EUROPEAN CENTRAL BANK
EUROSYSTEM

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Meeting of the working group on euro risk-free rates

held in Frankfurt am Main on Wednesday, 4 December 2019, 11:00 to 16:00 CET

SUMMARY

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

Steven van Rijswijk (Chair) opened the meeting by congratulating the European Money Markets Institute (EMMI) for successfully completing the phasing-in of the hybrid methodology for all Euribor Panel Banks.

He 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.

2. Next deliverables of the working group on euro risk-free rates

Cornelia Holthausen (ECB) shared some observations on the working group deliverables due in the coming months, notably those concerning the Euribor fallbacks. She recalled that the public sector, as already communicated, welcomed the reform of the Euribor methodology, as it allowed for the administrator EMMI to be authorised and therefore avoided significant uncertainty for all users and especially for consumers. The authorisation of EMMI under the BMR means that European supervised entities can continue to use Euribor in existing and new contracts.

She particularly stressed the following points: the public sector welcomes the reform of Euribor, while its long-term sustainability remains largely the responsibility of the private sector. In practical terms, this meant that Euribor's long-term sustainability would depend on: (i) its administrator, (ii) panel banks' willingness to continue supporting it, and (iii) the future liquidity of its underlying market. Users should therefore be prepared for all scenarios, including the possible disappearance of this benchmark. She recalled that while competent authorities under the BMR could provide a temporary backstop in the form of mandatory contributions to the benchmark or mandatory administration of the benchmark, this backstop was limited in nature and time. She also insisted that all parties affected by Euribor ought to be informed about the risks attached to this benchmark, which was especially relevant for consumer products, e.g. retail mortgages, where the lending institution using Euribor bore the ultimate responsibility for informing its clients about the related risks. Clear communication with clients about current risks and the set-up of fallbacks was a task and duty of each Euribor user – and one that the ECB would encourage them to perform without delay. Finally, she recalled that the risks related to Euribor could effectively be minimised by introducing fallbacks in all contracts making use of this benchmark.

In addition, Cornelia Holthausen recalled the FSB guidance of 2014, explaining that users could consider whether for some financial instruments or contracts it might be more appropriate to adopt the €STR, or term rates based on the €STR – and not only as fallbacks. Indeed, some financial products might be better suited to reference rates not capturing any credit spread, such as the €STR. This might be the case primarily for derivatives products, but not only for them.

In the subsequent discussion, it was clarified that such guidance should not be taken as implying less support or appreciation for the working group's efforts, but as a way of reaffirming the importance of the working group deliverables in the coming months and also the need to deliver practical recommendations on Euribor fallbacks in the first half of 2020.

In this context, **Jaap Kes (ING)** presented the deliverables of the working group on euro risk-free rates for the first half of 2020. Two simultaneous public consultations were envisaged for Q2 2020: the first one on the Euribor fallback methodologies, the methodologies for the credit spread adjustment and the related market conventions; the second one covering the "legal action plan" for embedding these fallbacks in the new Euribor contracts, and to the extent possible, in the legacy contracts. The final methodological and legal recommendations were expected around June 2020. The working group agreed on the plan, taking note of the relatively tight time frame for delivering the recommendations on Euribor fallbacks.

3. Update by Subgroup 5 on cash products and derivatives

Marjolein de Jong-Knol (ING) gave an update on the follow-up regarding a working group recommendation relating to the possibility of CCPs aligning their discounting switch dates as much as possible, to transition from an EONIA discounting regime to a €STR discounting regime.[1] The Chair's team had been in contact with the European Association of CCP Clearing Houses (EACH) to discuss the possibility of coordinating among CCPs, also taking into account competition law considerations. This process would not be relevant for all EACH members. However where individual members were affected, they would aim to align with a switch date on Monday 22 June 2020, subject to their own governance and operational processes and discussions with their clearing members and users.

Christian Gau (Deutsche Bank) and Anna Kozhevnikova (Generali) provided an update on Subgroup 5.

