EUROPEAN COMMISSION
DIRECTORATE-GENERAL FOR FINANCIAL STABILITY, FINANCIAL SERVICES AND CAPITAL MARKETS UNION

Financial markets
Securities markets

CONSULTATION DOCUMENT

Targeted consultation on the designation of a statutory replacement rate for CHF LIBOR

Disclaimer

This document is a working document of the European Commission services for consultation and does not prejudge the final decision that the European Commission may take.

The views reflected on this consultation paper provide an indication on the approach the European Commission services may take but do not constitute a final policy position or a formal proposal by the European Commission.

The responses to this consultation paper will provide important guidance to the European Commission when preparing, if considered appropriate, a formal European Commission proposal.

You are invited to reply **by 18 May 2021** at the latest to the **online questionnaire** available on the following webpage:
https://ec.europa.eu/info/publications/finance-consultations-2021-chf-libor-rate_en

Please note that in order to ensure a fair and transparent consultation process **only responses received through the online questionnaire will be taken into account and included in the report summarising the responses**.

This consultation follows the normal rules of the European Commission for public consultations. Responses will be published unless respondents indicate otherwise in the online questionnaire.

Responses authorised for publication will be published on the following webpage: https://ec.europa.eu/info/publications/finance-consultations-2021-chf-libor-rate_en

INTRODUCTION

1. PURPOSE OF THIS CONSULTATION

The present consultation is aimed to assess the suitability of designating a statutory replacement for certain settings[1] of Swiss Franc LIBOR (CHF LIBOR) to products such as savings accounts, mortgages and loans, including consumer credit agreements and small business loans, concluded prior to the entry into application of the EU Benchmark Regulation (EU BMR)[2], on 1 January 2018, and governed by the laws of one of the EU Member States.

The present consultation constitutes a procedural requirement for the European Commission before adopting an implementing act to designate such a replacement pursuant to Article 23b, paragraph 8, of the BMR, as recently amended[3].

2. BACKGROUND TO THIS CONSULTATION

The UK Financial Conduct Authority (FCA), on 5 March 2021, has announced, among others, the cessation of CHF, GBP, JPY and EUR LIBOR rates at the end of 2021. There are no plans by the FCA to require the administrator of LIBOR to continue publishing any of the CHF LIBOR settings on a non-representative, synthetic basis for a further period after such date.

The European Commission has received several submissions, from market participants active in the banking sector in a number of Member States, among which, Poland and Austria, according to which CHF LIBOR plays an important role in their financial markets. The submitters point out that the cessation of CHF LIBOR, in particular the 3-month (3M) setting, without designation of a contractual replacement rate would have impacts on financial stability in their respective consumer markets. The submissions further point out that the current stock of mortgage credit agreements to consumers and loans to small businesses denominated in CHF LIBOR amounts to several billion euros and that most of the existing stock matures after the end of 2021.

The submitters also state that practically none of their existing contracts expiring after 31 December 2021 referencing CHF LIBOR contains contractual fall-back arrangements (required pursuant to Article 28(2) of the BMR), as most of the mortgage credit agreements were concluded prior to 1 January 2018 – date of entry into application of the BMR. For the purpose of this document, the legacy stock in CHF LIBOR includes only contracts entered into before 1 January 2018 and expiring after 31 December 2021.

[1] In this document, the setting of an interest rate benchmark is considered as the tenor of the floating rate leg of an interest rate swap (for example, 1 week, 1 month, 3 months).

[2] Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (OJ L 171, 29.6.2016, p. 1).

[3] Regulation (EU) 2021/168 of the European Parliament and of the Council of 10 February 2021 amending Regulation (EU) 2016/1011 as regards the exemption of certain third-country spot foreign exchange benchmarks and the designation of replacements for certain benchmarks in cessation, and amending Regulation (EU) No 648/2012 (Text with EEA relevance) OJ L49, 12.2.2021, p. 6-17 (https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:L:2021:049:TOC).

