White Paper

LIBOR Transition of Legal Contracts

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Executive Summary

It might sound like that banks have enough time for LIBOR transition, however, considering the challenges attached to transition, it is almost certain that without absolute smart technology, well-thought-out strategy, LIBOR transition for an already signed contract can be a nightmare and might result in banks getting into lawsuits amounting to billions of dollars. Welcome to the LIBOR transition challenge.

The UK's Financial Conduct Authority (FCA) announced the discontinuation of LIBOR starting Jan 2022 and many central banks announced reference rate for their countries like Secured Overnight Financing Rate (SOFR) for the USA, Euro Short Term Rate (ESTER) for Europe, Reformed Sterling Overnight Index Average (SONIA) for the UK, Swiss Average Rate Overnight (SARON) for Swiss and Tokyo Overnight Average Rate (TONA) for Japan. While announcing these new reference rates was the first step but ensuring the complete transition is a massive project for every business.

Consider $400 trillion contracts running into hundreds of millions live contracts across banks, Insurers, Re-Insurers, businesses, and retail customers globally covering various products & services like financial instruments, derivatives, cross-currency loans, mortgages, securitization instruments, retail loans, business loans, Floating Rate Notes (FRN), etc. LIBOR transition is going to be a mammoth task making existing contracts enforceable in the post-LIBOR era.

The purpose of this document is to provide readers a journey through the LIBOR transition of legal contracts as the world sees the departure of LIBOR in Dec 2021 and how to make LIBOR transition of legal contracts smooth and successful. The document is meant for Board Members, CEOs, CFOs, General Counsels, Business Heads, and Treasury Heads across banks, insurance companies, financial services companies, and companies with LIBOR linked loans and businesses with treasury size of $ 100 million or more.

Management to create a Steering Committee

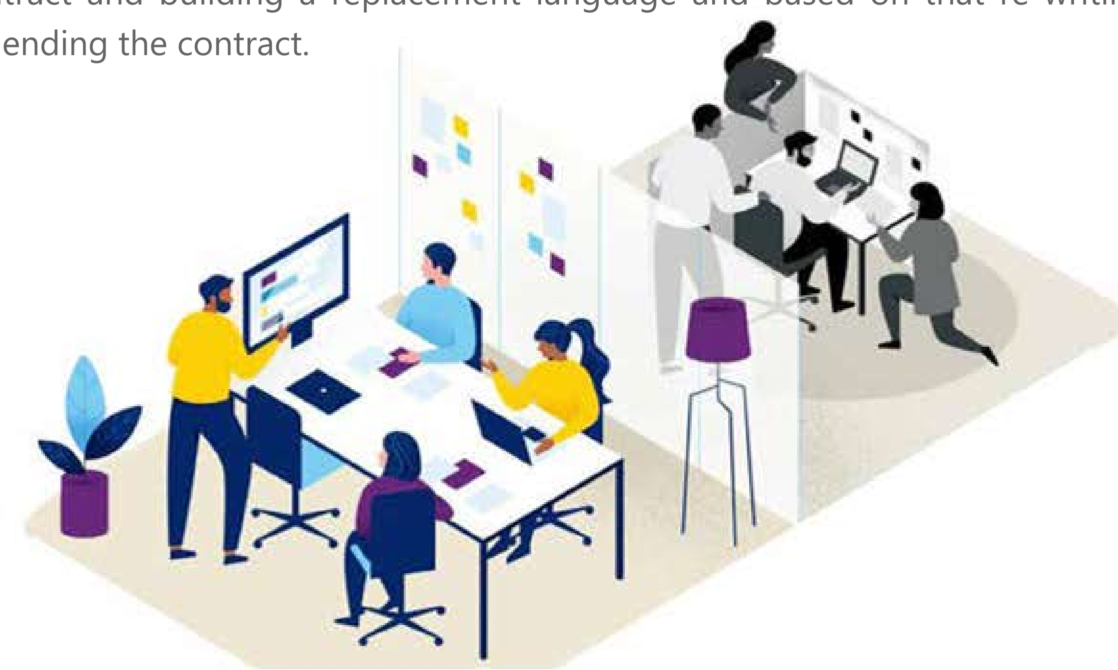
As the world sees the departure of LIBOR after four decades with many banks having as much as 250,000 legal agreements including mortgage loans, credit facility, loan swap, derivative agreements maturing beyond LIBOR life, this is not something which can be handled by Legal function alone. The formation of the Steering Committee is something businesses cannot ignore. Given the degree of uncertainty and complexity, the LIBOR transition is going to be one of the biggest transformations activity one has taken. Boards in consultation with the CEO should establish a senior-level Steering Committee (Steers Com) representing all relevant business functions to manage and oversee the LIBOR transition of legal contracts. Appointing a senior manager to oversee and take accountability for the program is imperative for all businesses globally. Steering Committee should have clear deliverables with definite timelines and expected outcomes.

