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# COMMISSION IMPLEMENTING REGULATION (EU) …/...

## of XXX

## on the designation of a statutory replacement for certain settings of CHF LIBOR

(Text with EEA relevance)

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**on the designation of a statutory replacement for certain settings of CHF LIBOR**

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) 2016/1011 of the European Parliament and of the Council[1], and in particular Article 23b(8) thereof,

Whereas:

(1) The Swiss franc London Interbank Offered Rate (CHF LIBOR) is one of the 5 LIBOR currency rates administered by the Ice Benchmark Administration (IBA). CHF LIBOR reflects the rate of interest at which large, leading, internationally active banks with access to the wholesale, unsecured funding market can fund themselves in such market in Swiss francs. The IBA calculates the rate based on data submissions communicated to IBA by a panel of banks.

(2) The Financial Conduct Authority of the United Kingdom (UK FCA) has announced the cessation of certain LIBOR benchmarks, including CHF LIBOR, by the end of 2021. That cessation is due to concerns about whether LIBOR, in certain of its settings, adequately represents an underlying market or an economic reality that is reflective of a wholesale, unsecured funding market. Those concerns find their origin in the unwillingness of the majority of LIBOR panel banks to continue contributing to the LIBOR settings concerned, as announced by IBA on 5 March 2021 in its ICE LIBOR Feedback Statement on Consultation on Potential Cessation.

(3) In the past, a number of banks have used CHF LIBOR in the Union as a reference rate in a large number of outstanding retail mortgages, most of which will expire after the end of 2021. According to the responses to a public consultation held by the Commission, there are currently EURO 35 billion mortgage contracts in the Union that reference CHF LIBOR. The greatest number of those contracts are outstanding in Poland, with the rest outstanding in Austria, Slovenia, the Netherlands and France.

(4) The magnitude of the potential disruption caused by the cessation of CHF LIBOR, and the need to mitigate the discontinuity of contracts referencing CHF LIBOR to avoid the materialisation of that disruption, were highlighted in a number of exchanges between the Commission and public authorities concerned. The Commission duly took into account the factual elements provided to assess whether the conditions set out under Article 23b of Regulation (EU) 2016/1011 are met and, therefore, to establish the need for the Commission to take action.

[1] 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).

(5) The 2021 Financial Stability Report issued by the National Bank of Poland[2] mentions that, at the end of 2020, more than 410 000 households in Poland had CHF LIBOR-related mortgages, based on various tenors of CHF LIBOR. That represents around 20% of the total Polish mortgage loan portfolio, which, according to other data provided by the relevant authorities, account for a total value of around PLN 100 billion (ca. EUR 22 billion). The majority of those mortgages is long-term and will remain outstanding beyond 2030. The report highlights the risks posed by the cessation of CHF LIBOR, and the need to ensure the continuity of Swiss franc denominated housing loan contracts to avoid the materialisation of such risks. The report further underlines that the absence of fallback provisions and legal acts designating the replacement for the CHF LIBOR benchmark might threaten the continuity of such agreements, and consequently, translate into financial losses of banks. The Polish Ministry of Finance submitted similar data to the Commission.

(6) In Austria, as of June 2021, between 50.000 and 60.000 mortgage loans to Austrian households reference CHF LIBOR, which represents a volume of 9,6 billion euros, and about 5,7% of Austria's entire household debt. Around 400 Austrian banks are engaged in mortgage portfolios referencing CHF LIBOR. The National Bank of Austria and the Austrian Financial Market Authority (FMA) submitted similar supporting data in a letter sent to the Commission.

(7) In Slovenia, over 6 700 consumer credit agreements for a total value in excess of EUR 300 million referenced CHF LIBOR on 31 December 2020, with the last batch of those contracts not expiring until 2043. In addition, 9 out of 15 banks are exposed to CHF LIBOR. The share of housing loans in CHF LIBOR in those 9 banks compared to all housing loans represents 6,34% and the share of mortgage loans in CHF LIBOR compared to all mortgage loans represents 7,13%.

(8) In the Netherlands, it is estimated that ca. EUR 500 million worth of retail mortgages without fall-back clauses reference Swiss CHF LIBOR.

(9) In France, regional banks have about 6 400 retail loan contracts referencing CHF LIBOR maturing after 2021.

