

Meeting of the working group on euro risk-free rates

Held in Frankfurt am Main on Wednesday, 27 February 2019, 08:30 to 12:30

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 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. Update on the legislative procedure for amending the EU Benchmarks Regulation as regards transitional provisions

Tilman Lüder (European Commission) updated the working group on the latest developments regarding a political agreement on amendments to the EU Benchmarks Regulation (BMR), which could provide for a two-year extension to the transitional period for critical benchmarks. This amendment would allow non-compliant critical benchmarks to be used until the end of 2021.

On 25 February 2019, the Presidency and the European Parliament reached a political agreement on low-carbon benchmarks. That agreement includes a two-year extension to the BMR's transitional provisions for critical benchmarks. It also extends the period of time that a competent supervisory authority can impose mandatory contributions to critical benchmarks from two to five years. Finally, it also extends the transitional period for third-country benchmarks. That agreement now needs to be formally adopted by both the Council and the European Parliament's plenary in April 2019.

The working group's members welcomed the two-year extension to the transitional period, which was consistent with the request made by the working group in September 2018. The Chair of the working group recalled that the two-year extension was aimed at giving market participants sufficient time to develop the usage of more robust benchmarks. The European Commission also specified that the extension should not be a reason to delay the authorisation process for critical benchmarks. Consequently, no timeline changes should be envisaged for the authorisation process, either for the EURIBOR, or for the EONIA in the case its methodology were to be "recalibrated" (as envisaged by the working group).

The European Commission reiterated the importance of the EURIBOR being authorised by the end of 2019, as maintaining a euro term rate was in the public interest, especially given the EURIBOR's key role in the European retail and mortgage sectors. In this regard, the ability to impose mandatory contributions for five years (as opposed to two) showed that the public interest imperative was being taken seriously. The European Commission also expressed confidence that, with the necessary reforms, the EURIBOR had good medium-term prospects and said that contributors should recognise the value of joining its panel.

The Chair of the working group thanked the European Commission for its statement in support of the EURIBOR in the medium term. Together with the FSMA's earlier conclusion that the EURIBOR's reformed methodology provided a solid basis for a robust EURIBOR, that supportive message from the European Commission confirmed the working group's working assumption that the EURIBOR should become BMR-compliant once the hybrid methodology had been finalised in the second half of 2019 and that the EMMI would become an authorised benchmark administrator for the EURIBOR. The Chair also agreed that non-contributing banks should join the EURIBOR panel in order to support the robustness and sustainability of the EURIBOR.

The Chair also recalled that, as a contingency measure to avoid future financial instability, the BMR requires supervised EU users to include a fallback provision in their contracts. Consequently, the working group will continue its work on the establishment of credible alternative benchmarks to the EURIBOR

which can be used as fallback rates in contracts referencing the EURIBOR, in order to ensure the robustness of those contracts and thus financial stability across the European Union.

3. Discussion regarding recommendations on the transition from the EONIA to ESTER

3.1. Summary of feedback on EONIA transition report

Yasmina Santalla Pérez (ECB Secretariat) presented a summary of the feedback that had been received on the report regarding the transition from the EONIA to ESTER that had been published on 20 December. 63 respondents had provided feedback, and that sample was sufficiently broad in terms of its geographical coverage and its representation of the various sub-sectors. The responses were very supportive of the working group's recommendations, with 97% of respondents regarding a time-limited recalibration with a spread and clean discounting as the most appropriate path for a smooth and orderly transition from the EONIA to ESTER. A significant number of respondents recognised the benefit of having the recalibrated EONIA authorised and supervised (89%) until its publication deadline at the end of 2021 (90%). However, some respondents requested greater clarity with regard to (i) the applicable discounting regime and (ii) the methodology for closing out or transitioning any legacy exposures on the succession date. Although a time limit for the publication of the EONIA was regarded as the most effective incentive for accelerating the transition to ESTER, other ideas were proposed, such as promoting ESTER-linked issuances and increasing communication and providing direction to the market.

Finally, as regards the time that was needed for systems to be ready for T+1 publication of ESTER (and thus the EONIA, if recalibrated), a wide range of responses were given, from 1 to 24 months. The most common reply was 6 months, followed by 9 and 12 months. It was noted, however, that the recalibration of the EONIA with a switch to T+1 would not leave that much time for preparation, as it should take place on the same day as the launch of ESTER – i.e. by October 2019. It was emphasised that readiness across market participants was essential in order for a smooth-functioning ESTER market to develop.