Contract Discovery: Understanding the quantum of agreements requiring amendment, re-writing & change

While Steering Committee has been assigned the task of ensuring a smooth transition of all legal contracts requiring re-writing or amendment due to LIBOR departure, the first thing is to build a list of legal contracts with complete information around the master data and respective stakeholders. All businesses, Procurement, IT, Finance & Legal functions are required to complete a list of legal contracts for their respective departments. Now here comes the catch, if a concerned business has already digitized the Contract Management operations then it is much easier to get information, master data, and executed contracts in one place, however, considering the low penetration of Contract Management Software globally its quite unlikely that the required information/database is available at one place. This can be a real daunting exercise requiring much attention from all stakeholders and no chance of any miss. Remember any possible missing contract in the whole transition journey can result in loss of invalidation of legal contracts risking millions. Here the most important thing to note is that transition is only for those contracts which are going to remain live beyond Dec 2021.

Why fallback clause or just a simple letter of amendmentis not enough?

It will be naive to assume that the LIBOR transition is just replacing the word LIBOR to a new reference rate. Had this been so easier it would have been done through a simple letter to all counterparties, however, that is not the way this can be handled. The reality is the transition to another Risk-Free Rate (RFR). The first decision is to finalize the relevant reference RFR and the second aspect is to see the relevance to the specific contract to decide on new terminology. As the world is zipping past LIBOR, many central banks announced a reference rate for their countries like SOFR for the USA, ESTER for Europe, SONIA for the UK, SARON for Swiss, and SARON for Japan. So while the challenge for respective Central Bank to put together the policy and provisions around the implementation of reference rate but the bigger challenge for businesses to get conviction about the efficacy and applicability of the relevant Reference Rate and its use cases and using this Reference Rate as replacement of LIBOR. Let us understand that, LIBOR is mentioned across contracts about derivative contracts, loan agreements, Swap Contracts, Credit Agreement or mentioned under penalty or indemnity clause of normal business contract. While on the subject, it is important to mention that there was always a fallback clause in all the contracts & agreements if LIBOR is not available for a very short period. Initially, there was a debate if the fallback clause would suffice and the contracts will remain enforceable post-Dec 2021. To put things in perspective, a fallback clause covers that in absence of LIBOR some other market-linked publicly available benchmark is provided. However fallback language or fallback clause was never included in the contracts imagining LIBOR will vanish one fine day after being part of billions of legal contracts for over four decades. The fallback language was always used for certain technicalities where LIBOR is not available for a day or two. To implement the transition, it is critical to understand the impact of the LIBOR clause in the respective contract. So, the process requires reading of relevant clauses in each respective contract and building a replacement language and based on that re-writing the contract or amending the contract.



