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MEMORANDUM

To EMMI

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Subject **Advice on the liability of panel banks as contributors to the Euribor benchmark resulting from the implementation of the proposed changes to the Euribor specification**

1. BACKGROUND: TRANSITION TOWARDS A TRANSACTION-BASED EURIBOR

1. This advice is based on the Consultative Position Paper on the Evolution of Euribor and its annexes published by EMMI on 30 October 2015 (the **Consultative Position Paper on the Evolution of Euribor**) and it should be read together with that document. Capitalised terms not otherwise defined in this advice, have the same meaning as provided by the Consultative Position Paper on the Evolution of Euribor.

We understand that because of regulatory recommendations EMMI wishes to make the transition from a quote-based Euribor to a transaction-based Euribor. This means that the current quote-based methodology will be replaced by a transaction-based methodology.

2. To implement the transition, the Euribor specification will be adapted. The Euribor specification consists of the Underlying Interest and the determination methodology. The current Euribor definition in the Euribor Code of Conduct reads

“Euribor® is the rate at which Euro interbank term deposits are being offered within the EMU zone by one prime bank to another at 11.00 a.m. Brussels time.”

A prime bank is defined as:

“a credit institution of high creditworthiness for short term liabilities, which lends at competitive market related interest rates and is recognised as active in euro-denominated

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money market instruments while having access to the Eurosystem's (open) market operations."

3. In EMMI's view, there are three shortcomings in the current Euribor specification:
 - The specification does not distinguish between the Underlying Interest and the determination methodology. The Underlying Interest is the economic variable (the market) that a benchmark seeks to measure. The determination methodology is the means to practically measure the Underlying Interest.
 - The concept that Euribor intends to measure a cost of funding, i.e. a borrowing rate, is not immediately evident in the current specification.
 - The term "prime bank" is not fully defined, leading to variations in interpretation.
4. From a legal point of view, EMMI wants to make five changes to the Euribor specification to remedy the three shortcomings:
5. The first change concerns the definition of Euribor itself. The current definition mixes the concept of the Underlying Interest that Euribor seeks to represent and the determination methodology used to actually measure the rate. The first change to the Code of Conduct seeks to clarify the Euribor Specification by making a clear distinction between the Underlying Interest and the determination methodology. We understand that EMMI does not wish to change the Underlying Interest of the Euribor; it only wishes to define the Underlying Interest explicitly. EMMI would define the Underlying Interest for Euribor as "*the rate at which banks of sound financial standing could borrow funds in the EU and EFTA countries in the wholesale, unsecured money markets in euro*".
6. The second change relates to the fact that the Euribor benchmark reflects a borrowing rate. We understand that the original intent for Euribor was to reflect a funding rate for banks, in other words, a borrowing rate. The current terminology of the Euribor specification does not state this point expressly. By referring to "*deposits (...) being offered (...) by one prime bank to another*", the current specification does not make it fully clear that the Underlying Interest is the rate at which the second prime bank could borrow the funds offered by the first prime bank. The goal of the second change is to re-emphasise that Euribor reflects a borrowing rate.
7. The third change relates to the eligible types of transactions and counterparties to determine the rate of Euribor. The current specification refers to interbank transactions which reflects the structure of the money markets in the 1980s and 1990s when bank-to-bank activity was a predominant source of bank wholesale funding. We understand that the last decade has witnessed a steady decline of interbank activity. There has been a significant shift in banks' funding sources as banks have increased their reliance on broader wholesale financing. In order to adapt the Euribor specification to the current market situation, the third change will clarify that the Underlying Interest needs to be understood as a wholesale funding rate where interbank deposits constitute only one possible source of funding. The current, express reference to interbank rates in the Euribor specification is thus a methodological consideration, reflecting the predominant source of bank funding at the time of Euribor's creation. It is not part of the Underlying Interest.
8. The fourth change relates to the concept "prime bank" in the current Euribor specification. Currently, this term is not precisely defined. The concept "prime bank" historically represented both a concept of the financial standing of the party borrowing the funds (a concept related to the

Underlying Interest) as well as of a substantial party supplying funds (a concept related to the determination methodology).

The first concept of “prime bank” as the financial standing of the party borrowing funds will be retained. This first concept continues to be reflected as a requirement that the banks that form the Euribor panel – the “sample” of borrowing banks under the new methodology – are of sound financial standing. Practically, the notion of sound financial standing will be expressly incorporated in the eligibility criteria to become a panel bank. We understand that the current eligibility criteria specified in the Code of Conduct implicitly embed this requirement, and that the Steering Committee already considers the financial standing of panel candidates in reviewing applications for panel membership.

The concept of a prime bank as a substantial party supplying funds is a methodological consideration, not a part of the Underlying Interest. As such, this role will be subsumed in the detailing of broader sources of wholesale funds within the new transaction-based determination methodology.

9. The fifth change is replacing the current quote-based methodology with a transaction-based methodology that is described in the Consultative Position Paper on the Evolution of Euribor.

10. For this advice, we assume that the Consultative Position Paper on the Evolution of Euribor contains the correct and complete reasoning behind the proposed changes and that the proposed changes will achieve their rationales.