3.2. Final recommendations on the transition from the EONIA to ESTER and the next steps for endorsement

Carlos Molinas (Crédit Agricole), the Chair of Subgroup 4 on the transition from the EONIA to ESTER, proposed that the recommendations set out in the working group's report of 20 December be left unchanged, given the very positive feedback received in response to the consultation.

However, he suggested that three clarifications could be considered (see clarifications and final recommendations of the working group in an annex to these minutes):

- As regards the clean discounting regime, he clarified that the concept of "clean discounting" would apply at counterparty level, with only one curve to be used for each counterparty pair. This approach stemmed from a desire for simplicity, especially for unsophisticated users, and a desire to encourage counterparties to move in a single step (i.e. to transition both legacy contracts and new contracts to ESTER in one step).
- As regards the methodology for calculating the spread between the EONIA and ESTER, he suggested that, in order to avoid any ambiguity, the final recommendations of the working group could be supplemented with more detailed information regarding the 15% trimming mechanism (exclusion of both the lowest 15% of values and the highest 15% of values).
- In addition, he specified that the spread should be calculated on the basis of the latest publicly available data, i.e. the 12-month observation period should be based on the latest pre-ESTER data series available at the time of the calculation of the spread.

Alberto López Martín (EMMI) confirmed that the working group's final recommendations to the EMMI as presented would be taken up by the EMMI once the working group had formally voted on the matter. He also presented details of the timeline that was envisaged by the EMMI if the final recommendations were adopted in March. In particular, he said:

- A launch date around October 2019 for ESTER would give the EMMI sufficient time to complete all the necessary steps to modify the EONIA's methodology as recommended.
- The working group's recommendation not to allow the parallel publication of ESTER and the EONIA as calculated under the current methodology would limit the time that market participants had to prepare for a change in the publication time of the EONIA.

- While the EMMI would lead the recommended change to the EONIA's methodology, it would prefer not to calculate the EONIA-ESTER spread for the recalibration and would rather see a third party performing that calculation on the basis of a methodology put forward by Subgroup 4 and the latest publicly available data. In response to a question from the Chair regarding the entity that would calculate the EONIA-ESTER spread, **Cornelia Holthausen (ECB)** said that internal debates were taking place within the ECB on whether such a role could be performed by the ECB, and that a decision would probably be announced in the next few weeks.

In a subsequent discussion, **Randy Priem (FSMA)** commended the working group for its recommendations. A few working group members inquired about the timeline for the EMMI to apply to the FSMA for authorisation, and for the FSMA to assess its compliance, and asked whether all of these decisions could take place before the first day of publication of the EONIA under the methodology recommended by the working group. The current timing was still uncertain and depended on various external factors and procedures, but both the EMMI and the FSMA were committed to expediting the process to the extent possible. In addition, the European Commission indicated that under the BMR administrators of benchmarks can apply for authorisation for single benchmarks if they so wish.

Following a request by the Chair, the working group endorsed the recommendations as proposed, including the above-mentioned clarifications. A formal vote on this set of recommendations will take place via written procedure, with the outcome being announced on 14 March.

3.3. Pending tasks in relation to the transition from the EONIA to ESTER

Carlos Molinas (Crédit Agricole) indicated that Subgroup 4 had identified two pending tasks that could assist with the transition from the EONIA to ESTER:

- Analysis of a possible compensation payment methodology to facilitate the calculation of compensation payments when moving the computation framework from the recalibrated EONIA to ESTER. That compensation payment could entail: (i) the establishment of high-level steps and standard parameters in order to compute a compensation payment (valuation dates and times, settlement dates, zero coupon methodology, spreads, etc.); (ii) the identification of potential data sources as inputs for the computation methodology; and (iii) the establishment of a high-level formula with some high-level examples;
- Establishment of an EONIA-ESTER transition protocol. Subgroup 4 also considered it beneficial to have a documentation protocol that would help to coordinate the transition of legacy contracts from the EONIA to ESTER. This point could be addressed by Subgroup 3 through the EONIA legal action plan.

4. Discussion regarding recommendations on term rate methodologies

4.1. Summary of feedback on the public consultation on ESTER-based term rates

Stephanie Broks (ECB) summarised the feedback on the public consultation on determining an ESTER-based forward-looking term structure that could be used as a fallback in EURIBOR-linked contracts. As stipulated in the consultation, the working group would ultimately conduct further analysis of both the backward- and forward-looking approaches as potential fallbacks for EURIBOR-linked contracts.

