



# LIBOR transition readiness: The current narrative

Results of a Numerix global survey on the LIBOR transition

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## I. INTRODUCTION

The decommission of LIBOR is making a huge imprint on the global financial services sector. The transition from LIBOR to alternative reference rates may just be the largest financial engineering project the world has ever seen. While the capital markets industry has observed that many of the largest global banks have started planning early for the transition away from LIBOR to replacement benchmarks, many other institutions are behind in their preparations.

Let's take a moment for a historical lookback. LIBOR was introduced in 1969 and served as an efficient and effective benchmark interest rate, reflecting the interest rate on unsecured interbank borrowings of designated panel banks. Following the financial crisis, the number of transactions on the interbank market significantly decreased, which raised questions about the sustainability of LIBOR. Additionally, in 2012, the UK's Financial Services Authority and other regulators found that a number of panel banks were submitting false rates to move LIBOR in their favor. This represented the beginning of LIBOR reform.

Ultimately, in 2017, the UK's Financial Conduct Authority (FCA) announced it would not compel panel banks to continue to provide LIBOR submissions beyond the end of 2021. Discussions around the transition of LIBOR rapidly advanced and some market participants started preparing for the transition to alternative reference rates (ARRs). Considering that, globally, LIBOR is the basis for tens of millions of contracts worth more than \$350 trillion, ranging from derivatives to mortgages, bonds, and retail and commercial loans, it quickly became clear how intensely complex such a transition would be—and that the enormous scale of the global migration to ARRs would pose considerable challenges, including legal, operational, and financial risks.

To better understand the industry's level of preparedness for switching from LIBOR to ARRs, we conducted a global survey of financial services market participants. The results of the survey show that lack of preparation certainly does exist, but our findings also suggest the challenges hampering LIBOR transition efforts vary considerably.

Our objective for conducting the survey was to explore what financial institutions are doing to prepare for the switch to new risk-free rates, and to observe how far along various firms are in their progress. We sought to grasp how institutions differ in their approaches and to better understand what technology and data decisions they've had to make along the way.

### Numerix's Position on the LIBOR Transition

Numerix is a provider of capital markets technology for trading and risk management serving more than 700 financial services organizations worldwide. Numerix has taken a leadership position to tackle the many facets of LIBOR reform and we are providing the industry a range of resources to successfully address this immense challenge. Whether it's about utilizing market-ready analytics and a modern curve framework to navigate the ARR landscape or helping your institution to meet its legal, operational and risk priorities, Numerix delivers the necessary technology solutions.

## II. ABOUT THE SURVEY

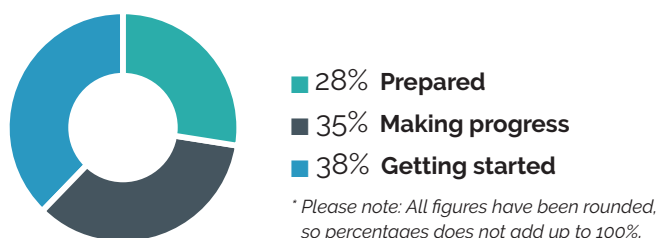
The Numerix 2020 LIBOR Transition survey was conducted from May 26, 2020 to July 29, 2020. Sixty-nine individuals from 55 institutions worldwide participated. The largest number of participants represent Banks (45%) and Advisory/Consulting (28%). The other representative firms by industry sector breakdown include:

- Asset Management
- Audit/Accounting
- Broker/Dealer
- Exchange/Clearing
- Government/Regulator
- Insurance
- Software/Hardware/Market Data

## III. SUMMARY OF KEY FINDINGS

### State of Preparations: Majority of Firms Generally Unprepared for the Transition

#### 1) As you consider the state of your LIBOR reform program, how would you characterize your firm's preparedness?\*



The transition from LIBOR to ARRs is gaining momentum, but many firms are struggling. Only 28% of survey respondents consider themselves "Prepared" for the LIBOR transition. Breaking this one result down further, only 23% of banks indicated they have a mature transition plan in place, while 37% of firms in advisory/consulting indicated they are well positioned for the transition.

From our perspective, we characterize being prepared as meaning a firm's transition plan is in a mature and progressive state, with a transition team working across the organization to address transition risks and assessing impacts across products, contracts, processes and technology. It also means being well positioned to meet internal deadlines and being able to adapt to upcoming reform milestones, in addition to actively exploring ways to optimize elements of the transition.

