

# **LIBOR Transition: Managing the Conduct and Compliance Risks**

Establishing an effective compliance  
governance framework

December 2019



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## Executive Summary

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This paper is the first in a series that considers the management of conduct risk by firms who are, or will be, engaged in the transition away from the London Interbank Offered Rate in all its tenors and currencies (“**LIBOR**”) to Risk Free Reference Rates (“**RFRs**”) by the end of 2021 (“**LIBOR transition**”). The process of LIBOR transition will be lengthy and complex. This paper identifies ways in which firms can mitigate the conduct risks posed by LIBOR transition when establishing their governance structure in the context of the following three phases of LIBOR transition:

- (i) Project planning;
- (ii) Project implementation; and
- (iii) Post-implementation.

This paper is intended as a possible framework to assist firms’ consideration of measures to manage certain conduct risks arising in connection with LIBOR transition. In practice, each firm’s LIBOR transition process will differ according to its individual business structure and the markets in which it operates. The discussion of risks and possible measures in this paper should not be treated either as comprehensive or as a checklist, for any purpose, or as uniformly applicable to a firm’s individual circumstances.

A summary of AFME Members’ feedback on further regulatory engagement is provided at the end of this paper, for the purposes of identifying suggested solutions and next steps. In summary:

- (A) Members are grateful for the engagement and guidance provided by the UK regulators on this topic, most recently in the *“Questions and answers for firms about conduct risk during LIBOR transition”* published by the FCA on 19 November 2019. Members would welcome continued guidance from the FCA as the LIBOR transition progresses and have suggested particular areas in respect of which they would benefit from further clarity, including:
  - (1) Illustrative examples of the ways in which conduct risk may arise in practice throughout LIBOR transition, and ways in which to manage that risk.
  - (2) Further detail regarding sales practices and product governance obligations that arise specifically in the context of LIBOR transition for affected products.
  - (3) Confirmation on the extent to which the FCA is engaging with overseas regulators in relation to achieving alignment on regulatory expectations regarding LIBOR transition.
  - (4) Guidance on how to mitigate competition risk in the context of industry discussions regarding LIBOR transition.
- (B) Members would benefit from regular industry discussions with the FCA in which shared challenges relating to the management of conduct risk can be discussed and potential solutions identified.

## Background

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The FCA has stated that, after the end of 2021, it does not intend to persuade or compel banks to submit contributions for LIBOR<sup>1</sup> and, therefore, by the end of 2021, firms will need to have completed their transition from LIBOR to RFRs. The LIBOR reference rate model has been the cornerstone of trillions of USD Dollars' worth of financial services contracts for more than three decades and its ubiquity means that LIBOR transition stands to be a complex and challenging project, particularly given the timeframe for implementation.

UK regulatory authorities have been working with market participants to transition the market from LIBOR to RFRs. As part of LIBOR transition, the FCA and PRA have highlighted the need for firms to identify and manage conduct risks associated with the transition<sup>2</sup>. In addition, they emphasised the need for firms to build mitigating actions to address these risks into their planning<sup>3</sup>. Further, the FCA has outlined its expectations that: (i) firms should have a strategy in place and take necessary action to manage conduct risk during LIBOR transition, and (ii) customers are treated fairly<sup>4</sup>.

The FCA has not provided an explicit definition of conduct risk because it considers "it is essential for firms to work through this task themselves as a preparatory step for designing, prioritising and monitoring change management initiatives"<sup>5</sup>. Broadly, firms have included the following key elements in their definition of conduct risk: any action of a firm that could lead to (a) poor outcomes for clients, or (b) behaviours that prevent, restrict or distort effective competition, or (c) have an adverse effect on market integrity<sup>6</sup>.

Against this backdrop, firms should ensure that their conduct risk framework can provide for the identification and management of the risks arising from LIBOR transition. In addition, firms should consider and incorporate a range of conduct risks, together with the relevant mitigating actions to address these risks, into their LIBOR transition plans<sup>7</sup>. A failure to manage conduct risk could lead to poor outcomes for clients and to an increased potential for litigation against firms by clients and other market participants as well as sanctions from regulators and competition authorities.