On the recommendations on how to develop a liquid €STR derivative and cash market, the Subgroup 5 Co-Chairs presented a draft document intended as a supplement to the report on the impact of the transition from EONIA to the €STR on cash and derivatives products published on 19 August 2019. The aim of the document was threefold: (i) to support the smooth transition from EONIA to the €STR, taking advantage of current EONIA liquidity in cash and derivatives markets, (ii) to provide guidance on how to ensure a liquid €STR cash and derivatives market and (iii) to provide clarifications around specific topics that have been discussed since the above report was published and required revisiting, in particular on recommendation 4 for derivatives and money market transactions.[2] The supplement to the report would now be finalised and was expected to be published at the beginning of next year. The main recommendations encouraged, among other things, the replacement of EONIA products by €STR alternatives as soon as possible, and notably by pricing and issuing new instruments on €STR as a first option, and advising market participants to keep similar product characteristics and conventions for a seamless transition. The working group also discussed the appropriate approach to be taken by the group on swaptions compensation, having regard also to compliance with applicable law. Upon further consideration, the working group considered that additional analysis of the transition challenges for swaptions was required before any decision would be taken on whether to make an appropriate recommendation in this area including as to the shape, form and possible direction of such recommendation. The next steps would be discussed in the next weeks by the working group members.

Regarding the work on fallbacks for the Euribor, **Christian Gau (Deutsche Bank) and Anna Kozhevnikova (Generali)** presented their proposed approach, i.e. the Subgroup 5 chairs are planning to take as an starting point the analysis already done by Subgroup 2 of the different backward looking methodologies and their proposed forward looking methodology, considering only the viable options and analysing the suitable fallback rates by asset class using a set of pre-defined criteria (yet to be determined). **Markus Schmidtchen (KFW),** as Subgroup 6 Chair, highlighted that from a risk management and financial accounting perspective, economic equivalence and consistency among fallback arrangements applying across jurisdictions and across products – in particular to hedge-related products – were very relevant criteria to take into consideration. Other members pointed out the difficulty of achieving consistent arrangements across jurisdictions.

4. Update by Subgroup 3 on the Euribor legal action plan

4.1. Update on the discussions on the trigger events for Euribor fallback provisions

Jose Carlos Pardo (BBVA) presented the status of the work of Subgroup 3 on legal aspects and contractual robustness with regard to Euribor fallbacks and, in particular, the draft consultation on Euribor fallback provisions under preparation by Subgroup 3. The public consultation would take into account the latest developments and

[1] See P7 recommendation 6c of the Report on the impact of the transition from EONIA to €STR on cash and derivative products, August 2019: "*Date for switching the discounting curve from EONIA to the €STR: For cleared trades, the working group recommends that central counterparty clearing houses (CCPs) align their discounting switch dates as much as possible to transition from an EONIA discounting regime to a €STR discounting regime, which would represent a "big bang" approach for cleared markets. In addition, the CCPs are recommended to set the discounting switch date as early as possible, preferably towards the end of the second quarter of 2020.*"

[2] See P4 recommendation 4 of the Report on the impact of the transition from EONIA to €STR on cash and derivative products, August 2019: "*Derivatives/money market transactions: Currently, EONIA-related transactions are, as a rule, settled on T+1. It is recommended that market participants switch to T+2 settlement, also to accommodate international (in particular Asian) market participants' operational requirements. Please note that, for money market transactions, this may entail a one-day difference between the payment dates of the nominal and the interest.*"

work by market associations on preparing new fallback provisions for different asset classes[3] with a view to avoiding overlaps. Also the consultation might invite market participants to give feedback on whether trigger events and fallback rates should be consistent among products and across currencies.

The draft consultation report considers the possible trigger events and operational considerations which might have an impact on the legal drafting of Euribor fallback clauses. It was agreed that the consultation paper would propose the same trigger events for all asset classes. Subgroup 3 would provide a comprehensive set of possible trigger events, describing their pros and cons. It would consider and decide whether to recommend a specific set of triggers in the public consultation, or leave the preferred set of triggers open for feedback. Subgroup 3 is also working on the identification of operational considerations that may need to be taken into account when drafting Euribor fallback provisions by asset class.