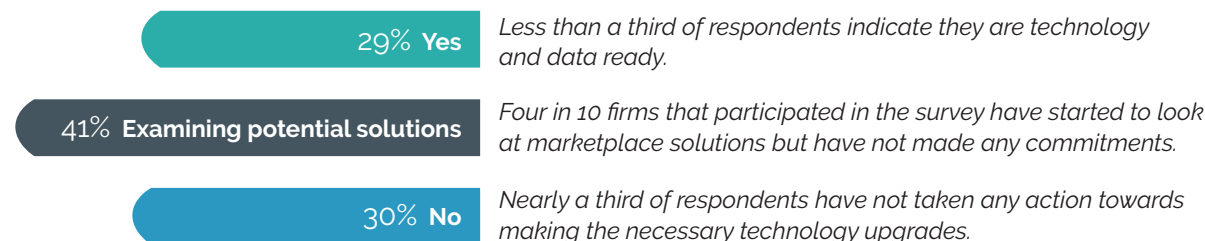
Based on the number of engagements with our widely accessed [Numerix LIBOR MasterClass Program](#), 24% of program participants described the state of their LIBOR transition program as "Prepared," 39% selected "Making Progress" and 37% selected "Just Getting Started."

The narrative that emerges is that there is a mixed picture of preparedness for the upcoming end of LIBOR. Particularly, there appears to be a very low level of preparation among financial providers, even at this late stage in the LIBOR transition. What could be the causes? Are firms underestimating the complexity of the task at hand? Is there a lack of understanding of the level of focus required? Are there hopes that regulators will move the 2021 deadline?

Our survey attempted to find answers to these questions.

## Meeting Technology Requirements: Most Firms Do Not Have the Necessary Technology or Data Systems

### 2) Has your firm purchased or built the required technology, infrastructure and data systems to adapt to new alternative reference rates?



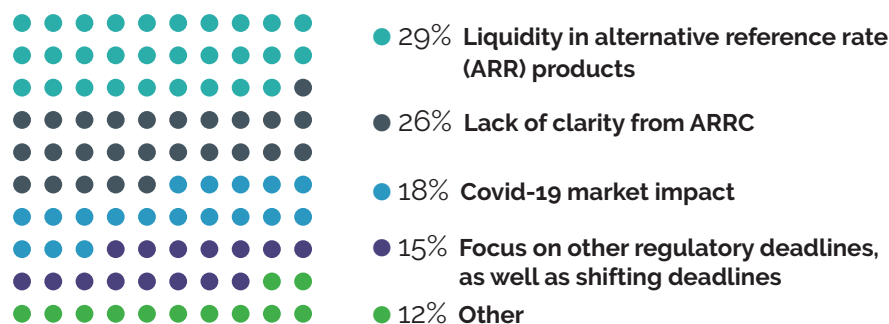
It is important to know and understand the enormity of the scale of the global migration to ARR. It will require software systems to be updated. However, by combining the last two results, we see that 71% of firms responding to this question have not yet built or acquired the required technology and data systems. The inability to address the technology challenges related to the transition from LIBOR to ARRs could very well result in material adverse consequences for financial market participants.

Let's also consider a LIBOR Transition survey conducted by Debtwire in Q3 2019 of 100 market participants. In this survey, 39% of respondents said they were not even close to being in the process of marshaling the required resources (including technology and data systems) to address conversion issues.

While some of the largest financial institutions may already host the technology know-how and can make the investment in building out their own technology and data infrastructure, most firms will be constrained by a lack of domain expertise and technology knowledge to manage this transition in-house. These firms will likely need to consider partnering with a service provider who has the software, digital accelerators, and technology expertise to deliver the necessary support.

## Top Transition Challenges: #1 Challenge to LIBOR Transition Efforts Is Lack of ARR Liquidity

### 3) What challenges (if any) are hampering your LIBOR transition efforts?



It is not surprising that a majority of survey participants selected the lack of ARR liquidity as being the primary challenge to transition efforts. Sufficient liquidity build-up is required to facilitate the transition to the new ARRs. While liquidity is developing, there is still a way to go.

About a quarter of firms selected lack of clarity from ARRC. The "lack of clarity" in this case refers to the ARRC receiving some criticism for not providing sufficient guidance on issues related to, for example, cash market products and non-linear derivatives. It is worth noting, however, that on May 27, 2020, the ARRC published best practices for completing the financial industry's transition away from U.S. dollar (USD) LIBOR to SOFR. With about 16 months remaining before the anticipated cessation of USD LIBOR, the ARRC's recommendations should provide market participants with further guidance as they continue to prepare for the transition.

Clearly, there is a wide range of challenges that can hinder LIBOR transition efforts. If there is comfort, it can be found in knowing that all of these and other challenges are being actively addressed by international working groups, central banks, trade bodies and industry forums. All of them know and understand that a widespread and simultaneous market adoption of ARRs will go a long way towards enabling an orderly and controlled transition across the globe.