This paper seeks to identify steps that LIBOR transition compliance teams might consider when establishing an effective governance framework for their LIBOR transition process to minimise conduct risk. These suggested steps, phrased in the form of questions, are set out below, by reference to the following three stages of LIBOR transition planning: (i) project planning; (ii) project implementation; and (iii) post-implementation.

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<sup>1</sup> Andrew Bailey, Chief Executive of the FCA: *The Future of LIBOR*, 27 July 2017

<sup>2</sup> *Feedback on the Dear CEO letter on LIBOR transition*, June 2019

<sup>3</sup> *Ibid*

<sup>4</sup> *Conduct risk during LIBOR transition – Questions and answers for firms about conduct risk during LIBOR transition*, 19 November 2019

<sup>5</sup> *5 Conduct Questions – Industry Feedback for 2017– Wholesale Banking Supervision*, April 2018

<sup>6</sup> *Ibid*

<sup>7</sup> *Feedback on the Dear CEO letter on LIBOR transition*, June 2019

## Phase 1: Project Planning

Many firms impacted by LIBOR transition will have undertaken large-scale legal and regulatory change projects in recent years (such as, for example, MiFID, MAR, Brexit, MiFID II and GDPR). In order to implement those projects, firms have had to ensure that detailed and effective project planning has been established from the outset. LIBOR transition is unprecedented in terms of scale even when compared to these types of projects. A robust and flexible project plan (and one which is kept regularly updated), is therefore particularly important.

Firms have been, and will continue to be, required to demonstrate to the FCA and PRA that they have implemented effective project plans for LIBOR transition. The benefits of developing a robust project plan are clear, for example:

- (A) It helps to demonstrate to regulators and key stakeholders that firms are in control of their LIBOR transition process and have considered the issues, challenges and resource that will be required;
- (B) It provides a platform from which potential conduct risks can be identified, appropriate mitigants implemented and subsequently monitored; and
- (C) It enhances effective cost budgeting and management (for example, it can enable the consideration of technology-led solutions and mapping of collaboration between service providers in ways that could be difficult to achieve once the project is more advanced).

Set out below are four key considerations for firms in planning LIBOR transition projects: (i) the appointment, briefing and role of Senior Managers; (ii) the development of a robust and flexible project governance structure; (iii) the management of industry and regulatory engagement; and (iv) the establishment of an effective record keeping process.

### Appointment, Briefing and Role of Senior Managers

To the extent that Senior Managers and Certification Regime (“**SMCR**”) will apply to a particular financial institution, it will apply to those involved in the LIBOR transition projects and, specifically, those assigned Senior Manager responsibilities for the relevant business areas<sup>8</sup>.

The FCA has stated that firms’ Senior Managers and boards are expected to understand the risks associated with LIBOR transition and take appropriate action to move to alternative rates ahead of end 2021<sup>9</sup>. Further, the FCA and PRA expect firms to: (i) identify the Senior Manager responsible for overseeing transition away from LIBOR; and (ii) detail those responsibilities in the relevant Senior Manager’s Statements of Responsibilities (“**SoRs**”)<sup>10</sup>.

In this context, we suggest that firms consider the following questions:

✓	Which Senior Managers will be given responsibility for LIBOR transition for each business area and overall? Do they have effective oversight and control of the relevant business area?
✓	How should LIBOR transition responsibilities be expressed in the Senior Manager(s)’ SoRs?
✓	How will the appointment of the Senior Manager(s) be kept under review as the LIBOR transition process progresses and how will that be managed?
✓	How are Senior Manager(s) briefed to ensure that they understand LIBOR transition and the risks that it poses, including to people, systems and controls, and outsourced functions?
✓	Where a Senior Manager holds global entity authority and has responsibility for cross-border activities, do they have sufficient oversight of the firm’s world-wide LIBOR transition framework to be able to effectively meet their obligations?
✓	Do the Senior Manager(s) have sufficient financial and non-financial resources available for them to carry out their role effectively?

<sup>8</sup> See, for example, the FCA’s [Guide to the SMCR for FCA solo-regulated firms](#). Senior Managers are responsible under the Conduct Rules, the Senior Manager Conduct Rules and also hold the Duty of Responsibility under s66A FSMA and need to ensure that they delegate and supervise appropriately.