4.2. Update on the discussions on the Euribor legacy portfolios

Subgroup 3 was also to prepare a set of guidelines for how to amend legacy contracts by private, contractual means. The analysis would be carried out by asset class and the starting point would be floating rate notes and mortgage loans. The ECB representatives emphasised that it was in the interest of all parties to contracts referencing Euribor for such contracts to have workable fallback provisions in place as contingency measures in case at some point Euribor was no longer available, and that the need for such contingencies applied not only to new contracts, but also to legacy contracts. A few working group members mentioned that the introduction of workable fallback provisions in legacy contracts might also include the need to amend regulations and/or legislation in some Member States to identify €STR as a possible basis for fallback rates. In particular, one working group member also mentioned the need to take into account, before the introduction of workable fallback provisions, their potential implications, if any, on the various non-performing loans (NPL) resolution schemes, implemented currently in a number of euro area countries.

4.3. Preliminary analysis as regards the compliance of the backward looking in arrears methodologies with the European Mortgage Credit Directive[4]

Subgroup 3 also presented a preliminary analysis of whether in arrears backward looking €STR methodologies were compatible with the EU Mortgage Credit Directive. According to this preliminary analysis, the requirement to inform the customer "before the change takes effect" (as included in Article 27 of the Mortgage Credit Directive) could be interpreted in different ways: (i) before the beginning of the new interest rate period, or (ii) before the end of the interest rate period. There is no conclusive outcome and the answer may depend on how the Directive has been implemented in the respective EU Member State and how local authorities interpret it in each jurisdiction. It was noted, however, that in some Member States changes of the interest rate during the interest rate period may be disallowed by consumer protection laws. As a follow-up, Subgroup 3, in coordination with public authorities, might launch a country-specific analysis in order to check how the European Mortgage Credit Directive had been transposed in certain jurisdictions. In addition, it might also be necessary to check how some Member States' local authorities and the European Commission understood in arrears backward looking methodologies to be applicable for mortgage loans.

Kam Mahil (LMA) pointed out that the issues in respect of compounding methodologies were wider than just compliance with the European Mortgage Credit Directive and could have an impact on debt products other than consumer loans. This was because some jurisdictions had general restrictions on the compounding of interest. She encouraged the group to analyse the legality of compounding methodologies in European jurisdictions, as it would be important to have a consistent view on this for certainty across the market. This matter was becoming more urgent, particularly given the speed of work in other jurisdictions to develop loan systems to deal with compounding methods on a global basis, with the US Alternative Reference Rates Committee (and UK) loan working groups now focusing on two particular compounding methodologies.

5. Update by Subgroup 7 on communication measures

Javier Pareja (Santander) reminded the working group members of the materials already provided by Subgroup 7 as part of the initial communication toolkit (frequent Q&A, standard set of slides and EONIA to €STR checklist) and clarified that this documentation would be periodically updated. In addition to this, as part of this initial communication toolkit, Subgroup 7 was currently working on the compilation of key messages from the respective subgroups in order to use them in future communications.

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[3] See for instance International Swaps and Derivatives Association (ISDA)'s work regarding derivatives and the Loan Market Association's on syndicated loans.

[4] See: https://ec.europa.eu/info/law/mortgage-credit-directive-2014-17-eu_en

Then **Javier Pareja** informed those present about some of the tools that Subgroup 7 was planning to use, i.e. the "ambassador" concept and the newsletter. He emphasised that working group members should now focus on raising awareness of the working group recommendations. In this respect, "ambassadors" would be appointed among working group and subgroup members, as spokespeople on behalf of the working group in the respective countries. Ambassadors should strive to inform and educate market participants, as well as local authorities and associations, about the working group's activities, recommendations and reports. **Mr. Van Rijswijk (Chair)** encouraged working group members to volunteer to become an "ambassador" for the Member States where they have a key presence.

Furthermore, **Javier Pareja** explained that the purpose of the newsletter would be to increase the visibility of the working group's activities by providing timely information on working group initiatives, recommendations and reports. Subgroup 7 would coordinate production and distribution of the newsletter, the content of which would be approved by the chair of the working group and the chairs of its subgroups. The newsletter would be published on the ECB website and distributed to, for example, ambassadors and banking and market associations.

Subsequently, **Olivier Hubert (BPCE/Natixis), Pierre Jenft (HSBC)** and **Juan Cebrián (CaixaBank)** from the three Subgroup 7 work streams updated the working group on their activities, including the objectives, target audience, materials to be produced, communication channels and timeline.

