EUROPEAN CENTRAL BANK

EUROSYSTEM

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FINAL

Meeting of the working group on euro risk-free rates

held in Frankfurt am Main on Thursday, 4 July 2019, 11:00 to 16:00 CET

SUMMARY

1. Introductory remarks, approval of the agenda and obligations of working group members as regards competition law

Steven van Rijswijk (Chair) asked the members of the working group on euro risk-free rates to approve the agenda for the meeting and reminded them of their obligations under EU competition law, as described in the guidelines on compliance with EU competition law published on the ECB's website.

He also reminded the working group members that the EURIBOR had just been authorised under its new hybrid methodology[1]. He congratulated its administrator, the European Money Markets Institute (EMMI), for this milestone. The fact that EMMI had obtained authorisation as administrator of the EURIBOR benchmark confirmed that the requirements contained in the EU Benchmark Regulation had been met. Consequently, the benchmark may also be used after 1 January 2020.

2. Market feedback and final recommendations on the EONIA to €STR legal action plan regarding legacy and new contracts referencing EONIA

2.1 Presentation of the summary of feedback on the public consultation on the EONIA to €STR legal action plan

Mikael Stenström (ECB) presented the summary of responses to the third public consultation by the working group on euro risk-free rates on the EONIA to €STR legal action plan, published on 27 June on the ECB website. He recalled that 58 market participants replied to the consultation, and that the feedback received was overall supportive of the working group's recommendations, with sometimes extensive comments. There was almost unanimous support for defining the EONIA's primary fallback rate as the €STR plus the fixed spread (8.5 basis points). Some other recommendations also received very strong support, notably: (i) the recommendation to the International Swaps and Derivatives Association (ISDA) to amend the 2006 ISDA Definitions to include a fallback to the €STR plus the spread triggered by the cessation of EONIA; and (ii) the recommendation to have an EONIA-specific protocol to complement the 2018 ISDA Benchmarks Supplement, whereby most respondents identified ISDA as the appropriate body to develop such a protocol (unless reference was made to a local master agreement, for which local organisations would be responsible). In addition, there was general consensus that central counterparties (CCPs) and exchanges should be encouraged to clarify their position with regard to the transition to the €STR and that market participants using EONIA should implement the legal action plan in a timely and consistent manner, which would entail (among other things) the following measures: (i) whenever feasible and appropriate, market participants should no longer enter into new contracts referencing EONIA as of 2 October 2019, in particular contracts maturing after 31 December 2021; (ii) market participants should consider introducing acknowledgements in new contracts signed before October 2019 that the EONIA methodology is expected to change and that references in contracts to EONIA shall be understood as references to EONIA as changed, as this would improve the transparency of their transactions while not being strictly necessary; and (iii) market participants should introduce robust fallback provisions and/or closing out EONIA positions before EONIA ceases to exist by the end of 2021. In addition, the vast majority of respondents also supported the recommendation that the sponsors of European local master agreements should consider amending these agreements to address the permanent cessation of EONIA and the transition to the €STR, to the extent relevant considering the existing structure and wording of such master agreements.

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1 See European Money Market Institute (2019), *EMMI granted authorisation by Belgian Financial Services and Markets Authority*, 3 July.

2.2 Discussion on the final recommendations of the EONIA to €STR legal action plan before formal endorsement

José Manuel González-Páramo (BBVA) introduced the work of subgroup 3 and indicated that the overall positive feedback on the EONIA legal action plan could be interpreted as a supportive message from the market community. **Adolfo Fraguas (BBVA)** presented the revised recommendations of subgroup 3, following the feedback received in the public consultation. He also recalled: (i) that applying the recommendations of the legal action plan would be voluntary; and (ii) that the recommendations would need to be read in conjunction with the consultation paper (EONIA legal action plan) and the feedback received (Summary of feedback), as well as the future recommendations of subgroup 5 on the EONIA to €STR transition for cash and derivative products, to be published later in the summer.

