PUBLIC CONSULTATION BY THE WORKING GROUP ON EURIBOR FALLBACK TRIGGER EVENTS

Spanish CNMV Advisory Committee (hereinafter “the Committee”) welcomes the public consultation by the European Central Bank (ECB) on EURIBOR fallback trigger events.

In this consultation paper, the working group identifies and provides recommendations on a generic set of potential permanent EURIBOR fallback trigger events that market participants could consider including in future fallback provisions in their contracts and financial instruments referencing EURIBOR.

The next table summarizes the consultation proposal on EURIBOR fallback triggers events:

		What	Who? Issuer		How? Decision			
#	Description of events	Public Statement	Supervisor	Admin	Cessation	Non-representative	Contingency	Illegality
1	**A public statement or publication of information by or on behalf of the regulatory supervisor of the administrator of EURIBOR** stating that the said administrator has ceased or will cease to provide EURIBOR permanently or indefinitely	✓	✓	–	✓	–	–	–
2	**A public statement or publication of information by or on behalf of the administrator of EURIBOR** stating that the said administrator has ceased or will cease to provide EURIBOR permanently or indefinitely	✓	–	✓	✓	–	–	–
3	**A public statement by the supervisor of the EURIBOR administrator that, in its view, EURIBOR is no longer representative**, or will no longer be representative	✓	✓	–	–	✓	–	–
4	The administrator of EURIBOR determines that EURIBOR should be calculated in accordance with its **reduced submissions or other contingency or fallback policies**	–	–	✓	–	–	✓	–
5	It has become, for any reason, **unlawful** under any applicable law and regulation for relevant parties to the agreement to use EURIBOR	–	–	–	–	–	–	✓
6	EURIBOR is **permanently no longer published** without a previous official announcement by the competent authority or the administrator	–	–	–	✓	–	–	–
7	**Material change** of EURIBOR methodology*	–	✓	✓	–	–	–	–

Source: European Central Bank (ECB)

The Committee strongly agrees that the ECB should promote suitable, workable and robust fallback provisions and therefore is clearly in favour of this initiative.

With the aim of contributing to the abovementioned objectives, below you may find the Committee answers to the questions raised in the consultation.

<u>Answers to the different questions raised in the public consultation</u>

QUESTION 1.-

Do you agree with the inclusion of "Event 1" as a trigger event in EURIBOR fallback provisions? (yes / no / no opinion) Please elaborate.

*<u>Event 1:</u> A public statement or publication of information by or on behalf of the **regulatory supervisor** of the EURIBOR administrator stating that said **administrator has ceased or will cease to provide EURIBOR permanently or indefinitely** provided that, at the time of the statement or publication, there is no successor administrator that will continue to provide EURIBOR.*

YES.

This trigger event requires the conjunction of three elements: (1) public statement, (2) by a regulatory supervisor, and (3) the cessation of the EURIBOR provided by the administrator.

The Committee agrees to include Event 1 as a trigger event in EURIBOR fallback provisions. This event is already included in the ISDA Benchmark Supplement, and it is aligned with one of the trigger events foreseen at the BMR amendment proposal, enabling the European Commission to designate one or more replacement benchmarks.

One event as the cessation of the EURIBOR without any other alternative requires necessarily a public statement by the regulatory supervisor avoiding misinterpretation or leaving open the possibility of other type of public information performed by other actor on its behalf.

That public statement from the supervisor should include the factors that impact in the potential cessation of the EURBOR, the analysis carried out on other alternatives, the reasoning that leads to the final cessation to provide EURIBOR permanently or indefinitely with no possible successor administrator and the specific date from which the fallback rate would apply after this trigger event (should be that of the discontinuation of EURIBOR publication or that of any other (factual or legal) barrier to the use of EURIBOR for the relevant cash product).

QUESTION 2.-
Do you agree with the inclusion of "Event 2" as a trigger event in EURIBOR fallback provisions? (yes / no / no opinion) Please elaborate.

<u>*Event 2:*</u> *A public statement or publication of information by or on behalf of the* ***EURIBOR administrator*** *stating that* ***said administrator has ceased or will cease to provide EURIBOR permanently or indefinitely*** *provided that, at the time of the statement or publication, there is no successor administrator that will continue to provide EURIBOR.*

YES.

The Event 2 is similar to the Event 1, but the subject who would make the public statement of the EURIBOR cessation would be the administrator instead of the supervisor.

The Committee agrees on the inclusion of Event 2 as a trigger event in EURIBOR fallback provisions. This event is already included in the ISDA Benchmark Supplement, and it is aligned with one of the trigger events foreseen at the BMR amendment proposal mentioned in the previous answer to question 1.

All comments made to question 1 would apply to this case.

QUESTION 3.-
Do you agree with the inclusion of "Event 3" as a trigger event in EURIBOR fallback provisions? (yes / no / no opinion) Please elaborate.

<u>*Event 3:*</u> *An official public statement by the* ***supervisor of the EURIBOR administrator*** *that, in its view,* ***EURIBOR is no longer representative****, or will no longer be representative, of the underlying market it purports to measure and no action to remediate such a situation is taken or expected to be taken as required by the supervisor of the EURIBOR administrator.*

As the consultative document states, the circumstances intended to be covered by this event have already taken place.