2. LEGAL ANALYSIS OF THE LIABILITY OF PANEL BANKS AS CONTRIBUTORS TO THE EURIBOR BENCHMARK DEFINITION

2.1 Scope of the analysis

11. We will only analyse the potential extracontractual liability of panel banks under Belgian law towards third parties resulting from the implementation of the proposed changes to the Euribor specification because the panel banks contribute to Euribor.

12. We will not analyse, among others, any potential liability which may arise between EMMI and the panel banks as a result of the proposed changes.

13. We will also not analyse the liability that panel banks may incur because they use Euribor in financial instruments or because they conclude agreements that reference Euribor with third parties. In other words, we will not analyse the risk of contract frustration. We do not perform this analysis for two reasons: (i) Whether the transition to a transaction-based Euribor is a material change with respect to a financial instrument or agreement that references Euribor (and thus potentially could lead to contract frustration) is not relevant for the analysis of the potential extracontractual liability of panel banks and (ii) analysing whether there would be a risk of contract frustration depends on two elements which are not known to EMMI at this moment. Both reasons are further developed below.

First, the question as to whether the proposed changes to the Euribor specification should be considered material, is only relevant for the issue of potential contract frustration. This question is not relevant for the liability of the panel banks as contributors to Euribor. As will be demonstrated below, it is clear that EMMI has the right to make material changes to the Euribor specification.

Therefore, the mere fact of making a material change to the Euribor specification cannot create liability for EMMI or the panel banks. Even if the changes would be considered material, a panel bank will not be liable unless an aggrieved third party can prove that the panel bank acted differently than a normal, reasonable panel bank would have acted in the same circumstances or that the panel bank has violated a specific legal provision concerning material changes to benchmark methodologies. The liability analysis of panel banks as contributors to Euribor is thus distinct from the issue of potential contract frustration.

Second, in order for a change to be considered material with respect to an agreement or financial instrument that references Euribor, it needs to be proven that (i) the material change to the methodology has an impact on Euribor and (ii) that the impact on Euribor has a material effect on the agreement. In other words, the question as to whether the proposed changes can be considered material with respect to an agreement or financial instrument that references Euribor depends on two interdependent factors that are currently unknown to EMMI: (i) the rate level and volatility differences between the quote-based Euribor and the transaction-based Euribor and (ii) the terms of the agreement in which the Euribor is used.

EMMI has already done some preliminary analysis on the rate level and volatility based on data from 2012-2013, but this preliminary assessment cannot be used to predict or forecast the spread between the quote-based Euribor and the transaction-based Euribor. We understand from the Consultative Position Paper on the Evolution of Euribor that EMMI will conduct a “pre-live impact verification” exercise prior to the planned launch of the transaction-based methodology. In the pre-live impact verification exercise, EMMI will estimate the rate level and volatility impacts under the then-current market conditions. Only at that moment can an estimate of the difference in the rate level and volatility be made.

The structure of the financial instrument and the specific terms of the agreement, i.e. the particular way in which the Euribor benchmark is used, will also have a major impact on whether the proposed changes can be considered material with respect to that financial instrument/agreement. Since only the parties involved fully know the structure and the terms, only those parties are in a position to analyse whether the proposed changes to the specification of the Euribor can be considered a material change to the particular financial instrument/agreement. It is not possible to analyse the issue of contract frustration in a general way across all types of financial instruments/agreements.

2.2 Applicable legal framework under Belgian law

14. The advice below analyses the liability question under Belgian law as this is the law of the country where EMMI has its seat. While extracontractual liability/tort law is not harmonised across the European Union, the general principles are quite similar in most European legal systems. Unless there would be specific national regulation, we think that the gist of our analysis will be applicable in most European countries.

15. At the moment there exists no specific binding regulation concerning the changing of the Euribor specification. A political agreement has been reached on the text of the proposal for a regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts (the **Benchmark Regulation**). The Benchmark Regulation will probably be published in April or May 2016. Pursuant to article 41 of the Benchmark Regulation, almost all articles of the Benchmark Regulation will only enter into force 18 months after its adoption, so probably sometime in the second half of 2017. A small number of articles will enter into force the day after the Benchmark Regulation is published but these articles

contain obligations for ESMA and/or the European Commission and not for contributors such as panel banks or benchmark administrators such as EMMI. Consequently, there will be no binding legal rules for EMMI and the panel banks during the transition towards a transaction-based Euribor. Please note that the text of the Benchmark Regulation is currently being reviewed by the EU linguists and that the numbering and some wording will likely change as a result of this review. We refer to the numbering used in the final compromise text of the Benchmark Regulation (document number ST 14985 2015 INIT)

16. Since there are no specific rules, the general principles of extracontractual liability under Belgian law apply. These rules are set out in articles 1382-1383 of the Belgian Civil Code. In order to establish extracontractual liability under Belgian law, a claimant needs to prove (i) that a panel bank has committed a wrongdoing, (ii) that the claimant suffered damage and (iii) that the damage is the result of the wrongdoing (the **causal link**).

A wrongdoing can either consist of the violation of a legal provision or of the general obligation to behave like a normal, reasonable person placed in the same circumstances (“*bon père de famille/ goede huisvader*” criterion).