Mr Fraguas (BBVA) recalled that the main recommendations of the working group also included a general recommendation that as of 2 October 2019, whenever feasible and appropriate, market participants should consider no longer entering into new contracts referencing EONIA, in particular new contracts maturing after 31 December 2021. In those cases where new contracts still reference EONIA and mature after December 2021 or fall within the scope of the EU Benchmarks Regulation, market participants should include robust fallback provisions. Following the feedback received from the market, it was suggested to put forward two EONIA discontinuation fallback language templates for new cash products, so that market participants may select and tailor the template to take into account the terms and conditions of each particular asset class and the legal requirements of each relevant European jurisdiction.

In the course of the discussion, some working group members welcomed the continued support from the public authorities for the EONIA transition path. They also encouraged the public authorities to continue to support the process through communication and education activities clarifying, among other topics, that the changed EONIA methodology would continue measuring the same interest.

In reply to a question, **Jean-Louis Schirmann (EMMI)** indicated that EMMI intends to file for authorisation for EONIA before 2 October 2019, and **Randy Priem (Belgian Financial Services and Markets Authority – FSMA)** confirmed that the assessment of EONIA's authorisation would be treated with priority by his institution, but the FSMA would also need to consult the college of supervisors and some time would be needed to ensure proper processing. In reply to a question, he recalled that the EONIA recalibrated methodology could be considered as potentially compliant with the requirements of the EU Benchmarks Regulation, as already discussed a few months previously when the working group decided on the EONIA transition path.

The public authorities observers in the group clarified the extent and scope of their support for the transition from EONIA to the €STR. In particular, **Holger Neuhaus (ECB)** recalled that, as observers in the working group, the public authorities had already provided clear guidance and support to market participants on euro benchmark reforms over the past year. In particular, the ECB had committed to deliver the €STR as a replacement for EONIA and as a basis for fallbacks for EURIBOR. Together with the other public authorities, the ECB was also supporting the working group and its participants on a daily basis to find solutions for a smooth transition. However, the public sector entities can only act within their respective mandates and noted that the recommended solutions would need to address contractual relationships and rely on tools available to the private sector. On their part, the public authorities observers in the working group were ready to continue to provide general support to the transition to the €STR within their respective mandates, but would not be in a position to qualify changes to benchmark methodologies.

Finally, in view of the feedback received in the public consultation on the EONIA legal action plan, the **ECB Secretariat** recalled that substantial feedback had been received with regard to regulatory impediments to the transition, and more specifically on margin requirements in the context of the European Market Infrastructure Regulation (EMIR). On this specific point, a working group letter had recently been sent to the European Commission and the European Securities and Markets Authority (ESMA), to request clarification that neither the incorporation or effect of fallback provisions, nor the amendment or replacement transactions which currently reference EONIA, would impose a margin or clearing obligation under EMIR. The working group letter will be published on the ECB website together with the working group's meeting documentation.

3. Presentation by subgroup 5 on market adoption for cash products and derivatives: report on the EONIA to €STR transition for cash products and derivatives including draft recommendations

Anna Kozhevnikova (Generali) and Christian Gau (Deutsche Bank) presented the timeline for subgroup 5, taking into account the objectives of the group, the main draft recommendations included in the report on the impact of the transition from EONIA to the €STR for cash and derivatives products, and the next steps for the finalisation of the report, which was expected to be published at the beginning of August on the working group on euro risk-free rates webpage.

The aim of the subgroup 5 report is to analyse the implications and intricacies surrounding the transition from EONIA to the €STR and to provide market participants with recommendations on how to make the transition smoother. The move from EONIA being calculated as a benchmark based on panel banks' contributions and available at the end of the day on which the transactions are conducted (T) to a transactions-based benchmark available on the next business day (T+1) requires market participants to prepare extensively, including by adapting IT systems, adjusting settlement defaults, and reviewing procedures and documentation. The report also provides an overview of all relevant affected products (derivatives, securities, secured cash products, unsecured cash products, investment funds and other products), processes and models (funds transfer pricing models, discounted cash flows, derivative pricing and derivative value adjustment models), and proposes concrete recommendations.

