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# Retiring LIBOR: timelines and best practices

Ted O'Connor of Arcesium reflects on the impending end of LIBOR

As the world of finance prepares for the impending retirement of the London Interbank Offered Rate (LIBOR) at the end of 2021, many financial firms have drafted plans and timeframes for transitioning to new pricing benchmarks – Risk-Free Rates (RFRs). As several key dates loom on the horizon, the critical phase of the transition will be the next few months of overlap when financial firms may use either set of rates and the accompanying protocols.

Ted O'Connor, SVP and head of treasury sales at financial software provider Arcesium, is optimistic about the buy-side's current level of preparedness but cautions firms about maintaining proper documentation and the potential stress that the transitional phase may bring to their systems.

"The good news is that our clients, really 100% of them, have so far adhered to the new protocols. What we saw in October of last year, when CME and LSE transitioned reference rates for their interest rate products, was that our clients were all successfully able to navigate to the new base rates," O'Connor says.

"One of the big considerations that firms should be thinking about is documentation. Many firms' existing documents make reference to LIBOR, and all of those documents will need to be updated to reflect the new RFRs."

A key date for market participants is 25 January, when ISDA's IBOR Fallbacks Supplement and IBOR Fallbacks Protocol will come into effect, helping participants define the terms of deployment for new relevant reference rates. These terms will be a crucial consideration for firms planning out their transition. Other checkpoints along the LIBOR retirement timeline include 31 March, when dealers in US-denominated derivatives must transition from LIBOR to the Secured Overnight Financing Rate (SOFR). As of 30 June, no new LIBOR-based loans or floating rate securitisations with maturities after December 31, 2021 may be issued. 30 September marks the deadline for CLO issuance to convert to the new rate, and the final deadline for LIBOR's retirement is scheduled for 31 December 2021.

## Updating calculations

One potential pitfall for market participants this year is the new requirement to maintain calculations with daily updated reference rates. The change from longer timelines – between 30 days and one year with LIBOR – means that one of the biggest challenges to firms will be updating pricing calculation models and tracking accruals on a daily basis. Fortunately, according to O'Connor, firms can make use of an extensive array of tools to address this.

"Nobody wants to be caught miscalculating pricing when valuing a security, especially when striking a NAV on liquid alternatives products or a private investment vehicle," O'Connor says. "Arcesium has been able to help our clients avoid this by updating our calculators to account for daily accruals and providing a reconciliation tool that helps them ensure that they've marked their instruments accurately. We've certainly seen an increase in demand for those tools as we approach LIBOR's retirement."

## Data governance is key to updating risk calculations

Crucially, the move to new RFRs is likely to impact risk calculations for hedge funds. A data audit is a fundamental step towards mitigating this impact.

Firms transitioning to new RFRs will need to ensure that any of their separate datasets are aligned and updated with their new pricing models ahead of LIBOR's retirement at the end of 2021.

"An essential consideration for risk is that managers need first to ensure that their enterprise data management systems are updated with their new pricing models," O'Connor explains.

"Our clients rely heavily on the Arcesium Financial Data Stack to populate their risk engines with validated, golden copy data. Data governance controls are a critical element in getting that done. You want to be thoughtful about the technology that supports all of your front, middle and back-office systems to ensure that you're getting a consistent and accurate read on the valuation of new instruments."

An audit trail of all transactions referencing LIBOR is crucial for transitioning as efficiently as possible, not just across pricing and risk but also across portfolio positions, according to O'Connor. To successfully achieve this transition, a modern, fully integrated data stack is the basic standard of preparedness for which any firm should strive.

## RFRs and cloud-hosted software

Funds using an entirely or primarily cloud-hosted data setup are likely to have an easier time transitioning their data stack and integrating it throughout the front, middle, and back office.

"Cloud-based technology has proven time and time again to be the most versatile when it comes to managing systemic and regulatory change," he explains.

"The ability for a hosted solution to update information in a timely manner and to integrate into portfolio management, risk management, accounting systems and any other pieces of a manager's architecture is certainly advantageous."

A bi-temporal database – one that timestamps data simultaneously along two axes, real world and system time – is potentially the best solution for data management facing the coming transition. These databases allow firms to easily consult a comprehensive, accurate view of their historical data.

"One of the things that Arcesium has found is that a bi-temporal database provides the most effective solution for tracking 'what you knew' and 'when you knew it' for financial instruments. This is a critical element of the rates transition because many derivative instruments that were put in place before the transition will have reference rates pegged to LIBOR. As those instruments transition to new RFRs, their financial terms will not change, so a bi-temporal database helps the user to understand the facts of the old IBORs versus the new RFRs whenever necessary."

## Communicating with service providers

The final key component of a seamless transition is communicating with service providers. Relationships with prime brokers and fund administrators, in particular, may be affected by the deployment of new RFRs. Outlining the due diligence questions to ask a PB in the coming weeks and months, O'Connor places the focus on ensuring that service providers have accounted for updated pricing models in their technology and have taken the time to help managers understand the changes that will impact their day-to-day process.

Summarising the chief priorities for funds in 2021, O'Connor pinpoints data governance, communication with service providers, as well as a comprehensive transition protocol covering portfolio, risk, accounting and legal as the core pillars of a successful LIBOR retirement.

"There are a handful of best practices to think about here. One is that the documentation will require all institutions to amend their documents. Working groups have been forthright in providing guidance for these terms across master agreements, repurchase agreements and security lending agreements for various product types," O'Connor explains.

"Next, risk models, whether it is market risk, operational risk or compliance risk, are best addressed by having a proper technology solution in place. This includes the pricing models and settlements because the technology is utilised to support all of it. Then, when thinking about engaging your counterparts, I would advise all market participants to overcommunicate the potential impact on their businesses."

"Another thing I would encourage everyone to do is to seek counsel. Lawyers and accountants are on top of the considerations, so keep them abreast of your execution plan. Once you finalise everything, test, test and test again. Have another final conversation with your counterparts. Test your systems, whether it is a treasury tool, a portfolio management system or an accounting platform. Everything needs to be perfect on the transition date, but if you've been testing in advance of that, you will have a great deal of confidence that you have done everything right."