Understanding the impact

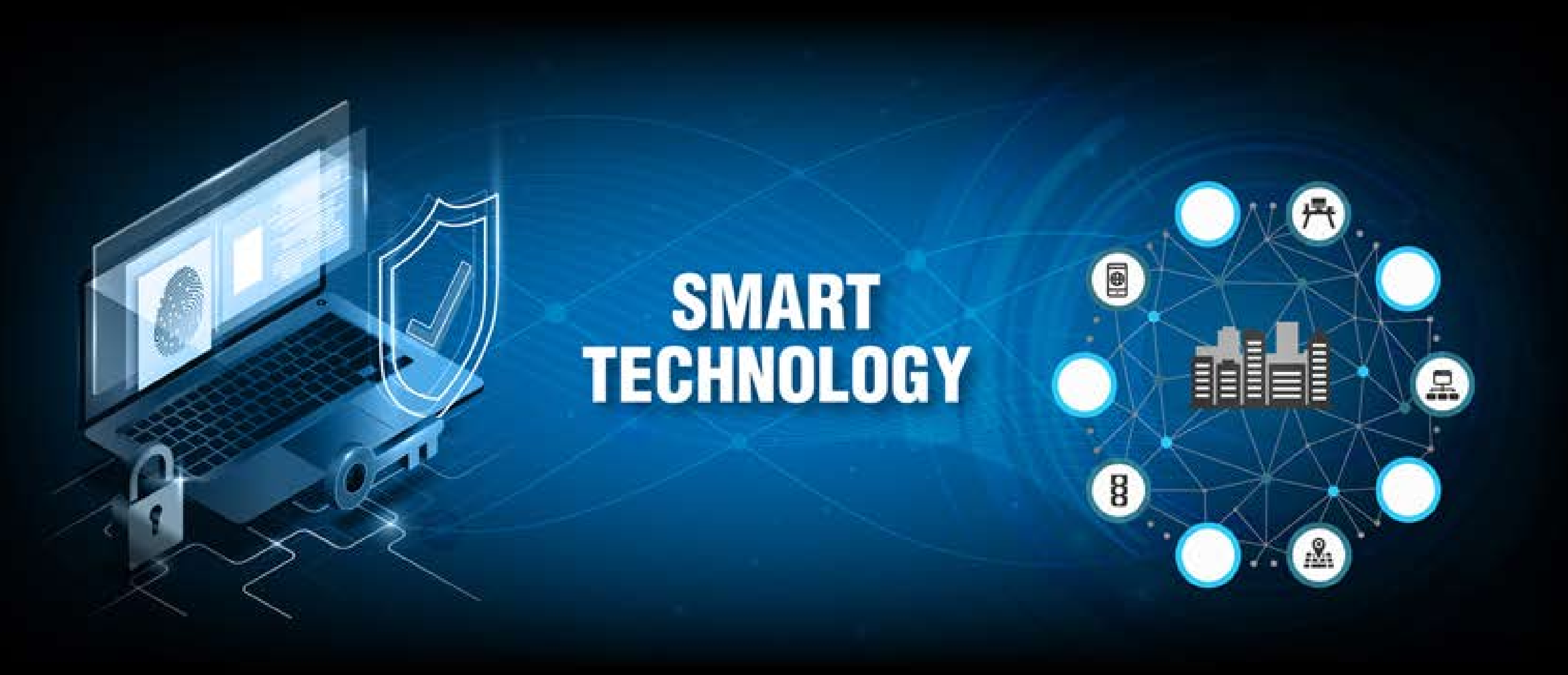
This is the biggest challenge of this transition to find out how many contracts across geographies, business units require amendment or re-writing the contract. Imagine businesses sitting on hundreds of thousands of contracts executed over maybe twenty years and are stored in all forms and shapes. For example, certain contracts were never digitized and still lying in physical storage with the record-keeping company.In COVID times, getting these contracts back for reading, and digitizing can be a challenge of another level. Take another case, businesses might have most of the legal contracts in digital format, however, these are non **Optical character recognition** format hence finding LIBOR linked clauses can be a nightmare.

Contract & Clause Discovery

The Discovery of LIBOR clauses within these contracts is the biggest challenge. LIBOR clause is present across multiple places in many contracts including normal business contracts where for example penalty clauses, indemnity clauses may have reference to LIBOR. Here comes a smart comprehensive intelligent solution that can provide means of conducting extensive search and cataloguing of contracts in a fully automated manner using state-of-art machine learning techniques combined with features of building contract addendum, negotiation features, and digital signature options across geographies. **Anyone thinking of doing this manually reading through all contracts knows that it is just next to impossible.** Steering Committee needs to discuss and deliberate extensively about the mechanism for building the new/amended contracts. No matter if the LIBOR is mentioned at one place of all the contracts, however, it is next to impossible to read out all the legal contracts manually and get assurance that the transition is successful. In today`s world, it is necessary to have a technology solution to read and identify the mention of LIBOR in each contract. Normal technology solutions are not compatible and capable enough to read through scan documents, which are non **Optical character recognition** format these are like scanned documents using old scanners, pictures taken from the phone, etc. Here businesses need smart solutions with capabilities of reading or parsing contents from scan image and putting it together in a structured form. So, any solution with machine learning, natural language processing, and artificial intelligence capabilities can only work. Any basic run of the mill solution will spoil the whole effort.

Build Vs Buy – Smart Technology Platform

Another strategic decision for Steering Committee to make is about the execution plan and having a smart tech platform is key. This at the time becomes quite a passionate discussion among Steering Committee members as some favour to build internally while some support buying safe & secure solution made by experts. It is a natural thought that building a solution will be better, however, this can be the biggest disaster in making! Imagine being a large financial institution you always go to experts or hire experts for credit decisions, banking operations, treasury business, and always look for global solutions for running business operations. The learning curve, business need, smart technologies available in the market are essential for building a smart tech platform. While stakes are extremely high with limited time in hand,the last thing you would do is to start building technology from scratch or making a wild decision to read through all contracts manually. The ideal answer is to buy and engage with a technology partner who is focussed on Contract Management and has the expertise of using machine learning & artificial intelligence for legal contract management solutions.



Communication and Outreach program with external stakeholders

Consider every organization having more than tens of thousands of counterparties including banks, businesses, retail customers, borrowers, intermediaries, etc. requiring a massive outreach & communication program about information dissemination, informing contract changes/amendment on account of LIBOR transition, and ensuring execution of revised contracts well within time. There is a need to engage with all external stakeholders, counterparties for taking their consent to agree for contract agreement, contract rewriting, and their signing. Here also it is quite impossible to send legal contracts one by one considering the volume at hand. A structured solution with features of contract negotiations, communication, and maintaining versions control remains the key. While most of the low-value contracts may not require too much of negotiations, however, contracts with a large value, longer-term will essentially not get executed without the negotiation process. Hence a smart Contract Management Solution remains the answer to this challenge.