Concerning latest events, during the recent outbreak of COVID-19 EURIBOR continued to be regularly published by its administrator. While the liquidity in the underlying market started to decrease between Q1 and Q2 last year, since May it has started to improve again trying to move back to the levels seen before COVID-19.

Also, at the peak of the COVID-19 crisis EURIBOR continued to react smoothly to monetary decisions by the ECB, playing its role in the monetary transmission mechanism for the euro area. EURIBOR navigated the difficulties of the last months implementing the phase-in of the the hybrid methodology that is used to calculate EURIBOR allowed for this smooth navigation. This methodology is based on a waterfall approach composed of several layers of input data. ESMA considers this hybrid methodology robust, resilient and transparent, as well as compliant with the applicable EU Benchmarks Regulation.

However, the majority of the transactions according to the "EMMI- EURIBOR Transparency Indicators" (November 2020 last publication), were based on Level 3 with a 70,2% on average (going from 62% for 1 week and 63% for 1 month, to 88% for 6 months). Therefore almost 2/3 of the EURIBOR calculation is based on transactions in the underlying Interest and/or other data from a range of markets closely related to the unsecured euro money market, using a combination of modelling techniques and/or the Panel Bank's judgment.

For all the below referred arguments the Committee considers that the inclusion of this event should be carefully analyzed at this stage, due to the uncertainty it may cause:

- The event should only occur when the remediation actions foreseen in the Article 23 BMR (specific measures to remediate this risk, such as mandating supervised entities to contribute to the benchmark for a limited period of time, or requiring the administrator to change the methodology or the code of conduct), have not been or will not be implemented. An official public statement made by the supervisor of the EURIBOR administrator, although not specifically foreseen in the BMR, should be desirable in this sense and should clearly and unambiguously state that remediation actions would not be expected or remediation actions already implemented would not be successful.

- This public statement should require a prior definition of "no representative" and an analysis explaining the reasoning why EURIBOR is "no longer" representative and even more when will no longer be representative. This analysis should cover the potential failure in the hybrid methodology (three levels performance, input data, contributors, market conditions in terms of liquidity, transaction based, etc.), the minimum period of time needed and other factors potentially involved to lead to the conclusion that EURIBOR will be no longer representative.

- This event may pave the way to inconsistencies as regards the point in time at which legal effects should occur. In the absence of a certain time period in the official statement by the supervisor, parties may decide by themselves their own transition time periods. As stated in the consultative document this situation may be difficult to explain to retail customers.

- Finally, in order to be harmonized with trigger events defined by ISDA, it would be important to highlight that such trigger event is included in ISDA documentation as a currently "pre-cessation" trigger, but only defined for LIBOR, not for EURIBOR.

In case Event 3 is finally recommended as a trigger event that determines the automatic application of a fallback rate, we would recommend to: (i) draft it in similar terms as the trigger event included in the recent amendment to BMR; (ii) add a reference to the fact that the official public statement has to state that EURIBOR is no longer representative or will no longer be representative "as of a specified future date"; and (iii) take into consideration that the public announcement or information relating to the trigger should be made by the public authorities in advance, in any case before the benchmark being non-representative.

QUESTION 4.-
Do you agree with the proposal of not including "Event 4" as a trigger event in EURIBOR fallback provisions? (yes / no / no opinion) Please elaborate.

*<u>Event 4:</u> The EURIBOR **administrator** determines that **EURIBOR should be calculated** in accordance with its reduced submissions or other contingency or fallback policies or arrangements and either: i) the circumstance(s) or event(s) leading to such determination are **not temporary**, or ii) EURIBOR is calculated in accordance with any such policy or arrangement for a period of **no less** than **one month.***

YES.

The Committee agrees with the proposal of not including this trigger event, since the referred measures to be applied by the EURIBOR administrator do not necessarily imply the disappearance of this benchmark.

In addition, as the consultation document states, this event it is not technically a trigger for fallbacks in the LMA document (for syndicated loans), but rather a suggested trigger for an amendment process.

Furthermore, this trigger event has also not been included in the Alternative Reference Rates Committee (ARRC) recommendations for floating rate notes, securitisations, business loans and syndicated loans.

QUESTION 5.-

Do you agree with the inclusion of "Event 5" as a trigger event in EURIBOR fallback provisions? (yes / no / no opinion) please elaborate.

<u>*Event 5:*</u> *It has become, for any reason, **unlawful under any law or regulation** applicable to relevant parties to the agreement **to use EURIBOR**.*

YES.

This trigger event is intended to cover any circumstance in which EURIBOR cannot be used as a result of a legal or regulatory prohibition.

As the consultation document explains, for those parties and asset classes under the scope of the BMR, this trigger would cover circumstances in which its use is not permitted as a result of the authorisation of EURIBOR's administrator being withdrawn or suspended under Article 35 of the BMR. In addition, the parties to the relevant contract might state that such trigger will also occur if such authorisation is suspended or withdrawn even if, at the time of such suspension or withdrawal, the continued provision and use of the benchmark is permitted in respect of the applicable securities or contract pursuant to BMR provisions.

