

Working group on euro risk-free rates Terms of reference for subgroup 5 on cash products and derivatives

1. Background

In September 2017 the European Central Bank (ECB), the Financial Services and Markets Authority (FSMA), the European Securities and Markets Authority (ESMA) and the European Commission announced the launch of the working group on euro risk-free rates (RFRs). This working group was tasked with the identification and adoption of RFRs to serve as a basis for an alternative to the current benchmarks used in a variety of financial instruments and contracts in the euro area.

The working group decided to set up several work streams to elaborate on more specific proposals to address the challenges of the “preparation phase”.

- Work stream 1 – identify and recommend (an) alternative RFR(s)
- Work stream 2 – identify and recommend a term structure for RFR(s)
- Work stream 3 – contractual robustness for legacy and new contracts
- Work stream 4 – transition from EONIA to the alternative RFR(s)

For work streams 2, 3 and 4 dedicated subgroups have been created.

Now, a year after its creation, the working group on euro risk-free rates is aiming to ensure that its recommendations are adopted by all market participants. The working group has set up additional work streams and related subgroups for this “market adoption” phase.

- Work stream 5 – adoption by cash products and derivatives
- Work stream 6 – financial accounting and risk management issues
- Work stream 7 – communication to and education of market participants

These terms of reference set out the detailed objectives, governance, membership, work, reporting and transparency arrangements applicable to the subgroup on cash products and derivatives (“subgroup 5”).

2. Objectives and output

Subgroup 5 is tasked with investigating, on a product-by-product basis and from an operational and valuation standpoint, (i) how to support market participants wishing to transition from EONIA to the €STR, in view of the discontinuation of EONIA after 2021; and (ii) how to enable market participants to embed fallbacks to Euribor based on a €STR-based term structure methodology (both forward-looking and/or backward-looking) as a Euribor contingency measure so as to avoid market disruption in the event that market participants choose these methodologies as fallbacks.

This includes the following tasks:

- detailing the discounting regime to facilitate the transition from EONIA to the €STR;
- designing a possible methodology for closing out or transitioning any legacy EONIA exposure and, in particular, a possible compensation mechanism to smooth out the effects of the transition from EONIA to the €STR;
- identifying use cases for the €STR in cash products;



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- establishing a liquid €STR derivatives market to provide an alternative to the current EONIA derivatives market and to construct the recommended €STR-based term structure methodology as a fallback to Euribor (preparations will require the involvement of market participants, trading venues and clearing houses, among others, to ensure this market will materialise);
- analysing and proposing recommendations concerning (i) how the €STR-based forward-looking and backward-looking term structures can co-exist as potential fallbacks to Euribor and (ii) the most relevant Euribor fallback methodology for each financial product, e.g. discussing and reviewing a €STR-based term structure methodology as a fallback to Euribor for both retail products and non-retail products;
- liaising with the International Swaps and Derivatives Association (ISDA) and similar initiatives in other jurisdictions via the Alternative Reference Rates Committee (ARRC) working group on cross currency swaps to ensure international coordination;
- identifying the possible system and infrastructure issues that will arise owing to the transition and providing guidance for market participants on how to mitigate these issues.

NB: Target dates differ for EONIA and Euribor, with EONIA the more pressing issue.

In the performance of its tasks, subgroup 5 will carefully consider how best to avoid potential conflicts of interest and conduct risks, especially in relation to the proposed “forward-looking” €STR-based term structure methodologies.

Subgroup 5 will ensure that coordination and collaboration with other work streams is efficient and effective so as to avoid overlaps with the tasks and deliverables of the other subgroups and to ensure timely progress on the working group’s output.

3. Chair

Subgroup 5 should be co-chaired by a working group member and a representative of the buy-side. The Chair of the working group, in consultation with the public institutions, appoints the Chairs of subgroup 5 taking into account the expertise and experience of the member and the buy-side representative, as well as the profile of the institutions they represent.

4. Membership

A call for applications to participate in the different subgroups remains open on the ECB’s website. The selection procedure is led by the Chair of the working group, the Chairs of the subgroups and the ECB Secretariat, with the support of the public institutions that act as observers in the working group (the European Commission, the Belgian FSMA and ESMA).

The selected institutions are chosen on the basis of several factors. First, their motivation and their commitment to providing support to the subgroup are considered. In addition, the institutions are selected with a view to including a variety of interests and perspectives, including some beyond the horizon of the credit institutions and, in particular, some representing the buy-side. Finally, geographical representativeness is also considered.

Representatives from the ECB, ESMA, the European Commission and the FSMA are given the opportunity to participate in subgroups as observers and the European Commission provides subgroup 5 with its Secretariat.



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Where appropriate, subgroup 5 may consult, directly or through other subgroups, with a broad cross-section of market participants. This will be done through the publication of consultative papers, hosting roundtable events, or through other suitable approaches. The types of market participants that may be invited to attend, or be consulted, include, but are not limited to: investment firms; asset managers; trading firms and other firms that may wish to use or trade RFR-referencing derivative instruments; market infrastructure firms with experience in developing products for regulated trading platforms; and firms that specialise in providing liquidity to these platforms.

5. Governance

Subgroup 5 will take decisions by consensus. If no consensus is reached, the Chairs of subgroup 5 will present the diverging proposals, options or views to the working group for agreement.

6. Reporting and transparency

Subgroup 5 will provide regular updates to the working group on its progress. These updates may take the form of letters, reports, emails or presentations to the working group. The verbal or written updates will be part of the minutes or documents published following each working group meeting.

7. Competition policy, conflicts of interest and member responsibilities

It is the responsibility of working group and work stream members to ensure that they understand their responsibilities under all applicable competition laws, including EU competition law. The competition law compliance policy agreed at the working group level applies equally to all work streams set up by the working group.