



# LIBOR to RFR Transition

**Developing a low risk, high value  
strategy & program**

Part of the Evolving LIBOR series.

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The end of 2021 is fast approaching - and marks when the London Interbank Offered Rate (LIBOR) may cease to exist. Now is the time to assess whether your organization will be ready for this seismic shift.

The transition is increasingly becoming one of the most complex post crisis transformation programs faced by financial services and its customers. With many pressing internal and external challenges and evolving timelines, firms are struggling to prioritize this transition.

The breadth of LIBOR's impact expands across many critical aspects of an organization. It touches on financing and transactions, clients and contracts, operations, systems, models, processes, and accounting. As firms start to look closely at the impact, more interrelated issues continue to emerge.

### **There are three key points need to be front-of-mind in the months ahead:**

1

#### **Reliance on LIBOR is unsustainable, change is coming**

The availability of LIBOR beyond 2021 is uncertain - there is a possibility it will continue in some form - but global regulators have signaled that organizations should not rely on this and need to plan for the switch to alternative RFRs.

2

#### **The market must act collectively and purposefully**

The pace at which the industry can create markets, build liquidity and infrastructure for alternative RFRs, will directly impact the speed and success of the transition. For it to be successful, effective co-ordination is key with all parties.

3

#### **Understanding the variety and interconnectivity of risks is essential**

To meet the industry 2021 timeline, planning needs to be underway. The scale and complexity of this transition should not be underestimated.

A full understanding of the probable transition scenarios, firms key risks and the potential roadblocks is a key starting point. From this, a clear strategy for your firm can be developed to help ensure a smooth planned transition.

**A transition strategy needs to be considered from a business, client and regulatory change perspective.**

**Successful outcomes will be dependent on planning for complex known and potentially unknown risks.**

Here we outline the steps we recommend firms consider in developing and implementing their LIBOR change program.

# Action steps towards a successful transition



## Strategy

- Developing a strategy and guiding principles are important to align and drive the direction of the organization. Having a strategic vision will help guide and challenge the program in meeting successful outcomes overall.
- Some of the variables will be in your control (resourcing, approach, etc.), but many other variables are external factors (market protocols, regulatory actions, competitor product offerings, client requirements etc).
- Examples of strategic issues that may affect your approach include:
  - What is your approach to industry and regulatory body engagement and advocacy?
  - What is the role you want to play in developing the alternative reference rate market?
  - When will your firm begin to trade in the alternative RFRs?
  - What is your approach to franchise protection and seeking new business opportunities?
  - How will you risk assess and prioritize clients, products and contracts?
  - Is there an opportunity to differentiate yourself in the marketplace and do you want to?
  - Will you leverage this transition to tackle other change programs within your firm (e.g. contract digitalisation, automation, simplification of models, data and processes).



## Governance & program structure

- The establishment and coordination of governance guidelines, robust oversight teams, and the assignment of project ownership are critical initial steps in any transition effort. Establishing the proper centralized steering group, comprising senior sponsorship and representation from key business units and functions, is vital to ensure the right tone and senior engagement.
- This steering group must oversee the firm's effective transition strategy and plan.
- Choosing specific technical resources that can link together large complex change programs will be important.. These individuals will continually need to challenge the priorities, interdependencies and ensure the program is aligned to the business and client strategy.



## New product development and liquidity

- Firms need to ready their ability to enter into cash and derivative RFR based products.
- Firms need to prepare to service their clients with these new products on a timely basis to enable sufficient time for the transition, liquidity develop and to support fallback clauses in legacy portfolios.



## Assessing the impact

- As LIBOR rate is used and embedded in a vast array of financial products and operational processes, a critical element in the transition plan will be developing and updating a clear inventory of all the impacted issues.
- It is important to remember to review areas beyond a firm's core products, and include the review of such areas as pricing models, funds transfer pricing (FTP), valuation models, accounting effects, tax considerations, and even procurement contracts.



## Developing a robust communication plan

- A communication and outreach strategy needs to be developed and must consider:
  - Clients: Be cognizant of conduct risk to both consumers and business clients.
  - Internal education: Develop and implement an education plan to ensure consistent messaging and cascading of the transition strategy.
  - Board of directors: Timely education and communication with board members will be imperative.
  - Regulatory: Prepare to share your institution's comprehensive plan with regulators (e.g. Dear CEO letters).
  - Industry bodies: Engage early and track outputs and agreed protocols.