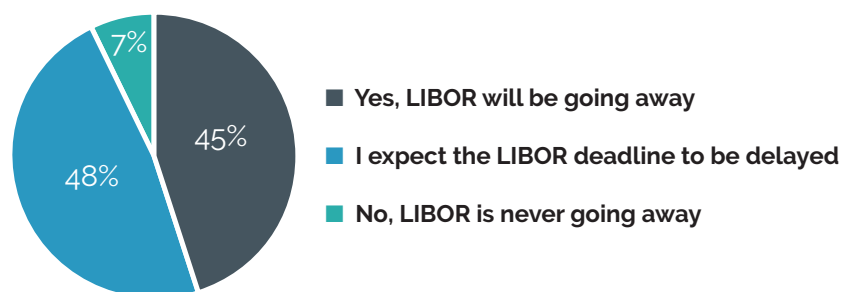
It is also not surprising that less than 20% of respondents cited the impact of COVID-19 as a challenge. It is true that the pandemic certainly places all market participants in an extremely strenuous situation. It is difficult to manage resources during a time when most working conditions could cause there to be less focus on preparations for the LIBOR transition. However, from what we see, many financial institutions continue to be highly interested in the subject and are not slowing down their preparations for the transition.

Regarding having a focus on other regulatory deadlines, a low percentage selected this challenge choice. Nonetheless, it should be known that the current regulatory landscape includes more than the LIBOR phaseout. Other parts of the landscape include the Fundamental Review of the Trading Book (FRTB), Initial Margin for non-cleared derivatives, new capital rules under Basel IV, SEC 18F-4 (a new SEC rule designed to enhance the regulation of the use of derivatives by registered investment companies) and SEC SBSD (SEC guidance for regulating cross-border security-based swaps).

"Other" includes scale of undertaking, lack of a sense of urgency, and competing priorities, among others.

## LIBOR Decommission Deadline: Most Think LIBOR Deadline Will be Delayed, but not Discontinued

### 4) Do you believe the 2021 deadline will be the true discontinuation of LIBOR?



The fact that almost half of respondents believe the end of LIBOR will be delayed represents the market's overall widespread lack of acceptance that LIBOR will actually cease to exist by the end of 2021. The reasons—or excuses—for firms to think this way can be numerous, such as: the arrival of COVID-19 making the challenge of disentangling from LIBOR all the more problematic; not having the people or resources to deal with the transition; not being in a position to hire the expertise to be able to expedite the transition; or because of the significant number of institutions that are seriously behind in the progress of their preparations.

It is worth noting here an opinion from industry panelists that participated in a Risk.net webinar in late March 2020 on the LIBOR transition. There was a consensus among the panelists that while they reluctantly welcome some degree of flexibility for interim transition milestones, they feel it is important to maintain the current end of 2021 date, December 31.

They also emphasized that maintaining the decommission date while allowing interim dates to move would show a lack of consistency, which is not what the market needs, so, therefore, dates need to be held where they can be held.

In our survey, only 31 of the 69 survey participants—and 42% of participating banks—believe that the ultimate end date would remain in place.

The FCA, the Bank of England and other groups have also all weighed in on the need to hold firm to original LIBOR transition timelines, even with the impact of COVID-19 on the markets. However, they also said that interim milestones are likely to be affected.

However, a main concern is that any change to interim milestones could cause a chain reaction that might ultimately delay the final LIBOR transition. As such, the authorities are very cautious regarding any proposals to postpone interim milestones. Nonetheless, under the current market circumstances, there may still be a chance that some of the most immediate milestones could be pushed further.

It is interesting that the two greatest industry participants in the survey—banks and advisory/consulting—are the only ones to have member firms that believe LIBOR is not going away.

## IV. CONCLUSION

While our and other industry surveys show a general lack of urgency in institutions' transition plans—with the exception being the larger Tier 1 banks—we strongly advise that steps be taken now to accelerate transition efforts. The inability to address the challenges and requirements could potentially result in serious adverse consequences for a firm, including legal, regulatory, financial, and even reputational jeopardy.

Transitioning from LIBOR is certainly not an activity to be taken lightly. That's why we want to stress that partnering with a third-party vendor that provides the needed solutions can create significant and immediate value for an institution. Numerix offers technology solutions and capabilities to help you successfully assess and execute your LIBOR transformation.

Learn how the right technology can help you minimize operational risks and financial exposures. Contact [sales@numerix.com](mailto:sales@numerix.com) to learn more.



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More than 550 clients and 90 partners across 52 countries rely on Numerix analytics. Headquartered in the financial capital of the world, with offices around the globe, Numerix brings together unparalleled expertise combined with local market understanding.



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