

EBF RESPONSE TO THE EUROPEAN COMMISSION CONSULTATION ON THE IMPLEMENTING REGULATION ON THE DESIGNATION OF A STATUTORY REPLACEMENT FOR CERTAIN SETTINGS OF CHF LIBOR

The European Banking Federation (EBF) welcomes and fully supports the Commission's initiative to exercise the power to designate a statutory replacement rate for LIBOR CHF as part of a comprehensive solution to avert the risk of serious and detrimental consequences on the functioning of financial markets, for any contract using such benchmark and especially those with consumers. Such replacement will guarantee continuity of contracts and provide legal certainty with the highest level of consumer protection.

The statutory replacement under the art. 23b is the only pan-European solution which prevents the risk of significant disruption in the functioning of financial markets in the Union and simultaneously guarantees an adequate level of protection for those contracts which do not contain adequate fallback provisions and especially on residential mortgages.

The proposal provides for a transparent, clear and balanced solution for all affected parties, especially considering that counterparties remain able to agree on alternative solutions.

Consequently, with our previous positions, completely sharing the argumentations expressed in the preamble of the Draft Regulation, **we advocate for the need for a statutory replacement in relation to CHF LIBOR to be issued as soon as possible.** The industry needs such solution urgently, to safeguard counterparties from the risk of contracts discontinuity. On the other hand, the statutory fallback will start applying to each contract in scope on its first fixing date following the cessation of CHF LIBOR, and the 30-day notice would have to be given to clients 30 days prior this first fixing date of the contract that follows the cessation of CHF LIBOR.

Additionally, to this general support to the exercise of the statutory replacement for CHF Libor, we would like to express further specific appreciations regarding certain solutions included in the regulation:

1) **The form of a regulation** – The form of a regulation is consistent with proportionality principles and guarantees direct and uniform application in all Member States, being immediately binding in its entirety.

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2) The replacement for all crucial tenors of CHF LIBOR – We appreciate the decision of the Commission to comprehensively determine replacement for all CHF LIBOR tenors, designating replacements not only for CHF LIBOR 3M but also for CHF LIBOR 1M, 6M and 12M. The replacement designation only for the 3M tenor - although being the most represented – would leave the remaining settings without a systemic solution, would cause huge confusion in the market and would unjustifiably differentiate the situation of customers having agreed contracts with other CHF LIBOR tenors. Also, we welcome the Commission’s decision to designate replacement for 1M, 3M, 6M and 12M tenors in one unique act.

3) The scope of the regulation – We also support the comprehensive decision to determine the scope of the Regulation to all contracts and financial instruments - not only to contracts with consumers and SMEs - and to provide a solution also for contracts entered into and instruments issued after January 2018.

4) SARON Compound Rate as a replacement including designation of a tenor specific spread adjustment – We support the choice of replacing CHF LIBOR with a SARON Compound Rate plus a tenor specific spread adjustment (Spread Adjustment Value). The statutory implementation of such replacement benchmark of CHF LIBOR will ensure a smooth and effective performance of “tough legacy” contracts, in particular the long-term loans lacking suitable fallback clauses. Particularly, we appreciate that recital 17 mentions the use of the “last reset” methodology, which provides retail clients the opportunity to know the amount of the obligation in advance, at the beginning of a given period. We’d therefore appreciate, for the sake of clarity, if art.1 expressly mentioned the last reset methodology as well.

We further fully agree with the approach to set out the relevant SARON Compound Rate based replacement rates for each of the CHF tenors including the applicable Spread Adjustment Value (along with the ISIN number for the relevant SARON Compound Rate) in a table. This approach ensures that the applicable replacement rate can be clearly identified and easily determined by all counterparties.

5) Maintaining the characteristics of the contracts and instruments – a SARON Compound Rate based statutory benchmark replacement is the best approach to maintain the original features of the contracts and instruments, especially in the case of loans.