<sup>9</sup> *Conduct risk during LIBOR transition – Questions and answers for firms about conduct risk during LIBOR transition*, 19 November 2019

<sup>10</sup> *Ibid*

✓	What management information (“ <b>MI</b> ”) is required to enable the Senior Manager(s) to effectively oversee the progress of the project?
✓	Which individual(s) or team(s) will be responsible for compiling the relevant MI? What process is in place to record the way in which MI is being scrutinised and, if needed, challenged?

## Project Structure and Operation

The structure and governance that firms put in place to manage their LIBOR transition will define how they engage with external parties (e.g. clients, regulators), assess and manage information and make key decisions. The framework that firms choose to implement will therefore have potentially significant consequences for the LIBOR transition both during and after its implementation. In this regard, the FCA stated that insufficient preparation for transition from LIBOR to alternative rates could: (i) impact on the safety and soundness of firms; and (ii) cause harm to clients and the market<sup>11</sup>.

The optimal project framework will differ across firms given the range of business lines, legal and management structures across the industry. Regardless of the differences between firms’ businesses, establishing an effective committee structure is one way that firms can facilitate the determination, implementation and recording of decisions in relation to LIBOR transition. In particular, committees should be structured to allow appropriate escalation of issues, including, if necessary, to the Senior Manager. It is important to note that, whilst important, an effective committee structure will not absolve the Senior Manager of responsibility in respect of LIBOR transition.

In this context, we suggest that firms consider the following questions:

✓	What committee structure and constitution is required in order to ensure appropriate coverage of each business area affected by LIBOR transition? Can this be achieved through existing committee structures or will additional committees be required?
✓	How does the committee structure evidence effective management oversight of the LIBOR transition process? Are the committee members providing adequate challenge to decision-makers?
✓	How is the committee’s role set out in the terms of reference? What is the process to consider whether the committee is delivering on its responsibilities?
✓	What steps needs to be taken to ensure that the MI provided to the committee is being analysed, monitored, challenged and acted upon?
✓	How can the firm demonstrate that conduct issues such as information sharing (both internally and externally) and conflicts of interest are considered within the LIBOR transition governance structure, including in committee, as relevant?
✓	Has the firm considered to what extent the committees in its LIBOR transition governance framework will require legal advice and to what extent the project structure can be designed to protect legal professional privilege?

<sup>11</sup> Conduct risk during LIBOR transition – Questions and answers for firms about conduct risk during LIBOR transition, 19 November 2019



## Record-Keeping

Firms will be required by the FCA and PRA to maintain effective records of their implementation of LIBOR transition, in particular in accordance with their SYSC obligations<sup>12</sup>: The FCA has stated that, in the specific context of ensuring governance and accountability oversight for LIBOR transition, firms will have obligations to act with due skill, care and diligence and make and retain adequate records<sup>13</sup>.

The scale and complexity of LIBOR transition means that each firm's project will generate a significant volume of documents. As such, firms may wish to consider at the outset of their project planning process, what records should be separately maintained in order to demonstrate compliance with their regulatory obligations. We suggest that the practicalities of record maintenance (in particular, location, organisation and ownership) be established from the start of LIBOR transition, in order to facilitate timely retrieval and reference later on.

In this context, we suggest that firms consider the following questions in the context of LIBOR transition:

✓	What processes are in place to ensure that effective records of relevant committee meetings, MI, Senior Management appointments, policies and procedures and key decisions relating to LIBOR transition are maintained and can be easily located and retrieved if needed at a later date?
✓	What processes and controls are in place to record the identification, management, monitoring and reporting of risks to a firm's business? In particular, how is the management of potential conflicts of interest across different business divisions being recorded?
✓	What processes are in place to ensure that effective records of historic client communications relating to LIBOR transition, such as meetings, letters, fact sheets, FAQ documents and risk disclosures, are maintained and can be easily located and retrieved if needed at a later date?

## Industry and Regulator Engagement

The FCA expects firms to engage proactively with industry groups on LIBOR transition. In particular, the FCA and PRA expect firms to demonstrate "an up to date understanding of relevant industry initiatives and the timeline and probability of delivery of proposed industry solutions"<sup>14</sup>. The Bank of England has added to this by stating that industry working groups "need to be supported by actions at individual firms"<sup>15</sup>. Practically that means that if an issue is raised in an industry working group, the UK regulators expect that it should also be discussed, and corresponding action(s) implemented, by the senior governance teams at the relevant firms.