17. Given that there are no specific legal provisions, a claimant would need to prove that a panel bank has violated its general obligation to behave like a normal reasonable panel bank placed in the same circumstances. We expect that the courts, when making such assessment, will lean heavily on the Benchmark Regulation and on the Principles for Financial Benchmarks set out by IOSCO, the International Organization of Securities Commissions (the **IOSCO Principles**).

The rules set out in the Benchmark Regulation will not yet have entered into force, but we do think that judges will take these rules into account when determining what a normal and reasonable panel bank placed in the same circumstances would do.

Similarly, while the IOSCO Principles are not binding legal rules but are “soft law”, i.e. non-binding recommendations, we also believe that judges will to a large extent take these principles into account when determining what constitutes normal and reasonable behaviour in respect of financial benchmarks.

18. In conclusion, while the Benchmark Regulation and the IOSCO Principles are legally speaking not binding, we think that in practice judges will attach great weight to them so that many provisions should for most practical purposes be considered to be binding.

2.3 Legal Analysis on the liability risk associated with implementing the proposed changes

19. The hypothetical situation analysed in this section is one whereby following the implementation by EMMI of the proposed changes to the Euribor specification, some users of the Euribor benchmark would initiate legal action against one or more panel banks claiming that the changes in the Euribor specification result in a different rate level or different volatility and that those differences cause damages for which the panel banks are liable.

(a) Wrongdoing

20. Users who would bring such claims would need to prove that a panel bank has violated its obligation to behave like a normal, reasonable person placed in the same circumstances by contributing to Euribor after the proposed changes are implemented.

This requires that the user proves (i) that the proposed changes to the Euribor specification would not have been made by a normal, reasonable benchmark administrator in the same circumstances and (ii) that the panel bank is somehow responsible for the implementation of the proposed changes by EMMI. Both questions will be analysed below.

The first question focuses on whether EMMI could be held liable for these changes. If EMMI cannot be held liable, it will in our view be extremely difficult to hold the panel banks liable for the changes. The first question also implicitly requires the user to prove that the proposed change is an actual change and not a mere rephrasing. A mere rephrasing is not an actual change and it would in our view be extremely difficult to argue that a rephrasing could have an impact on the rate and/or volatility of the Euribor.

The second question focuses on whether the panel banks could be held liable if a court would rule that EMMI was not allowed to make the changes.

(i) Would a normal, reasonable benchmark administrator in the same circumstances enact the proposed changes?

21. The first change to the Euribor Specification aims to make a clear distinction between the Underlying Interest and the determination methodology used to measure that underlying interest. In our view, it will be difficult to claim that this change would not be made by a normal, reasonable person provided that the Underlying Interest does not change. The Underlying Interest will be defined as “*the rate at which banks of sound financial standing could borrow funds in the EU and EFTA countries in the wholesale, unsecured money markets in euro*”. We understand from EMMI and from the Consultative Position paper on the Evolution of Euribor that this is the same underlying interest which Euribor has always sought to measure. In essence, this appears to be a clarification and not an actual change. Therefore, assuming that in reality this change is no real change but rather a clarification, we think that it is highly unlikely that a court would decide that adopting the first change constitutes a wrongdoing.

22. The second change relates to the fact that the Euribor benchmark reflects a borrowing rate. By referring to “*deposits (...) being offered (...) by one prime bank to another*”, the current specification does not make it entirely clear that the Underlying Interest is the rate at which the second prime bank could borrow the funds offered by the first prime bank. As a consequence, today there is a mixed reliance by the panel banks on borrowing and lending rates in the determination of Euribor. With this second change EMMI wishes to re-emphasise that Euribor reflects a borrowing rate and to ensure that the determination of Euribor only relies on borrowing rates.

We understand that the original intent for Euribor was to reflect a borrowing rate because the family of –IBOR benchmarks are based upon and aimed at representing funding markets¹. The Underlying Interest of the Euribor (which we assume has not changed, see also above) indeed reflects a borrowing rate. The second change does bring the determination methodology in line with the Underlying Interest. Therefore we think that it is unlikely that a court would rule that this change as such would constitute a wrongdoing provided that it can be shown that Euribor has always sought to measure a borrowing rate.

The fact remains that the current Euribor specification is unclear on this topic. The first consequence of this lack of clarity is that the Euribor benchmark is determined on the basis of both

¹ See International Monetary Fund, *What Is LIBOR?* <http://www.imf.org/external/pubs/ft/fandd/2012/12/basics.htm>; IOSCO, *Review of the Implementation of IOSCO’s Principles for Financial Benchmarks by Administrators of Euribor, Libor and Tibor*, p. 64, http://www.fsb.org/wp-content/uploads/r_140722a.pdf

borrowing and lending rates. As the Underlying Interest of the Euribor constitutes a borrowing rate, there currently exists in our view a discrepancy between the Underlying Interest and the determination methodology. This discrepancy has created and creates liability risks as long as the determination methodology is not adapted and brought in line with the Underlying Interest. The second consequence is that the lack of clarity could potentially mislead some Euribor users into thinking that Euribor constitutes a lending rate or a mixed borrowing/lending rate.

