Brussels, 18 May 2021

EACB Answer to European Commission's targeted consultation on the designation of a statutory replacement rate for CHF LIBOR

May 2021

The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4,050 locally operating banks and 58,000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 210 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 79 million members and 749,000 employees and have a total average market share of about 20%.

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The EACB welcomes the opportunity to provide its feedback to the European Commission's targeted consultation on the designation of a statutory replacement rate for CHF LIBOR by way of an implementing act.

Our members support the general approach proposed by the European Commission to replace 3-month (3M) CHF LIBOR in the event of cessation with the 3M compounded SARON based on the 'last reset' methodology + 0,31 bps spread adjustment according to the ISDA methodology. However, please find below some recommendations on the approach via our answers to the following consultation paper questions:

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.

Our answer is Yes.

For some of our members (even beyond Austria and Poland), the CHF LIBOR is widely used as a benchmark rate particularly when granting mortgages to private households. Indeed, to-date the amount of CHF LIBOR linked mortgages to private households still outstanding stands in the Euro billions. Therefore, its discontinuation poses challenges to the contracting parties. Against this background, the EACB supports the envisaged approach of the Commission to designate a statutory replacement of the 3M CHF LIBOR as it would be accompanied by the necessary legal certainty for the contracting parties in case the benchmarks cease to exist or wind down. This is the only way to assure legal certainty for both borrowers and lenders and to prevent any event being disruptive to financial stability and contractual continuity in the European financial market.

However, we would like to highlight some issues with the approach that would undermine this legal certainty:-

(i) Financial instruments/ contracts outside of scope

We note the potential for financial market disruptions also in the area of other financial instruments (such as bonds) and even derivatives transactions because the conversion of such contracts is similarly complex and legally uncertain. **Consequently, they should also be covered by the scope of a statutory replacement rate.**

(ii) Applicability date of contracts and instruments in scope

Currently, it is proposed that only contracts concluded before the full applicability of the EU BMR (i.e. 1 January 2018) are included in the protection scope of the replacement rate. This event does not seem appropriate to us.

For the existing CHF LIBOR linked contracts leading up to the years until 2010 (when a concrete replacement indicator was not yet proposed/predictable and the EU BMR was not yet in place), virtually none of the existing contracts contain a fallback language covering the permanent cessation of CHF LIBOR. In many of these contracts, vague contractual wording was used, for example, referencing that the fallback rate would be the economically closest indicator.

After the proposed cut-off date of 1 January 2018, it has still however been impossible to agree on any fallback provisions concerning the CHF LIBOR and thus a suitable as well as publically available substitute has been unknown for a long time. In fact, it has only been in late 2020 that the National Working Group on Swiss Franc Reference Rates (NWG) of the Swiss National Bank (see Executive summary and Minutes of NWG meeting held on 29 September 2020) has agreed on SARON being an appropriate fallback for CHF LIBOR.

The huge number of outstanding contracts as well as issues with transparency laws in some Member States (such as Austria), has also not allowed the retrospective inclusion of a fallback clause covering the cessation of CHF LIBOR, as such a contract change would require the mutual consent of the client if it does not explicitly state and define which rate will be used as a successor rate. Therefore, many contracts that were concluded even after the coming into force of the EU BMR in 2018, also do not contain a fallback clause. **Therefore, in order to ensure consistency and legal certainty, the designated replacement rate should apply to all CHF LIBOR linked contracts, regardless when they were concluded. If this is not feasible, then we would at least deem appropriate as a cut-off date the cessation announcement of 5 March 2021 by the UK Financial Conduct Authority, marking the future official end of CHF LIBOR for all market participants.** This date is particularly relevant since such change has since been communicated in the contractual arrangements in accordance with the contingency plans.

(iii) Extension of scope to other tenors

We would also like to emphasize that the designation of a statutory replacement rate for CHF LIBOR would be the first such case of its kind for consumers, in line with the EU BMR. Therefore, any measure by the European Commission should bring clarity and not leave any open questions. Therefore **we advocate that such decision should not be limited to the 3M CHF LIBOR only, but consistency requires the same decision to be extended to other CHF LIBOR tenors irrespective whether the volume linked to such other tenors is significant or not.**

Finally, we also consider that a need for a statutory replacement may, in particular, also exist for USD LIBOR and EONIA references.

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.

Our answer is Yes.