It is expected that the FCA and PRA will be focussing their supervisory efforts on ensuring that firms are prepared for the cessation of LIBOR at the end of 2021. As such, firms should: (i) be prepared for increased regulatory supervisory engagement; and (ii) identify, consider, and to the extent reasonably practicable, implement key market and regulatory developments and associated milestones, as part of their LIBOR transition processes.

The FCA has further highlighted the importance of engaging at an industry level when stating that "Firms are more likely to be able to demonstrate they have fulfilled their duty to treat customers fairly where they adopt a replacement rate that aligns with established market consensus, reached through appropriate consultation, and is recognised by relevant national working groups as an appropriate solution"<sup>16</sup>. Equally, as part of its involvement in various industry initiatives regarding LIBOR transition, the FCA has "emphasised the importance of ensuring these are progressed in compliance with competition law"<sup>17</sup>. We understand that a key concern of market participants therefore relates to the balancing of regulatory expectations regarding industry engagement with managing the competition risk associated with exchanges between firms either bilaterally or at industry level in relation to LIBOR transition.

<sup>12</sup> "A firm must arrange for orderly records to be kept of its business and internal organisation, including all services and transactions undertaken by it, which must be sufficient to enable the FCA ... to monitor the firm's compliance with ... requirements ..." SYSC 9.1.1R "A firm should have appropriate systems and controls in place with respect to the adequacy of, access to, and the security of its records so that the firm may fulfil its regulatory and statutory obligations. With respect to retention periods, the general principle is that records should be retained for as long as is relevant for the purposes for which they are made." SYSC 9.1.5G

<sup>13</sup> Conduct risk during LIBOR transition – Questions and answers for firms about conduct risk during LIBOR transition, 19 November 2019

<sup>14</sup> FCA, Feedback on the Dear CEO letter on LIBOR transition, June 2019

<sup>15</sup> Last Orders: Calling Time on LIBOR: Speech given by Dave Ramsden, Deputy Governor for Markets & Banking, 5 June 2019

<sup>16</sup> Conduct risk during LIBOR transition – Questions and answers for firms about conduct risk during LIBOR transition, 19 November 2019

<sup>17</sup> Ibid

In this context, we set out below questions that firms may wish to consider when determining how to manage their external engagement with regulators and the wider industry in relation to their LIBOR transition.

Regulatory engagement	
✓	What steps need to be taken to set up an effective process to update the relevant regulators in relation to the firm's LIBOR transition process (for example, which team(s) are responsible for the direct communications, who are the relevant internal stakeholders, how are communications coordinated across different business lines)?
✓	Who is best placed to consider what information might need to be provided to regulators (for example, in relation to: (i) the relevant governance framework; (ii) the firm's timeline for transition; (iii) the conduct risks that have been identified and how they have been mitigated; and (iv) a firm's communication strategy with clients)?
✓	What process is in place to ensure information provided to a regulator is accurate and complete, and stored where it could be easily retrieved if needed at a later stage?
Industry engagement	
✓	In which industry groups does the firm participate, through attendance and through more active roles? What process is in place to record the firm's participation?
✓	Who is best placed to maintain an understanding and awareness of market developments and to ensure that market developments are disseminated effectively within the firm?
✓	How is the firm recording its consideration and management of any competition risks which may be associated with its participation in industry discussion groups?
✓	How will industry developments be communicated to the relevant areas of the firm?
✓	Who is responsible for considering the appropriate level of engagement at an industry level and who is responsible for undertaking that engagement, for example in industry groups?
✓	How will the firm evidence that it has responded to and actioned industry developments in the context of the firm's LIBOR transition project in a timely manner?
✓	What process is in place to consider contingency plans if anticipated market developments (e.g. industry approved fallback language in a business area) do not materialise?
✓	What process is in place to ensure that engagement in industry groups is happening in a manner compliant with competition law and in a way which will enable a firm to demonstrate that compliance if challenged?