(10) Regulation (EU) 2016/1011 requires that users of benchmarks produce and maintain robust written plans setting out the actions that they would take in the event that a benchmark materially changes or ceases to be provided and, where feasible and appropriate, designate one or several alternative benchmarks as fall-backs for a benchmark that would no longer be published. Contracts referencing CHF LIBOR have been concluded long before the cessation of CHF LIBOR could be expected and before Regulation (EU) 2016/1011 started to apply. Those contracts therefore do not contain fall-back provisions that address the event that a benchmark administrator can no longer publish a contractual reference after a certain date.

(11) Due to the difficulty to identify an appropriate replacement for CHF LIBOR before clear recommendations were offered to the market by the National Working Group on Swiss Franc Reference Rates (Swiss NWG), also contracts concluded after the date of application (1 January 2018) of Regulation (EU) 2016/1011 do not contain fall-back provisions or suitable fall-back provisions.

(12) Without transitioning contracts referencing CHF LIBOR to a designated replacement for that benchmark, there is a serious risk of contract frustration in several Member

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2 Narodowy Bank Polski (National Bank of Poland), Financial Stability Report, June 2021 https://www.nbp.pl/en/systemfinansowy/fsr202106.pdf?v=2

States. The designation of that replacement should therefore ensure the mitigation of such risk, the materialisation of which might significantly disrupt the functioning of financial markets in the Union.

(13) On 5 March 2021, the UK FCA announced the future loss of representativeness and cessation of all CHF LIBOR settings. Such statement constitutes a trigger for the Commission to exercise its power to designate a statutory replacement for CHF LIBOR pursuant to Article 23b(8) of Regulation (EU) 2016/1011.

(14) The result of the public consultation by the Commission established the important role of certain CHF LIBOR tenors in mortgage contracts, particularly the 1-month, 3-month, 6-month and 12-month tenors. The lack of a clear and unambiguous replacement rate in mortgage contracts that reference CHF LIBOR would give rise to legal uncertainty, which may trigger litigation and contract frustration. It is therefore appropriate for the Commission to designate a statutory replacement for those four tenors of CHF LIBOR to be used in any contract, and in any financial instrument as defined in Directive (EU) 2014/65 of the European Parliament and of the Council[3], including but not limited to savings accounts, mortgages and loans, including consumer credit agreements and small business loans, governed by the laws of one of the Member States that do not contain fall-back provisions or suitable fall-back provisions.

(15) In 2017, the Swiss NWG recommended the Swiss Average Rate Overnight (SARON) administered by SIX Swiss Exchange Financial Information AG (SIX) as the replacement rate for CHF LIBOR[4]. In September 2020, after acknowledging the impossibility to create a forward looking term rate based on SARON, the Swiss NWG recommended that compounded SARON should be used as the basis for a fall-back rate for references to CHF LIBOR for cash products. A designated replacement for the relevant tenors of CHF LIBOR in legacy cash contracts should therefore be calculated as a compounded rate of SARON.

(16) The result of the public consultation by the Commission has shown support, including by public authorities from the Member States most concerned for designating a statutory replacement for all settings of CHF LIBOR in line with the recommendations of the Swiss NWG. While CHF LIBOR is a forward-looking rate, where the client knows in advance the interest due for the upcoming period, compounded SARON is a backward-looking rate. That means that the interest rate over a given period is only known at the end of that period. In order to facilitate the use of the interest rate at the beginning of the interest period, a potential solution would be to determine the interest rate on the basis of an observation period preceding the interest period. On 29 September 2020, the Swiss NWG recommended, in cases where the interest payment has to be known at the beginning of the interest period, to use the compounded SARON in accordance with the "last reset" methodology. Such methodology consists of determining the interest rate for the upcoming period on the basis of the observed compounded interest rate for a prior period that is equal to the length of the interest period at hand.

[3] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU Text with EEA relevance (OJ L 173, 12.6.2014, p. 349).

[4] SARON is published at the relevant webpage of its administrator: https://www.six-group.com/exchanges/indices/data_centre/swiss_reference_rates/compound_rates_en.html.

(17) According to the Swiss NWG recommendation of 1 February 2021, users should adopt, as a replacement rate for CHF LIBOR 1-Month, SARON 1-Month Compound Rate and for CHF LIBOR 3-Month, SARON 3-Month Compound Rate determined under the last reset methodology, that is, the compounded SARON rate as calculated on the basis of respectively the 1-month and 3-month period directly preceding the interest period.

