EUROPEAN CENTRAL BANK

EUROSYSTEM

ECB-PUBLIC
26 July 2018

Meeting of the working group on euro risk-free rates

held in Frankfurt am Main on Thursday 11 July 2018, 11:00-16:00 CET

SUMMARY

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

Mr Timmermans (Chair) welcomed the meeting participants and reminded the working group members of their obligations under EU competition law, as described in the guidelines on EU competition law published on the ECB's website.

2. Potential scenario for EONIA and Euribor: timeline issues

Mr Kes (ING) informed the working group about several developments and pieces of information that should be taken into account in the potential scenarios for EONIA and Euribor. First, the publication of ESTER (Euro Short-Term Rate, one of the euro risk-free rate (RFR) candidates) on a daily basis by October 2019.[1] Second, that in the United States, the Alternative Reference Rates Committee estimated in its ''Paced Transition Plan'' that it would need more than three years to develop a derivative market based on the Secured Overnight Funding Rate (SOFR) from the start of its daily publication. He also emphasised that market participants and associations generally find the timeline scenarios for transition at best challenging or too tight. Given EONIA's non-compliance with the EU Benchmarks Regulation (BMR), its usage in new contracts should be restricted as of 1 January 2020. At the same time, there is uncertainty as to Euribor's compliance with the BMR.

The working group agreed to work on a high-level transition plan for all potential scenarios around EONIA and Euribor, to be presented at the next working group meeting in September 2018.

3. Deliverables of work stream 1 - Selecting the risk-free rate(s)

3.1. Update on the public consultation on the candidate RFRs

Mr Giannopoulos (Barclays) recalled that the public consultation on the three candidate RFRs (ESTER, GC Pooling Deferred and RepoFunds Rate) was ongoing until 13 July, cob. The market feedback will be published on the ECB's website in mid-August. Working group members will have no prior knowledge of this feedback. Voting members of the working group will be able to take the feedback into consideration in their own reflections ahead of the vote on the euro RFR recommendation.
The ECB Secretariat also informed the group that a proposal for an additional RFR candidate had been received through the procedure for benchmark providers advertised on the ECB's website.[2] An initial assessment of the proposal against the selection criteria adopted by the working group on euro risk-free rates in April 2018 concluded that there was no basis for proceeding with an in-depth analysis. More specifically, the rate would not be based on real, at arm's length transactions and it will not be provided by a benchmark provider. The working group approved the draft rejection letter of this application by written procedure.

3.2. Presentation of ESTER by the ECB

Mr Nicoloso (ECB) presented the future ECB rate, ESTER, which will be published by October 2019. He reminded the working group that the rate will be calculated as a trimmed weighted average rate of the eligible unsecured borrowing transactions, based on the ECB Regulation on money market statistical reporting (MMSR).
Working group members asked about certain methodological features of ESTER, the verifications of the eligible transactions, as well as the contingency procedures. A few members insisted on the need to extend the MMSR

[1] See: http://www.ecb.europa.eu/press/pr/date/2018/html/ecb.pr180628.en.html

[2] See http://www.ecb.europa.eu/paym/initiatives/interest_rate_benchmarks/WG_euro_risk-free_rates/html/index.en.html

scope beyond the current 52 reporting agents in order to improve the geographical representativeness of the benchmark.

Asked about the announced projected start date of ESTER production (by October 2019) – particularly in view of the industry transition needs and the projected daily release time of the rate (by 9:00) – Cornelia Holthausen and Holger Neuhaus confirmed that, pending the outcome of internal systems and procedures testing, the ECB would also assess whether, and to what extent, the start date and timing could be accelerated.

3.3. Information on the decision-making procedure on the euro RFR

The Chair and the ECB Secretariat informed the working group on the following steps regarding the choice of the euro RFR.

After the publication of the market feedback on the three candidate RFRs in mid-August 2018, each of the 21 voting members will prepare the vote on behalf of its own institution. The ECB Secretariat will compile the votes, which will remain anonymous to the group. If a decision is reached, the recommended euro RFR will be announced to the working group and published on the ECB's website simultaneously. Such a decision will ideally be taken at the next working group meeting on 13 September. Consistent with the working group's terms of reference, a two-thirds majority is required for a working group decision.

4. Establishment of Subgroup 4 on EONIA transition

The working group decided to establish an additional Subgroup 4 dedicated to the EONIA transition given the following considerations: (i) the very tight timeline for an EONIA replacement, as discussed under Item 2; (ii) the context of the Subgroup 2 discussions, which showed the difficulties of defining a term structure without a clear view on the EONIA scenarios and transition possibilities. In light of the concerns expressed by certain working group members as regards the creation of a further sub-group, it was agreed that, in order to avoid overlap and ensure suitable collaboration with the other subgroups, a clear scope should be defined for this subgroup in addition to its terms of reference. Both the terms of reference and the composition of this subgroup will be published on the ECB's website.