Change/Patch upgrade in all business applications

LIBOR remains a critical element for most of the banks globally and most banks use more than fifty technology applications globally. Considering this being fact of life the Steering Committee needs to first ascertain several applications businesses are using and the extent of change required in those applications. Most of the applications must have been procured through an external vendor and hence it is essential to engage with all the external vendors and plan for an upgrade in the applications. Change in technology applications across organizations involving geographies, languages, regulatory framework is another challenge, which is coming up due to the LIBOR transition. Every business has more than fifty various technology applications to handle business globally and every application might have some connection with LIBOR rate, hence technology change for LIBOR transition requires engagement with tech application vendors. The tech vendors need to be made aware of the change requests, the timeline for development, testing, understand use cases, and making the applications go-live.

Training to Customer facing Staff

As its quite evident, there is a lot of anxiety in the minds of the customers, counterparties, and prospects as well. The whole LIBOR transition program also requires extensive training and engagement with employees dealing with customers, vendors, counterparties for businesses, purchases, negotiations, etc. Everyone needs to know which new risk-free reference rate businesses are deciding on and what is the execution plan. Though the work of the LIBOR transition must be going at the right pace, however, customers, vendors, and counterparties need to know the updates. There is a need to prepare a dossier for all the customer-facing staff along with continuous training and engagement program to ensure the messaging to all external stakeholders is right in terms of timing and terms of a statement of fact.

COVID has delayed the whole transition plan by at least 6 months and business continuity and thoughts of business, as usual, remains a challenge with lots of uncertainty around businesses that needs to take this on priority and put an internal target to complete the LIBOR transition of legal contracts by Jun 2021. Stakes are high here and even a possible single contract becoming invalid or bringing in legal claims can cost millions of dollars in such business turbulent time.

Conclusion

LIBOR transition is not a simple business change, it is a massive exercise that requires a wholehearted commitment of the Board, Senior Management, and Business Heads. Stakes are high here and you don't have options to fail. Many of you may remember Y2K or EURO conversion which we saw in the late 90s which required extensive efforts by the banking fraternity and business at large, LIBOR transition is of a similar scale or maybe more.

To ensure seamless LIBOR transition, Steering Committee must consider partnering with a specialized solution provider with the right mix of domain knowledge in terms of advanced technology, banking domain expertise, and deep commitment. As the deadline for the LIBOR phase-out is fast approaching, Treasury Managers, General Counsels, Contract Management professionals are busy putting the strategy and execution plan in place. LIBOR transition, though, will come with a lot of challenging situations given banks' complex operational structure. It is about time now to put an implementation plan in place to complete the LIBOR transition by Jun 2021.

About Volody Contract Management

Volody is a Contract Lifecycle Management Solution, which is being adopted by several leading businesses to automate their contract execution processes. Legal contracts are an integral part of every business and legal contract content access is only limited to certain people in organizations. In today's world data has become very critical and with all the crucial data within legal contracts with clients, vendors, and partners, it restricts limited competitive advantage. This in return limits the scope for revenue expansion and cost management.

Volody Contract Management is a smart AI & ML infused software platform which enables Smart Contract Management! The solution will help to digitize all the historical contract data in the software in the readable format and simplify access to business-critical information from every contract to management. Having a common repository also means the contract no longer must move via mail or shared server. Track change mode within the software helps the responsible person to keep eye on changes made by any team member who is authorized as it has a role-based access feature.

Volody Products is a well-known name for Legal & Contract Management software. Volody has been working with some of the top brands around the world to provide its products and services.

Founder's Profile

Dinesh Sharma, Founder of Volody is a successful entrepreneur and a leading corporate professional who is known for his in-depth knowledge, devotion, and enthusiasm for the business. Dinesh kick-started his professional career with the world`s largest bank, Deutsche Bank working for more than a decade in the Credit & Finance function. Later, Dinesh moved to the largest payment service company, Fidelity Information Services. As the Head of Finance, he managed the business's finance, legal & compliance functions. Eventually, he evolved in the industry and gained immense experience at the CFO level while serving various large global corporations as Global CFO for CRISIL Ltd. and Tech Process Solutions Ltd.

Dinesh founded Volody in 2015 and has been working relentlessly to grow the company and cater to the needs of its clientele in digitizing and automating the Legal Contract LifeCycle Management processes globally. Author, columnist, and expert in the Legal Tech domain, Dinesh has written articles for ET, YourStory, Pioneer, and has been covered by reputed media houses including Forbes India and INC42 on subjects relating to digitization, automation, technology trends, blockchain, etc.

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