



# How to Update \$400 Trillion in Contracts for LIBOR Transition

Addressing Section 7 of the  
LIBOR ARRC Checklist

Prepared & protected. Win. Win.

“Time is running out for LIBOR, and immediate action is necessary to ensure that firms have a robust transition plan. [Our] checklist ... details practical measures that firms can take to prepare and transition now.”

- Tom Wipf, ARRC Chair, September 19, 2019

# Introduction:

LIBOR, or the London Interbank Offered Rate, referred to by many in the financial industry as “the world’s most important number,” will be phased out on December 31, 2021. It’s an event with major reverberations throughout the financial industry with close to \$400 trillion in loans, securities and derivatives affected. Yet many institutions that will be affected are not preparing.

There are many risks to doing nothing. For borrowers, their loan terms could become dated or faulty.<sup>(1)</sup> They may incur increased financial costs or experience cashflow fluctuations. For investors in LIBOR-based debt instruments (including floating rate debt, bank loans, LIBOR-linked derivatives, some asset-backed securities), the value of their investments may become unclear thus harder to sell or trade.<sup>(2)</sup> And for banks that issue debt or loans they open themselves up to potential regulatory fines, litigation, negative press, reputational damage and loss of business.

According to a recent survey,<sup>(3)</sup> only 20 percent of organizations report they are functionally prepared to move away from LIBOR, and 40 percent point to regulatory ambiguity on reference rates as reasons for inaction. Transitioning from LIBOR is a critical, complex challenge for banks, capital markets, corporates and insurance firms, but there’s a general lack of preparation among these groups.

Some organizations are waiting for issues with ARRs (Alternative Reference Rates such as SOFR) to be addressed, while others are not sure about using fallback language on existing loan contracts. That said, the guidance from the regulators is clear: mobilizing for LIBOR transition needs to begin **now**. Randal K. Quarles, vice chair of supervision for the Federal Reserve Board of Governors, states, “... beginning that [LIBOR] transition now would be consistent with prudent risk management and the duty that you owe to your shareholders and clients.”

Fortunately for banks and corporates, the LIBOR Alternative Reference Rates Committee (ARRC),

convened by the Federal Reserve Board and the Federal Reserve Bank of New York, recently published *Practical Implementation Checklist for SOFR Adoption*<sup>(4)</sup>. This checklist outlines ten categories of implementation, including “Section 7: Contractual Remediation Impact and Design.”

**There are many risks to doing nothing: banks open themselves up to potential regulatory fines, litigation, negative press, reputational damage, loss of business.**

There is an enormous number of contracts that need to be transitioned. For large banks, a million or more loan contracts are not out of the ordinary. As an example, when Lehman Brothers went bankrupt in 2008, it was involved in more than 900,000 derivatives contracts.<sup>(5)</sup> The volume of documentation poses severe challenges with review, secure collaboration and distribution, as well as reporting for organizations implementing the recommendations listed in Section 7 of the ARRC Checklist.

This white paper details these challenges, and shows how the application of workflow, and document collaboration technologies coupled with artificial intelligence (AI), can help manage these challenges and facilitate LIBOR transition at scale.

# Overview of AARC Section 7: Contractual Remediation Impact and Design<sup>(4)</sup>

A key item in the Alternative Reference Rates Committee's (ARRC) checklist pertains to understanding the financial, customer, and legal implications from the transition out of LIBOR via fallbacks, and planning for changes to contracts.

## 7.1



Review existing LIBOR related contracts to determine the impact of fallbacks.

## 7.2



Project the impact if the fallbacks have to be executed and use this to inform future steps and priorities.

## 7.3



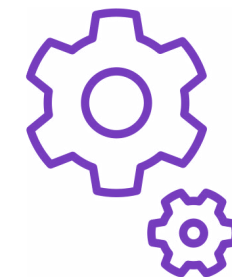
For new contracts that reference LIBOR, incorporate recommended fallback language developed by ARRC, the International Swaps and Derivatives Association (ISDA), and other industry working groups.