## Phase 2: Project Implementation

The process of implementing a firm's LIBOR transition project will vary depending on the nature and size of each institution. Broadly, for many firms it will include: (i) identifying and assessing exposure to legacy LIBOR contracts and impacted business areas; (ii) conducting client impact and risk assessments; and (iii) identifying, assessing and implementing LIBOR transition method(s) (for example, amending or replacing existing contracts to either include robust fallback provisions or replacing LIBOR with RFRs or an alternative rate).

Set out below are a number of key considerations for firms when establishing the governance structure to implement their LIBOR transition project, including: (i) product governance; (ii) Treating Customers Fairly; (iii) client communications; (iv) conflicts of interest and market abuse; (v) outsourcing; and (vi) training.

### Product Governance

The FCA has stated that banks and investment firms will need to consider the design and risks of any new LIBOR-referencing instruments as part of their product governance obligations<sup>18</sup>. Firms will need to consider the risks of continuing to offer LIBOR-linked products, taking into consideration the impact of LIBOR discontinuation on those products and the risk that clients do not understand this. Firms should also ensure that they have robust product approval processes in place that take into consideration their product governance obligations in relation to: (i) new products that reference RFRs; (ii) existing products that use LIBOR; and (iii) existing products that are transferred to RFRs.

In this context, firms may wish to consider the following questions:

✓	What process is in place, or might need to be implemented, in order to consider the impact of LIBOR transition on: (i) existing instruments referencing LIBOR; (ii) the transition of legacy instruments to RFRs; and (iii) new instruments referencing LIBOR?
✓	How will a firm's existing product governance structures and systems cater for the complexity and resourcing impact of LIBOR transition through the product lifecycle?
✓	To the extent firms are continuing to issue LIBOR linked instruments, what process is in place to ensure that the necessary product approvals have been obtained?

### Treating Customers Fairly

An overarching concern for the FCA will be whether firms have taken reasonable steps to treat customers fairly<sup>19</sup>. In particular, the FCA has emphasised the need for firms to ensure that:

- (A) the replacement rate is fair;
- (B) they consider whether any contract term they may rely on to amend a LIBOR related product is fair under the Consumer Rights Act 2015 in respect of consumer contracts; and
- (C) they communicate effectively how fallback provisions are expected to operate, for example whether clauses operate at, or before, cessation and on what basis (see Client Communications section below)<sup>20</sup>.

In relation to determining whether the replacement rate is fair, the FCA has stated that firms should consider the following<sup>21</sup>:

- (A) "LIBOR discontinuation should not be used to move customers with continuing contracts to replacement rates that are expected to be higher than what LIBOR would have been, or otherwise introduce inferior terms..."

<sup>18</sup> *Interest rate benchmark reform: transition to a world without LIBOR*, Speech by Andrew Bailey, Chief Executive of the FCA, at Bloomberg, London, 12 July 2018

<sup>19</sup> *Conduct risk during LIBOR transition – Questions and answers for firms about conduct risk during LIBOR transition*, 19 November 2019

<sup>20</sup> *Ibid*

<sup>21</sup> *Ibid*

- (B) When transitioning their existing contracts, firms receiving LIBOR-linked interest are not expected to give up the difference between LIBOR and SONIA, which results from the term credit risk premium that is built into the LIBOR rate, but not into SONIA.<sup>22</sup>

As such, firms will need to consider how to handle any potential value transfers at the point of transition and during any periods when LIBOR and RFRs continue in parallel, to ensure any replacement rate selected is considered fair<sup>23</sup>.

In relation to assessing the adequacy of existing or proposed new fallback language, firms will be expected to consider whether that language remains suitable for customers. In this regard, the FCA has highlighted that “fall backs are not designed as, and should not be relied upon, as the primary mechanism for transition”<sup>24</sup>.

In ensuring that customers are treated fairly and not disadvantaged as a result of the firm’s approach to LIBOR transition, firms may wish to consider the following:

✓	To what extent has the firm identified comprehensively those product and client areas affected by LIBOR transition?
✓	What process is in place for identifying all relevant contracts affected by LIBOR transition and determining what (if any) fallback language is included in each contract?
✓	What process is in place for conducting an assessment of the consequences of LIBOR transition in relation to affected clients and corresponding contracts and identifying transition options?
✓	What process is in place for identifying those new rates for which there is an “established market consensus” <sup>25</sup> ?
✓	What process is in place for identifying potential value transfers when considering transition to RFRs or alternative rates and corresponding spread adjustment methodologies where relevant? How is the firm ensuring that spread adjustment methodologies are fair and applied consistently?
✓	What process is in place for monitoring the performance of contracts affected by LIBOR transition and, where relevant, the performance of RFRs or alternative rates?

