

Working group on euro risk-free rates - Terms of reference for subgroup 2 on the identification and recommendation of a term structure on RFRs

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) (hereinafter 'working group'), 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 at its first meeting to set up three workstreams to flesh out more specific proposals:

- workstream 1 - Identify and recommend alternative RFR(s);
- workstream 2 - Identify and recommend term structure on RFR(s);
- workstream 3 - Contractual robustness for legacy and new contracts.

For workstreams 2 and 3, dedicated subgroups have been created. These terms of reference define the detailed objectives, governance, membership, work, reporting and transparency arrangements applicable to subgroup 2.

2. Objectives and output

The working group tasked subgroup 2 with producing the following deliverables:

- explore the possible fallback arrangements for Euribor;
- determine and recommend a term structure methodology on RFR(s) as a fallback in Euribor-linked contracts.

The working group has further provided the following guidance:

- The applicable methodology needs to be compliant with the EU Benchmark Regulation.
- The methodology ideally needs to be applicable also to alternative RFRs in the case Euribor does not become registered with ESMA by end-2019.
- The subgroup may consider the work already ongoing in the relevant International Swaps and Derivatives Association (ISDA) currency groups, given ISDA's mandate by the Financial Stability Board (FSB) to work on the interbank offered rates (IBORs) fallback methodologies as regards the derivative industry. However, the working group should not restrict itself only to the work already carried out by ISDA and should also take into consideration the broader usage of Euribor, i.e. beyond the derivatives market.
- The scope covers all financial products referencing existing interest rate benchmarks.

Subgroup 2 will initially organise its work along three substructures:

- Group 2A tasked with assessing available methodological approaches to constructing term rates for selected RFR(s);
- Group 2B tasked with evaluating the legal and compliance implications of assessed methodologies including their compliance with IOSCO principles and the provisions of the EU Benchmark Regulation;
- Group 2C tasked with identifying requirements that enable a broad-based adoption of a new term structure and working out framework proposals ensuring their implementation. The group will also look at issues related to the potential spread adjustment.

Subgroup 2 may set up additional groups or discontinue existing ones as it deems most effective for delivering on its tasks.

3. Chair

The Chair of subgroup 2 should be a working group member. The working group Chair in consultation with the public institutions appoints the Chair of workstream 2 based on experience, expertise and the institution's profile.

4. Membership

A call for applications to participate in subgroup 2 was published on the ECB's website. The selection procedure was led by the working group Chair, the Secretariat and the other public institutions. The selected institutions were chosen on the basis of their motivations and their commitment to providing support to the subgroup. In addition, the institutions were selected with a view to including a variety of interests and perspectives, beyond the horizon of the credit institutions. Geographical representativeness was also considered.

Representatives from the ECB, ESMA, the European Commission and the FSMA are given the opportunity to participate in subgroup 2 as observers and the ECB will provide its Secretariat.

Subgroup 2 may consult with a broad cross-section of market participants where appropriate, through the publication of consultative papers, hosting roundtable events, or other suitable approaches. The types of market participants who may be invited to attend, or be consulted, includes but is not limited to: investment firms; asset managers; trading firms and others who may wish to use or trade RFR-referencing derivative instruments; market infrastructure firms with experience in developing products for regulated trading platforms; and firms which specialise in providing liquidity to these platforms.

5. Governance

Subgroup 2 shall take decisions by the consensus of its members. In case no consensus is reached, the Chair will present the diverging proposals, options or views to the working group for agreement.

6. Reporting and transparency

Subgroup 2 will make regular updates to the working group in the form of letters to or presentations at 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 workstream 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 workstreams set up by the working group.