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Infosys BPM

# LIBOR: The end of an era

## What banks and financial institutions need to do for transitioning successfully

**Infosys BPM partners with EdgeVerve to enable financial institutions to plan their LIBOR transition effortlessly**

In 2011, murmurs of manipulations opened up a can of worms that would see the end of one of the most important numbers in the world – LIBOR. The London Interbank Offered Rate or LIBOR is the benchmark rate for global lending and a reference rate for pricing many financial instruments that is tied up to contracts worth approximately $350 trillion on a gross notional basis .

However, the lack of trust in LIBOR and the sharp decline in interbank borrowing led the UK's Financial Conduct Authority (FCA) to announce the end of a single global benchmark rate. From 2022, global lending transactions will be based on a basket of rates tagged to major currencies, and financial institutions (FI) will have to choose the rate they want to transition to. These include:

- Secured Overnight Financing Rate (SOFR) for USD
- Sterling Overnight Index Average (SONIA) for GBP
- Euro Short-Term Rate (ESTER) for EUR
- Swiss Average Rate Overnight (SARON) for CHF
- Tokyo Overnight Average Rate (TONAR) for JPY

This is perhaps the single most significant event to impact financial services in over 50 years, requiring complex transformation at a massive scale. The question is — Are banks and financial institutions prepared for the transition?

## Understanding the challenges in LIBOR transition

The key challenge of LIBOR transition is that it's a complex and pervasive rate embedded deeply within contracts, valuations, processes, systems, and policies, and replacing it within a short time frame is no mean feat. There are 35 LIBOR rates published every business day in the London market for five currencies and seven tenors. Businesses need to identify the contracts impacted by these rates, determine the best-suited alternative rate they wish to adopt, and change the rate reference in millions of contracts by the end of 2021. This change is not just a matter of replacing a clause in a contract, but also to reflect this change in the back-end systems that the operations team would refer to — including the training materials and the customer communications. Banks undertaking LIBOR transition programs need to understand the impact, risks, and remediation requirements across their operating models, products, and transaction portfolio.

This assessment requires a significant level of data collection and analysis. The sheer volume of data points to be analyzed is mind-boggling. The task is made increasingly complex because of interlinked structured and unstructured data sets.

An effective transition requires that financial institutions minimize the negative impact on margins and valuations and contain legal and contractual exposure while ensuring the shift happens within the stipulated timelines and at manageable costs. Another key challenge is managing post-LIBOR and transitional environments running in parallel internally and within the ecosystem.

Perhaps the enormity of the task, risks, associated costs, and lack of a regulatory mandated hard deadline is why no one has yet completed this transition. While UK FSA has been pushing firms to be ready by September 2021, LIBOR would possibly be withdrawn at some undetermined time in 2022. Other international IBORs will be withdrawn at different dates. There has been a flurry of high-level impact assessment, and perhaps some roadmaps have been charted, but decisive actions are lacking. This inertia might prove costly as 2022 dawns, and even as you read this, critical milestones are fast approaching. Not making a timely transition to alternative rates will mean being stuck with illiquid contracts and systems, policies, and communications, among others, that are referencing a rate that no longer exists.

Manually tackling this major change is an impossible task with unrealistic costs and effort implications for changing terms of contracts, modifying systems, process, and educating thousands of staff on the alternative rates. AI and automation skills backed by deep domain understanding of LIBOR architecture with the right mix of legal expertise are essential to ensure a seamless and timely transition, without undue risk or process uncertainty.

### LIBOR transition: A Rocky Road

LIBOR is deeply embedded into current systems and contracts.

Contract repapering and remediation is a mammoth task.

The new rate needs to be chosen carefully to minimize financial implications.

There is a lack of trusted end-to-end solution providers who can orchestrate the transition smoothly.

Massive amounts of data spread across millions of contracts needs to be analysed to understand true impact of the transition.

The cost of not transitioning is too high.