Implementing the second change and thus eliminating this lack of clarity risks suggesting to those users that their understanding of the Euribor benchmark was not fully correct and possibly that the determination methodology was not fully in line with the Underlying Interest. It cannot be excluded that those users may try to claim damages from EMMI alleging that they were misled about the nature of the benchmark and/or that the determination methodology was not fully in line with the Underlying Interest.

In conclusion, the second change is in our view unlikely to cause liability (on the contrary, to some extent, it stops certain liability risks), but we cannot exclude the risk that it would lead to liability claims against EMMI concerning the current Euribor specification. This liability risk is further detailed in Title 3 of this advice.

23. The third change consists of updating the determination methodology to the changing structure of money markets. The use of the term “interbank transactions” in the Euribor specification reflects the structure of the money markets in the 1980s and 1990s when bank-to-bank activity was a predominant source of bank wholesale funding. We understand that in the last decade there has been a steady decline of interbank activity and a significant shift in banks’ funding sources has occurred. With the third change EMMI wishes to clarify that Euribor’s Underlying Interest needs to be understood as a wholesale funding rate and to expand the eligible types of transactions and counterparties to include (i) unsecured cash deposits attracted from the following counterparties irrespective of their location: deposit-taking corporations except those of the central bank subsector; other financial institutions; official sector institutions; non-financial corporations that are not categorized as small business customers in the Basel III LCR regulations; insurance corporations and pension funds and (ii) short term securities irrespective of the type and the location of the counterparty.

With respect to making it explicit that the Underlying Interest of Euribor needs to be understood as a wholesale funding rate, we refer to our analysis for the first change. Provided that it can be shown that this is not a change but a clarification of the Underlying Interest, we do not think that a court would rule that this constitutes a wrongdoing.

With respect to the expansion of the eligible types of transactions and counterparties for the determination of Euribor, the following articles of the Benchmark Regulation and the IOSCO Principles are relevant

Article 7.1 (4) of the Benchmark Regulation states:

“Where the administrator considers that the input data does not represent the market or economic reality that the benchmark is intended to measure, it shall, within reasonable time limits, either change the input data, the contributors or the methodology to ensure that the input data represents the market or the economic reality that the benchmark is intended to measure, or cease to provide that benchmark.”

Principle 10 of the IOSCO Principles provides:

“The administrator should periodically review the conditions in the Underlying Interest that the Benchmark measures to determine whether the Interest has undergone structural changes that might require changes to the design of the Methodology”.

Article 7a (2) of the Benchmark Regulation states:

“When developing the benchmark methodology the benchmark administrator shall:

(a) take into account factors including the size and normal liquidity of the market, the transparency of trading and the positions of market participants, market concentration, market dynamics, and the adequacy of any sample to represent the market or the economic reality that the benchmark is intended to measure;”

Principle 6 of the IOSCO Principles reads:

“Benchmark design should take into account the following generic non-exclusive features, and other factors should be considered, as appropriate to the particular Interest:

a) Adequacy of the sample used to represent the Interest;

b) Size and liquidity of the relevant market (for example whether there is sufficient trading to provide observable, transparent pricing);

c) Relative size of the underlying market in relation to the volume of trading in the market that references the Benchmark;

d) The distribution of trading among Market Participants (market concentration);

e) Market dynamics (e.g., to ensure that the Benchmark reflects changes to the assets underpinning a Benchmark).”

It is clear from article 7.1 (4) of the Benchmark Regulation and Principle 10 of the IOSCO Principles that benchmark administrators (such as EMMI) should periodically review whether the market their benchmark intends to measure (the Underlying Interest) has undergone changes that require changes to the methodology.

Article 7a (2) of the Benchmark Regulation and Principle 6 of the IOSCO Principles also explicitly provide that the distribution of trading among market participants (market concentration) and the market dynamics need to be taken into account in the benchmark design.

While we are not in a position to verify the changing money market situation, to the extent that the situation on the money markets as described above is correct, we think that it is unlikely that a court would decide that the changes to the determination methodology would constitute a wrongdoing as they are intended to adapt the determination methodology to the changing market concentration and market dynamics by including the additional sources of data to determine the Euribor.

24. The fourth change relates to the concept of “prime bank”. The concept of “prime bank” historically represented both a concept of the financial standing of the party borrowing the funds (a concept related to the Underlying Interest) as well as of a substantial party supplying funds (a concept related to the determination methodology).

The first concept of prime bank as the financial standing of the party borrowing funds will be retained. The notion of sound financial standing will now be explicitly incorporated in the definition of the Underlying Interest: *“the rate at which banks of sound financial standing could borrow funds in the EU and EFTA countries in the wholesale, unsecured money markets in euro”*. The current definition of Euribor reads *“Euribor® is the rate at which Euro interbank term deposits are being offered within the EMU zone by one prime bank to another at 11.00 a.m. Brussels time.”* The current definition of prime bank reads *“a credit institution of high creditworthiness for short term liabilities, which lends at competitive market related interest rates and is recognised as active in euro-denominated money market instruments while having access to the Eurosystem’s (open) market operations.”* In our view the current definition of “prime bank” already implies the concept of sound financial standing. Consequently, the current definition of Euribor already includes the concept that the banks used to determine the rate should be of sound financial standing, albeit in an indirect way