## Client Communications

The FCA and PRA have highlighted that those firms who produced stronger responses in reply to the Dear CEO Letter sent in September 2018 provided evidence that they were developing and executing comprehensive internal and external communication strategies to promote education on transition<sup>26</sup>. Effective client communications strategies will mitigate some of the potential conduct risks associated with LIBOR transition. For example, firms have an obligation to treat customers fairly and should consider whether proposed communications to clients are drafted in a way which takes into consideration different client needs, sophistication and levels of understanding.

In this context, firms may wish to consider the following questions:

✓	Which team(s) oversee communication strategies in relation to each impacted client area? What process is in place to ensure alignment of client communications by client types (e.g. retail, small and medium-sized enterprises, professional, eligible counterparties), business units and jurisdictions and which spans the lifecycle of the LIBOR transition to mitigate the risk of potential conflicts of interest or asymmetries of information?
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<sup>22</sup> Ibid

<sup>23</sup> Letter from the Working Group on Sterling Risk-Free Reference Rates to Andrew Bailey, CEO of the FCA dated 23 October 2019

<sup>24</sup> *Interest rate benchmark reform: transition to a world without LIBOR*, Speech by Andrew Bailey, Chief Executive of the FCA, at Bloomberg, London, 12 July 2018

<sup>25</sup> *Conduct risk during LIBOR transition – Questions and answers for firms about conduct risk during LIBOR transition*, 19 November 2019

<sup>26</sup> *Feedback on the Dear CEO letter on LIBOR transition, June 2019, section 5: Identification and management of conduct risks associated with the transition*

✓	What process is in place to ensure consistent responses to questions from clients in relation to LIBOR transition (for example, through the use of playbooks and FAQs)?
✓	What process is in place to identify the content, format and timing of client communications? How will Legal and Compliance functions contribute to this process?
✓	What information will be provided in respect of each client communication strategy (for example, information relating to: the background to LIBOR transition; differences between existing LIBORs and RFRs; timing of LIBOR transition; the potential risks and outcomes clients may encounter as a result of LIBOR transition; and where clients can find further information in relation to LIBOR transition)?
✓	What process is in place to ensure client communications remain 'live' documents that are updated regularly to account for industry developments?
✓	In what format will information be provided to clients depending on communication strategy type (for example, FAQ documents; reports and briefings; or webinars and update calls)?
✓	What process is in place to ensure effective records of client communications are maintained?
✓	How will the firm engage with client queries and complaints?

## Conflicts of Interest and Market Abuse

In assessing potential conduct and compliance risks arising from LIBOR transition, firms will need to identify potential conflicts of interest<sup>27</sup> and market abuse risks. One of the FCA and PRA's key findings from the Feedback on the Dear CEO Letter was that "less strong responses lacked recognition of potential conflicts that could, for example, result in clients and third parties being misinformed and/or disadvantaged and did not acknowledge potential risks from market manipulation or insider trading"<sup>28</sup>.

There are a number of factors relating to LIBOR transition that may increase these risks (including, for example, the pace of transition across different product types as a result of the availability of RFRs given the relative liquidity of underlying instruments). As such, firms should ensure that the identification, mitigation and monitoring of potential conflicts of interest and potential market misconduct are included as part of their conduct risk framework in relation to LIBOR transition.

In this context, firms may wish to consider the following questions:

✓	What process is in place to: (i) identify potential conflicts of interest that may arise as a result of, or during, LIBOR transition; (ii) determine corresponding risk mitigants; and (iii) monitor implementation of those mitigants? Is the existing conflicts register sufficient to be able to incorporate management of these potential conflicts?
✓	What process is in place to manage potential conflicts of interest across each of the firm's business divisions?
✓	What process is in place to: (i) identify potential behaviours that may lead to market misconduct in the context of LIBOR transition; (ii) determine corresponding risk mitigants; and (iii) monitor implementation of those risk mitigants?
✓	What process is in place to assess how the manner in which Front Office staff are rewarded or incentivised may be relevant to LIBOR transition?
✓	What process / training / controls are in place where firms are aware of customer intentions with regard LIBOR / RFRs and these intentions have a negative impact on firm positions or lend themselves to being exploited with a view to making a profit?