## 7.4



For existing contracts that reference LIBOR, define approach and prioritization strategy for renegotiating/repapering contracts so as to include enhanced fallbacks or other amendments simplifying transition.

## 7.5



Assuming a material number of contracts cannot be remediated, determine size and program needed to implement fallback language as written, and begin planning for implementation.



# ARRC Step 7.1

Review existing LIBOR related contracts to determine the impact of fallbacks. This should include inventorying the triggers, changes to terms, financial impact, customer impact and legal interpretations. The review should assemble relevant information into a vehicle for capturing contractual data.<sup>(4)</sup>



# What this means for banks

**Assess the universe of contracts and get organized.** Paper contracts will need to be scanned and converted into PDF files; digital files will need to be located. All files need to be searchable. Contracts will need to be assessed and grouped into at least the following categories.

Categories	Before 12/31/2021	After 12/31/2021	New Contracts
Required Action			
Quality Assurance Confirmation	X		
Fallback language or Alternative Reference rate (ARR)		X	
Alternative Reference rate (ARR)			X

**Analyze and categorize:** This process involves deep expertise and understanding of asset classes. Even the first pass—determining if a contract refers to LIBOR—may be complicated. For example, a fixed-rate loan contract that does not appear to involve LIBOR may contain an interest rate derivative linked to it (i.e. a parent/child document relationship). In these instances, subject matter experts will need to set guidelines for reviewers and AI tools to find the impacted contracts.

**Ensure security and confidentiality:** These contracts are full of sensitive information, including materially non-public information (MNPI) and personally identifiable information (PII). The consequences of this information getting into the hands of malicious individuals—whether internal or external to the bank—will be an even bigger headache than the LIBOR

transition. The bank needs to implement an ultra-secure document repository and collaboration/transmission mechanism: a system that ideally has the ability to manage user permissions as well as audit every step of this process.

**Subject matter experts will need to set guidelines for reviewers and AI tools can be used to find impacted contracts.**



# ARRC Step 7.2

Project the impact if the fallbacks have to be executed and use this to inform future steps and priorities.

This is a combination of expected financial, legal, customer and operational impacts.<sup>(4)</sup>



# What this means for banks

**Determine if fallback terms or alternative reference rates, when applied, disproportionately benefit one party over another.** Final alternative rates and calculations may still be up for debate, but it's important to flag contracts that, once fallback terms or new rates are applied, become significantly beneficial for one group – whether the bank or the customer. If too advantageous to one party, the contract may be legally deemed invalid.<sup>(6)</sup>

One can imagine the fire drill if a large number of contracts are in this category once LIBOR ends. The banks should therefore: analyze financial exposures, contractual language, and affected counterparties. Lawyers and accountants will be significantly involved in this exercise as well.

**Calculate potential tax implications.** Analysis should include tax implications by asset class and also jurisdiction. Deloitte experts cite as

examples “hybrid rules, corporate interest restriction rules, transfer pricing and thin capitalization rules.”<sup>(6)</sup> Banks should evaluate the impact from the perspective of the client counterparty and address as appropriate. Tax advisors should be engaged to review updates/ amendments to contracts and determine if any tax consequences are surfaced in the contractual language.<sup>(6)</sup>

**Establish secure, auditable workflow and communication lines.** As cross-functional collaborators are incorporated into this process, the importance of security and auditability cannot be stressed enough. Sensitive documents are moving across and outside the bank. Traditional document transfer channels such as email and ground shipping are not secure, hard to track and slow. Add to this the challenge of workflow tracking as each

contract moves through legal, tax, finance and other teams. This is where centralized status dashboards and granular audit trails are key to tracking progress and maintaining a defensible process.

**Improve productivity with artificial intelligence (AI).** Even for a bank staffed with teams of lawyers and accountants, LIBOR transition is a gargantuan endeavor, and there's only about two more years to get everything done. Enter AI, which can automate sorting through potentially affected contracts, identifying relevant contract provisions (including fallback language), flagging documents for further review or analysis, culling out nonimpacted contracts and so on.