Ms Mariotti (Crédit Agricole) representing the Chair of the new subgroup, Mr Molinas, indicated that, on the one hand, this is a horizontal topic for which coordination with the other subgroups is essential, while on the other hand, it is market sensitive and thus requires a specific and exclusive work stream. The working group members should signal to Crédit Agricole their interest in participating in the new subgroup as soon as possible. Additional institutions will also be integrated in Subgroup 4, either from the already established subgroups, or through the call for applications to substructures which remains open on the ECB's website.

5. Update by Subgroup 2 on the identification and recommendation of a term structure on RFRs

Mr Chauvet (BNP Paribas) updated the working group on the Subgroup 2 governance and organisation. Some technical changes will be made to the terms of reference of Subgroup 2, notably to take into account the work on establishing a liquid derivatives market based on the new RFR – a prerequisite for deriving term structures. He reported on the first informal interactions with participants of the Sterling Working Group in the United Kingdom and the Alternative Reference Rates Committee in the United States. Among the main points of interest for the working group, he underlined that both groups were thinking about a potential coexistence of both forward-looking and backward-looking methodologies to compute a term rate, depending on the asset class and usage.

The leaders of the three Subgroup 2 work streams subsequently informed the working group on the progress made by their respective work stream.

Mr McLeod (Erste Bank) outlined a timeline for establishing liquid overnight index swaps (OIS) and centrally cleared derivatives markets, pointing to a 18-24 months preparation time as of the announcement of the preferred new RFR by the working group, followed by a liquidity growth phase ranging from 12 to 14 months. He also outlined the work plan for studying term RFR methodological options.

Mr Infesta (Santander) presented the evaluation template which will be used for assessing the different methodological options against IOSCO Principles[3].

Mr O'Farrell (Unicredit) reported that the subgroup dealing with end-user requirements was assessing the possibility of the coexistence of several methodologies (backward and forward), accounting for the specificities of different financial products.

Mr Boudghene (EIB) summarised the key messages from a survey at working group level on the usage of term rates. The definition of an RFR term structure is deemed important for both legacy and new contracts, while three-month and six-month benchmarks are seen as the most important tenors. The instruments identified as being most dependent on a term rate were interest rate derivatives, retail products and syndicated loans. Regarding the preferred data inputs to be used in the term rate construction, MMSR and repositories data seemed to be preferred over panel banks' data. The consistency with other jurisdictions was also underlined as a key issue.

The discussion by the working group members centred around the methodological options as well as the pros and cons of data sources used in fixing term rates.

Subgroup 2 will present the working group in September 2018 with a complete list of the pros and cons of different methodological options, as well as with selection criteria and work plan steps for narrowing the list down to the final options to be recommended.

6. Update of Subgroup 3 on contractual robustness

6.1. Presentation of the Subgroup 3 interim report on the legal analysis by asset class and country

Mr Gonzalez-Páramo and **Mr Fraguas** (both **BBVA**) updated the working group on the progress of Subgroup 3.

Subgroup 3 presented a draft report on the legal frameworks applicable for all asset classes in the euro area. Subgroup 3 will prepare an executive summary for the next working group meeting in September. The conclusions will not be made public until more progress has been made. The preliminary findings of the subgroup showed that there are no (or few) workable fallback provisions in place that would cater for the permanent cessation of existing reference rates. For legacy contracts, legal frameworks and market legal practices do not ensure a smooth transition to a new reference rate. Hence, the transition to a successor benchmark with legal certainty is not ensured. Subgroup 3 will analyse the legal options in the following months. For some asset classes, a legal change would be necessary, while other products would require lenders and obligors' agreements, in some cases on a bilateral or multilateral basis.

6.2. Update on developing new temporary fallback language in new contracts

Subgroup 3 is also working on developing good practices in temporary fallback language in new contracts. Indeed, from January 2018, the EU Benchmarks Regulation requires banks to include fallback rates in new contracts, where feasible and appropriate. However, as alternative reference rates to EONIA and Euribor are not yet defined, these fallbacks can only be temporary. A more in-depth analysis on a possible fallback template will be provided to the working group in the following working group meetings.

7. Information on benchmark reforms

7.1. Loan Market Association to present their change in documentation for the replacement of screen rate clause

Ms Mahil (LMA) presented the recent changes to the ''replacement of screen rate clause[4]'' in the LMA documentation. These changes seek to increase the flexibility to make changes in the future to include a replacement benchmark with a lower consent threshold than may otherwise be required in a wider range of circumstances.

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[3] After a thorough analysis, the assessment of the term rate methodologies will not refer to any EU Benchmarks Regulation provisions as these do not focus on methodological considerations (contrary to IOSCO principles).