73 respondents had provided feedback on the consultation. For each asset class considered (and particularly in the case of corporate lending, floating rate notes, securitisation structures, and retail loans and mortgages), the majority of respondents considered it essential or desirable to have a forward-looking term rate methodology as a fallback for the EURIBOR. Many respondents stressed that consistency across asset classes was required, while others asked for consistency across jurisdictions to the extent possible. Stephanie Broks pointed out that, given the ongoing work of the ISDA and developments in other jurisdictions, it would probably not be feasible to use a forward-looking term rate and achieve consistency across products and jurisdictions at the same time.

Respondents broadly agreed with the working group's analysis of the four forward-looking methodologies considered (i.e. the OIS transactions-based methodology, the OIS quotes-based methodology, the OIS composite methodology, and the futures-based methodology), and they largely agreed with the working group's conclusions regarding a point-in-time fixing. 77% of respondents agreed with the working group's assessment that the OIS quotes-based methodology offered the best prospect of producing a viable forward-looking fallback rate within a reasonable time period following the launch of the daily publication of ESTER. At the same time, respondents highlighted a number of issues and challenges that would need to

be addressed in order for the OIS quotes-based methodology to be feasible, such as the need for further development of electronic trading, the need to ensure that a sufficient number of market participants provided tradeable quotes, the minimisation of manipulation risk, and the clarification of a number of methodological details.

4.2. Final recommendations on ESTER-based term rates and next steps for endorsement

4.3. Update on next steps for Subgroup2

Dominique Le Masson (BNP Paribas) noted that the public consultation had elicited a decent number of responses and that the feedback provided suggested strong support for the working group's analysis. She highlighted the feedback received on the preference for a forward-looking term rate as a fallback for the EURIBOR. She pointed out that the majority of respondents for each asset class (including derivatives) viewed a forward-looking rate as essential or desirable, and that consistency across asset classes was seen as key. Consistency with other jurisdictions was also required by market participants, although that could be a challenge if forward-looking methodologies were chosen as fallbacks for the EURIBOR in the future. She also highlighted the feedback received on the analysis of the OIS quotes-based methodology and the point-in-time fixing, with a clear roadmap and timeline for the implementation of the methodology being required.

Dominique Le Masson presented the draft recommendation on the preferred calculation methodology for a forward-looking term structure that could be used as a fallback in EURIBOR-linked contracts. This would be submitted to the working group for a vote with a view to a final recommendation being adopted on 14 March. The recommendation would be to use the OIS quotes-based methodology, subject to a successful transition from the EONIA to ESTER, with several conditions to be met. She stressed that communication around the working group's recommendation would need to address the following issues: (i) the ISDA's ongoing work on fallbacks for derivatives; (ii) the potential feasibility of a futures-based methodology in the future, depending on market developments; and (iii) the fact that the working group was working on fallback rates, as opposed to replacement rates.

Dominique Le Masson went on to present details of the steps to be taken in the next few months: (i) analysis of the most relevant methodology for fallbacks for the EURIBOR by asset class, including an analysis of how forward-looking and backward-looking methodologies could co-exist; (ii) the establishment of a road map and timeline for the implementation of the OIS quotes-based methodology; (iii) a discussion on how to deal with the choice of administrator for the OIS quotes-based methodology (i.e. who would make the choice and how, as the working group would not be responsible for choosing an administrator, since this could result in conflicts of interest); (iv) analysis of fallback triggers and spread methodologies; and (v) cooperation with other fora.

Working group members noted that a number of issues had yet to be resolved and asked several questions (asking, for example, how the potential use of a forward-looking methodology tallied with the work of the ISDA, whether backward-looking methodologies would be analysed separately, and what the role of the working group would be with regard to potential administrators). Dominique Le Masson explained that these issues would be addressed in the next steps document that was due to be published on the ECB's website after the next meeting of the working group.

Following a request by the Chair, the working group endorsed the recommendations as proposed. A formal vote on this set of recommendations will take place via written procedure, with the outcome being announced on 14 March.

4.4. Market consultation on adjustment spreads for fallbacks for cash products and transition of legacy documents

Kam Mahil (LMA) informed the working group about an initiative by the Working Group on Sterling Risk-Free Reference Rates, which had agreed with a proposal by its loan and bond markets subgroup, for a market consultation on adjustment spreads for fallbacks and transitioning legacy deals for cash products. That consultation would make reference to the work of the ISDA on adjustment spreads for fallbacks for derivatives and would seek feedback on whether the proposed ISDA methodology for an adjustment spread was appropriate in the context of the cash markets (particularly if the fallback rate was different from that used in the derivatives market), and if not, what other options were available.