## Make LIBOR transition easy with Nia Contracts Analysis

LIBOR transition is a 3-stage process that includes **impact assessment, repapering, and remediation**, and we offer end-to-end consulting and technology solutions in this lifecycle.

The task of identifying all the contracts that carry LIBOR risk is enormous and involves:

1. Identifying the contracts that have an expiry date beyond 2021
2. Identifying all the contracts that reference LIBOR among those contracts
3. Create the alternate contract language needed for renegotiating contracts and replacing LIBOR with a new reference rate in all financial contracts/agreement documents

## Impact Assessment

A significant phase of LIBOR transition, impact assessment, helps understand the exposure at enterprise and portfolio levels. We leverage our assessment frameworks and AI solutions from the Infosys Nia product suite along with data analytics and text mining tools to help companies quickly evaluate impact to create a remediation roadmap.

We use an enterprise-level assessment and readiness survey to determine the organizational readiness for transition, estimated transition time, and the portfolio impact. The assessment questions are chosen from a library of 200 pre-built configured questions that are remotely administered via a cloud-based survey administration tool. This online assessment significantly cuts down the assessment time, costs, and effort.

While the assessment helps determine the enterprise's impact, banks need to understand which contracts, clauses, and terms are getting impacted by the LIBOR transition. Nia Contracts Analysis significantly reduces the effort involved in the portfolio impact analysis (See Fig. 1).

Our AI-powered contract review and analysis product, Nia Contracts Analysis, enables business users to find the contracts that have referenced LIBOR for base rate calculations, quickly and accurately. Nia Contracts Analysis also brings the speed of processing 12,500 contracts per hour and scale of processing volumes of contracts up to millions.

With the unprecedented task of processing millions of contracts and the deadline coming closer, enterprises need the power of an AI solution that combines Machine Learning techniques like Computer Vision, NLP, and Deep Learning, enabling a smooth transition in a post-LIBOR world.

The AI and ML capabilities of Nia Contracts Analysis help locate specific information, based on complex criteria, from lengthy documents, isolating it for users to monitor, review, and update effortlessly. The next-gen AI product can parse thousands of contracts and make the findings available on an easy-to-use dashboard. This can help understand the fallback trigger events, identify the related LIBOR Fallback Provisions and Alternative Reference Rates, and identify parameters like currency, number, value, expiration date, etc. of contracts. This provides a single view of what is the portfolio impacted, and where is the need for remediation.

