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DG for Financial Stability, Financial Services and Capital Markets Union

Director General

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Mr Holger Hartenfels
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Group
Legal Groups Team
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Subject: Legal Consequences of the introduction of a new index replacing the Euribor

Dear Mr Hartenfels,

Thank you for your letter of the 25th September regarding the consequences of replacing Euribor with a new index.

Benchmarks, in particular interest rate benchmarks, play a crucial role in financial markets and recent cases of attempted market manipulation have undermined confidence in the reliability and robustness of benchmarks. Coordinated action has therefore been required by the authorities to ensure that benchmarks are subject to standards that ensure that they are robust and reliable. However given the international nature of benchmarks, it is essential that actions are coordinated amongst different jurisdictions. In July 2013 IOSCO therefore published the Principles for Financial Benchmarks which set out a number of internationally agreed standards to enhance the integrity of the benchmark setting process. The European Commission then launched a proposal for a Regulation on indexes used as benchmarks in financial instruments (the "Benchmarks Regulation") in September 2013 which, amongst other things, implements the IOSCO principles for benchmarks provided in the European Union. Both the IOSCO principles and the Commission proposal recognise that benchmarks based on transactions are likely to be less susceptible to manipulation and therefore transactions should be used as a basis for benchmarks where possible.

Against this background, the G20 asked the FSB to undertake a review of the major interest rate benchmarks, LIBOR, EURIBOR and TIBOR, and in particular analyse how to develop transaction based alternatives to these benchmarks and the best way to transition the market to these alternatives. A high-level Official Sector Steering Group (OSSG) of regulators and central banks and a Market Participants Group were formed to look into these issues. Drawing on this expertise, the FSB issued a report in July 2014 that set out plans and timelines for the reform of LIBOR, EURIBOR and TIBOR and the development and introduction of alternatives. These recommendations and implementation plans have been fully endorsed by the FSB Plenary.

The FSB report recommends that *“The overarching objective should be to transition to rates which are anchored in transactions.”*¹ In respect of Euribor the intention is to meet this objective through the development of Euribor+ by the European Money Market Institute with the assistance of the ECB. However the FSB made clear in its mandate to the OSSG that it should *“encourage the private sector to identify additional benchmark rates and analyse the transition issues arising in the event of a move to an alternative rate.”* And it is an overarching principle of the FSB report that the *“Authorities should work with and guide the private sector”* i.e. the transition should be carried out by the private sector, under the guidance of the authorities. A “regulatory solution” to redenominate benchmarks in private contracts, as advocated in your letter, would clearly go beyond this recommendation. Moreover, the detailed plans for the transition to Euribor+ set out in the individual currency reports² clearly specify that the transition approach from Euribor to Euribor+ should be by way of a *“parallel-run”* transitional period rather than a *“big bang”* approach. This conclusion was reached following extensive analysis and input from market participants, lawyers and public authorities.

Without reiterating at length the comprehensive and detailed considerations that the FSB took before coming to this conclusion, I would however like to highlight three significant difficulties with a “big bang” transition accompanied by regulatory redenomination. First it would mean the authorities stepping in and assuming both the responsibility for and liabilities arising out of the transition from one commercially run benchmark to another. It is not apparent that such a “bailout” could be justified. Secondly, this approach would represent an unwarranted, and potentially unlawful, interference with private property rights. Third, the future Union legal framework on the Benchmarks Regulation is under negotiations in the European Parliament and the Council, therefore the specific legal requirements that a benchmark provided in the Union should fulfil have not yet been fixed and the relevant supervisors have not yet been entrusted the powers to assess the compliance of the relevant benchmarks, i.e. authorise, with the future legislation. The Commission therefore sees no grounds for deviating from the FSB recommendations for transitioning to Euribor+.

We believe that the future harmonised rules for the administration of and submission of input data to benchmarks across the Union will contribute to enhancing the accuracy, integrity, robustness and reliability of benchmarks in the EU. We consider that the future Benchmarks Regulation should provide, as stated in the Commission proposal, for clear rules for the governance of the benchmarks, the obligation to the benchmarks administrators to establish contingency plans in case of cessation of a benchmark, specific powers to competent authorities to compel contributors to a benchmark to continue contributing in specific circumstances and a transitional provision in case an existing benchmark does not meet the requirements of the Benchmarks Regulation.

¹ "Reforming Major Interest Rate Benchmarks" FSB 22 July 2014, pages 12-13

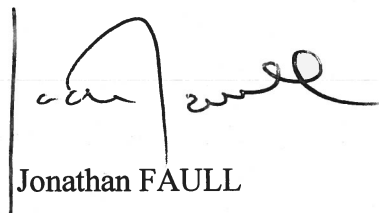
² "Reforming Major Interest Rate Benchmarks" FSB 22 July 2014, pages 20-27

In addition the overarching approach for resolving the problems with interest rate benchmarks has been to ensure international coordination. This is reflected in the FSB recommendation that "*authorities should seek, to the extent possible, to promote international coordination in any recommendation for alternatives and transition paths.*"³ It would clearly be inconsistent with this recommendation for Europe to unilaterally decide to use legislation to redenominate contracts. And, as you observe, unless other jurisdictions outside Europe also enacted similar redenominating legislation, the benefits of unilateral action would be limited.

In summary we therefore believe that this issue has been extensively analysed at FSB level and see no case for deviating from the approach to the parallel run transition to Euribor+ agreed there.

In this context, legal certainty is crucial, thus the Commission will continue urging the European Parliament and the Council to make progress on the negotiation of the Commission proposal for a regulation on benchmarks for a prompt adoption and entry into application.

Yours sincerely,



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³ "Reforming Major Interest Rate Benchmarks" FSB 22 July 2014, page 13