6. Other business

6.1 Update on the public letter from the Sterling working group on risk-free rates to the European Commission

Working group members were informed that on 23 October 2019, the Working Group on Sterling Risk-Free Reference Rates had sent a public letter to the European Commission on pan-European regulatory barriers to transitioning away from LIBOR and other IBORs. Members of the working group on euro risk-free rates took note that some of the issues highlighted in the letter are also of relevance for the euro benchmarks reform and have been addressed in the report by the working group on the risk management implications[5]. In particular, they recalled that their letter to the IASB and the letter on EMIR margin requirements touched upon similar issues. The working group agreed that a similar initiative would not be necessary at this stage in the context of the euro benchmarks reform, but could be contemplated in the coming months.

6.2. Update on the BMR Review by the European Commission

The European Commission recalled that it had launched a public consultation on the review of the EU Benchmarks Regulation in October 2019. The objective of this consultation was to gather feedback on the functioning of the EU benchmarks regime, two years after its entry into application. The consultation focused primarily on the regime for critical benchmarks and the effectiveness of the mechanism for the authorisation and registration of EU benchmark administrators. Issues such as the categorisation of benchmarks and the rules for third country benchmarks were also touched upon. In the subsequent discussion, the European Commission representative recalled that the consultation was a balanced document, and that it touched upon the robustness of critical benchmarks as well as issues around orderly cessation of critical benchmarks. The European Commission encouraged all the working group members to provide their feedback before the end of the consultation period on 31 December 2019. On the basis of the responses received, the European Commission would prepare a report to the European Parliament and Council by April 2020.

6.3. Any other business

The next meeting of the working group would take place at the ECB on 27 February 2020, from 11:00 to 16:00 CET.

[5] See: https://www.ecb.europa.eu/pub/pdf/other/ecb.wgeurofr_riskmanagementimplicationstransitioneoniaeurostrfallbackseuribor~156067d893.en.pdf

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 Carlos Pardo
BBVA	Mr José Manuel González-Páramo
BNP Paribas	Mr Patrick Chauvet
BNP Paribas	Ms Dominique Le Masson
BPCE/Natixis	Ms Sophie Asselot
BPCE/Natixis	Mr Olivier Hubert
CaixaBank, S.A.	Mr Juan Cebrián
CaixaBank, S.A.	Mr Francesc Xavier Combis Comas
Crédit Agricole	Mr Carlos Molinas
Deutsche Bank	Mr Christian Gau
Deutsche Bank	Mr Jürgen Sklarczyk
DZ Bank	Mr Philipp Nordloh
DZ Bank	Mr Michael Schneider
Erste Group Bank AG	Mr Neil Mcleod
Eurobank-Ergasias SA	Mr Theodoros Stamatiou
HSBC	Mr Pierre Jenft
ING Bank	Mr Jaap Kes
ING Bank	Ms Johanneke Weitjens
Intesa Sanpaolo	Ms Maria Cristina Lege
KfW Bankengruppe	Mr Markus Schmidtchen
KfW Bankengruppe	Mr Ingo Ostermann
LBBW	Mr Jan Misch
Santander	Mr Javier Pareja
Santander	Mr Oscar García Maceiras
Société Générale	Mr Olivier Balpe
Société Générale	Mr Stephane Cuny
UniCredit Bank	Mr Alberto Covin

Non-voting members

European Money Markets Institute	Ms Petra De Deyne
International Capital Market Association	Mr David Hiscock
International Swaps and Derivatives Association	Mr Graham Bryant
Loan Market Association	Ms Kam Mahil

Invited institutions

European Investment Bank	Mr Thomas Schröder
Generali	Ms Anna Kozhevnikova

Observers

European Central Bank	Ms Cornelia Holthausen
European Central Bank	Mr Helmut Wacket
European Commission	Mr Tilman Lueder
European Commission	Ms Alessandra Atripaldi
European Securities and Markets Authority	Mr Michele Mazzoni
Financial Services and Markets Authority	Mr Randy Priem

Secretariat

European Central Bank	Ms Anne-Lise Nguyen
European Central Bank	Ms Yasmina Santalla Pérez
European Central Bank	Mr Mikael Stenström
European Central Bank	Mr Pascal Nicoloso
European Central Bank	Mr Vladimir Tsonchev
European Central Bank	Mr Armin Greif
European Central Bank	Mr William Lelieveldt