

WG Euro RFRs – workstream #1A

Insight in legal framework for embedding fallbacks in contracts within Eurozone

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Workstream #1A investigated legal framework per asset class and per Eurozone country

By asset class

Syndicated loans

Business loans

Corporate business loans
Other business loans
CRE/Commercial mortgages

Retail loans

Retail mortgages
Credit cards
Auto loans
Consumer loans
Student loans

Floating rate notes

Floating rate notes
CD/CP

Securitisation

RMBS
Other (CMBS/ABS/CLO)

OTC derivatives

Interest rate swaps
Forward rate agreements
Interest rate options
Cross-currency swaps

Exchange traded derivatives

Interest rate options
Interest rate futures

Deposits

Other

Collateral

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Outcome provides insight in:

- Local laws that apply per asset class
- Fall back arrangements that are already required by local law and included in contracts as such
- Level of standardization across asset classes and/or countries
- Level of customer protection and requirements for communication towards customers for changes in legacy contracts as set by law
- Expected timelines to implement (alternative) RFR and RFR + term structure in legacy and new contracts

General observations legal framework on contractual fallback arrangements in Eurozone

EU Benchmark Regulation article 28.2 on ‘Changes to and cessation of a benchmark’:

*Supervised entities other than an administrator as referred to in paragraph 1 that use a benchmark shall **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. Where feasible and appropriate, such plans shall nominate **one or several alternative benchmarks that could be referenced to substitute the benchmarks no longer provided**, indicating why such benchmarks would be suitable alternatives. The supervised entities shall, upon request, provide the relevant competent authority with those plans and any updates and **shall reflect them in the contractual relationship with clients**.*

Besides this BMR requirement, there is no specific (local) law within the Eurozone that:

- Requires permanent fallback arrangements to be in place for variable interest rates used in contracts
- Prescribes how changes in applied benchmarks must be effected or communicated, hence (local) client protection laws apply

Market practice shows:

- If fallback arrangements are included in contracts, these are of temporary nature
- A few banks have started to include language in the contractual terms/protocols of certain products, but are also awaiting the outcomes of the different working groups on RFR and the different associations

General observations on impact for new contracts

Market associations set a high level of contract standardization for products offered to professional and global market participants (LMA, ICMA, ISDA, GMRA/GMSLA, BAFT – mostly governed by UK or US law).

However, for local markets, institutions often deviate from these standards (shorter contract formats, local language, etc.).

For markets not covered by the market associations, we see a medium/low level of contract standardisation, where each institution sets its own uniform contractual terms/formats.

Given that most contracts currently do not include permanent and sustainable fallback arrangements, market associations and institutions will have to update their contract standards to embed (1) Eonia replacement, (2) Eonia fallback arrangements and (3) Euribor fallback arrangements in newly offered contracts.

General observations on impact for legacy contracts

Within the Eurozone, client protection is mostly governed by local law for specific products or client groups.

In some countries, for certain products, it may be possible to make unilateral changes to existing contracts, with the option for the client to object and terminate the contract within a certain time frame.

However, in most Eurozone countries and for most products, material changes to existing contracts are only possible if:

1. Permitted under the agreement;
2. (Written) consent is received from all or majority of individual parties involved; or
3. Provided by law.

Given that most contracts do not include permanent and sustainable fallback arrangements, institutions will have to renegotiate existing contracts to embed (1) Eonia replacement, (2) Eonia fallback arrangements and (3) Euribor fallback arrangements once the RFR and RFR + term structure are available.

This means institutions must contact all impacted clients and bond-holders to address this issue.

Exception: derivatives based on ISDA definitions, where future protocol can be used for existing contracts.

Estimated timeline ranges to implement contractual fallback arrangements in new and legacy contracts in Eurozone (1/2)

In general it is difficult to quantify estimated timelines as permanent and sustainable fallback arrangements are often not foreseen in the contractual terms.

The estimated timelines depend on amongst others:

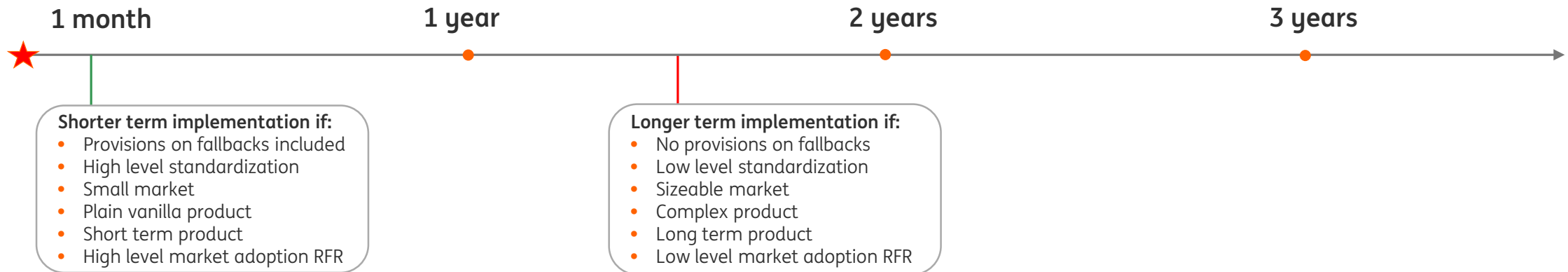
- Provisions included in the contract;
- Type of counterparty;
- Market size of the specific product;
- Complexity of the specific (individual) product;
- If new contractual terms will be generally accepted by the market and supervisors;
- If new reference rate has been generally accepted by the market.

The timeline ranges mentioned on the next slide are a rough estimate based on a high level analysis of the legal frameworks within the Eurozone.

Detailed adoption plans based on in-depth analysis will be developed in workstream #3 on contractual robustness of new and legacy contracts.

Estimated timeline ranges to implement contractual fallback arrangements in new and legacy contracts in Eurozone (2/2)

New contracts – implementation may vary from 1 up to 18 months



Legacy contracts – implementation may vary from 6 months up to 3 years

