ABI response to the EU Commission consultation *"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

The Italian Banking Association (ABI) agrees on the need that the Commission exercises the statutory replacement powers for the CHF LIBOR, to avert the risk of serious consequence on the functioning of financial markets, following to its cessation, for those kinds of contracts with usually less sophisticated parties.

ABI would highlight that, for the designation to be fully effective in ensuring a smooth transition, the Commission's implementing act should clarify not only the replacement rate, but also all accompanying specifics, including calculation methodology, spread adjustment and the application of other contractual features including floor, in order to minimize the rooms for uncertainties and the risk of litigation. Detailed suggestions are provided in the relevant paragraphs.

ABI would also encourage the Commission to expand the scope of the statutory replacement. First, ABI recommends including the contracts agreed after 1 January 2018. The fallback clauses present in these contracts might indeed prove not sufficiently robust, having been defined in a condition of uncertainty about the availability of the new benchmarks. It would be therefore worth providing a solution also for these contracts, by applying the same framework as for legacy contracts agreed before 2018.

In addition, ABI recommends defining a statutory replacement rate not only for contracts referencing the 3-month (3M) CHF LIBOR - clearly addressed in the proposal - but also for the 1-month (1M), 6-month (6M) and 12-month (12M) settings. These account for a significant share of overall banks' and clients' exposures to CHF LIBOR, and seems therefore warranted, to ensure equal treatment of customers, that a suitable solution should be provided also for these contracts.

More precisely, ABI fully agrees with the proposed approach to replace 3M CHF Libor with 3M SARON calculated as a compounded SARON under a last reset methodology plus the ISDA adjustment spread for the corresponding tenor, calculated under historical median approach over a five-year lookback period, on a date which, in line with market practice, can be March 5, 2021, date of the announcement by the UK Financial Conduct Authority on the future cessation and loss of representativeness of the LIBOR benchmarks.

For the sake of transparency, it would be important that the Commission explicitly sets the value of the adjustment (rather than explaining how to retrieve it).

The same approach outlined for 3M CHF LIBOR could be applied for 1M (i.e., 1M CHF LIBOR replaced with compounded SARON 1M under a last reset methodology + ISDA adjustment spread for 1M).

For 6M and 12M a different solution is proposed, since the last reset methodology applied to the compounded rate for the corresponding tenor is not deemed suitable in these cases. This opinion is also based on the assessment of the Working Group on Euro Risk-Free Rates, which highlighted the concerns on the application of the last reset methodology for tenors longer than 3M (e.g., about compliance with the accounting framework) in the recent consultation on €STR-based EURIBOR fallback rates.

The proposed alternative is replacing 6M and 12M CHF LIBOR with compounded SARON 3M under a last reset methodology plus an appropriate adjustment. For the latter, a fair solution would be the ISDA spread adjustment corresponding to the original benchmark (e.g., 6M CHF Libor replaced with compounded SARON 3M under a last reset methodology + ISDA spread adjustment for 6M). This solution would allow to limit the adjustment to a single and publicly available spread (keeping the solution easier, thus enhancing transparency and consumers' understanding) while accounting for its main component (the credit risk component embedded in the CHF LIBOR rate is proportional to the time horizon).

The proposed approach for 6M and 12M requires some "conforming changes" to be specified in the Commission act. Among others, since different arrangements are possible in contracts as regards the frequency of fixing and payments, it might be appropriate that the latter are aligned to the new benchmark (3M) in cases where they are longer in the original contract.

Among the specifics that ABI recommends clarifying – valid for all tenors - is how floors (if present) should be applied. In line with the solution identified by the Euro RFR WG, ABI suggests considering the final rate (SARON + adjustment) as substitute of CHF LIBOR in the floor computation.

In addition, it should be noted that contracts might be referencing to a "punctual" fixing (i.e. the rate observed in a specific date) or to "average" rates (over a predefined period). The Commission should clarify how to apply the replacement in both cases. It is deemed reasonable that reference be made in both cases to the "punctual" compounded SARON (which already can be assumed to represent an "average" of the rates observed over the period).

To better explain all the above-mentioned issues, a table is enclosed (Annex).

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

Being a banking association, ABI is not the intended addressee of this question. Nevertheless, since the question pertains to the issue of the suitability of the proposed solution to be accepted by consumers, it is deemed worth highlighting that the proposals and suggestions above have been elaborated with a view to customers' acceptance as well as with the objective to ensure, to the extent possible, equivalence between the new rate and the original benchmark (in the interest of both parties of the contract). In addition, the highest attention has been paid to the need for transparency in all aspects of the replacement.