Practically, the notion of sound financial standing will be reflected in the eligibility criteria governing which banks may become panel banks. The current qualification criterion reads *“A bank may qualify for panel membership if it has the capacity to handle significant volumes in euro-interest rate related instruments, especially in the money market”*. We understand that the assets and liabilities of the applicant for panel bank membership are also analysed in the framework of the application for panel bank membership. The current Euribor Specification thus already contains an implicit reference to sound financial standing. We also understand that the Steering Committee already considers the financial standing of panel bank candidates in reviewing applications for panel membership. With respect to the first concept, the proposed changes are in our opinion more of a rephrasing than an actual change. Therefore, we think that it is highly unlikely that a court would hold that this rephrasing would constitute a wrongdoing.

The second concept of prime bank as a substantial party supplying funds is a methodological consideration. This second concept is related to the structure of the money markets the 1980s and 1990s when bank-to-bank activity was a predominant source of bank wholesale funding. We understand that because the structure of the money markets has changed, this second concept will be replaced by the broader sources of wholesale funds. These broader sources include interbank transactions but also other sources of funding for banks. The liability analysis for the second concept is essentially the same as for the third change. To the extent that the situation on the money markets has changed as described above, we think that it is unlikely that a court would decide that the changes to the determination methodology would constitute a wrongdoing as they are intended to adapt the determination methodology to the changing market circumstances.

25. The fifth change is replacing the current quote-based methodology with a transaction-based methodology that is described in the Consultative Position Paper on the Evolution of Euribor.

We think that it is likely that the transition towards a transaction-based Euribor will be considered a material change to the methodology of the Euribor benchmark.²

² Please note that it is not because the changes to the Euribor methodology could be qualified as material with respect to the current Euribor specification that this automatically means that those changes can be considered to be material with respect to an agreement or financial instrument that references Euribor. As set out in Title 2.1, whether the transition can be considered a material change that could lead to contract frustration depends on (i) the rate level and volatility differences between the quote-based Euribor and the transaction-based Euribor and (ii) the terms of the agreement/financial instrument in which the Euribor is used. This is a separate question that will not be addressed in this advice.

Article 7b 1 (iii) of the Benchmark Regulation states:

“The administrator shall develop, operate and administer the benchmark data and methodology transparently. To this end, the administrator shall publish or make available: the procedures for consulting on any proposed material change in its methodology and the rationale for such changes, including a definition of what constitutes a material change and when it will notify users of any such changes.”

Article 7b 2 (a) of the Benchmark Regulation continues:

“The procedures required under paragraph 1 point (iii) shall (a) provide advance notice, with a clear timeframe, that gives the opportunity to analyse and comment on the impact of such proposed material changes;”

Principle 12 of the IOSCO Principles states:

“The publication of the rationale of any proposed material change in its Methodology, and procedures for making such changes. These procedures should clearly define what constitutes a material change, and the method and timing for consulting or notifying Subscribers (and other Stakeholders where appropriate, taking into account the breadth and depth of Benchmark use) of changes.”

It follows from the abovementioned articles that benchmark administrators are allowed to make material changes to the methodology of the benchmark. The mere fact that an administrator makes a material change to the determination methodology cannot create liability. If a user of the Euribor benchmark wants to hold EMMI liable for the material change, the user will need to prove that a normal, reasonable benchmark administrator in the same circumstances would not have made those material changes or that a normal, reasonable benchmark administrator in the same circumstances would have followed a different process to implement those material changes.

26. With respect to the question as to whether a normal, reasonable benchmark administrator in the same circumstances would have made the transition towards a transaction-based Euribor the following articles are relevant.

Article 7.1 (a) of the Benchmark Regulation reads:

“The input data shall be sufficient to represent accurately and reliably the market or economic reality that the benchmark is intended to measure.

The input data shall be transaction data, if available and appropriate. If transaction data is not sufficient or is not appropriate to represent accurately and reliably the market or economic reality that the benchmark is intended to measure, input data which is not transaction data may be used, including committed quotes, indicative quotes and estimates;”

Principle 7 of the IOSCO Principles states:

“The data used to construct a Benchmark determination should be sufficient to accurately and reliably represent the Interest measured by the Benchmark and should: (...)

b) Be anchored by observable transactions entered into at arm’s length between buyers and sellers in the market for the Interest the Benchmark measures in order for it to function as a credible indicator of prices, rates, indices or values. (...)

This Principle requires that a Benchmark be based upon (i.e., anchored in) an active market having observable Bona Fide, Arms-Length Transactions. This does not mean that every individual Benchmark determination must be constructed solely of transaction data.”