Therefore the objectives covered in the report are: (i) identifying possible system and infrastructure issues that could arise due to the transition and providing guidance for market participants to mitigate those issues; (ii) setting out the discounting regime to enable the transition from EONIA to the €STR; and (iii) designing a possible methodology for closing out or transitioning legacy EONIA exposure.

To address these objectives, subgroup 5 had divided the report and its recommendations into two main sections: (1) recommendations to be implemented before 2 October 2019, i.e. the first €STR publication date and initial transition from EONIA to the €STR + 8.5 basis points in the light of the planned change in EONIA calculation methodology, linked to the move from T to T+1; and (2) recommendations to be implemented during the transition phase, i.e. the transition from EONIA being the €STR + 8.5 basis points to the €STR, also taking into account two important milestones for this transition – CCPs' ability to start clearing €STR products and CCPs' switch date from EONIA to the €STR for collateral remuneration.

With regard to the timing for CCPs' switch to the €STR as the collateral remuneration rate, subgroup 5 had analysed different approaches that these market participants could follow, including the pros and cons of having a big bang approach versus a phased-in approach, highlighting the potential benefits of aligning their discounting switch date to the extent possible, preferably towards the end of Q2 2020, while taking into account compliance with EU competition law.

For bilateral trades, however, the working group acknowledged that the price alignment interest/discounting switch date could not be aligned for practical reasons, so it recommended following a phased-in approach that should be started as early as possible.

As a follow-up to the debate on CCPs' switch date, the Chair suggested approaching CCPs to examine, to the extent possible, their plans for supporting the transition to the €STR, while being mindful of EU competition law. The proposal was supported by the working group members and it was agreed that the potentially interested CCPs could be invited to share this information with the working group, under the modalities to be determined by Subgroup 5.

Finally, **Christian Gau (Deutsche Bank)** and **Anna Kozhevnikova (Generali)** explained that, after the summer, subgroup 5 would focus on the development of the derivative market based on the €STR, as well as the most relevant EURIBOR fallback methodologies applicable for each financial product, with a view to including both topics in a second report and sharing its initial draft with the working group at its meeting on 16 October.

Holger Neuhaus (ECB) announced that the European Commission would take over the Secretariat function of subgroup 5, replacing the ECB. The terms of reference for subgroup 5 would be amended accordingly on the ECB website.

4. Presentation by subgroup 7 on communication and education

Maria Teresa Bermudez (Santander), as the Chair of subgroup 7 on communication and education, recalled the mandate and objectives of her subgroup, and presented the composition of subgroup 7. National associations and significant consulting firms were included in subgroup 7 with the aim of reaching out to target groups that were thus far less aware of the benchmarks topics. For the same reasons, specific attention was paid to corporate representatives. She explained that the subgroup was still discussing its priorities (topics, target groups) and would come back with a more detailed roadmap at the next meeting of the working group.

She highlighted a few key points which seemed important: (i) the need for good coordination with other subgroups, particularly to make their output more visible; and (ii) the need to quickly raise awareness of some urgent issues, notably in view of the changes arising as early as 2 October 2019 (T+1 issues), as shown by subgroup 5.

5. Presentation by subgroup 6 on financial accounting and risk management

Markus Schmidtchen (KfW) provided an overview of the three main deliverables for subgroup 6: an analysis of the impact of the euro benchmarks reform on (i) risk management and (ii) financial accounting, and (iii) the letter that the working group was planning to send to the International Accounting Standards Board (IASB) in mid-July which would also be published on the working group webpage.

5.1 Status update on the reports on financial accounting and risk management

To address its two first deliverables, subgroup 6 was working on a report with a view to presenting it at the 16 October working group meeting and subsequently publishing it.

On risk management topics, the report will include an analysis of the impact of: (i) the transition from EONIA to the €STR, possibly including a checklist of the affected risks and respective impact assessments, practical implications for valuations and market risk management for the trading book and the banking book, and technical implications covering the impact of the lack of historical data and the impact on the corresponding IT systems; (ii) the inclusion of €STR-based fallbacks for EURIBOR and their potential effect on valuation, the potential basis risks that could arise, potential hedging mismatches and the impact on the liquidity of new hedging instruments; and (iii) the implications of (i) and (ii) for the insurance and asset management industries.

