Brussels, 17 May 2021

EBF RESPONSE TO THE EUROPEAN COMMISSION'S TARGETED CONSULTATION ON THE DESIGNATION OF A STATUTORY REPLACEMENT RATE FOR CHF LIBOR

1. ON THE EFFECTIVE NEED FOR A REPLACEMENT FOR CHF LIBOR

Pursuant to article 23a of the EU BMR, the Commission may only designate replacement rates for third-country benchmarks "if their cessation or wind-down would significantly disrupt the functioning of financial markets in the Union or pose a systemic risk to the financial system in the Union."

Question 1. Do market participants agree that the situation as described above, requires that the Commission exercises the statutory replacement powers for the CHF LIBOR? Please explain and provide data if available.

a) Yes

b) No

c) No opinion

For financial markets in various countries in Europe, CHF LIBOR plays an important role due to the existing or legacy stock of mortgage credit agreements. We consider that the exposure of mortgage credits to CHF LIBOR in these markets fulfils the premise that the cessation of CHF LIBOR would result in significant disruption in the functioning of financial markets in the EU. Therefore, the EBF agrees there are valid grounds for the Commission to exercise the statutory replacement powers stipulated in art. 23b BMR and designate a replacement for CHF LIBOR. Such a statutory replacement of the 3M CHF LIBOR would provide the necessary legal certainty for market participants.

Considering that 3M CHF LIBOR is mainly used in savings accounts, mortgages and loans, narrowing the scope of the statutory replacement rate as proposed by the Commission seems in principle to be appropriate in this particular case. However, any further statutory replacements regarding other critical benchmarks may require a significantly broader scope. It should be considered that as a starting point for further public consultations (Art. 23b para. 10 (EU) 2021/168) contracts and financial instruments according to Art. 23a (EU) 2021/168 should be included.

Such need for a statutory replacement may in particular exist regarding US Dollar LIBOR and EONIA references.

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We are convinced that with a view to these reference rates a similar or even more serious potential for financial market disruptions may also exist regarding other types of financial instruments (such as bonds) and even derivatives transactions. The transition to new reference rates will in these cases be at least equally challenging and give rise to similar legal uncertainties. Consequently, they should be considered in future implementing acts introducing statutory replacement rates.

We consider that the key objective pursued by the legislative solution and one should also be addressed within the Commission's implementing act is that the replacement rate is set by law. This means that the Commission's implementing act will have to set out the rate with all accompanying specifics including the calculation methodology, the specific spread adjustment, designation of robust fallback(s) for the replacement rate, and the legal consequences for existing references to LIBORs i.e. that the replacement reference interest rate replaces all previous references to LIBOR. The Commission's implementing act should resolve to the existing uncertainties and problems in all legacy contracts in scope of the implementing act directly and without requiring any kind of further actions by the parties.

As to the cut-off date, we strongly believe that the intended positive effects on financial markets and legal certainty could be significantly improved by choosing a later cut-off date for the statutory replacement. Currently, it is proposed that only contracts concluded before the full applicability of the Benchmark Regulation ((EU) 2016/1011, BMR) on 1 January 2018 are included in the scope of the replacement rate. This date is, however, not an appropriate cut-off date. Even though supervised entities have been required to establish and maintain robust written plans after entry into force of the BMR, a successor benchmark for CHF LIBOR (and other LIBOR tenors and currencies) was unknown for a long time. The absence of recommended and publicly available substitutes led to uncertainty over what successor benchmark would be appropriate and accepted in the market. Market participants therefore had to resort to very recently – after the cessation announcement by the Financial Conduct Authority as of 5 March 2021 – been in a position to introduce suitable/detailed and market accepted fallback provisions and/or replacement rates. Specially as it was only on this date that a reasonable spread adjustment could be made. This central element is essential to ensure an economically neutral outcome for the contracting parties in the transition. Such an approach is also in line with the recommendations of all major RFR working groups, which see the inclusion of the spread as a central element in the transition. Against this background, the more appropriate and practically relevant cut-off date would be the 5 March 2021. This event marks the official end of CHF LIBOR for all market participants.

