



IBOR TRANSFORMATION AUSTRALIAN WORKING GROUP

19 December 2019

Council of Financial Regulators

Chair of Council of Financial Regulators - Dr Phil Lowe
Secretary of the Treasury - Dr Steven Kennedy
Chair of APRA - Mr Wayne Byres
Chair of ASIC - Mr James Shipton

Dear Council Members

Request for Guidance on matters associated with IBOR Transition

I am writing to the Council of Financial Regulators in my capacity as Chair of the IBOR Transformation Australian Working Group (Australian Group). The Australian Group is the national working group that considers the strategic issues facing Australia as the market is transformed by IBOR transition.

We appreciated the opportunity to have an initial discussion with ASIC officers regarding some of the challenges in transitioning from LIBOR to risk-free reference rates (RFRs). This discussion took place at the September meeting of the Australian Group.

In this letter, we request guidance on the supervisory expectation regarding conduct matters associated with the transition from LIBOR to RFRs. While this letter focuses on the challenges facing banks, other Australian financial institutions may be facing similar challenges. We bring two specific matters to your attention.

The first matter concerns conduct risk in relation to the transition to RFRs; the second concerns client communications.

1. Conduct risk in relation to the transition to RFRs

The discontinuance of LIBOR presents a particular challenge due to the complexity of the transition to RFRs. The asymmetry of understanding between the banks and many of their customers, and the wide divergence of understanding across the customer base adds to

this challenge. We emphasise the critical importance of treating all our clients equitably and fairly.

The challenge is not unique to Australia and the acuteness of the problems is well articulated by the Working Group on Sterling Risk-Free Reference Rates (RFR WG) to the UK Financial Conduct Authority in their [recent letter](#) dated 23 October 2019. That letter discusses what are described as *'examples of conduct risk that firms are finding (...) difficult to navigate in developing their transition plans'*. We quote a relevant passage of the letter. Whilst we take note of the guidance subsequently provided by the FCA in its ['Q&A on Conduct risk during LIBOR transition'](#), some questions remain.

The RFR WG letter emphasises that *'all customers should expect to be treated fairly throughout the transition'*. The letter also states that:

'...it should be noted that it will not be possible to guarantee that there will be no future value transfer between counterparties. The RFR WG seeks guidance on how firms should consider handling any potential value transfers at the point of transition and during any periods where LIBOR and SONIA continue in parallel...'

The above comment draws attention to the fact that transitioning clients from LIBOR to RFR exposure in what may be an illiquid market environment, is not without risk and could involve considerable execution costs.

The UK formulation of treating customers fairly accords with the general obligation under the Corporations Act in section 912A of doing all things to provide financial services efficiently, honestly and fairly. The concept of what is 'fair' is particularly challenging when transitioning clients to RFR-based products, where financial institutions such as banks generally possess wider market insight regarding significant positions. This implies the need to manage conflicts of interests in some circumstances. For example, the state of market liquidity of RFR products and LIBOR products over the period of transition may provide an opportunity for pricing biases to emerge.

Accordingly, guidance on these matters from the Council would be valued by the industry.

2. Client communications

The Australian Group encourages the Council to consider how financial regulators can work with industry to ensure that all market participants are receiving consistent and appropriate communications regarding LIBOR transition. Banks acknowledge the importance of ensuring that their customers are appropriately informed about LIBOR transition. However, the uncertainty of the path of transition presents a significant impediment to the development of a comprehensive client engagement strategy. Examples of market uncertainties include:

- The development of market solutions and market standards for the transition to RFRs is still in progress.

- Liquidity in markets is evolving at different speeds in respective products and currencies.
- The future viability and acceptance of forward-looking RFR term rates is uncertain.

Accordingly, guidance from the Council on the delivery of communications while these market uncertainties persist, would be valued by the industry.

Future Developments

In addition to the matters raised in this letter, we are aware of considerable overseas dialogue concerning aspects of the prudential capital regime and the discussion of a solution for the 'tough legacy', including potential legislative solutions. There may be a potential need for changes and/or forbearance in this regime to support a smooth and timely transition to RFRs. The Australian Group intends to study the relevant prudential and legal issues further, with the aim of approaching the relevant Australian authorities in due course.

The Australian Group encourages international coordination and alignment in the regulatory treatment of transition across relevant jurisdictions.

We would look forward to hearing from you, and to discussing the issues raised in this letter with members of the Council in relation to their respective regulatory responsibilities. Queries and communications concerning this letter can be directed through the Australian Group's secretariat in the Australian Financial Markets Association. Contact details are David Love at dlove@afma.com.au and on (02) 9776 7995.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Pieter Bierkens', with a long horizontal flourish underneath.

Pieter Bierkens
Chair
IBOR Transformation Australian Working Group