<sup>27</sup> Conduct risk during LIBOR transition – Questions and answers for firms about conduct risk during LIBOR transition, 19 November 2019

<sup>28</sup> Feedback on the Dear CEO letter on LIBOR transition, June 2019, section 5: Identification and management of conduct risks associated with the transition

✓	To what extent have existing policies and procedures relating to managing conflicts of interest and market misconduct been reviewed and updated in light of LIBOR transition?
✓	What training is provided to staff on conflicts of interest and market abuse requirements in the context of LIBOR transition?
✓	What consideration is the firm giving to enhanced surveillance for particular members of staff, specifically those involved in rates that are transitioning?

## Outsourcing

Outsourcing has been a focus for the FCA in its last four Business Plans and the UK regulatory framework and Final Notices are clear that: (i) firms can outsource regulated functions but not regulatory obligations and; (ii) firms will be accountable for regulatory failures resulting from outsourced providers' work<sup>29</sup>.

Many firms will have existing outsourcing and delegation arrangements in place with third parties or existing insourcing arrangements in place with other group entities and/or will need to put such arrangements in place in order to effect their LIBOR transition process. The FCA will expect firms to take appropriate steps to ensure that outsourced services are performed in compliance with applicable regulation. It is therefore important that firms ensure that sufficient oversight and scrutiny is given to these arrangements<sup>30</sup>.

In this context, firms may wish to consider the following questions:

✓	Does the firm have any existing outsourced, insourced or delegated functions that might be impacted by LIBOR transition? If yes, is the outsourced/insourced service provider or delegee taking appropriate steps to manage LIBOR transition – can the firm evidence appropriate oversight of that function?
✓	To what extent will the firm be outsourcing functions to third party firms or instructing third-party service providers in relation to implementation of the LIBOR transition? If so,
	➤ Should that particular function be outsourced at all?
	➤ What due diligence has been undertaken prior to deciding to use one or more third parties, such as for the delivery of technology services to assist in the location and review of LIBOR referencing contracts?
	➤ Does the firm have Service Level Agreements in place with third-party firms which make clear the role of the third party and terms of engagement, including in the context of LIBOR transition?
	➤ What process is in place to identify any aspects of the third party service provider's role that may be relevant in relation to one of the firm's regulatory obligations?
	➤ What process is in place to understand the quality and accuracy of the product(s) delivered by the third party firms?
	➤ What process is in place to ensure the firm has given adequate consideration to the relationship between different service providers (if, for example, one provider cannot offer a complete solution)? How will that arrangement operate in practice?
	➤ Does the firm have an exit plan in place for these service providers and how would the firm transition to an alternative service provider?
✓	Has the firm considered data protection issues in relation to third party service providers? For example, will data be removed from the service providers' systems?

<sup>29</sup> See, for example, SYSC 8.1.6 R

<sup>30</sup> In addition, whilst different but linked to outsourcing is delegation. Senior Manager Conduct Rule 3 (COCON 2.2.3) is therefore relevant in the context of Senior Managers' responsibilities: "SC3: You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively."

## Training

Effective training and awareness of a firm's regulatory and legal obligations among all business divisions will help to mitigate certain conduct risks associated with LIBOR transition.

In this context, firms may wish to consider the following questions:

✓	What training is required to mitigate conduct risks? For example, should LIBOR transition be considered as part of existing competition, market abuse or conduct risk training? Is standalone training required?
✓	Which internal teams should be trained on LIBOR transition?
✓	Which team(s) are responsible for determining the content of, and delivering, relevant training? How will Legal and Compliance functions contribute to this process?
✓	How will internal teams be kept regularly updated on developments in relation to LIBOR transition (for example, through the use of: (i) regular internal update meetings within product areas and across legal and compliance; (ii) specific separate workshops for the front office, legal and compliance, operations and risk; and (iii) a hotline for questions and escalation of LIBOR transition issues for each business line)?
✓	How will the firm ensure that all relevant staff, to the extent possible, attend the training sessions?
✓	Should the firm evaluate internal stakeholders' understanding of LIBOR transition at key stages of the project (for example, by using e-learning courses)?