2. ON THE FAIRNESS AND ACCEPTABILITY OF THE SOLUTION RECOMMENDED BY THE SWISS NATIONAL WORKING GROUP

Question 2. Do consumers, small and medium enterprises and relevant consumer bodies agree that the proposed replacement rate (3M SARON calculated as a compounded SARON under a last reset methodology) plus the ISDA adjustment spread (calculated as a historical median approach over a five-year lookback period) is a fair and equitable solution for a replacement of CHF LIBOR in mortgages and small business loans and consumer credit agreements? Please explain and, if necessary, provide alternative solutions.

a) Yes

b) No

c) No opinion

From our perspective as a trade association representing the banking sector, we consider an alternative benchmark rate should resemble as much as possible the existing situation. Consequently, the preferred solution would be forward-looking methodologies and a simple, not too complex, waterfall of alternative rates in order to ensure a transparent outcome for banks and consumers alike. Should a forward-looking methodology not be feasible in view of potential legal constraints in some European countries under existing consumer protection laws which may require advance information on the applicable rate at the beginning of the interest-bearing period, the proposed last reset methodology seems to be the best alternative.

We consequently support the Commission's proposal to use the compounded SARON under a last reset methodology plus the ISDA adjustment spread as replacement rate. SARON compound being a BMR compliant benchmark also ensures a high standards and quality of the calculation method.

The replacement of the 3M CHF LIBOR by the 3M compounded SARON plus the ISDA spread adjustment seems in principle appropriate and fair. However, this requires that the final spread adjustment (for 3M CHF LIBOR = 0.0031 %) is directly fixed and published in the implementing act - instead of a mere reference to the ISDA/Bloomberg website. However, regarding other CHF LIBOR tenors, the 3M compounded SARON plus ISDA spread seems not be suitable.

We deem critical that such solution should not be limited to only 3M CHF LIBOR as the consultation paper seems to imply. We believe that a designation of replacement for only one tenor, leaving the remaining tenors without a systemic solution, will cause turmoil on the market. It will also unjustifiably differentiate the condition of customers having a 3M CHF LIBOR in their contracts from those with others CHF LIBOR tenors. Leaving the necessity for bilateral arrangements i.e. between banks and clients, for tenors other than 3M will never ensure such convergence compared to using a systemic solution from Art. 23b BMR.

Therefore, we call that the implementing act by the Commission specifies replacement for all currently used tenors of CHF LIBOR.

We also would like to stress the importance to timely address the issue of the public availability of information on SARON rates as well as their usability in contracts without cost i.e. no need for license.

Lastly, the timeline for introducing legislative solution at EU level is very important. Since implementation of the solution will involve changes to banks' IT systems and an appropriate customer information campaign, the implementing act should ideally be adopted in the course of the coming quarter as having this later than September 2021 represents greater operational risk for the sector.

3. ON THE COMPATIBILITY OF THE CHOSEN METHODOLOGY WITH EU AND MEMBER STATES LAWS PROTECTING CONSUMERS

Question 3. Do market participants agree that the proposed calculation method (so called last reset) is compatible with the requirements of the MCD, the CCD, Directive 93/13/EEC and of other legislation protecting consumer credit and national implementation laws and with any other applicable legislation? Please explain.

a) Yes

b) No

c) No opinion

We see no contradictions between using the last-reset method and the requirements of the MCD, the CCD and Directive 93/13/EEC. It is important to note that the market participants' opinion is of no legal relevance in adjudging compatibility with the MCD, the CCD, Directive 93/13/EEC and any other legislation. Final judgment is always reserved to the Courts, hence the need for legislative replacement of reference interest rate to avoid ambiguity and legal disputes.

Applicable law may in some countries set out a requirement to be provided to consumers in advance of the applicable interest rate and/or the amount of instalments and its components of principal and interest. This of course can only be done when the applicable interest rate in question can already be determined in advance. Consequently, forward-looking methodologies or backward looking last reset methodologies would be better suited. Thus, and given current constraints on forward-looking alternatives to CHF LIBOR, SARON based methodologies appear to be the best alternative to such forward looking rates and would allow market participants to comply with existing requirements under national legislation.

In order to prevent any uncertainties or potential conflicts with such existing laws it is important that the implementing act will clearly specify the replacement reference interest rate including all accompanying details such as the specific spread adjustment without requiring references to any third-party information.

If these requirements are fulfilled, the counterparties can clearly verify and identify the applicable interest rate themselves. Only such transparent approach can meet the relevant civil law requirements. It would in particular be unreasonable to force counterparties and especially consumers to search for the relevant information details required to identify and calculate the applicable (new) the interest rate on third-party information providers (i.e. SIX or Bloomberg webpage). This could also introduce legal risks for all involved parties.