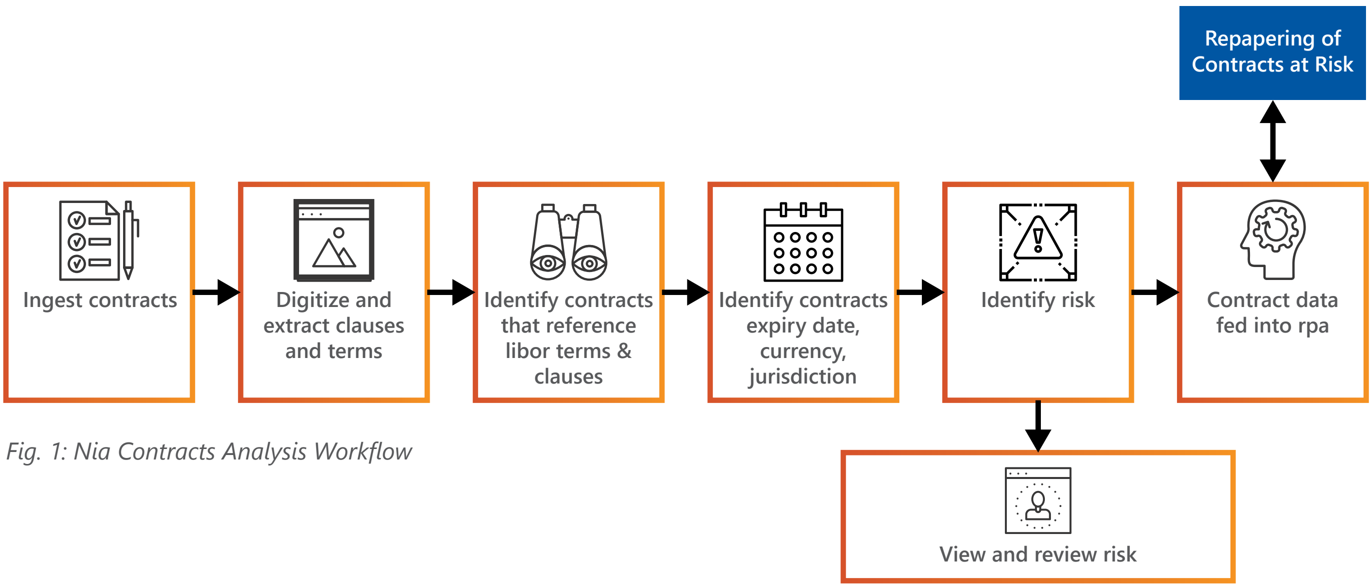


*Fig. 1: Nia Contracts Analysis Workflow*

Nia Contracts Analysis is trained to extract LIBOR specific information with samples for LIBOR specific and other generic clauses. Nia Contracts Analysis reads the document and identifies relevant clauses with an NLP-based approach. Once a clause is identified, terms can be extracted to check for the at-risk portfolio.

High accuracy of extraction, the capability to process a wide variety of document formats like scanned contracts and digital contracts, and the capability to read documents with different layouts are essential in order to have a successful outcome. Nia Contracts Analysis provides these capabilities using the concept of "Parallel Pathway," wherein different specialized algorithms are used to extract content from different sections of a document (See Fig. 2). Our simple and efficient user interface to validate and correct extracts provides necessary human-in-the-loop intervention. This human intervention also helps to retrain models for better accuracy of extraction for your contracts.

Automating contract analysis can save a lot of time and effort and move the organization faster on the road to LIBOR transition. One of our large banking clients has used Nia Contracts Analysis to automate the contract review process. Within a short timeframe, they achieved an 80-90% reduction in turnaround time (TAT).

## Repapering

Once the impacted contracts are identified, they need to be repapered. This means every clause that is related to LIBOR needs to be changed, and the new contract, which includes fallback languages has to be sent to the other party, signed, and stored. Repapering can be made possible by a couple of options, either by amending an existing contract or by issuing a new contract altogether. (See Fig. 3).