# ARRC Step 7.3

For *new* contracts that reference LIBOR, incorporate recommended fallback language developed by ARRC, the International Swaps and Derivatives Association, and other industry working groups.<sup>(4)</sup>



# ARRC Step 7.4

For *existing* contracts that reference LIBOR, define approach and prioritization strategy for renegotiating/repapering contracts so as to include enhanced fallbacks or other amendments simplifying transition.

The approach should consider the work required to remediate in advance and how to realize economies of scale. As soon as possible, begin either

- a) amending contracts to incorporate enhanced fallback language, or
- (b) determining if contracts can be renegotiated or closed out prior to end-2021.<sup>(4)</sup>



# What this means for banks

**Time to update contracts.** Armed with the set of contracts that need to be updated (with either fallback language or alternative reference rates) as well as analysis around taxes and customer impact, it's time to get to work. Double-check revisions, validate changes with all necessary collaborators and maintain document version control.

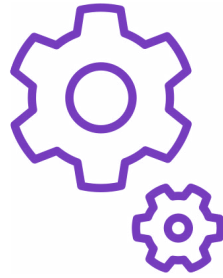
**(Continue to) leverage AI tools.** Use AI to extract contract terms, validate against types of contracts or updates needed, and apply the actual contract revisions. AI can confirm amendments are processed and reconciled with guidelines/instructions from lawyers, accountants, etc. AI tools are already being used across different industries to manage risk, improve efficiency and governance in contract workflow. These solutions have demonstrated up to 80 percent improvement in process efficiency and 70 percent less time spent on processing documentation.<sup>(5)</sup>

**Artificial intelligence can confirm amendments are processed and reconcile with guidelines from lawyers and accountants.**



# ARRC Step 7.5

Assuming a material number of contracts cannot be remediated, determine size and program needed to implement fallback language as written, and begin planning for implementation. This should include customer notification processes.<sup>(4)</sup>



# What this means for banks

## **Collaborate with clients and stakeholders.**

Customer communications are likely to be complicated. Banks have many relationships with customers across banking products. Market protocols can make derivatives contract amendments much easier. Bond amendments, by contrast, will be more difficult since they require majority bondholder approval.<sup>(6)</sup> A bank's communications plan specific to LIBOR transition should consider these nuances.

## **Centralize and ensure secure communication channels.**

One consistent method for communicating with clients is best. Consider centralizing communications with collaborators, customers and other stakeholders within a secure platform that can also provide audit/activity reporting. This allows collaborators to post questions, answers, comments, etc., minimizes email volume, confusion and risk of exposing MNPI and PII.

## **Flag and store unremediated contracts separately.**

These contracts may have to go through additional workflow, so it's best to keep them separate from contracts that have been remediated.

**Consider centralizing communications with collaborators, customers, and other stakeholders to ensure proper audit and activity reporting.**

# Conclusion

There's not much time left. Contract review and remediation alone is complex, with many documents and parties involved. A combination of immediate action, secure document exchange, artificial intelligence, and efficient workflow is key in getting contracts into shape by December 31, 2021.

Intralinks' innovative LIBOR transition solution helps banks efficiently and securely share millions of loan documents, identify affected contracts, and execute updates with multiple internal and external collaborators. Our ultra-secure virtual data room (VDR) technology is used by 99% of the Fortune 1000 to manage and execute sensitive, high-value transactions. Contact us to learn how Intralinks VDRs can help with your organization's LIBOR transition.

**“Some say only two things in life are guaranteed: death and taxes. But I say there are actually three: death, taxes and the end of LIBOR; everyone in the financial services industry needs to be aware that the date when the existence of LIBOR can no longer be guaranteed is fast approaching.”**

- John Williams, President and CEO,  
Federal Reserve Bank of New York,  
September 2019

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# About SS&C Intralinks

SS&C Intralinks is an industry leader in virtual data rooms (VDRs) and secure document collaboration, offering a comprehensive contract remediation solution designed to integrate with enterprise-wide LIBOR transition activities. 99% of the Fortune 1000 have executed close to \$35 trillion of financial transactions using our VDR technology.

Contact us to learn more about how our LIBOR solution can help your organization get to work on ensuring contracts are updated as required and on time.

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