## Contract remediation and fallback language

- One of the largest potential efforts and risks will be identifying and modifying client/third party contracts. All contracts need to be assessed to determine which ones reference LIBOR and what, if any, fallback language exists in the contracts.
- The scale of the task in some organizations will all require the use of intelligent automation tools, such as KPMG Ignite, to digitise and interrogate the contracts.
- Legal assistance will be required to conduct an assessment of the fallback language and determine how contracts need to be adjusted. Organizations will need to understand if adequate legal resources are available to be dedicated to this effort.
- Even where fallback language exists in contracts, it may not truly contemplate this type of event and provide economic equivalence.
- The strategy for contractual negotiation and change will need to be included as part of a firm's wider business strategy and customer outreach plans.
- Are you today issuing new products with inadequate fallback language? It is important to stop the bleeding now as well and not cause additional contract modification work.



## Data, systems and vendors

- How complete and readily available is the institution's data?
- The quality of legacy data from prior acquisitions, multiple systems, and decentralized locations all will contribute to LIBOR transition program challenges.
- LIBOR transition can be used as a catalyst to build out a stable data set and streamline existing systems.
- Does the institution have the tools to sweep the code to find the LIBOR/reference rate occurrences? Identifying and assessing EUCs for LIBOR impact might prove to be quite a challenge.
- Have you identified dependencies/reliance on vendors for the vendor supported systems and applications?
- Are your vendors doing the same assessment and are you tracking their progress



## Models

- The devil is in the detail - there is a wide spectrum of models used throughout your organisation that have reference-rate inputs. Assessing all models and creating an inventory may take a considerable amount of time from specialized resources.
- If hundreds of models need to be changed, duplicated for multiple rates, and/or retired, how would these activities fit into your model-development planning and model-risk-management review activities?
- Certain models will require regulatory approval for significant changes. The time to obtain regulatory approval will need to be built into a firm's overall transition timeline.





## Finance, accounting, and treasury

- Many finance activities may be impacted by transition. Some examples may include pricing committee activities, balance-sheet management, accounting-valuation assessments and FTP activities.
- Understanding all of the existing hedge relationships and how they were documented will be essential.
- Hedge accounting will be a significant issue to consider. A change in the critical terms to one side of the hedge may result in termination, thereby causing a de-designation of the associated hedge relationship.
- Debt agreement changes could trigger debt modifications or defined as a debt termination — and each could have important accounting impacts.
- New reference rates may change discount rates used in many models, including those used for capital calculations, valuation and impairment testing.



## Tax liability impact

- The discussions should include both analyzing the tax impact the LIBOR change could have on the organisation's debt and non-debt contracts, as well as reviewing the steps the organisation is considering to manage the cessation of LIBOR.
- Tax departments should continue to monitor whether guidance is released by the major jurisdictions that provides clarity regarding how the cessation of LIBOR, and transition to new rates, is treated for tax purposes.



## Risk management readiness

- Risk-management teams and assessments should be included throughout the process from impact assessment through to execution of the LIBOR transition strategy.
- Developing specific assurance programs to assess the progress of the transition program will be essential to support senior management.



## One eye on the market - benchmarking

- One thing will be certain, the market will continue to evolve.
- We believe most institutions are in the early innings of the LIBOR transition journey, and many factors will weigh on the transition in the months ahead, including:
  - Regulatory expectations: Will regulators ask for periodic updates on an institution's plans?
  - How will marketplace pricing and liquidity change as we move closer to 2021?
  - How will clients react to changes in products and perceived pricing?
  - When is the right time to transition your backbook? Will competitors leave you behind in offering new RFR products earlier ?

# A review of action steps to consider

As the timelines and industry protocols develop, there are some important no regrets actions that organizations should undertake in preparing for the wider implementation:



Unlike many other regulatory change initiatives, the impact assessment will need to be revisited as the program evolves and new issues emerge. There are a significant number of interrelated issues that will need to be linked up and coordinated as contracts are amended, new product capability is built out and infrastructure enhancements finalized. The sequencing of changes will need to be carefully worked through and planned.

One thing is certain — any initial strategy and plan will need to change and evolve. It will be important to be aware of the evolving external market and regulatory expectations. As a result, programs will need to adapt and remain nimble as the transition moves through to 2021.

# LIBOR Navigator

## KPMG's transition framework



# KPMG's AI-Enabled Contract Case Management Platform

One of the greatest internal risks to a LIBOR transition program is the identification of all relevant legal language and documentation, including contracts, leases, SLAs/OLAs.

