Evolution of LIBOR on 10-K risk disclosures

LIBOR ranks among top risks SEC is monitoring
The transition away from London Interbank Offered Rate (LIBOR) ranks with the impact of Brexit and cybersecurity as key market risks the U.S. Securities and Exchange Commission (SEC) is closely monitoring in its review of U.S. public company disclosures, said SEC Chairman Jay Clayton in December 2018.

Noting that “banks currently reporting information used to set LIBOR will stop doing so after 2021,” Clayton underscored the significance of this development by pointing out that of the USD $200+ trillion in transactions currently referencing USD LIBOR, 18 percent ($35 trillion) will not have matured by 2021.

A focus on LIBOR in relation to public company disclosures was addressed in earlier SEC communications. At the Financial Executives International (FEI) Current Financial Reporting Issues Conference in November 2018, Kyle Moffatt, chief accountant at the SEC’s Corporation Finance Division, said, “Companies should increase the level of disclosure on the planned phase-out of the London interbank offered rate.” Expanding on this point he said, “To the extent that the phase-out of LIBOR is material to the company, we would definitely expect a company to disclose the fact and describe the implications of phase-out, including any associated risks, to investors.” What’s more, Moffatt said, the SEC expects companies to monitor their disclosures to make sure they reflect any changes: “[Y]our disclosures need to evolve. Every quarterly period or annual period, you need to make sure that you reassess your disclosure and add any updates.”

Although the Alternative Reference Rate Committee has identified the Secured Overnight Financing Rate (SOFR) as a potential alternative to LIBOR, the SEC is also urging banks and other financial institutions to review their financial instruments for LIBOR fall-back clauses that allow for the succession of the next alternative reference rate.

Monitoring risks of transition
As part of KPMG’s efforts to monitor LIBOR transition developments, we have been tracking how major U.S. banks are preparing for the move to a new reference rate. Our most recent benchmarking survey found evidence of banks having begun to include the discontinuity of LIBOR within the risk factors of their SEC filings (e.g., the 10-Ks) to address comments raised by the SEC and other regulators.

Our benchmarking analysis
We surveyed the public filings of America’s top 15 largest banks (as ranked by bankrate.com in 2018) for mention of LIBOR in their 2017–2018 10-K risk factors with two goals in mind: (1) to ascertain the industry’s current perspective on the matter, and (2) to track any shift in disclosure over time.

In 2017, our research showed that major banks (1) saw LIBOR as a risk to the value of their assets, (2) were just beginning to prepare for the discontinuity of LIBOR, and (3) could not yet quantify the impact the transition would have on their business. Approximately 47 percent of these banks said the transition was indeed an industry risk, yet they had not quantified individual risks associated with it. These banks referenced within their risk factors the language the Financial Conduct Authority (FCA) announced in 2017, but were uncertain of the specific impacts the transition would have on their institutions.

In 2018, banks appear to have made progress with the LIBOR transition, in that approximately 60 percent of those surveyed say they have recognized individual risks associated with the transition. Based on the result of our analysis, banks’ disclosures fell into the following categories:

1. Made no mention of LIBOR in risk factors
2. Identified LIBOR as a risk, but only as a broader impact on assets
3. Cited LIBOR as an industry risk
4. Identified individual risks associated with LIBOR
5. Described remediation efforts to mitigate the impact of LIBOR.


Note that each disclosure level increases in comprehensiveness. For example, for banks who fall into the last category of “identifies individual risks associated with transition and approach,” they also fall into other categories except for “No reference to LIBOR Transition.”
The road to 2021
Our current research shows how the industry has evolved in its managing of LIBOR risks—specifically in the months following the aforementioned regulator communications: (1) the FCA’s September 2018 letter to the CEOs of major banks and other financial institutions urging them to take action in preparation for the transition, and (2) the SEC’s December 2018 announcement of LIBOR as an emerging risk, and (3) the SEC’s staff comments at the Current Financial Reporting Issues Conference in November 2018.

Our analysis of the top 15 U.S. banks’ 2018 10-Ks indicates leaders’ awareness of the variety of impacts this transition could have on their institutions. Per their 2018 financial statements, 53 percent of surveyed banks included more specifics about LIBOR in their risk disclosures, with details such as, “Uncertainty regarding IBORs and the taking of discretionary actions or negotiation of fall-back provisions could result in pricing volatility, loss of market share in certain products, adverse tax or accounting impacts, compliance, legal and operational costs and risks associated with client disclosures, as well as systems disruption, model disruption and other business continuity issues […]”

These specifics indicate banks’ concerns that the discontinuation of LIBOR will indeed present risks that require attention across multiple frontline units of each institution.

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LIBOR disclosure in Top 15 U.S. Banks’ 10-Ks

<table>
<thead>
<tr>
<th>Disclosure level</th>
<th>Number of Banks Pursuant to 2017 10-K</th>
<th>Number of Banks Pursuant to 2018 10-K</th>
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<tbody>
<tr>
<td>No reference to LIBOR transition</td>
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<td>0</td>
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<tr>
<td>Considers LIBOR transition only as impact on broader risks, e.g., ALM, Pricing</td>
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<tr>
<td>Identifies LIBOR Transition only as Industry/firm risk</td>
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<td>Identifies individual risks associated with transition and approach</td>
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</tr>
<tr>
<td>Identifies remediation planning efforts/quantifies exposure</td>
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<td>1</td>
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</tbody>
</table>

Contact us

LIBOR, the interest rate benchmark that the industry has grown to love over the years, will inevitably disappear in 2021. Choosing the right partner to help navigate the LIBOR transition is key to your firm’s success. KPMG has the experience to help make it a smooth journey.

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