## Phase 3: Post-Implementation

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As new business is transacted using RFRs and existing contracts are transferred to RFRs, and more generally post end 2021, the conduct risks associated with LIBOR transition will continue. Moreover, these risks are likely to crystallise in this period and it is expected that firms will receive questions, and possibly complaints, from clients. Firms will need to be ready to assess and respond appropriately to these types of communications from clients.

As RFRs will perform differently from LIBOR linked contracts, careful monitoring of performance post-implementation is likely to assist in identifying arrangements where further communications would assist. Firms should ensure consistency in approach when answering those questions (by, for example, using playbooks) and involve the Legal and Compliance functions. Firms will want to review their current process for handling complaints from clients to ensure that it would be appropriate for any LIBOR related complaints.

In this context, firms may wish to consider the following questions:

✓	Who will be responsible for monitoring client impact and engagement?
✓	How will the firm monitor client engagement and ensure that learnings are fed back into the firm's systems?
✓	When in the LIBOR transition process is client engagement most likely to occur?
✓	Which business areas and product lines are likely to receive the most client engagement? Would those areas benefit from additional training?
✓	How will the firm ensure consistency in the treatment of different client types and, within those groups, clients?
✓	How will the firm engage with client queries and complaints?
✓	Does the firm have an effective surveillance process to prevent, manage and mitigate the potential conduct risks, arising out of the firm's LIBOR transition project?
✓	Does the firm have a process in place for determining if and when the LIBOR transition process has been unsuccessful in certain areas? Is there an escalation procedure for client engagement, client complaints, results of the surveillance programme in order to limit the firm's exposure, in the event that any of the conduct risks materialise?
✓	If there are failings in the LIBOR transition process how will the firm communicate with clients? Is there a clear strategy in place?

## Summary of AFME Members' Feedback on Further Regulatory Engagement

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The interest in this topic from AFME Members has been significant and we would like to thank all of those who contributed their thoughts and suggestions for taking the time to do so.

Members are grateful for the engagement and guidance provided by the UK regulators on this topic, most recently in the FCA Q&A. Members would welcome continued guidance from the FCA as the LIBOR transition progresses. Individual Members have suggested particular areas in respect of which they would benefit from further clarity, which we have summarised below:

- (A) Examples of the ways in which conduct risk may arise in practice throughout LIBOR transition, and ways in which to manage that risk, particularly in relation to:
  - (1) Market abuse;
  - (2) Conflicts of interest; and
  - (3) Communications with different client types who will vary in their level of sophistication.
- (B) Guidance on ways to manage the practical challenges associated with transition of legacy complex structured products linked to LIBOR.
- (C) Guidance on the practical application of “established market consensus” in respect of customers when replacing LIBOR prior to cessation, particularly in relation to examples where deviations from market consensus may be more appropriate.
- (D) Further criteria to be used in assessing whether a replacement rate is “fair”.
- (E) Further detail regarding sales practices and product governance obligations that arise specifically in the context of LIBOR transition for affected products.
- (F) Confirmation on the extent to which the FCA is engaging with overseas regulators in relation to achieving alignment on regulatory expectations regarding LIBOR transition.
- (G) Practical ‘do’s and don’ts’ to mitigate competition risk in the context of industry discussions regarding LIBOR transition.

Members would benefit from regular industry discussions with the FCA in which shared challenges relating to the management of conduct risk can be discussed and potential solutions identified.



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We are grateful to our Member firms and the individuals who contributed their time and thoughts in producing this report.

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## / About AFME

The Association for Financial Markets in Europe (AFME) is the voice of all Europe's wholesale financial markets, providing expertise across a broad range of regulatory and capital markets issues.

We represent the leading global and European banks and other significant capital market players.

We advocate for deep and integrated European capital markets which serve the needs of companies and investors, supporting economic growth and benefiting society.

We aim to act as a bridge between market participants and policy makers across Europe, drawing on our strong and long-standing relationships, our technical knowledge and fact-based work.

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