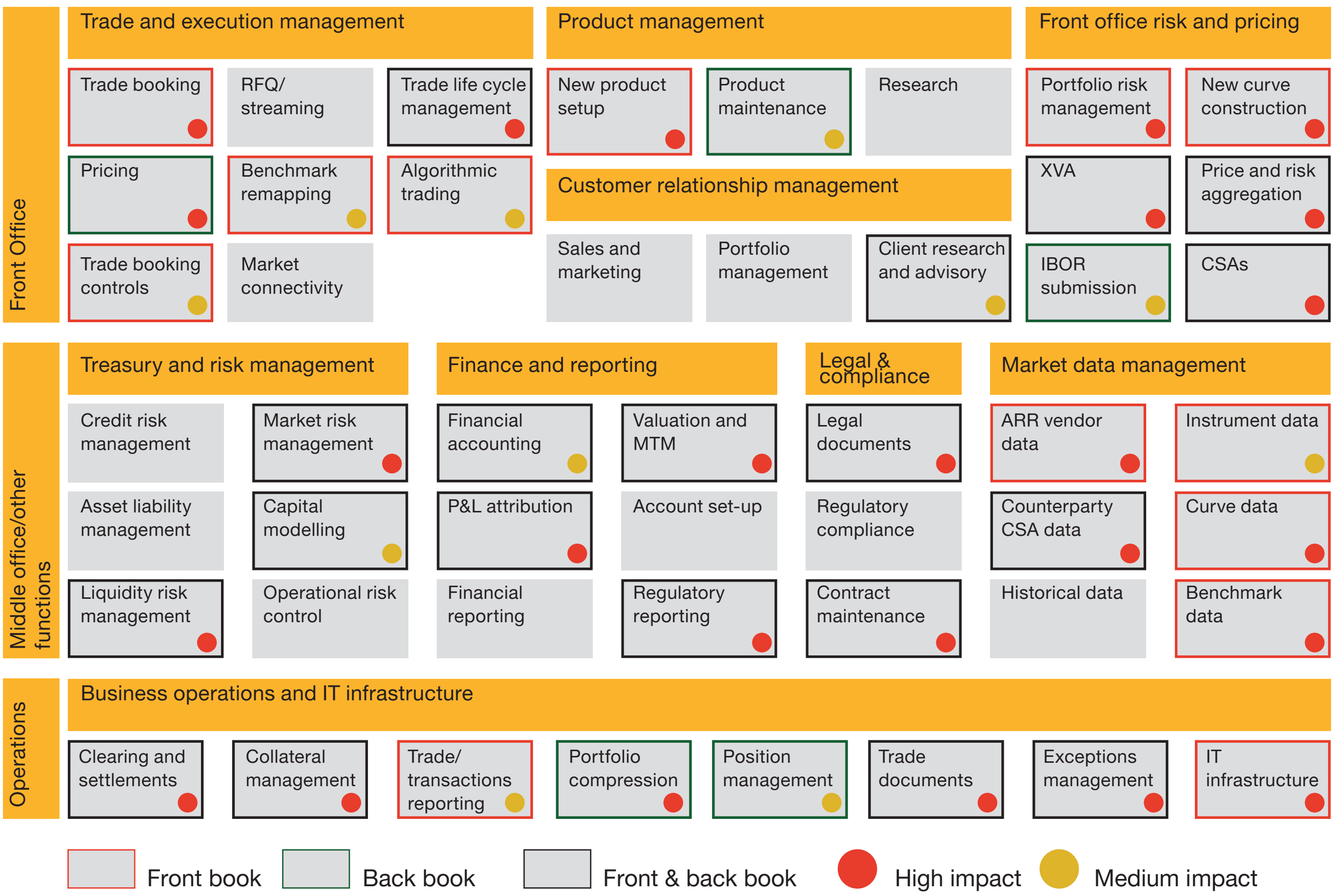
Our proposition

Our LIBOR business process and systems change proposition is designed to take the burden off your internal teams – while collaborating closely and openly with you to future-proof your business and systems. We'll help you build operational readiness across your business and systems landscape, by supporting your LIBOR change programmes in three key areas.

1 Business process change

The starting-point for identifying the impacts on operational processes is a business- and product-led discussion on the processes and systems impacted, and the extent of those impacts. This involves looking at each product and asset class, and assessing the scale and nature of the change required to that particular product or class to complete the transition to RFRs. Areas of potential impact range across the entire functional value chain – from profit and loss to pricing strategies, and from risk controls to core operations and related systems.