As the sterling groups considered it important to work towards achieving consistency across currencies (given the incidence of multicurrency cash products), they were now reaching out to working groups in other jurisdictions to discuss the possibility of those working groups joining this work project. Kam Mahil enquired as to whether the working group on euro risk-free rates would be interested in joining in these discussions, which was confirmed by the Chair.

5. Update from Subgroup 3 on the EONIA legal action plan and work programme for 2019

Adolfo Fraguas Bachiller (BBVA) informed the working group that Allen & Overy had become a member of the subgroup on contractual robustness. That subgroup now includes three international law firms (Allen & Overy, Clifford Chance and Linklaters), which were selected on the basis of their broad experience in the financial sector and the fact that they have a presence in most European countries. The list of members on the ECB's website will be updated accordingly.

Adolfo Fraguas Bachiller also updated the working group on Subgroup 3's next deliverable: a legal action plan for the transition from the EONIA to ESTER. That legal action plan should be submitted for public consultation in May, before being adopted by the working group in July. The action plan is expected to be implemented gradually by all market participants once ESTER is launched. It will cover both legacy contracts and new contracts for all asset classes.

The EONIA legal action plan will put forward several recommendations for amending legacy contracts by asset classes – e.g. by means of protocols, bilateral negotiations and the introduction of robust fallback language.

The working group took note of the work undertaken by Subgroup 3, and noted that it would be given a further update at the next working group meeting, with possible recommendations being discussed ahead of the consultation on the EONIA legal action plan.

6. Presentation of a proposal for a reorganisation and next steps for the working group

Jaap Kes (ING) expressed his gratitude to the various subgroups for all the important work that had been undertaken over the last 12 months. He explained that it is very important that the existing subgroups continue to deliver on their important tasks.

However, given that the working group on euro risk-free rates was about to conclude its preparatory phase, he said that it was now time to reconsider the structure of the working group to allow for a smooth adoption by the market. The proposed reorganisation of the subgroups was aimed at better delivering on the challenges lying ahead as regards the benchmarks transition. The main purpose of the suggested change was to increase the involvement of the industry by inviting a broader range of market participants to join the different substructures.

Jaap Kes explained that the working group needed to move towards the next phase, where these rates would be adopted by market participants, with an impact on activities across the entire value chain. Rather than having separate groups dealing with the transition from the EONIA to ESTER and “term rate methodologies”, one proposal would be to move towards a more integrated approach based on topics and to open up participation in the subgroups to a broader range of market actors. In this regard, the ECB Secretariat reminded members that the call for expressions of interest in the subgroups was still open on the ECB's website and that applications were still being received and considered.

The working group debated the deliverables of the new groups and made a few suggestions. Working group members will send their suggestions to the ECB Secretariat in preparation for a more detailed discussion at their next meeting.

7. Any other business

7.1. EMMI to present the results of its second public consultation on the EURIBOR hybrid methodology

Alberto López Martín (EMMI) updated the working group on the results of the EMMI's second public consultation on the EURIBOR hybrid methodology. The consultation closed in November 2018 and feedback was received from 37 respondents. The EMMI received broad support for the proposals put

forward. Alberto López Martín confirmed that the next step was for the EMMI to apply to the FSMA, by the second quarter of 2019, for authorisation under the BMR as the administrator of the EURIBOR and to start phasing in the EURIBOR hybrid methodology in that quarter.

Some working group members asked for further information on the phasing-in of the hybrid methodology. Alberto López Martín explained that panel banks would transition progressively to the hybrid methodology and that the FSMA was aware of all details of the phasing-in process. He confirmed that the phasing-in would begin shortly after the EMMI had submitted its application for authorisation to the FSMA.

7.2. Next meeting

It was agreed that the next meeting of the working group would take place at the ECB on Thursday, 14 March 2019, from 11:00 to 16:00.