I. Adjustments to be considered to improve effectiveness of the statutory replacement tool

Having said that, and notwithstanding our general support for the Commission’s initiative to designate a statutory replacement for CHF LIBOR settings and the general approach chosen, we believe that it is worth raising the European

Commission awareness to certain aspects which could be reviewed in order to improve the effectiveness of the statutory replacement tool in this particular case.

Our suggestions and considerations are limited to these specific aspects and are not intended to put the proposed application of the statutory replacement tool to the CHF LIBOR tenors into question:

1) Suggestions on replacement rate mechanism/proposal for certain Libor tenors

We believe that it could be considered to distinguish between the shorter CHF LIBOR tenors (1 and 3 months) on the one hand and the longer CHF LIBOR tenors (6 and 12 months) on the other by adjusting the approach applicable to the two longer CHF IBOR tenors to a methodology that better reflects the structural differences between the original LIBOR and the SARON and reduces distortive effects.

To this end, both in the case of the 6-month as well as the 12-month CHF LIBOR, the replacement rate should be based on the 3-month SARON Compound Rate plus the relevant spread adjustment set out in the draft implementing act for that tenor.

The use of the 3-month SARON Compound Rate and the last reset methodology (rather than the SARON Compound Rate with a longer observation period corresponding in length to the relevant CHF IBOR tenor) may imply a more accurate reflection of the current interest rate environment avoiding the economic distortions, hedging mismatches and accounting challenges (in particular IFRS9 SPPI, Solely Payments of Principal and Interest, test) caused by the structural differences between the IBOR (as forward looking) and the SARON (as backward-looking rates). These distortive effects are particularly pronounced in case of longer-term tenors. The above suggested adjustment would also align the approach in the draft implementing regulation more closely with both the recommendations of the Swiss National Working Group on Swiss Franc Reference Rates as well as the methodology recommended by the Working Group on Euro Risk-Free Rates which also advocates for the application of replacement rates with shorter observation periods for longer term RFR-based replacement rates.

Such differentiation between the approaches for the two shorter and the two longer term CHF IBOR tenors would also be more suited to address the broad personal and product scope covered by the draft implementing regulation and the fact that longer term CHF IBOR rates (6 and 12 months) are more prevalent in instruments other than consumer and residential mortgage loans - which instruments are particularly exposed to the above-mentioned distortive effects.

The matrix of the applicable replacement rates incorporating the above suggested adjustments would be as follows (changes to proposal in draft implementing regulation are **marked**):

- 1-month CHF LIBOR: 1-month SARON Compound Rate (SAR1MC) with Spread Adjustment Value - 0.0571% (no change to the proposal in the draft implementing regulation)
- 3-month CHF LIBOR: 3-month SARON Compound Rate (SAR3MC) with Spread Adjustment Value 0.0031% (no change to the proposal in the draft implementing regulation)
- 6-month CHF LIBOR: **3-month** SARON Compound Rate (SAR3MC) with Spread Adjustment Value 0.0741%
- 12-month CHF LIBOR: **3-month** SARON Compound Rate (SAR3MC) with Spread Adjustment Value 0.2048%

The table designating the replacement rates for CHF LIBOR would thus be as follows:

| LIBOR | TENOR | Replacement Rate | Spread Adjustment Value |
|--------------|--------------|--------------------------------------------------------------------------|--------------------------------|
| CHF | 1M | SARON 1 month Compound Rate (SAR1MC) ISIN CH0477123886 | -0.0571 |
| CHF | 3M | SARON 3 months Compound Rate (SAR3MC) ISIN CH0477123902 | 0.0031 |
| CHF | 6M | SARON 3 months Compound Rate (SAR3MC) ISIN CH0477123902 | 0.0741 |
| CHF | 12M | SARON 3 months Compound Rate (SAR3MC) ISIN CH0477123902 | 0.2048 |

Needless to say that, following the BMR and the relevant Euro RFR WG recommendations, and considering the wide scope of the draft Regulation which also include contracts and instruments other than consumers' loans, the implementing act by the Commission should also include conforming changes that are essential to assure the financial soundness of the designated fallback rates and consistency with the observation period embedded in the statutory replacement rate.