Scrutinizing contracts is time consuming and difficult to manage on a global scale. Any change entails reviewing all in-scope contracts to determine the right transition path. When done manually, this places a heavy burden on finance, legal, and operations teams. To address these challenges, KPMG brings together two assets to automate contract analysis and remediation:

- Ignite is KPMG's global artificial intelligence platform. It enables KPMG to rapidly process and interpret large volumes of contracts and other types of unstructured data using state-of-the-art machine learning and natural language processing.

- Appian is a low code, application development platform that accelerates the creation of high-impact business applications. Appian is a fast path from idea to application, enabling document sharing, customizable business rules, real-time reporting, and powerful process management

By automating repetitive, rule-driven processes with KPMG's AI-enabled contract management and workflow platform, you have the ability to realize lower costs, greater accuracy, rapid deployment, improved compliance, and higher customer satisfaction.

For more information, and to watch a short video, go to [kpmg.com/evolvinglibor](http://kpmg.com/evolvinglibor)

	Document Ingestion & Detection	Completeness Checking and Error Handling	Contract Assessment and Amendment Generation	Contract Language Amendment Execution and Approval Workflow	Contract Negotiation Process Tracking	System of Record Updates	IBOR & CDOR Exposure Controls & Reporting
Customization Requirements	<ul style="list-style-type: none"> <li>– Identify document source repositories</li> <li>– Determine contract types, variation and formats (jpg, pdf etc.)</li> <li>– Agree key data elements (KDEs) for extraction</li> <li>– Data format(s) for data extract results</li> <li>– AI training and control sample contract production</li> </ul>	<ul style="list-style-type: none"> <li>– Business rules for data quality and anomaly detection</li> <li>– Business rules for hedging relationships and patterns</li> <li>– Business rules for establishing relationships between documents under single contract</li> <li>– Sensitivity score parameters</li> <li>– Reporting thresholds, dimensions and pathways for AI performance and approvals</li> </ul>	<ul style="list-style-type: none"> <li>– Define amendment templates and policies for loans and hedges</li> <li>– Refined business rules template selection</li> <li>– Reporting thresholds, dimensions and pathways for contract impact analysis</li> </ul>	<ul style="list-style-type: none"> <li>– Review existing loan and hedge workflow, case management and automation capabilities</li> <li>– Confirm review and approval workflow for contractual amendments</li> <li>– Review and confirm reporting thresholds, dimensions and pathways for escalation policies and QA.</li> </ul>	<ul style="list-style-type: none"> <li>– Review and confirm metrics, reporting thresholds, dimensions and pathways etc.</li> <li>– Define any custom dashboards required</li> </ul>	<ul style="list-style-type: none"> <li>– Business rules for data quality and anomaly detection</li> <li>– Define any custom dashboards required</li> </ul>	<ul style="list-style-type: none"> <li>– Review and confirm levels of exposure aggregation and disaggregation</li> <li>– Define any custom dashboards required.</li> </ul>
Output	<ul style="list-style-type: none"> <li>– Contract Repository</li> <li>– Answer keys for training and control sample contracts</li> </ul>	<ul style="list-style-type: none"> <li>– Data quality &amp; data validation business rules</li> <li>– DQ / error reporting &amp; thresholds</li> </ul>	<ul style="list-style-type: none"> <li>– Amendment Repository</li> <li>– Amendment policies and business rules</li> </ul>	<ul style="list-style-type: none"> <li>– Negotiation workflow including escalation workflow &amp; metrics</li> </ul>	<ul style="list-style-type: none"> <li>– Drillable Contract Negotiation Process Tracking</li> </ul>	<ul style="list-style-type: none"> <li>– Validated System of Record Data</li> </ul>	<ul style="list-style-type: none"> <li>– Drillable IBOR Exposure Reporting</li> </ul>
Configuration	<ul style="list-style-type: none"> <li>– Data extraction from document repositories and systems of record</li> </ul> <p>KPMG Ignite AI data extraction</p>	<ul style="list-style-type: none"> <li>– KPMG Ignite AI Rules</li> </ul>	<ul style="list-style-type: none"> <li>– KPMG Ignite Amendment Generator Tool</li> </ul>	<ul style="list-style-type: none"> <li>– Existing workflow capabilities</li> <li>– KPMG Ignite Automated Workflow and Tracking Tool</li> </ul>	<ul style="list-style-type: none"> <li>– KPMG Ignite Automated Workflow and Tracking Tool</li> </ul>	<ul style="list-style-type: none"> <li>– KPMG Ignite AI data extraction</li> <li>– Systems of record in scope</li> </ul>	<ul style="list-style-type: none"> <li>– KPMG Ignite IBOR Dashboard Toolkit</li> <li>– Systems of record in scope</li> </ul>

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