Principle 8 of the IOSCO Principles states:

“An Administrator should establish and Publish or Make Available clear guidelines regarding the hierarchy of data inputs and exercise of Expert Judgment used for the determination of Benchmarks. In general, the hierarchy of data inputs should include:

- a) Where a Benchmark is dependent upon Submissions, the Submitters’ own concluded arms-length transactions in the underlying interest or related markets;*
- b) Reported or observed concluded Arm’s-length Transactions in the underlying interest;*
- c) Reported or observed concluded Arm’s-length Transactions in related markets;*
- d) Firm (executable) bids and offers; and*
- e) Other market information or Expert Judgments.”*

The Benchmark regulation expresses a clear preference for transaction-based benchmarks. While the IOSCO Principles allow for some more flexibility, they also indicate a preference for transaction-based benchmarks. The rationale for this preference is that benchmarks based on transactions are much less likely to be subject to manipulation. Therefore, we think that it is unlikely that a court would hold that a transition towards a transaction-based benchmark would constitute a wrongdoing as it is likely that a normal, reasonable benchmark administrator in the same circumstances would make the same transition. Changes to the determination methodology that are necessary for the transition towards a transaction-based benchmark are in our view also unlikely to constitute a wrongdoing as they are the logical consequence of such a transition. For the purposes of this advice, we assume that the proposed changes to the determination methodology are necessary to implement a transaction-based methodology.

In the development of the new determination methodology, EMMI should take into account the guidelines for creating a methodology set out in the Benchmark Regulation and the IOSCO Principles. We understand from EMMI that it has taken those guidelines into account.

27. A user could also try to argue that a normal, reasonable administrator in the same circumstances would have followed a different process to implement the changes.

The abovementioned articles 7b 1 (iii) and 7b 2 (a) of the Benchmark Regulation provide that a benchmark administrator must give the stakeholders advance notice of the proposed changes and that the stakeholders should be consulted on the proposed material changes.

Principle 12 of the IOSCO Principles states:

“The Administrator should develop Stakeholder consultation procedures in relation to changes to the Methodology that are deemed material by the oversight function, and that are appropriate and proportionate to the breadth and depth of the Benchmark’s use and the nature of the Stakeholders. Procedures should:

a) Provide advance notice and a clear timeframe that gives Stakeholders sufficient opportunity to analyse and comment on the impact of such proposed material changes, having regard to the Administrator’s assessment of the overall circumstances;”

It follows from the articles 7b 1 (iii) and 7b 2 (a) of the Benchmark Regulation and Principle 12 of the IOSCO Principles that the stakeholders should be given advance notice that gives stakeholders sufficient time to analyse the impact of the proposed changes and that the stakeholders should be consulted on the material changes. With respect to the process, it is thus essential that the stakeholders are timely informed of the proposed changes and that they are consulted. If EMMI respects both principles during the implementation of the transaction-based methodology, we think that a court is unlikely to rule that EMMI has committed a wrongdoing.

In addition, it could be argued that EMMI can exercise a certain discretion in changing the determination methodology and that a court cannot simply assess which decision it would have made if it were in EMMI’s position (i.e., the court could only perform a “marginal review” of EMMI’s decisions to change the determination methodology).

(ii) Can the panel banks be held responsible for the implementation of the changes

28. In order to establish a wrongdoing on behalf of the panel banks, the claimant would also need to prove that the panel banks can be held responsible for the changes to the Euribor specification if EMMI decides to implement them. We think that this will be extremely difficult for potential claimants.

Article 6 of the Euribor Code of Conduct states

“Rules for amending the documentation related to Euribor

1. The European Money Markets Institute General Assembly can decide to amend this Code upon recommendation from the Steering Committee.

2. Amendments to this Code are not subject to the approval of the Panel Banks. Meanwhile, when necessary, such changes will be subject to consultations with Panel Banks.

3. Changes in the Euribor definition or methodology shall be disclosed in advance and shall not occur more frequently than necessary.”

It is clear from this article that even though panel banks should be consulted prior to the implementation of changes to the Code of Conduct (which contains the Euribor specification), the ultimate decision lies with EMMI. From a legal point of view, panel banks do not have the possibility to decide on or block changes to the Euribor specification. Therefore we think that it will be very difficult for potential claimants to convince a court that the panel banks could be held liable for the proposed changes as they have no power to block the proposed changes.

(b) Damage and causal link

29. A claimant does not only need to prove that a panel bank committed a wrongdoing, he will also need to prove that he has suffered damage and that there exists of a causal link between the wrongdoing and the damage.

Users of Euribor who would consider introducing claims against panel banks would be faced with significant evidence problems concerning the causal link and the existence and extent of their damages. It will be extremely difficult for those third parties to prove what the rate of the Euribor would have been if the changes were not implemented. Therefore, they may not be able to prove that they have actually suffered damages, let alone the extent of their damages.

Under the dominant causal link theory in Belgium, the equivalence theory, users will have to prove that they would not have suffered losses if the proposed changes implemented by EMMI would not have been wrongful (i.e., the so-called *condition sine qua non*-test). This is difficult to prove. It will also be challenging for users to prove that the changes to the rate or volatility were caused by the proposed changes and not by changing market circumstances. This will further complicate such claims and reduce their chances of success.

(c) Case study: Rating agencies

Although there are important differences, there are also certain analogies between the position of EMMI as benchmark administrator and the situation of credit rating agencies. Generally speaking, the activity of credit rating consists of the evaluation of the creditworthiness of financial instruments or issuers of such instruments, i.e. the risk that payment of interest and capital will not or not entirely take place at the promised time. The resulting credit rating reflects the concluding opinion of that evaluation. Benchmarks and credit ratings have in common that they are determined by a central entity (i.e., respectively, a benchmark administrator or credit rating agency) on the basis of the information that entity has gathered and that third party market participants rely on them for the purpose of the pricing of financial instruments and financial contracts (such as loans and credit facilities).