Ideally, a fallback rate based on a forward-looking methodology would be preferable. Being it not available, and considering the strong preference (and legal constraints in some European countries) for a solution enabling banks to provide consumers with upfront information prior to the beginning of the interest-bearing period, the last reset methodology has been identified as the most suitable alternative in concrete.

Besides, all the proposed parameters are determined by third parties and widely used (or expected to be used) in market practice, and, as said above, for the other aspects ABI encourages the Commission to clarify as much details as possible.

Against this background, in the context of continued dialogue with Consumer Associations, ABI is engaging in dialogue on this topic with consumer bodies, to raise awareness of the issue and explain the rationale behind the proposed solutions.

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

Based on the assessment conducted to date, we have not identified major issues with respect to the compatibility of the proposed solution with existing EU legislation.

Anyway, the need has to be highlighted that the Commission enacts appropriate actions to ensure that information on SARON rates be publicly available in all EU languages and that the benchmark might be used in contracts without incurring in costs (i.e. no need for licence).

It is in any case important that, in order to avoid any kind of uncertainty or any potential conflict with the introduction of SARON with above mentioned Directives, within the Commission's implementing act the replacement reference interest rate is clearly specified with all accompanying specifics.

In light of the above, ABI recommends that the Commission's implementing act clearly states that – in the absence of suitable fallback clauses or different agreement – the replacement operates by law, without requiring further actions by the parties of respective contracts.

Lastly, it might be worth highlighting that the cessation of the CHF LIBOR is planned at the end of this year, and therefore time is of the essence. Since implementation of the solution involves changes to banks' IT systems and an appropriate information campaign towards clients, a timely adoption of the legislative act is key.

Annex

	AS IS					Statutory Replacement								
	Tenor	**Rate Type**	**Fixing Frequency**	**Payment Frequency**		**Tenor**	**New Index Description**	**Compounded Rate**	**Fixing Frequency**	**Payment Frequency**	**Spread Adjustment (ISDA)**	**Spread Adjustment Bloomberg Ticker**	**Spread Adjustment Value**	**Zero Floor Option**
Standard Cases	**CHF LIBOR 1M**	Single Value / Average	1M	1M	→	LAST RESET 1M	1M SARON	SARON 1 month Compound Rate (SAR1MC) ISIN CH0477123886	1M	1M	1M	SSF0001M Index	-0.0571	Index + Spread Adj
Standard Cases	**CHF LIBOR 3M**	Single Value / Average	3M	3M	→	LAST RESET 3M	3M SARON	SARON 3 months Compound Rate (SAR3MC) ISIN CH0477123902	3M	3M	3M	SSF0003M Index	0.0031	Index + Spread Adj
Standard Cases	**CHF LIBOR 6M**	Single Value / Average	6M	6M	→	LAST RESET 3M	3M SARON	SARON 3 months Compound Rate (SAR3MC) ISIN CH0477123902	3M (Conforming Change)	3M (Conforming Change)	6M	SSF0006M Index	0.0741	Index + Spread Adj
Standard Cases	**CHF LIBOR 12M**	Single Value / Average	12M	12M	→	LAST RESET 3M	3M SARON	SARON 3 months Compound Rate (SAR3MC) ISIN CH0477123902	3M (Conforming Change)	3M (Conforming Change)	12M	SSF0012M Index	0.2048	Index + Spread Adj
Non Standard Cases	**CHF LIBOR 3M**	Single Value / Average	3M	1M	→	LAST RESET 3M	3M SARON	SARON 3 months Compound Rate (SAR3MC) ISIN CH0477123902	3M	1M	3M	SSF0003M Index	0.0031	Index + Spread Adj
Non Standard Cases	**CHF LIBOR 6M**	Single Value / Average	6M	1M	→	LAST RESET 3M	3M SARON	SARON 3 months Compound Rate (SAR3MC) ISIN CH0477123902	3M (Conforming Change)	1M	6M	SSF0006M Index	0.0741	Index + Spread Adj
Non Standard Cases	**CHF LIBOR 12M**	Single Value / Average	12M	1M	→	LAST RESET 3M	3M SARON	SARON 3 months Compound Rate (SAR3MC) ISIN CH0477123902	3M (Conforming Change)	1M	12M	SSF0012M Index	0.2048	Index + Spread Adj