2) Art. 2 of the Project – Information sharing

We recognize the need of appropriate communication with the clients, but also consider that it should be limited to consumers. Such an appropriate and timely information is also in the interest of the institution. Institutions will have to inform

their consumers on the statutory replacement in accordance with already existing regulatory requirements, thoroughly set also at national level.

Should a specific requirement be established in order to emphasize the need for appropriate information, we would like to ask some changes and clarifications regarding the below mentioned aspects in order to make this requirement efficient and flexible, thereby reducing the risk of administrative burdens and/or overlaps with the other information requirements, including those under applicable laws of the member states.

- Considering the purpose of this obligation we suggest **narrowing the scope of it solely to the consumers** and with respect to consumer loans and residential mortgage loans (to the financial contracts defined in the BMR).
- Any information to be provided **should be limited to the key and major aspects**, namely the fact of the benchmark replacement and **the identification of the new, now applicable benchmark: the legal basis** (by way of reference to the EC implementing act), **and the new applicable rate**. Unclear terms must be avoided since they will not result in useful and concrete information and can cause unintended legal risks which would undermine the purpose of the statutory replacement. Any further information is likely to produce confusion and may also overlap with other parallel information requirements. This holds particularly true as regards the proposed information on the “effects on the contracts”: These cannot be described accurately and with absolute certainty. Therefore, we ask for the deletion “and the effects on their contracts” as an unclear part of the requirement.
- The institutions also need a **sufficient level of flexibility as to the information timing and format** and should be able to choose the most suitable manner to best disseminate the information:
 - The 30-day notice period currently proposed in the draft implementing act is likely to be unrealistic considering the implementing act will presumably be adopted at the end of this year. In this context, institutions should be allowed to provide the information “as soon as possible” or “at the earliest opportunity”. This would provide more flexible regulatory approach for institutions to inform their clients.
 - The requirement to provide **written information can be interpreted narrowly and may exclude electronic means of communications** the customers are already accustomed to. The currently proposed requirement to provide the information “in writing” should be replaced by a more open and already established term, such as “durable medium” as defined e.g. in MIFID II or the CCD. Moreover, the implementing act should grant that the form of communication agreed between the institution and the client in the contract shall prevail.

II. Useful Clarifications

We further believe that the following clarifications (by way of recitals) could be considered to prevent misconceptions and uncertainties regarding the way the statutory replacement tool is intended to apply:

- **No displacement of replacements or suitable fallback provisions** agreed by the parties and other contractual provisions concerning interest rates.

The statutory replacement tool applies to a broad range of contracts and financial instrument, including instruments and contracts where the counterparties may have already agreed on replacement or suitable fallback provisions, often on the basis of templates or standards developed for the relevant market and market standard documentations (e.g. protocols or supplemental agreements with replacement and fallback provisions for derivate contracts). It already follows from Art. 23b (3) (a) and (b) of the BMR that such contractually agreed replacement and suitable fallback provisions will not be set aside by the statutory replacement tool. However, to avoid any uncertainty or misconception in the market **this could be clarified by way of a recital in the preamble**. Such clarification would also serve as a further encouragement to market participants to implement necessary replacements and fallback provisions, including for other IBOR rates, bilaterally or by way of protocols.

It could further be considered to clarify that the replacement only affects the reference to the CHF LIBOR rate to be replaced and that other contractual provision continue to apply. The legal substitution instrument should not imply a contract modification nor that the parties are entitled to claim modification or termination of the contract due to its application.

- **Statutory replacement independent from information requirements**

Although this follows from the nature of a statutory replacement, and in order to avoid misconceptions or uncertainties, it could also be considered to clarify by way of a recital that legal effectiveness and applicability of the benchmark replacement is independent from any information requirement. Any perceived dependency would undermine the very purpose of the statutory replacement to provide legal certainty.