4 "Screen Rate" is a defined term which sets out, in relation to a relevant benchmark rate e.g. Euribor, the administrator of the rate and the screen or other public source on which the rate can be found.

The new changes should facilitate the inclusion of a replacement benchmark which (i) is formally selected as a replacement for the screen rate by the administrator or by an appropriate regulator; or (ii) is otherwise accepted by the relevant markets; or (iii) is deemed appropriate by the requisite majority of lenders and the obligors.

While practical difficulties could arise in the implementation of these clauses (e.g. obtaining the requisite consent), the changes provide future flexibility in the absence of current clarity on an appropriate replacement rate for loans and require the parties to address the approach to potential LIBOR or Euribor discontinuation.

7.2. Update from ISDA on: (i) its international survey and report on global benchmark transition; (ii) the future amendment of its documentation.

Mr Mc Gonagle (ISDA) gave an update on a few recent ISDA initiatives at international level, i.e. also applying to some non-euro currencies.

He presented ISDA's work on implementing contractual fallbacks that would apply if a major interbank offered rate (IBOR) was permanently discontinued. The fallbacks will apply upon the permanent discontinuation of the relevant IBOR (based on pre-determined, objective triggers) and will be the relevant alternative risk-free rate, subject to term and spread adjustments. ISDA is conducting a market-wide consultation on the methodologies that should be used to adjust transactions which fall back in this way, in particular for determining a credit spread and term structure adjustment.

Once finalised, ISDA will amend the 2006 ISDA Definitions to incorporate these fallbacks. It is expected that ISDA will also publish a protocol to amend legacy contracts. With respect to Euribor, the fallbacks will not be implemented until the alternative RFR has been selected by the working group, published by the administrator (where not already published) and has been given time to be adopted. In the interim, the 2018 Benchmark Supplement may apply (if adopted by parties).

He presented the Benchmark Supplement, which ISDA is preparing in response to Article 28(2) of the Benchmarks Regulation. The Benchmark Supplement will implement fallbacks to all of the interest rate benchmarks referenced in the 2006 ISDA Definitions (including EONIA and EURIBOR). The fallbacks would operate in the event of a cessation of a benchmark or if a benchmark does not become, or ceases to be, authorised for use in the European Union under Article 35 of the Benchmarks Regulation.

In the subsequent discussion with working group members, ISDA and LMA noted that trade associations are in cooperation in developing their fallback language, but underlined that their solutions could not be perfectly aligned given the differences in their respective products.

Finally, the working group discussed the results of the recent IBOR transition survey gauging market readiness to transition away from certain IBORs and adopt alternative risk-free rates. The overwhelming message from the report is that market participants have to start the process of transitioning now in order to protect themselves against the systemic risks posed by over-reliance on IBORs.

8. Other business: planning the next meeting and follow-up

The next meeting of the working group will take place in Frankfurt am Main at the ECB on Thursday 13 September 2018.