Credit rating agencies carrying out their business in the EEA are subject to Regulation 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, as amended from time to time (the **CRA Regulation**). The CRA Regulation sets out rules with respect to, amongst other things, the mandatory registration of credit rating agencies with ESMA, their internal and external organisation, the credit rating activity, the credit rating market and the liability of credit rating agencies both towards the regulator and towards the issuing entity and investors.

In the context of this memorandum, it is important to note that article 8 of the CRA Regulation requires that credit rating agencies use rating methodologies that are “*rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing*”. Credit rating agencies should disclose information to the public on the methodologies, models and key rating assumptions which they use in their credit rating activities. A credit rating agency must review its methodologies “*on an ongoing basis and at least annually*”. If it intends to make a material change to, or use, new rating methodologies, models or key rating assumptions which could have an impact on a credit rating, it must publish the proposed material changes or proposed new rating methodologies on its website inviting stakeholders to submit comments for a period of one month together with a detailed explanation of the reason for and the implications of the proposed material changes or proposed new rating methodologies.

Although it relates to a different type of entity and activity, article 8 of the CRA Regulation is thus comparable with articles 7a and 7b of the Benchmark Regulation.

As mentioned above, the CRA Regulation contains specific rules on the liability of credit rating agencies. We refer in particular to article 35a of the CRA Regulation, which relates to the civil liability of credit rating agencies and applies when a credit rating agency commits, intentionally or with gross negligence, certain infringements on the CRA Regulation having an impact on a credit rating. If that is the case, an investor or issuer may claim damages from that credit rating agency for damage caused to it due to that infringement.

National rules on civil liability remain relevant for those matters which are not covered by article 35a of the CRA Regulation (e.g. if the infringement is not included in the list or was not committed intentionally or with gross negligence). As set out above, to establish extracontractual liability under Belgian law, a claimant needs to prove (i) that a credit rating agency has committed a wrongdoing, (ii) that the claimant suffered damage and (iii) that the damage is the result of the wrongdoing.

(i) Wrongdoing

As credit rating agencies are subject to the CRA Regulation, any infringement of the CRA Regulation would constitute a wrongdoing under Belgian law.

In addition, a credit rating agency would commit a wrongdoing if it does not behave like a normal, reasonable person placed in the same circumstances. According to Belgian legal doctrine in relation to this matter, one should assess this standard of care by taking into consideration the rules applicable to credit rating agencies (including the non-binding rules laid down in the IOSCO principles applicable to credit rating agencies). Further inspiration to provide colour to the concept of “the normal, reasonable credit rating agency” can according to at least one author be found in a teleological and comparative interpretation of the rules of conduct applicable to other market participants, in particular when distributing financial information. Reference is made, without limitation, to the MiFID rules, the rules on market abuse and other rules aimed at protecting the integrity of the financial and capital markets.

Based on case law relating to miss-selling of financial instruments, it is also argued that credit rating agencies issuing ratings without performing the required analysis or without including all relevant information can be held liable because of negligence since such acting would be contrary to third parties’ legitimate expectations based on the specific role of credit rating agencies. In this context, it is argued that any person participating in the public distribution of information may be held liable if it has impinged on the legitimate trust of the public when carrying out its activity.

(ii) Damage and causal link

The question as to whether an issuer, in case it receives an unsolicited rating, or investor has suffered a loss is a matter of fact. However, the question whether a loss can be considered to be “damage” within the meaning of article 1382 of the Belgian Civil Code requires further legal analysis.

It is generally acknowledged that the losses suffered by issuers or investors can be considered damage within the meaning of article 1382 of the Belgian Civil Code. However, the doctrine we have reviewed notes that some difficulties may arise in providing evidence of the amount of the losses. By way of example, issuers that have received an unsolicited rating would need to show that

the conditions at which they would have been able to obtain financing would have been better if the rating would have been correct

As set out above, the standard rule for causality under Belgian extra-contractual liability is usually referred to as the *equivalence theory*. The traditional application of the equivalence theory in cases of investment losses would require the investor to show that he in fact relied on the incorrect rating when making the investment decision and that he would not have made the same decision if he had had correct information. This would mean that if a particular investor cannot prove that the rating was a decisive factor in his decision, the conditions for liability under article 1382 of the Belgian Civil Code would not be met.

A more modern approach is to look at the causality problem using the so-called efficient market hypothesis, i.e. the incorrect credit rating has influenced the market conditions and therefore any investor that has made an investment decision under these circumstances suffers consequences that were caused by the incorrect rating, *“irrespective of whether this individual investor in fact directly relied on the rating or not, more even, irrespective of whether this individual investor was even aware of the credit rating”*.

Based on published case law, Belgian courts seem to assess the causality requirement in connection with investment losses mainly by taking into consideration the influence of a wrongdoing on the investor’s decision rather than investigating the causality between the wrongdoing and the pricing of the product, as would be the case if the "modern approach" were followed.