(18) The Euro Risk-Free Rate Working Group, in its recommendation of 11 May 2021, indicated that the last reset methodology for periods longer than three months may create accounting and hedging challenges caused by the structural differences between the IBOR (as forward looking) and the SARON (as backward-looking), which are particularly pronounced in case of longer-term tenors. As an alternative methodology, the Swiss NWG, on 1 July 2021 recommended the use of the "last recent" methodology with 1-month observation period. Such methodology consists of determining the interest rate for the upcoming period on the basis of the observed compounded interest rate for a prior period that is shorter than the interest period at hand. Taking stock of the recommendations of the Euro Risk-Free Rate Working Group, and in order to remain as close as possible to the original reference period for each tenor, the 3-Month SARON Compound Rate was considered more appropriate than the 1-Month SARON Compound Rate for CHF LIBOR tenors of 3 months and beyond. It is, therefore, considered appropriate to use SARON 1-Month and SARON 3-Month Compound Rates as replacements for, respectively, CHF LIBOR 1-Month and CHF LIBOR 3-Month and to use SARON 3-Month Compound Rate also as a replacement for CHF LIBOR 6-Month and 12-Month.

(19) There is a difference in value between CHF LIBOR and SARON Compound Rate. In order to reflect such difference and minimise the economic impact of a replacement, a fixed spread adjustment should be added to SARON Compound Rate for each of the CHF LIBOR tenors it replaces.

(20) The public consultation held by the Commission has confirmed the appropriateness of calculating a fixed spread adjustment based on the historical median spread between Swiss franc LIBOR and the SARON Compound Rate concerned over a five-year lookback period up to 5 March, 2021.

(21) It is therefore appropriate that the rates designated by the Commission to replace the tenors of CHF LIBOR concerned correspond to the SARON Compound Rate plus the relevant adjustment spread as published for each of the relevant compounded SARON tenors concerned (1-month, 3-month, 6-month and 12-month).

(22) According to Article 23b(3) of Regulation (EU) 2016/1011, a replacement for CHF LIBOR replaces, by operation of law, all references to that benchmark in any contract, and in any financial instrument as defined in Directive (EU) 2014/65 not containing fall-back provisions or suitable fall-back provisions. This replacement does therefore not affect contracts that have been successfully renegotiated to cater for the cessation of CHF LIBOR, as provided for under Article 23b(11) of Regulation (EU) 2016/1011.

(23) Considering that LIBOR will cease to be published on 1 January 2022, the designated rates should replace references to CHF LIBOR as of such date.

(24) The UK FCA, as supervisor of the CHF LIBOR administrator, the Swiss National Bank in its role of secretariat to the Swiss NWG and the European Securities and Market Authority (ESMA), provided their views on this Regulation.

(25) The measures provided for in this Regulation are in accordance with the opinion of the European Securities Committee,

HAS ADOPTED THIS REGULATION:

*Article 1*
*Replacement of CHF LIBOR*

1. The following rates are designated as the replacement rates for the CHF LIBOR in references to CHF LIBOR in any contract, and in any financial instrument as defined in Directive (EU) 2014/65:

   (a) 1-month CHF LIBOR is replaced by 1-month SARON compound Rate, as observed over the 1-month period preceding the interest period;

   (b) 3-month CHF LIBOR is replaced by 3-month SARON Compound Rate, as observed over the 3-month period preceding the interest period;

   (c) 6-month CHF LIBOR is replaced by 3-month SARON Compound Rate, as observed over the 3-month period preceding the interest period;

   (d) 12-month CHF LIBOR is replaced by 3-month SARON Compound Rate, as observed over the 3-month period preceding the interest period.

2. A fixed spread adjustment shall be added to the replacement rates designated pursuant to paragraph 1. That fixed spread adjustment shall be equivalent to the spread published for each relevant tenor and calculated on 5 March 2021 as a historical median spread between the CHF LIBOR concerned and the respective SARON compound over a five-year lookback period for each particular term.

3. The replacement rates for CHF LIBOR shall be designated in accordance with the following table:

| **LIBOR** | **TENOR** | **Replacement Rate** | **Spread Adjustment Value (%)** |
|---|---|---|---|
| CHF | 1M | SARON 1 month Compound Rate (SAR1MC)<br>ISIN CH0477123886 | -0,0571 |
| CHF | 3M | SARON 3 months CompoundRate (SAR3MC)<br>ISIN CH0477123902 | 0,0031 |
| CHF | 6M | SARON 3 month CompoundRate (SAR3MC)<br>ISIN CH0477123902 | 0,0741 |
| CHF | 12M | SARON 3 month CompoundRate (SAR3MC)<br>ISIN CH0477123902 | 0,2048 |

*Article 2*
*Entry into force and application*

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall apply as of 1 January 2022.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission*
*The President*
*Ursula VON DER LEYEN*