Annex 1. Proposed recommendations of the working group on euro risk-free rates, to be voted on by the working group

1. Proposed recommendations on the transition from the EONIA to ESTER and other transition modalities

1. The working group recommends that the European Money Markets Institute (EMMI), as the administrator of EONIA, takes the following steps before 1 January 2020:
 - a) Modify the current EONIA methodology to become ESTER plus a spread for a limited period, in accordance with Financial Stability Board (FSB) recommendations and IOSCO Principles for Financial Benchmarks to further anchor EONIA's methodology in transactions;
 - b) Engage with the relevant authorities to ensure the compliance of EONIA, under its evolved methodology, with the EU Benchmarks Regulation;
 - c) Consider and consult market participants on discontinuing the publication of EONIA under its evolved methodology, after a transition period that ensures firms can achieve transition to ESTER in a smooth manner and that pays due regard of the existing EONIA legacy book. This transition period should last until the end of 2021, which is consistent with benchmarks transitions in other jurisdictions.
2. The working group also invites EMMI to take the following considerations into account:
 - a) Consider an EONIA-ESTER spread methodology based on a simple average with an observation period of at least 12 months, combined with a 15% trimming mechanism;
 - b) That the recalibration methodology and the effective determination of the spread are announced at the same time before ESTER's first day of publication;
 - c) That the recalibration date is on the first day of ESTER's publication for simplicity reasons.
3. The working group recommends that market participants gradually replace EONIA with ESTER as a reference rate for all products and contracts and make all adjustments necessary for using ESTER as their standard benchmark after the transition period (including making the appropriate changes to their systems to enable a T+1 publication).
4. The working group encourages market participants to make all reasonable efforts to replace EONIA with ESTER as a basis for collateral interest for both legacy and new trades with each of its counterparties (clean discounting).

The working group is providing the following clarifications in response to market feedback received via the public consultation:

- The clean discounting regime is to be applied at counterparty level, with only one curve to be used for each counterparty pair. This approach stems from a desire for simplicity, especially for unsophisticated users. In practice, counterparties A and B could choose either the EONIA or ESTER as the basis for discounting. Once they have agreed, a single curve would be used for all of their bilateral transactions, whether for their legacy book or their forward book. The agreement between A and B does not prevent counterparty B from using a different benchmark with counterparty C, so long as a single curve is used for all transactions between B and C.
- As regards the methodology for calculating the EONIA-ESTER spread, the suggested 15% trimming mechanism applied to the spread should be understood as the exclusion of both the lowest 15% of values and the highest 15% of values, so effectively using 70% of the data to compute the average¹.

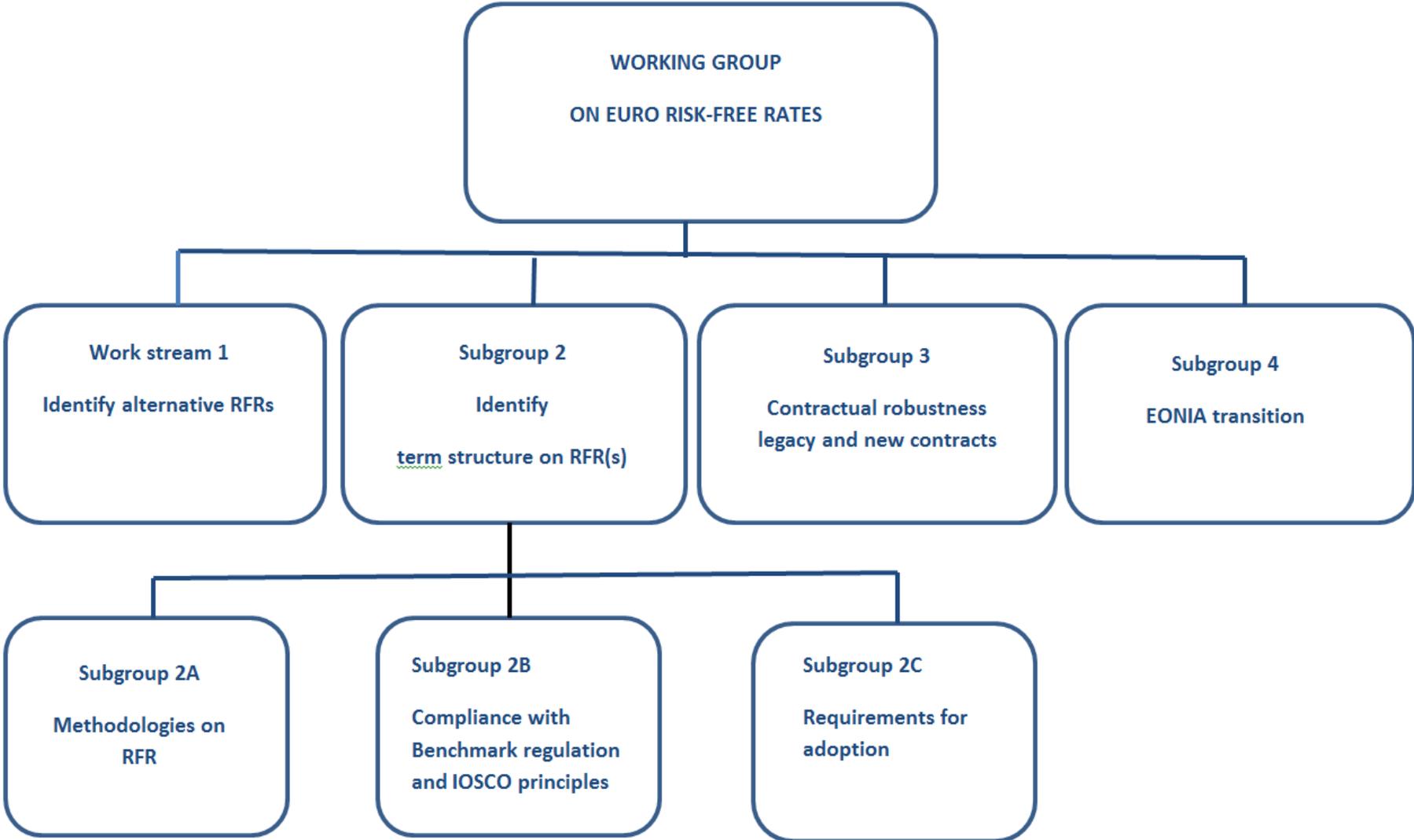
¹ Erratum: one of the annexes to the EONIA transition report (Annex 8.2) should be corrected in this regard, with a corrected version of the report being published in the next few weeks to avoid any ambiguity.