Under article 35a of the CRR Regulation:

- an investor may claim damages where it establishes that it has reasonably relied on a credit rating for a decision to invest into, hold onto or divest from a financial instrument covered by that credit rating; and
- an issuer may claim damages where it establishes that it or its financial instruments are covered by that credit rating and the infringement was not caused by misleading and inaccurate information provided by the issuer to the credit rating agency, directly or through information publicly available.

We note that in the Benchmark Regulation there are no similar specific rules on damage and causality with respect to benchmark administrators. Hence, the general civil law rules as outlined above would apply.

Finally, we note that the discussions on the liability of credit rating agencies indicate difficulties that could also arise for market participants seeking to hold EMMI liable: demonstrating damage and causal link could be challenging.

Also, while there are certain analogies between the activities of the rating agencies and benchmark administrators, their role and the type of information provided to market participants differs. Nevertheless, we think that the following conclusions can be drawn from the case-law on rating agencies:

- The courts are likely to look at the IOSCO Principles to determine what constitutes normal, reasonable behaviour for benchmark administrators.

- It is challenging for users of a benchmark to demonstrate the causal link. Under the prevailing equivalence theory, they would need to show that they would not have referred to Euribor in their agreement if they would have known that the proposed changes would be made.

3. LEGAL ANALYSIS OF THE LIABILITY RISK ASSOCIATED WITH NOT IMPLEMENTING THE PROPOSED CHANGES

30. In this part of the advice, we will analyse the liability risk for the panel banks if no changes are made to the Euribor specification. In order to establish that panel banks are liable if no changes are made, a claimant will need to prove that (i) a normal, reasonable person in the same circumstances would have changed the Euribor specification and (ii) that the panel bank is responsible for the fact that EMMI did not implement changes to the Euribor specification.

31. As set out above article 7.1 (4) of the Benchmark Regulation and Principle 10 of the IOSCO Principles provides that the administrator of a benchmark should periodically review whether the market their benchmark intends to measure (the underlying interest) has undergone changes that require changes to the methodology.

As we understand that the structure of the money markets has changed considerably since the 1990's, it would in our view be risky not to adapt the Euribor specification. By not adapting the methodology, EMMI could indeed be said not to comply with its duty to periodically review and adapt the methodology.

32. The currently existing lack of clarity on whether Euribor is a borrowing rate also creates some liability risks.

Article 15 of the Benchmark Regulation provides that a benchmark administrator must provide a benchmark statement that shall:

“(a) clearly and unambiguously defines the market or economic reality measured by the benchmark and the circumstances in which such measurement may become unreliable”.

Principle 11 of the IOSCO Principles states:

“The Administrator should document and Publish or Make Available the Methodology used to make Benchmark determinations. The Administrator should provide the rationale for adopting a particular Methodology. The Published Methodology should provide sufficient detail to allow Stakeholders to understand how the Benchmark is derived and to assess its representativeness, its relevance to particular Stakeholders, and its appropriateness as a reference for financial instruments.”

It is in our view possible that a court would rule that the current Euribor specification is not in line with the abovementioned article and principle. The current specification does not clearly and unambiguously define the economic reality it intends to measure as it is not entirely clear that the Euribor represents a borrowing rate.

An argument could also be made that the current Euribor specification is not representative enough because both borrowing and lending rates are currently used for the determination of the Euribor

rate. Taking into account the Underlying Interest of Euribor, in principle only borrowing rates should be used.

33. Continuing to use the current Euribor specification thus creates liability risks for EMMI. As set out above, implementing the proposed changes may trigger liability claims because it might suggest to users of Euribor that the current Euribor specification does not meet all articles of the Benchmark Regulation and IOSCO Principles. However, the longer the current Euribor specification is used, the more real the liability risks become.

34. While the liability risk should again not be overestimated for the panel banks (because it will be very difficult to hold the panel banks responsible for changes which EMMI could and should have implemented unilaterally but failed to adopt on the basis of article 6 of the Euribor Code of Conduct), we think that the overall liability risk associated with not implementing changes to the determination methodology are higher than the risk associated with implementing the proposed changes given that the first line of defence (EMMI committed no wrongdoing) will be less strong.

4. CONCLUSION

35. In conclusion, we think that it will be very difficult for users of Euribor to successfully argue that panel banks are liable as a result of the proposed changes to the Euribor specification.

We think that it will be difficult for Euribor users to convince a court that the proposed changes constitute a wrongdoing under Belgian law. This in itself already limits to a large extent the liability risk related to the proposed changes as a claimant will need to convince the court that EMMI committed a wrongdoing in order to hold a panel bank liable.

It will also be very difficult for a claimant to prove that the panel banks are responsible for the proposed changes. Article 6 of the Code of Conduct clearly provides that EMMI can decide unilaterally to amend the Code of Conduct.

Lastly, the claimants would face serious practical difficulties to prove the existence and the extent of their damages as well as the causal link between the changes and the proposed damages. This is clear from court cases involving liability claims against credit rating agencies, which are to a certain extent comparable.

Taking into account all these elements, it seems very unlikely that the courts would decide that a panel bank can be held liable for the proposed changes to the Euribor specification.