The Committee agrees with the inclusion of Event 5, since it is a generally accepted event.

QUESTION 6.-

Do you agree with the inclusion of "Event 6" as a trigger event in EURIBOR fallback provisions? (yes / no / no opinion) Please elaborate.

<u>*Event 6:*</u> *EURIBOR is permanently **no longer published without a previous official announcement** by the competent authority or the administrator.*

This trigger event opens the possibility of the permanent discontinuation of EURIBOR without prior communication. As the consultation document states, it seems unlikely the permanent discontinuation of EURIBOR without prior communication, either by EMMI or another competent authority. According to Article 21 of the BMR, the administrator of a critical benchmark has to notify to its competent authority its intention to cease providing a benchmark.

Moreover, Event 6 covers remote scenarios and it may cause uncertainty. The discontinuation of EURIBOR without a previous official announcement by the competent authority or the administrator will impact severely in the contracts, will increase the risk of legal disputes and will avoid the main objective of this initiative, which is to provide market participants with effective tools to comply with the EU Benchmarks Regulation regarding fallback provisions.

Furthermore, it is extremely difficult to find a situation where the EURIBOR is permanently no longer published and no previous official announcement has been done. In addition, this remote event may be covered by Event 5 (for instance, in case of unlawfulness).

Therefore, under the coverage of remote scenarios the Committee does not deem feasible the inclusion of Event 6.

However, if this trigger is finally approved to cover unforeseen events ("catch-all" nature) that could lead to a discontinuation of the benchmark not captured by other trigger events, we also consider that it should not apply if upon a discontinuation scenario an announcement is subsequently made by the administrator informing that such discontinuation is due to a specific circumstance which can be fixed.

In order to distinguish between the activation of this trigger and a temporary cessation scenario, two important issues would be considered: (i) the number of days without publication of EURIBOR that would lead to the trigger of this event rather than to the application of temporary fallbacks; and (ii) what would happen if EURIBOR is re-published again after the fallback has been triggered.

This is a really complex issue, so it would be convenient to further analyze it (with the involved stakeholders) to try to get to a market consensus about it.

QUESTION 7.-

Do you agree that the inclusion of a material change in EURIBOR methodology (as defined by the EMMI) should not result in an automatic trigger event and parties are free to agree when entering into the contract that either (i) references in contracts to EURIBOR shall be understood to be references to EURIBOR as changed, or (ii) discuss between parties to continue the contract with the materially changed EURIBOR or to fall back to the EURIBOR fallback rates included in the contract? (yes / no / no opinion) Please elaborate.

<u>Event 7:</u> Material change is made to EURIBOR methodology.

YES.

Fallback provisions are defined by three key elements which determine the application of, and the conditions applicable to, the provision:

- Trigger event: defines events and the future date the fallback will be applied on.
- Fallback rate: identifies the alternative reference rate.
- Spread adjustment: if the new fallback rate provides an economically different outcome to the original rate, a spread is included to avoid or minimize the transfer of value.

This event tries to cover Article 28(2) of the BMR, which requires supervised entities to "produce and maintain robust written plans setting out the actions that they would have to take in the event that a benchmark materially changes or ceases to be provided."

EMMI is responsible for determining what would amount to a material change and for consulting on any proposed material change in EURIBOR methodology.

This event would not be understood as an automatic trigger event. As the consultation document concludes, since changes to EURIBOR methodology may happen in the future given that Article 5(3)(a) of the BMR requires benchmark administrators to review the definition and methodology of benchmarks at least annually, two options are available (i) an acknowledgment that EURIBOR may materially change and references to EURIBOR shall continue to be referenced to EURIBOR as changed; or ii) an option for parties to discuss whether to continue the contract with the materially changed EURIBOR or to fall back to the EURIBOR fallbacks included in the contract.

Therefore, the Committee considers that the inclusion of a material change in EURIBOR methodology should not result in an automatic trigger event.

QUESTION 8.-

Should all asset classes have the same fallback trigger events, to the extent possible? (yes / no / no opinion) Please elaborate.

YES.

One of the main considerations regarding the scope of the public consultation on EURIBOR trigger events is to cover all asset classes and therefore proposes the use of the same trigger events for all to ensure as much consistency as possible.

In this regard, it is worth noting the relevant determination made by the working group in trying to harmonise and avoiding duplicated efforts with the recommendations made by market associations (e.g. ISDA, LMA, AFME).

Although this initiative involve different markets, such as cash products, retail loans, debt securities, syndicated loans, securitisations, floating rate notes, derivatives and market participants (lenders-borrowers, issuer-investors), and with the improvement of fallbacks market participants should take the opportunity to harmonise fallbacks across products where feasible and appropriate.

As the consultation document states, even if the precise language used cannot be identical between products, market participants should aim for fallbacks to have harmonised outcomes across related products to minimise basis risk.

Therefore, the Committee considers that all asset classes should have the same fallback trigger events, since they are broad enough to be applied to any product.