On accounting topics, the report will include an analysis of: (i) the impact on hedge accounting of the transition from EONIA to the €STR, which will provide explanatory notes for the content of the letter addressed to the IASB; (ii) the impact of including €STR-based fallbacks for EURIBOR and the potential impact of the trigger events and potential inconsistencies on hedge accounting; and (iii) the implications of the euro benchmark reform on other accounting standards (non-hedge related).

5.2 Discussion and approval of working group letter to IASB

Markus Schmidtchen (KfW) presented the letter that the working group was planning to send to the IASB, which included a description of the current focus of the euro reform agenda, i.e. the transition from EONIA to the €STR, and stressed the urgency of the IASB starting phase 2 of its IBOR reform project ("replacement phase"), which in the opinion of the working group members was particularly relevant for the euro area where the €STR would become effective as of 2 October 2019. In addition to this, the letter included some requests for clarification and for the IASB to provide some potential relief concerning the implementation of IFRS 9 and IAS 39 with regard to modifying contracts and discontinuing hedge accounting relationships, in order to avoid triggering accounting issues solely due to the replacement of EONIA with the €STR, which was seen as an update that responded to the market-wide transition to the €STR and did not reflect a change in the underlying risk management objective.

The letter was endorsed by the working group members. It would be sent from the Chair to the IASB in mid-July and subsequently published on the working group webpage.

6. Presentation by subgroup 2 on term rates methodologies

6.1 Status update by subgroup 2A on overview of backward-looking methodologies and credit spread calculation methodologies

Neil McLeod (Erste Group) updated the working group on the progress made by subgroup 2A thus far. Regarding the analysis of methodologies for calculating a spread representing the difference between EURIBOR and €STR-based term structure methodologies, subgroup 2A was currently analysing three options: (i) a historic credit spread methodology; (ii) a forward credit spread methodology; and (iii) a dynamic credit spread methodology. Regarding the analysis of backward-looking methodologies for calculating a €STR-based term structure, subgroup 2A felt that the methodologies outlined in the user guide to overnight risk-free rates, recently published by the Financial Stability Board (FSB), provided a definitive list. Subgroup 2A would then proceed by assessing each of the methodologies included in the user guide. Furthermore, subgroup 2A would start its work on a technical analysis of the interaction between forward and backward-looking methodologies once its other tasks were completed.

6.2 Status update from subgroup 2B on call for expressions of interest to benchmark administrators on publishing €STR-based forward-looking term rates as possible fallback for EURIBOR

Alberto Covin (UniCredit) and **Carlos Infesta (Santander)** updated the working group on the progress made by subgroup 2B thus far. They outlined the main guiding principles to be followed by subgroup 2 and the working group when addressing potential benchmark administrators for a €STR-based forward-looking term structure. The guiding principles followed the guidance received from the legal firms participating in subgroup 3. Going forward, Clifford Chance would, on a pro bono basis, advise subgroup 2 on compliance with competition law in relation to the interaction with potential benchmark administrators. They also presented the envisaged call for expressions of interest to benchmark administrators for producing a forward-looking term structure based on the calculation methodology recommended by the working group in March 2019. The call for expressions of interest would be published on the ECB's website. Administrators would be invited to indicate their interest by 30 September 2019 and to present their proposals at the working group meeting of 16 October 2019. The working group approved the call for expressions of interest for publication on the ECB's website.

7. Other business

7.1 Roundtable on euro risk-free rates on 25 September 2019

Steven Van Rijswijk (Chair) announced that a second roundtable on risk-free rates would take place on 25 September in Frankfurt at the ECB, focusing on future milestones for the benchmark reforms in the euro area and, in particular, on the launch of the €STR on 2 October 2019.