This assessment enables the creation of a heat map of impacts across your front to back model, capturing the level of impact (medium or high) and area (front book, back book, or both). An illustrative example is shown below, mapping the impacts across the functional value chain in capital markets. The result is a clear view of the end-to-end business process impacts in all areas and operations for each product and asset class.



An illustrative heat map of the LIBOR transition impacts across a capital markets firm's functional value chain

Based on the size and area of the impacts identified, our team will help you review and implement the required changes across end-to-end business processes, and support the related remediation required to documents such as policies and procedures. We'll then assist you in building awareness and training the relevant front-office, risk and back-office staff in the changes being made, including – as required by benchmark regulation – how the new calculations work and what the move to RFRs means for clients.

2 Technology and systems change

With the impacts on business processes identified and quantified, the next step is to determine what touchpoints in the technology infrastructure will need to change. We'll help with the creation of an implementation roadmap, providing teams front-to-back with an overall approach and specific migrations at the desk and product level. Throughout, we'll support you with end-to-end programme management and business requirements documentation across the IT stack, and data landscape reviews, cleansing and lineage.

In tackling the systems change requirements, a key challenge for many FIs is that their technology landscape is a complex "spaghetti junction" of ageing in-house legacy systems and multiple third-party vendor applications. While the changes to in-house systems might appear more straightforward and directly controllable, issues can arise about older versions of applications and release management. With third-party systems, vendors generally say implementing changes can take between nine and 12 months. With the final deadline looming in December 2021, conversations with third-party vendors need to start as early as possible.

Our technology change workstream leverages two specially-designed proprietary accelerators. The first is an automated code analysis tool, which helps identify the elements within your IT estate that contain an interest rate reference, and generates an inventory of applications and systems to be enhanced. The second is an EUC (such as Excel sheet) review tool, which goes out into your systems, picks up the various documents in use, and generates an inventory showing their purpose and how many have a LIBOR reference.

The benefits for you

By engaging PwC to help address the business process and systems changes arising from LIBOR reform, you'll relieve your internal teams of the burden of handling LIBOR-related change alongside business-as-usual, and be able to capitalise on our breadth and depth of market and industry insight from engagement across many of the world's foremost FIs. You'll also gain cost-effective access to scarce, market-leading skills and capabilities to support your LIBOR programme. And you'll have ultimate confidence that your business processes and systems are fit and ready for a post-LIBOR world.

3 Programme Assurance and testing

Our Programme Assurance specialists will work closely with you through frequent interventions, ensuring that the changes identified to products and asset classes are translated fully and accurately into the right business process and technology changes. We embed Programme Assurance throughout the programme, including end-to-end systems and process testing, and – at the appropriate time – model validation and back-testing for vendor platforms, as well as system testing and go-live testing. For overall readiness prior to the transition, we provide a programme health check, stage gate reviews, deep dives and outcome assurance so you can successfully deliver the LIBOR transition.

Achieving strategic transformation through your LIBOR programme

It's clear that addressing the business process and system changes needed for the transition from LIBOR to RFRs is a major task. But it also presents massive upside potential.

This is because the sheer scope and scale of internal changes required – from individual products and asset classes to the entire operating model and IT stack – mean the LIBOR transition presents a golden one-off commercial opportunity for FIs to take a step back, and think holistically and strategically about what products they want to offer in the market, and what their target systems infrastructure will look like in the future.

The transition to RFRs represents the ideal juncture at which to transform business processes and systems to future-proof the enterprise for the post-LIBOR world. And PwC has the right combination of market-leading industry, process, technology and regulatory expertise to help you seize this opportunity – while also meeting the regulatory timelines.

Why PwC?

Our solution to future-proof your institution for is differentiated by four key attributes:

A business-focused approach

We approach LIBOR-related business process and system changes through a business – not technology – lens, starting with products and asset classes, and following these through to the resulting impacts on operations and IT.

Deep industry and regulatory understanding

Our teams consist of highly experienced sector specialists, whether in banking, capital markets, insurance, or asset and wealth management. We also have strong relationships with industry regulators, and have engaged with many of the world's largest FIs to truly understand the challenges of LIBOR reform.

Technology leadership

We are acknowledged leaders in developing and delivering technology solutions for FIs, with experience that includes developing data models and workflows for most LIBOR document types.

Worldwide reach and delivery

Our global presence and scale mean we can support LIBOR business process and systems change programmes for FIs of any size anywhere worldwide. And our track record in delivering large, complex programmes is second to none.

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