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Preparing for the LIBOR Phase Out: Contract Remediation Starts with Contract Intelligence

The London Interbank Offered Rate has long been the global basis for agreements that include a variable interest rate component. However, LIBOR would be replaced by other benchmarks by the end of 2021. Key to assessing risk of exposure, quantifying the financial impact, developing remediation plans and communicating material information to stakeholders will be the identification, analysis and remediation of LIBOR-based contracts.

By RYAN DRIMALLA AND KARL DORWART

The New York Times called it the "most important number in finance." The London Interbank Offered Rate (LIBOR) has long been the global basis for agreements that include a variable interest rate component. In 2018, in eventual response to scandals during the financial crisis, the Federal Reserve and regulators in the U.S. and UK confirmed that LIBOR would be replaced by other benchmarks by the end of 2021.

Now, with less than two years until the phase out, 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. Doing so will require significant efforts across numerous business units within impacted corporations. Key among them will be the identification, analysis and remediation of LIBOR-based contracts.

Representative of an estimated $400 trillion in financial contracts, LIBOR will not be easy to phase out. 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. As a result, legal, compliance and treasury teams at financial institutions are now under pressure to make substantial progress in identifying contracts subject to transition, determining how they are impacted and remediating agreements according to new and evolving standards or face potential litigation exposure post-transition.

This process takes time, and legal counsel will need runway to complete contract renegotiation by the deadline. The massive volume of contracts impacted alone makes LIBOR transition a major undertaking. Further complicating the issue is uncertainty about the replacement standards — which have not been fully determined and will likely vary between jurisdictions. Banks and other institutions will need to set up their contract transition plans and related technologies with flexibility to adapt to changing standards as they are defined or revised.

Also of note is the impact of the current coronavirus pandemic. In late March, the 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.

Addressing LIBOR with Contract Intelligence

Artificial intelligence technology solutions — that can automatically identify and extract LIBOR transition-relevant terms and conditions — will play a key role in enabling the process. But AI technology alone isn't a silver bullet for this complicated and sensitive matter. As institutions prepare to sunset LIBOR and address their contracts accordingly, the following checklist of tips, tricks and considerations can help keep the process on track:

- **Understand the scope:** In-house legal teams tasked with repapering LIBOR-based contracts need to prepare for the massive scale of this effort. It will likely involve a large volume of affected contracts, foreign language documents, various repository and management systems, and collaboration across disparate business units. Teams should set expectations, timelines and budgets accordingly.
- **Collection is critical:** Depending on the institution's contract management practices and organizational structure, the process of collecting contracts into a centralized repository for comprehensive analysis can be particularly challenging. This will involve pulling documents from multiple systems and in numerous locations, including across borders. Support from digital forensics experts who are experienced with complex data collections will help ensure an efficient and thorough effort.
- **Select the right technologies:** First and foremost, the tools used for this initiative should be flexible to provide a consistent approach across the varying jurisdictions' data requirements, and able to detect and translate foreign and machine languages. Artificial intelligence is essential to quickly classify and analyze documents but a complete program will need to supplement AI technology with robust document analysis workflow, management information (MI), and template generation capabilities.
- **A multi-pronged approach will improve results:** Establishing the right mix of technologies creates a foundation to analyze and organize contracts but those platforms must be supported with organized workflows and quality control methodologies to ensure accuracy and efficiency. Experts who provide deep technical experience in the managed review processes can guide the effort and help determine when either the algorithms or people require adjustment.
- **Enable Integration:** Data capture and centralization methodology should be in partnership with internal contract management process and IT/infrastructure requirements to facilitate seamless integration with existing systems. Try to select tools with available integrations to automate migration of documents and data to repapering platforms or internal management systems.
- **Build a robust team for renegotiation:** While outside counsel will often drive the repapering process, it's important to support them with people who are familiar with the results of the contract analysis and review. This will help provide context where needed and bolster counsel with a deeper understanding of the contract universe, the data within it and the technology used to make decisions about it.

Many financial institutions are unprepared to make the transition away from LIBOR. But we're seeing an increased focus on this initiative for 2020 as they recognize the complexity that will be involved in repapering certain agreements. Financial institutions that take quick action on addressing their LIBOR-based contracts, and allow ample time for contract renegotiation, will be in a much stronger position to reduce their overall risk and exposure relating to new benchmarks and standards.

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Ryan Drimalla is a managing director with FTI Consulting, where he leads FTI Technology's Contract Intelligence service. Karl Dorwart is a Senior Director at FTI Consulting and is based in New York. **Mr. Dorwart** has deep legal services industry experience in contract lifecycle management.