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The replacement of the 3M CHF LIBOR by the 3M compounded SARON plus the ISDA Spread-Adjustment is appropriate and fair, as proposed by the Swiss National Working group and applied according to the "last-reset" convention. This is the only way to assure legal certainty for both borrowers and lenders and to prevent any event being disruptive to financial stability and contractual continuity in the European financial market. Furthermore, the last-reset convention allows for compatibility with the requirements of the MCD and CCD (and their national implementation laws) to inform consumers on the change of the borrowing rate before the start of an interest period. Hence, there shall be no doubt that this will find acceptance and be regarded as fair. Please see our further comments on alignment with consumer protection law in our answer to Question 3.

However, we feel that a few clarifications are required with respect to the Spread-Adjustment:-

- **the Spread-Adjustment (for 3M CHF LIBOR = 0.0031 %) must be directly fixed and published in the implementing act - instead of a mere reference to the ISDA/Bloomberg website**. This should be fixed irrespective if the three-month (3M) CHF LIBOR spread-adjustment seems insignificant at 0,31bps (as opposed to -5,71bps for 1M and 7,41bps for 6M according to the ISDA methodology) and the Swiss National Working Group has stated that borrowers can neglect the adjustment spread for simplification if it is better for the customer. The fact of the matter is that CHF LIBOR linked mortgages in Switzerland usually include a reference rate floor of zero. Hence, given the negative SARON and interest rate projections, the reference rate would be zero for a longer period, whether the adjustment spread is included or not. On the other hand, flooring the reference rate at zero in contracts with consumers is legally not allowed in some jurisdictions, and such a floor can only be applied to the total interest rate (reference rate + margin). Furthermore, we do not believe that waiving the adjustment spread would contribute towards simplification, neither from an operational nor from a legal perspective. Of course, it could emerge that the waiver of such a small adjustment spread for the 3M tenor could be accepted by lenders and requested by consumer protection authorities. On the other hand, for the one-month tenor (1M) the level is negative, and no consumer protection agency would agree on waiving the adjustment spread. Given that all of the other major RFR Working Groups (ARRC, WG on Sterling Risk-Free Reference Rates, Cross-Industry Committees on Japanese Yen Interest Rate Benchmarks, ECB WG on Euro Risk-Free Rates) are striving to achieve consistency across currencies and are recommending the application of a spread adjustment, not including it as part of a statutory fallback rate for CHF LIBOR would: a) undermine consistency efforts undertaken on a global level and; b) prevent the transition to an economically equivalent reference rate. It is critically important to have a consistent approach, not only across currencies but also across products, where in many cases there are clearly defined fallbacks in place. Deviating from this standard for a specific product in a specific currency would create huge uncertainty, undermining the confidence in the overall process for future transitions in other currencies.

- the purpose of an adjustment spread is to assure the economical equivalence of an unsecured term rate (LIBOR) and a compounded SARON (nearly) risk free rate. It shall not create an advantage or disadvantage to any of the contract parties, and thus its level can be positive as well as negative. Hence, the

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application of such a spread is per se not a compensation for the borrower. **In this context it should be clarified that the optional waiver of the inclusion of the spread is always possible if it is not economically disadvantageous for the customer. It is also conceivable that the spread (at least for 3M SARON) can be waived without the client suffering any economic disadvantage.**

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.

Our answer is Yes.

The SARON Compound rate is only known at the end of the respective interest period for which it is calculated, which creates problems related to the consumer protection laws in various Member States. The issue is that some of these laws require any change in the borrowing rate (including those caused by changes in the reference rate) of an interest period to be communicated to the retail client (consumer) before it comes into effect. Therefore, there is an economic and legal clash between the two realities (forward looking approach vs. compound rate known at end of the period). If the forward-looking approach cannot be used, the last-reset method is the most acceptable way to inform customers of the relevant interest rate at the beginning of the contractual relationship ("in-advance"). In our opinion, this procedure is in line with the requirements of European civil law subject to:-

- the interest rate being made available by the administrator in a manner, that gives central and public access e.g. as is the case since 30 March 2021 by the SIX Index Data Centre; and
- the relevant spread-adjustment being definitely fixed in the implementing act.

If these requirements are fulfilled, contract parties can verify their interest rate, and also, such comprehensible, transparent approach would be able to fully meet the relevant civil law requirements. In addition, banks would be able to provide a proper implementation of their IT systems and to launch an appropriate information campaign towards clients.

Contact:

The EACB trusts that its comments will be taken into account.

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