Corporate Counsel Business Journal
September ▪ October 2020
CCBJournal.com
CCBJ

As LIBOR Sunsets, Contract Intelligence Takes Center Stage

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What happens when "the most important number in finance" is eliminated? With the impending retirement of the London Interbank Offered Rate (LIBOR), financial institutions around the world are now faced with that question.

The longtime global basis for most agreements with a variable interest rate component, LIBOR will officially sunset at the end of 2021. During the latest financial crisis, it was manipulated by certain parties and became the source of several scandals. In response, the Federal Reserve and regulators in the United States and the United Kingdom eventually decided to replace LIBOR with other rate benchmarks. With less than two years to go, banks are now beginning to prepare for the transition.

An estimated $400 trillion in financial contracts rely upon LIBOR. While the phase out will impact banks across numerous fronts, one of the most significant effects will be addressing the identification, analysis and repapering of all related contracts. By the time it is retired, any contracts that either lack a fallback provision or have not been renegotiated will be left without a rate benchmark.

Many financial institutions are unprepared but are beginning to recognize the urgency and complexity of repapering their LIBOR-based agreements. Banks and other institutions that take quick action and allow ample time for contract renegotiation will be in a much stronger position to reduce their overall risk and exposure relating to new rate benchmarks and standards.

Also of note is the impact of the current coronavirus pandemic. In late March, the UK Financial Conduct Authority (FCA) issued a statement that it is considering the impact of the coronavirus on firms' transition plans. For now, the timeline is moving forward unchanged. Financial institutions are expected to continue working toward the existing deadline, while monitoring for any updated guidance from the FCA.

Repapering LIBOR Contracts: Key Challenges

The process of identifying contracts subject to transition, determining how they are impacted, and remediating agreements according to new and evolving standards will require significant runway ahead of the deadline. The alternative is potential litigation exposure post-transition.

Size and scope: LIBOR is central to millions of contracts, including mortgages, student loans, pensions and business investments. For a single financial institution, the universe of impacted contracts likely spans numerous systems, languages, business units and international borders. The sheer volume of contracts and repository and management systems that must be addressed will make this change a significant burden for legal, compliance and treasury teams at financial institutions.

Contract collection: The first step in transitioning is collecting contracts for analysis and review – a complex process of pulling large volumes of documents from multiple systems in numerous locations, including across borders, into a centralized repository. This is similar to the type of work computer forensic investigators undertake in large-scale investigations and electronic discovery matters.

The U.S. Securities and Exchange Commission (SEC) and the UK Financial Conduct Authority (FCA) are advising public companies and regulated entities to assess their risk exposure, quantify the financial impact, develop remediation plans and communicate material information to stakeholders.

Banks will need support from experts experienced with these types of collections to ensure an efficient and thorough effort with minimal business disruption.

Identifying and analyzing impacted agreements: Artificial intelligence technology solutions – that can automatically identify and extract LIBOR transition-relevant terms and conditions and prioritize them for remediation – will be a critical component of quickly identifying contracts that must be amended or repapered. Tools that can bulk-extract metadata from repository and management systems will further enhance the process of classifying and analyzing documents and may even reduce the need for more costly artificial intelligence–based processing. Legal teams with limited experience using these types of tools may struggle to select the right technology or apply tools in the most effective way.

Renegotiating terms: Once identified, many contracts will undergo a renegotiation process with counterparties, even if just to acquire a consent to amendment. Legal counsel will drive this process but will need adequate time to address each contract individually. Counsel will rely on visibility into the results of the contract analysis process but may still require additional head count to manage the project and complete it on time. Organizations should also be prepared for certain parties to leverage LIBOR repapering as an opportunity to revisit or renegotiate other terms in their agreement. Creating a cushion in the timeline to deal with these scenarios will help reduce risk.

Market inconsistency: Replacement standards for LIBOR have not been fully determined and are expected to change over the course of the next two years. They will also vary between jurisdictions. Transition plans and supporting technologies should be flexible to adapt to evolving standards as they are defined or revised.

The Financial Accounting Standards Board (FASB) is working to provide relief for organizations impacted by the LIBOR transition. In 2019, FASB's chairman said in a statement: "We're committed to ensuring standards help stakeholders successfully adapt to changes ahead . . . "

Tentative contract modification relief decisions include:

- *If criteria are met, a change in a contract's reference rate may account for continuation of a contract.*
- *In certain cases, the creation of a new contract would not be necessary.*
- *Standards changes to reduce accounting costs and complexity relating to LIBOR transitions.*
- *Applicability to loans, debts, leases and other arrangements.*

Addressing LIBOR with Contract Intelligence

To tackle the LIBOR retirement in a timely manner and reduce risk, financial institutions need a cost-effective solution for finding, reviewing, analyzing and repapering their global contract universe. While artificial intelligence (AI) can identify the terms and language affected by LIBOR retirement in each contract, the process should be supported with organized analysis workflows and quality-control methodologies to interpret and prioritize the impacts. The benefits of a centralized contract intelligence methodology, which incorporates people, process and technology, include:

- Support from experts who provide deep technical experience in forensic collection and the contract-review process.
- Guidance for the overall effort, technology optimization and adjustment of technology applications as needed.
- Sophisticated application of advanced tools to automatically identify relevant documents and extract implicated elements and clauses.
- The ability to process multiple languages and convert captured information to structured, actionable data in required languages.
- Project reporting and analytics to visually demonstrate contract content, inform counsel of key data trends and support repapering efforts.
- Integration and plug-ins to seamlessly connect to other tools, and to automatically document key information and migrate it to repapering platforms.
- Robust workflows and quality assurance.

FTI's Technical Excellence

FTI Technology offers a purpose-built, structured analytics engine that identifies and analyzes a company's relevant contract universe. Working alongside legal counsel, our AI-driven solutions assess the current state of fallback provisions and prioritize contracts that require remediation or renegotiation. Our team is deeply invested in technology and includes in-house programmers devoted to building customized solutions for clients. We understand the complexity of the LIBOR phaseout and that no one-stop technology solution exists. That's why we have dedicated technologists building, managing and refining our technology stack and application programming interfaces to integrate with the other tools needed in the process.

As in most critical business initiatives, technology is not a silver bullet. At FTI Technology, our Contract Intelligence practice provides legal and financial services industry expertise, deep technical capabilities, innovative technology solutions and proprietary workflows to holistically approach LIBOR contract transition.

FTI Consulting has established a LIBOR Transition Task Force to work with clients, industry groups, law firms and policymakers, and to advise affected stakeholders on the most challenging issues related to the shift in reference rates. One of the crucial services performed by this task force is identifying and inventorying firmwide LIBOR exposure, which we accomplish via our Contract Intelligence service. ■

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