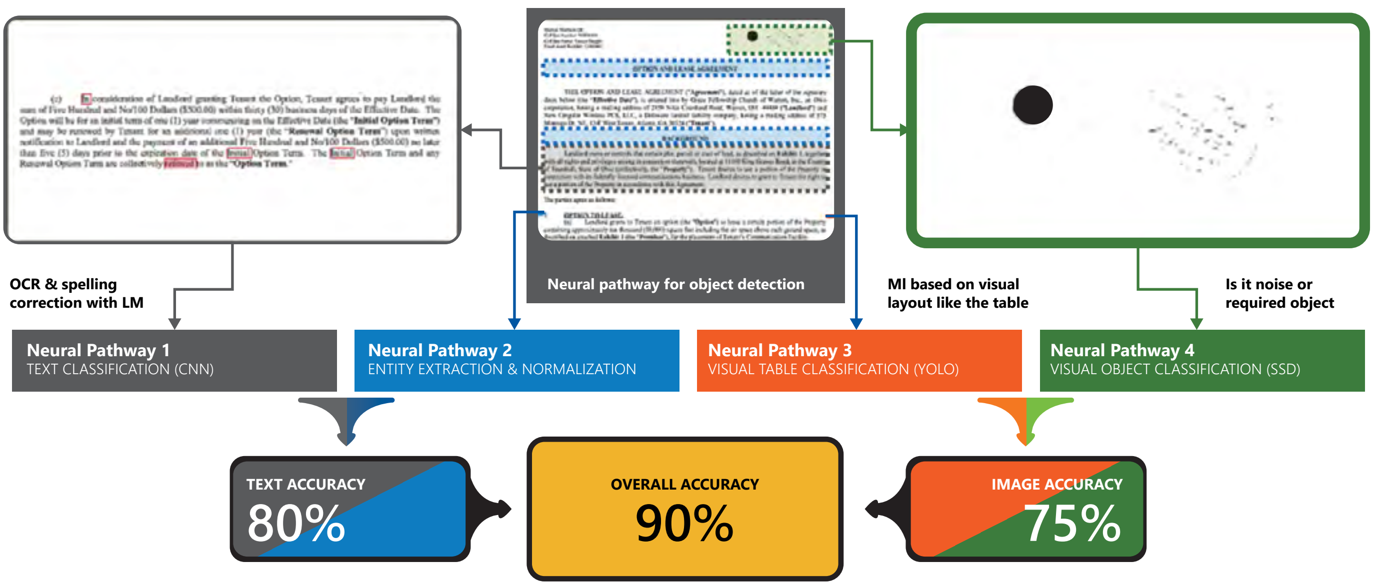


*Fig. 2: Multiple pathways to ensure better extraction accuracy*

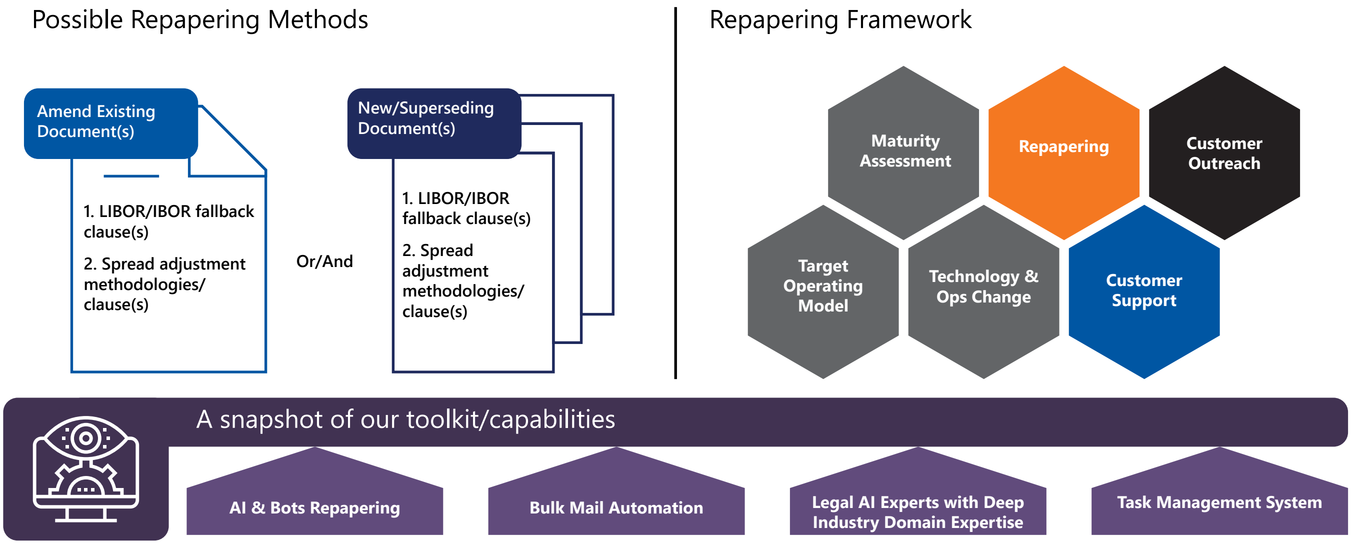


*Fig. 3: Infosys Repapering Framework*

Robotic Process Automation (RPA) can make this daunting task relatively easy (See Fig. 4).