ANNEX

DESIGNATION OF STATUTORY REPLACEMENT RATES FOR VARIOUS LIBOR CURRENCIES AND TENORS

We would like to take the opportunity of our response to the CHF LIBOR consultation to share important remarks about the European application of statutory replacement for LIBOR discontinuation.

We acknowledge the relevance and impact of the powers given to the Commission under the recent amendment of the Benchmark Regulation by the Regulation 2021/168 in order to designate a statutory replacement rate for, among others, a critical benchmark under a discontinuation / non-representativeness scenario as it is the case for LIBOR. We consider that these powers are essential to prevent unprecedented contractual disruption and they should contribute to maintain financial stability and customer protection in the EU and ensure a smooth transition when benchmarks (as relevant as Libor) are discontinued.

As explained in the Regulation 2021/168 amending the Benchmark Regulation, the upcoming discontinuation of LIBOR is a situation requiring the Commission's intervention as it might result in material negative consequences that significantly disrupt the functioning of financial markets in the Union.

Regarding the implementation of the statutory replacement by the Commission, in our view, it should have a technical/pragmatic approach to help all the affected market participants and it cannot be seen as political driven measures. We consider necessary to ensure that market participants know and have the opportunity to participate in the adoption of these benchmarks' statutory replacement measures through consultations. Without prejudice of taking into account the result of the consultations, we encourage the Commission to have a broad view of the global relevance of the LIBOR discontinuation proposing a comprehensive pragmatic solution for discontinuation of LIBOR currencies and tenors aligned to the recommendations and solutions adopted by the UK, US and other third countries competent authorities and central banks in order to make sure that the European market solution will be consistent with those adopted by the international authorities. A mismatch among the solutions adopted by the relevant international authorities can create new market risks that would be difficult to anticipate and mitigate.

Accordingly, we deem that the best option to mitigate the impacts on financial stability of the LIBOR discontinuation explained in the previous paragraphs is to designate statutory replacement rates for LIBOR currencies and tenors that will be discontinued by December 2021. This would be the best feasible way to ensure a seamless transition and avoid potential contract disruptions and to protect the consumers, the markets, and the legal certainty of the contracts.

The relevant international working groups, such as the Working Group on Sterling Risk-Free Reference Rates or the ARRC, have recommended fallbacks provisions that can be taken into account by the Commission to provide a quick and gradual solution to the disappearance of LIBOR in 2021 or 2023 depending on the tenors. The implementation of replacement rates should be progressive and requires recurrent monitoring of working groups and market developments as, for example, the evolution of forward-looking term rates for €STR and SOFR or the publication of spread to mitigate a potential risk transference value.

In addition, we call the Commission to consider the decision of the UK authorities regarding the publication of synthetic methodology for LIBOR pound 1 month, 3 months and 6 months tenors and LIBOR JPY 1 month, 3 month and 6-month tenors, in order to release a consultation during 2021.

The new powers that will be granted under the UK legislative initiative allow the FCA to direct a change in LIBOR methodology. Whilst this solution is positive per se, there is however a contingent risk that it could also provide a platform for litigation or result in the frustration of contracts in agreements that are subject to US or EU law as according to current drafts of the UK legislative proposal, it is implicit that a change in the methodology implies that LIBOR is no longer representative of the underlying interest. In addition to that, according to FCA publications, the synthetic LIBOR would be limited in time, so instead of solving the problem, it would only reduce/delay it.

In order to mitigate these risks, the EC could extend the designation of the statutory fallback also to LIBOR tenors and currencies that would become synthetic benchmarks under the FCA powers, applying the same solution (methodology and spreads) than the FCA but through the means of the statutory fallback.

Lastly, we also fully support the application of the statutory fallback for EONIA linked contracts, as it will provide legal certainty to the transition from EONIA to €STR. There are hundreds of collateral agreements linked to EONIA that would benefit from this measure with no downside for any of the parties. The private sector has been negotiating the transition towards €STR or €STR+8,5bp during the last months/years, but market participants are overwhelmed with IBOR related tasks and resources are limited, so the percentage of transitioned collateral agreement is still very low. The statutory fallback would prevent unfair negotiations and potential market disruptions.

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About EBF

The European Banking Federation is the voice of the European banking sector, bringing together national banking associations from across Europe. The federation is committed to a thriving European economy that is underpinned by a stable, secure and inclusive financial ecosystem, and to a flourishing society where financing is available to fund the dreams of citizens, businesses and innovators everywhere.

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