Stakeholders propose that the Commission statutory designation follows the recommendation of the Swiss National Working Group on Swiss Franc Reference Rates (Swiss NWG)[4] for replacing CHF LIBOR in mortgages and also propose that, in order to reflect differences in the 3M CHF LIBOR and the 3M SARON compounded rate, a spread adjustment would have to be added. This, stakeholders argue, also reflects the recommendations of the Swiss NWG.

3. THE PROPOSED REPLACEMENT RATE

As reported by the Financial Stability Board 2020 **progress report** on **reforming major interest rate benchmarks**[5], in October 2017, the Swiss NWG) recommended the Swiss Average Rate Overnight (SARON) as the alternative for CHF LIBOR. Such a rate should then be used as a **fall-back** for references to CHF LIBOR in legacy contracts.

SARON is an overnight benchmark administered by SIX Swiss Exchange Financial Information AG (SIX) in Switzerland and already endorsed for use in the European Union and therefore listed in the ESMA register pursuant to Articles 33 and 36(1)(d) of the BMR.

In October 2018 **t**he Swiss NWG assessed that the market of derivatives based on SARON is not liquid enough to allow the creation of a forward looking term rate based on SARON and recommended to use compounded SARON as a term rate for CHF LIBOR.

As further reported by the FSB 2020 **progress report**, in September 2020, the Swiss NWG recommended that compounded SARON plus ISDA's spread adjustment can be used as a **fall-back** rate cash products. The spread can be neglected for simplification if it is beneficial for the customer[6].

As indicated in the FSB 2020 **progress report**, after extensive market consultation, the International Swaps and Derivatives Association (ISDA) proposed for the adjustment spread a historical median approach over a five-year lookback period[7].

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[4] The Swiss National Working Group (NWG) on Swiss Franc Reference Rates is the key forum to foster the transition to SARON and to discuss the latest international developments. The Swiss NWG is co-chaired by a representative of the private sector and a representative of the Swiss National Bank (SNB). The Swiss NWG publishes recommendations based on consensus. Recommendations are not legally binding. The SNB acts as a moderator and runs the Swiss NWG's technical secretariat, facilitates the organisation of the meetings and publishes on its webpage documents discussed by the Swiss NWG. The Swiss NWG will cease to exist once the transition to SARON is materially completed.

[5] Financial Stability Board 2020 progress report 'Reforming major interest rate benchmarks - The year of transition away from LIBOR' p. 27 https://www.fsb.org/wp-content/uploads/P191120.pdf.

[6] Minutes of the Swiss NWG of 29 September 2020 https://www.snb.ch/n/mmr/reference/minutes_20200929/source/minutes_20200929.n.pdf .

[7] The International Swaps and Derivatives Association consulted in September 2019 on the final parameters of the adjustments that would be incorporated into its fall-backs: (https://www.isda.org/2019/09/18/isda-publishes-consultation-on-final-parameters-for-benchmark-fall-back-adjustments/) and published a report summarising the responses in November 2019 https://www.isda.org/2019/11/15/isda-publishes-results-of-consultation-on-final-parameters-for-benchmark-fall-back-adjustments/.

The Swiss recommendation, as reported in the FSB 2020 **progress report**, further clarified that **fall-back** language proposed for mortgages can also be used for bilateral loans to corporates or SMEs.

The administrator of SARON, SIX, launched in March 2020 the so called SARON Compound Rates. The SARON Compound Rates are standardised term rates published each business day, e.g. "SARON 3 months Compound Rate". Furthermore, SIX launched in September a free to use web-based calculator, which can for instance be used by retail clients to verify the compounded SARON charged by the lender.

4. ISSUES AROUND CONSUMER PROTECTION

A large number of mortgage credit agreements that would be affected by the designation of a statutory replacement for CHF LIBOR in the Union were concluded before the entry into application of the EU Mortgage Credit Directive (MCD)[8], on 21 March 2016. Hence the provisions of the MCD do not apply to those agreements unless there is a re-negotiation by the parties of an essential term of the agreement equivalent to the conclusion of a new contract.