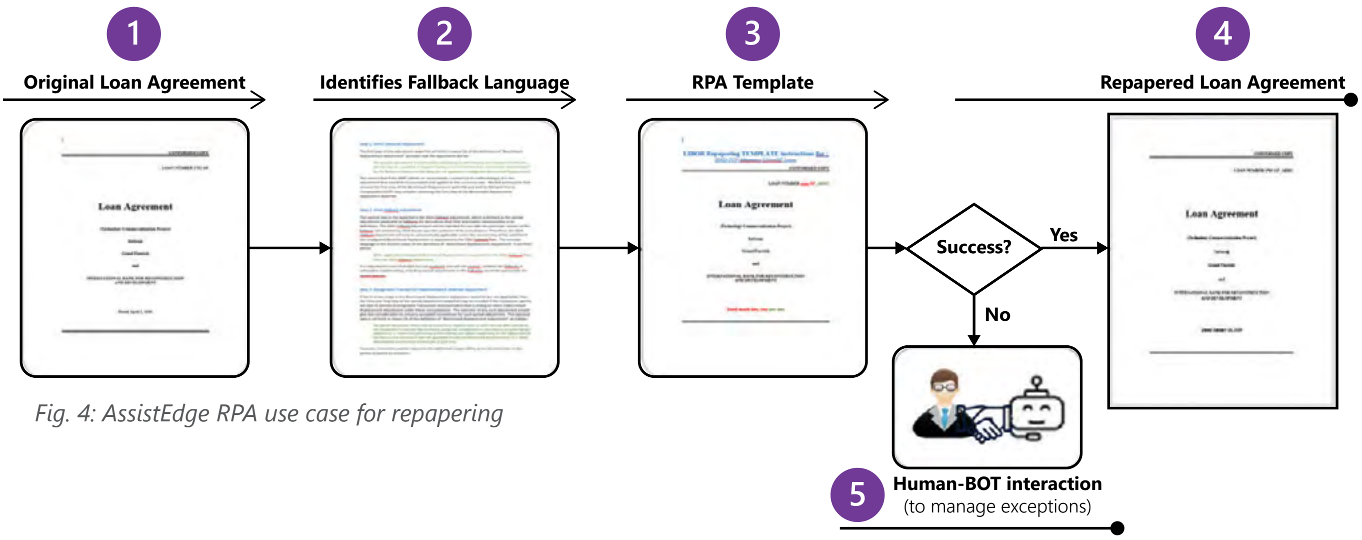


*Fig. 4: AssistEdge RPA use case for repapering*

Our legal experts and the AssistEdge RPA platform help clients draft new fallback clauses and populate them in the new contracts or as Amendments, addendums to an existing contract. These new standards and fallback clauses are defined in the system; any deviations from standard clauses are identified by text analysis and automatically replaced with the fallback language. A customer communication is drafted to reflect the change and sent to the other party (See Fig. 5). However, every process has exceptions, and our highly trained team deals with these on a case-by-case basis.