7.2 Request from Official Sector Steering Group (OSSG) for feedback from the working group regarding possible official sector support on tax, accounting and regulatory issues

Vladimir Tsonchev (ECB) debriefed the working group about an initiative of the Financial Stability Board's group in charge of the interest rates benchmarks, the OSSG. The OSSG had created a new subgroup ("subgroup 2") to better coordinate accounting, regulatory and tax issues potentially arising from the benchmark reforms, and had asked for feedback from the national working group on these topics. The ECB Secretariat would report to the OSSG/subgroup 2 on some specific euro initiatives, notably the IASB letter on accounting issues, the letter on EMIR margin requirements (both available on the ECB webpage of the working group), and the publically available feedback received from the public consultation on the EONIA legal action plan regarding the legal impediments of the benchmark transition.

7.3. Any other business

The working group members were informed by the ECB that ECB Banking Supervision had sent a letter to their supervised entities to assess the state of play of their preparations for the interest rate benchmark reforms and the use of risk-free rates. The letter had been published on the ECB Banking Supervision website.

The ECB Secretariat informed the working group members of the changes to the composition of the various subgroups, and that the subgroup composition would be updated on the ECB website.

7.4. Next meeting

The next meeting of the working group would take place at the ECB on 29 August 2019, from 11:00 to 16:00 CET.

List of meeting participants

Participant's organisation	Name of participant
Chairperson	Mr Steven van Rijswijk
ING	Ms Marjolein de Jong-Knol
Voting members	
Bank of Ireland	Mr Barry Moran
Barclays	Mr Joseph McQuade
Bayerische Landesbank	Mr Harald Endres
BBVA	Mr José Manuel González-Páramo
BBVA	Mr Adolfo Fraguas Bachiller
BBVA	Mr José Carlos Pardo
BNP Paribas	Ms Dominique Le Masson
BPCE/Natixis	Ms Sophie Asselot
BPCE/Natixis	Mr Olivier Hubert
CaixaBank, S.A.	Mr Sergio Castellá Quintana
CaixaBank, S.A.	Mr Julius Moschitz
Crédit Agricole	Mr Carlos Molinas
Crédit Agricole	Ms Florence Mariotti
Deutsche Bank	Mr Juergen Sklarczyk
Deutsche Bank	Mr Christian Gau
DZ Bank	Mr Michael Schneider
DZ Bank	Ms Cornelia Gericke
Erste Group Bank AG	Mr Neil Mcleod
Eurobank - Ergasias SA	Mr Theodoros Stamatiou
HSBC	Ms Nathalie Gay Guggenheim
ING Bank	Mr Jaap Kes
ING Bank	Ms Johanneke Weitjens
Intesa Sanpaolo	Ms Maria Cristina Lege
Intesa Sanpaolo	Ms Alessandra Iuliucci
KfW Bankengruppe	Mr Markus Schmidtchen
KfW Bankengruppe	Mr Ingo Ostermann
Nordea	Mr Markku Keränen
Santander	Mr Carlos Fernández Infesta
Santander	Ms Maria Teresa Bemudez Tejero
Santander	Mr Óscar García Maceiras
Société Générale	Mr Olivier Balpe
Société Générale	Mr Gregory Albertini
UniCredit Bank	Mr Alberto Covin

Non-voting members

European Money Markets Institute	Mr Jean-Louis Schirmann
European Fund and Asset Management Association	Ms Agathi Pafili
International Capital Market Association	Mr David Hiscock
International Swaps and Derivatives Association	Mr Ciaran McGonagle
Loan Market Association	Ms Kam Mahil

Invited institution

European Investment Bank	Mr Thomas Schroeder
Generali	Ms Anna Kozhevnikova

Observers

European Central Bank	Mr Holger Neuhaus
European Securities and Markets Authority	Mr Michele Mazzoni
Financial Services and Markets Authority	Mr Randy Priem
European Commission	Mr Rik Hansen

Secretariat

European Central Bank	Ms Anne-Lise Nguyen
European Central Bank	Ms Stephanie Broks
European Central Bank	Mr Mikael Stenström
European Central Bank	Mr Pascal Nicoloso
European Central Bank	Ms Yasmina Santalla Pérez
European Central Bank	Mr Vladimir Tsonchev