The end of Libor in Switzerland

Martin Anderson and Frédéric Bétrisey of Bär & Karrer outline how you need to prepare in Switzerland for the consequences of the discontinuation of Libor

The UK Financial Conduct Authority (FCA) announced on 27 July 2017 it would no longer require that banks that are members of the Libor panel be obliged to communicate a daily rate after 2021.

2021 is perhaps not tomorrow, but it is definitely very soon after tomorrow. Financial institutions should now review their Libor-based contracts and products to quantify their exposure to the discontinuation of such a rate. While the effort is obviously larger for financial institutions, other enterprises, and even retail investors and borrowers, should assess their risk and determine what measures to take. We provide below an overview of the contracts that may be affected and possible remedies.

In Switzerland a large number of loan agreements use the London Interbank Offered Rate (Libor) as a reference rate for the calculation of interest amounts. The discontinuation of Libor will therefore affect the **lending market**, whether the relevant loans have been granted to retail customers (eg consumer loans, credit cards or mortgage loans) to investors (eg so-called lombard loans, where the credit is secured by way of pledge on a portfolio of assets) or to large corporates, commodity traders and/or small or medium enterprises. Intercompany loans within corporate groups may also use Libor as a reference market rate. In other words, the discontinuation of Libor will impact all types of loans, lenders and borrowers on the Swiss lending market.

Likewise, Libor and Euribor are applicable references for several types of **derivative transactions**, such as interest rate swaps, cross-currency swaps or forward rate agreements, and **capital market products**, such as bonds, floating rate notes and securitisation products (eg residential mortgage-backed securities). The disappearance of these widely used references will therefore affect all respective parties.

As the agreements taking Libor as a reference benchmark are term contracts that may well come to maturity after 2021, the parties should determine how they will calculate the rate when Libor disappears. Most of the recent contracts generally take this issue into account and, accordingly, **provide for a mutually acceptable fallback mechanism**, such as allowing a party to elect for another reference rate or selecting a new reference rate.

By contrast, a majority of the contracts entered into prior to July 2017 do not contain such a fallback mechanism. Furthermore, it is still unclear whether replacement rates will effectively be available when Libor is discontinued.

Swiss statutory provisions do not offer any predictable solution to address the uncertainty and risk when Libor-based agreements do not contain any contractual fallback mechanism. Hence, where the reference rate of a contract is no longer available, Swiss courts will commonly attempt to supplement the contract according to the hypothetical intention of the parties. If such intention cannot be ascertained in relation to a loan agreement, interest will be deemed to accrue at 'the usual rate for similar loans prevailing at the time when the loan was made' (article 314 of the Swiss Code of Obligations (CO)). For other types of contracts, it is also the usage that will determine the applicable rate (article 73 CO), provided that, **in the event that no 'usual rate' can be determined, then the rate of 5% per annum will apply**. Considering the current level of interest rates, borrowers and other parties thus need to take preparatory measures and consider implementing amendments to their existing contracts sooner rather than later.

Derivative contracts are normally based on standard forms published by professional organisations, such as the International Swaps and Derivatives Association (ISDA) or the Swiss Bankers Association. The documentation often incorporates by reference a set of definitions made available by the ISDA, which, among others, contain **Libor-related terms**. Such terms, however, only represent a partial response to the discontinuation of Libor. According to such terms, when Libor disappears, the reference rate is to be determined as the average of quotations obtained from designated banks. However, it is uncertain whether banks will provide such quotations. Experience has shown that obtaining market quotations is not straightforward.

In order to remedy these issues, efforts are being made by authorities and industries to agree on alternative rates that could serve as replacement for Libor after its discontinuation. In Switzerland, the Swiss National Bank has taken the lead in the efforts towards the replacement of Libor, setting up the National Working Group on Swiss Franc Reference Interest Rate, which meets regularly to deal with the issues affecting specifically the loan and derivative markets. At this stage, it is still uncertain, however, whether and when an appropriate alternative rate for Swiss francs-denominated contracts will be available. Furthermore, loans and derivative contracts on the Swiss market are not necessarily issued in Swiss francs. Therefore, the regulatory and industry initiatives currently under way abroad are also materially relevant for Swiss corporate and financial institutions.

Finally, regulators are increasing the **pressure on financial institutions** participating in the lending, derivative and capital markets to take appropriate measures. In Switzerland, the Swiss Financial Market Supervisory Authority ordered in a communication of 17 December 2018 that regulated institutions appropriately identify, measure and manage the legal and valuation risks inherent in the discontinuation of Libor, and indicated that it would investigate whether the appropriate measures have been taken.

For more information, please contact:

Martin Anderson, partner
E: martin.anderson@baerkarrer.ch

Frédéric Bétrisey, partner
E: frederic.betrisey@baerkarrer.ch

Bär & Karrer
Quai de la Poste 12
CH-1211 Geneva
Switzerland

T: +41 582 615 700

www.baerkarrer.ch