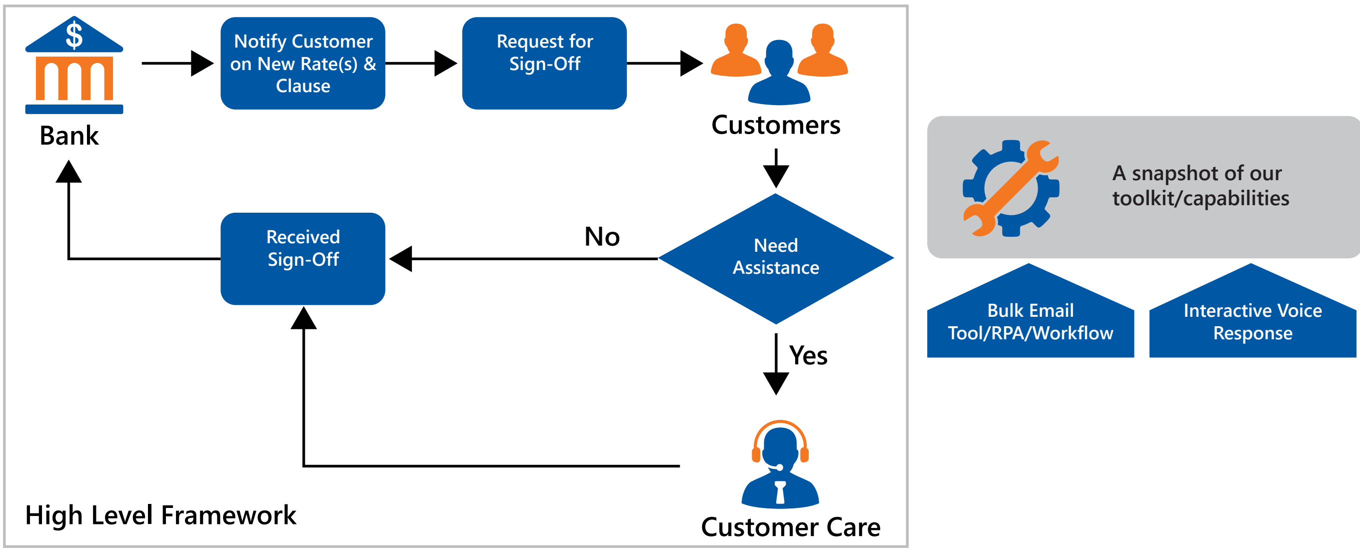


*Fig. 5: Infosys Customer Outreach Framework*

## Remediation

However, just repapering the contracts is not enough. The true transition happens with remediation when the contractual changes are reflected in operational systems, procedures, and policies (See Table). Remediation helps eliminate potential operational risks by defining target operating models at each sub-process level and initiating the necessary infrastructure or systems and operations change in proprietary and third-party platforms.

We help firms incorporate new instruments and rates in their proprietary systems with detailed transition planning, design and testing of changes required. In addition, we also help redraft SOPs, training material, and customer communications to reflect the change for a smoother transition.

## The time to act is now

With only a year and a half for the transition deadline, firms need to take action now, especially when designing new contracts and identifying those that are not due for renewal before December 2021 and requiring amendments. Since bank systems and procedures have been linked to LIBOR for decades, change is going to be hard. As the curtains drop on LIBOR, it's time to prepare for the second act by unlocking business improvement opportunities, minimizing disruption, and significantly reducing the cost and risk associated with this transition.

| Potential Tasks | Description |
|---|---|
| Maturity Assessment | The primary objective is to identify the ability of the existing processes to adopt change(s) |
| Remediate Identified Gap Areas | Identify the gaps in the existing systems and operations, and proposal to implement |
| Change Management | Redefine the procedures and facilitate needed training(s) |
| Operations Management | Potentially upgrading systems with new rate(s) and other key data elements |

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### About Infosys BPM Ltd.

**Infosys BPM Ltd.,** the business process management (BPM) subsidiary of Infosys Ltd. (NYSE: INFY), was established in April 2002. We offer end-to-end transformative BPM services, and have journeyed through the table-stakes of effectiveness and efficiency with an ever-increasing focus on enhancing stakeholder experience and empathy. We consistently deliver enhanced business value for our clients and enable them to navigate their digital journey.

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### About EdgeVerve

**EdgeVerve** is a global leader in AI and Automation, assisting clients thrive in their digital transformation journey. Our technology is deeply integrated into the heart of 350+ Global 2000 companies, medium and small enterprises across 140+ countries, enabling them to derive entrenched value in their business.

Our mission is to create a world where our technology augments human intelligence and creates possibilities for enterprises to thrive in disruption. Our team at EdgeVerve is central to this mission and continuously strives to make it happen for enterprises across the world. We are making constant strides towards transforming enterprises by providing products and solutions across the AI & Automation continuum.

**EdgeVerve Systems Limited**, a wholly-owned subsidiary of Infosys Limited, through its leadership, employees, and partners, is transforming the AI and Automation industry. Visit us to know how enterprises across the world are thriving with the help of our technology.

For more information, write to us at contact@edgeverve.com www.edgeverve.com