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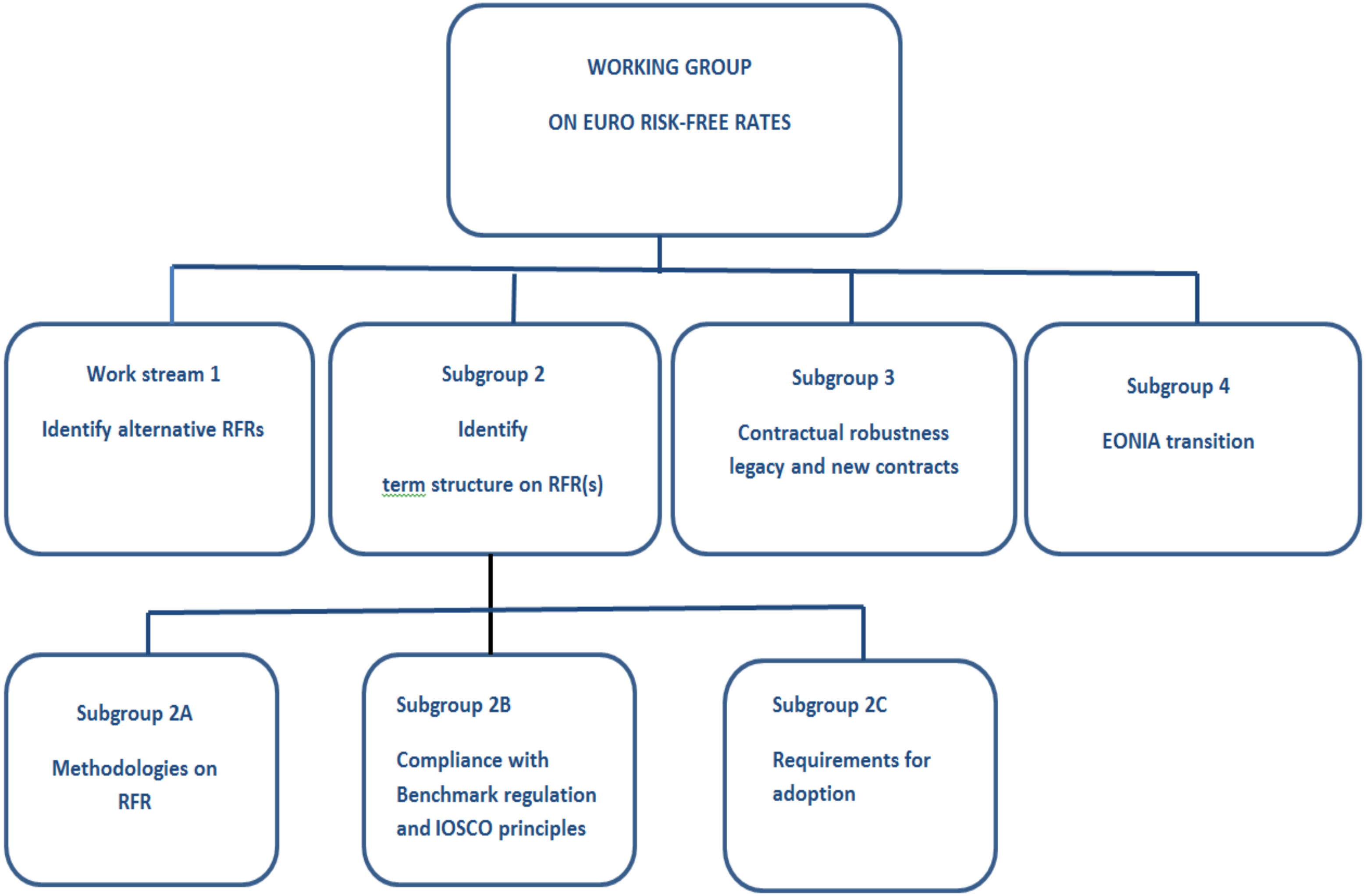

List of meeting participants

Participant's organisation	Name of participant
Chairperson	Mr Koos Timmermans
ING	Ms Johanneke Weitjens
Voting members	
Bank of Ireland	Mr Barry Moran
Barclays	Mr Sascha Weil
Barclays	Mr Andreas Giannopoulos
Bayerische Landesbank	Mr Harald Endres
BBVA	Mr José-Manuel Gonzalez-Páramo
BBVA	Mr Adolfo Fraguas
BBVA	Mr José Carlos Pardo
BNP	Mr Patrick Chauvet
BPCE/Natixis	Mr Olivier Hubert
BPCE/Natixis	Ms Sophie Asselot
CaixaBank, S.A.	Mr Juan Cebrian
CaixaBank, S.A.	Mr Javier Pano
Crédit Agricole	Ms Florence Mariotti
Deutsche Bank	Mr Juergen Sklarczyk
DZ Bank	Mr Michael Schneider
DZ Bank	Mr Philipp Nordloh
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 Marjolein de Jong-Knol
Intesa Sanpaolo	Mr Marco Antonio Bertotti
KfW Bankengruppe	Mr Markus Schmidtchen
KfW Bankengruppe	Mr Ingo Ostermann
LBBW	Mr Jan Misch
Santander	Mr José Manuel Campa
Santander	Mr Carlos Infesta Fernández
Société Générale	Mr Stéphane Cuny
Société Générale	Mr Olivier Balpe
UniCredit Bank Ireland p.l.c	Mr John O'Farrell

Non-voting members

European Money Markets Institute	Mr Alberto Lopez Martin
European Money Markets Institute	Ms Gaëlle Marques dos Santos
International Swaps and Derivatives Association	Mr Ciaran McGonagle
International Swaps and Derivatives Association	Ms Julia Rodkiewicz
Loan Market Association	Ms Kam Mahil

Invited institution

European Investment Bank	Mr Yassine Boudghene

Observers

European Central Bank	Ms Cornelia Holthausen
European Central Bank	Mr Holger Neuhaus
European Securities and Markets Authority	Mr Jakobus Feldkamp
European Securities and Markets Authority	Ms Elena Brannetti
Financial Services and Markets Authority	Mr Rik Hansen
European Commission	Ms Alessandra Atripaldi

Other

Secretariat

European Central Bank	Ms Anne-Lise Nguyen
European Central Bank	Mr Philippe Molitor
European Central Bank	Mr Pascal Nicoloso
European Central Bank	Ms Yasmina Santalla Pérez
European Central Bank	Mr Vladimir Tsonchev