The statutory replacement rate for CHF LIBOR may not fall under the scope of application of Directive 93/13/EEC on unfair terms in consumer contracts[9], as according to its Article 1 the contractual terms that reflect mandatory statutory or regulatory provisions shall not be subject to this Directive[10]. However, Directive 93/13/EEC will remain applicable to all terms of the relevant contracts, insofar as those contract terms have not been negotiated individually.

An essential design feature of a compounded rate is that the payments due on the mortgage are only known at the end of the reference period. For example, the 3M SARON compounded rate is only known at the end of the three-month period for which it is calculated. For mortgages concluded on or after 21 March 2016, this could create consumer protection issues as Article 27 of the MCD requires that any change in the borrowing rate (including those caused by changes in the reference rate) for an interest period is communicated to the retail client (consumer) before it comes into effect (in-advance). The information shall at least state the amount of the payments to be made after the new borrowing rate takes effect. This consumer protection issue could appear also in consumer credits that fall under the scope of the EU Consumer Credit Directive (CCD)[11] since Article 27 of MCD and Article 11 of the CCD provide equivalent rules.

In order to make the 3M SARON compounded rate known in advance, stakeholders propose to apply the rate compounded from daily SARON overnight rates over the last three months for the following three months. This mode of calculating an in arrears

[8] Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 Text with EEA relevance.

[9] Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts *OJ L 95, 21.4.1993, p. 29–34* (Text with EEA relevance.)

[10] As interpreted by the Court or Justice of the European Union. See also the Commission notice — Guidance on the interpretation and application of Council Directive 93/13/EEC on unfair terms in consumer contracts - *OJ C 323, 27.9.2019, p. 4–92*

[11] Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC, OJ L 133, 22.5.2008, p. 66–92.

compounded rate to apply in advance is also called the "last-reset", as it allows an in-advance application of the 3M SARON compound rate. The last reset methodology is currently being assessed by the Euro Risk-Free Rate Working Group as the best one to be used also for EURIBOR **fall-back** clauses in mortgage, consumer loans and SME loans, where a forward looking term rate is not available[12].

Stakeholders are concerned that a private contractual conversion from CHF LIBOR to SARON compounded will be subject to litigation. They point out that the proposed transition could give rise to uncertainty on the best rate to replace LIBOR and, ultimately, be deemed inappropriate or illegal by a court decision. Such a situation would, in their view, be disruptive to financial stability and contractual continuity in their respective jurisdictions.

In these circumstances, stakeholders have called on the Commission to designate 3M SARON compound with the adjustment spread as recommended by the Swiss NWG as a replacement rate for 3M CHF LIBOR, pursuant to Article 23b(8) BMR.

In designating a replacement for a benchmark, pursuant to Article 23b(8) of the EU BMR, the Commission is required to consult the market and to take into account the following recommendations:

on the replacement rate;

on the corresponding conforming changes; and

on the spread adjustment;

made by the central bank responsible for the currency area in which the relevant benchmark is being wound down, or by the alternative reference rate working group operating under the auspices of the public authorities or the central bank (in this case the Swiss Central Bank and the Swiss NWG).

[12] Public consultation by the Working Group On Euro Risk-Free Rates on €STR-based EURIBOR fall-back rates (23 November 2020) https://www.ecb.europa.eu/pub/pdf/other/ecb.pubcon_ESTRbasedEURIBORfall-backrates.202011~d7b62f129e.en.pdf

Summary of responses to the public consultation by the Working Group On Euro Risk-Free Rates on €STR-based EURIBOR fall-back rates (15 February 2021) https://www.ecb.europa.eu/pub/pdf/other/ecb.summaryresponsespublicconsultation_ESTRWGonEURIBORfall-backrates~b5af670561.202102.pdf

CONSULTATION QUESTIONS

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

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

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