- The calculation of the EONIA-ESTER spread should be based on the latest publicly available data, i.e. the 12-month observation period should be based on the latest pre-ESTER data series available at the time of the announcement of the spread.

2. Proposed recommendation for a forward-looking ESTER-based term structure methodology that could function as a fallback for the EURIBOR

- The working group recommends the OIS (tradable) quotes-based methodology as the ESTER-based forward-looking term structure methodology as a fallback for EURIBOR-linked contracts within a reasonable time period following the launch of the daily publication of ESTER.

- It acknowledges that a successful transition from the EONIA to ESTER is needed, with (i) significant transfer of liquidity to ESTER OIS markets, (ii) a transparent and regulated underlying derivatives markets, such as trading on multilateral trading facilities (MTFs), and (iii) sufficient sources of data.



List of meeting participants

Chair

ING

Mr Steven van Rijswijk

Ms Marjolein de Jong-Knol

Voting members

Bank of Ireland

Mr Barry Moran

Barclays

Mr Joseph McQuade

Barclays

Mr Andreas Giannopoulos

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

BNP Paribas

Mr David Gorans

BNP Paribas

Mr Patrick Chauvet

BPCE/Natixis

Mr Olivier Hubert

BPCE/Natixis

Ms Sophie Asselot

CaixaBank SA

Mr Juan Cebrián Torallas

CaixaBank SA

Mr Javier Pano

Crédit Agricole

Mr Carlos Molinas

Crédit Agricole

Ms Florence Mariotti

Deutsche Bank

Mr Jürgen Sklarczyk

DZ Bank

Mr Michael Schneider

DZ Bank

Mr Philipp Nordloh

Erste Group Bank AG

Mr René Brunner

Eurobank Ergasias SA

Mr Theodoros Stamatou

ING Bank

Mr Jaap Kes

ING Bank

Ms Johanneke Weitjens

Intesa Sanpaolo

Ms Maria Cristina Lege

KfW Bankengruppe

Mr Markus Schmidtchen

LBBW

Mr Jan Misch

Nordea

Mr Lars Eric Franck

Santander

Mr José Manuel Campa

Société Générale

Mr Olivier Balpe

Société Générale

Mr Stéphane Cuny

UniCredit Bank

Mr Alberto Covin

Non-voting members

European Fund and Asset Management Association
European Money Markets Institute
International Capital Market Association
International Swaps and Derivatives Association
Loan Market Association

Ms Agathi Pafili
Mr Alberto López Martín
Mr David Hiscock
Mr Rick Sandilands
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Invited institution

European Investment Bank

Mr Yassine Boudghene

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