Interest rate benchmarks

This issue of the ICMA Quarterly Report includes two feature articles relating to work on interest rate benchmarks and the transition from IBORs to risk-free rates, including details of several relevant recent developments.

On 7 March 2019, ESMA published a statement on its approach to the application of some key MiFID II/MiFIR and EU BMR provisions should the UK leave the EU under a no-deal Brexit. Regarding the EU BMR this sets out details regarding the ESMA register of administrators and third country benchmarks. Subsequently, on 13 March, the FCA published a statement on various MiFID obligations and the BMR if the UK leaves the EU without an implementation period. This highlights that the FCA will be setting up a UK public register of benchmarks and administrators authorised in the UK. In a further statement, on 22 March, the FCA then expanded on details of its plan to introduce a UK Benchmarks Register.

Previously, on 7 January 2019, EMMI announced Banca Monte dei Paschi di Siena's withdrawal from the panel of banks contributing to the EURIBOR benchmark, with immediate effect. Following this, the panel of banks contributing to EURIBOR consists of 19 banks.

On 21 January, the €RFR WG published a paper, *Guiding Principles for Fallback Provisions in New Contracts for Euro-Denominated Cash Products*. This paper offers an overview of the legal frameworks and market practices applicable to cash products, such as mortgages, loans and bonds, that reference EURIBOR and EONIA, with a specific focus on fallback clauses. It is important that market participants prepare for the transition to RFRs and the paper proposes a set of guiding principles promoting the use of effective fallback provisions in new contracts for euro-denominated cash products. In the course of 2019, the €RFR WG intends to recommend more detailed fallback language to be used in legacy and new euro-denominated contracts.

The Alternative Reference Rates Committee (ARRC) is publishing frequently asked questions, which are updated from time to time to reflect developments, in order to provide information about the work of the ARRC, its progress to date and the overall effort to promote voluntary market adoption of its recommended alternative to US$ LIBOR, SOFR. The latest updated set was published by the ARRC on 31 January. The ARRC also posted an updated timeline of key milestones.

The National Working Group on Swiss Franc Reference Rates (NWG) met, on 5 February, to discuss current challenges in respect of the LIBOR transition in Switzerland and relevant international developments. At its previous meeting, in October 2018, the NWG recommended using a compounded SARON as a term rate alternative to the CHF LIBOR, wherever possible. The key item in this latest meeting was a discussion of the options for using a compounded SARON in cash products. The NWG members agreed on the following main recommendations: (i) market participants should consider and assess the options presented for using a compounded SARON; (ii) financial institutions should individually define action plans with respect to their product strategy; and (iii) exchanges are encouraged to facilitate the listing of SARON FRNs.

On 12 February, EMMI published a summary of stakeholder feedback on the *Second Consultation Paper on a Hybrid Methodology for EURIBOR*. This consultation is part of EMMI's commitment to deliver a reformed and robust methodology for EURIBOR, which aims to meet regulatory and stakeholder expectations in a timely manner. Feedback that was received shows broad support for EMMI's proposals. EMMI will file for authorisation to the Belgian FSMA by Q2 2019. Subsequently, EMMI will start transitioning panel banks from the current EURIBOR methodology to the hybrid methodology, with a view to finishing the process before the end of 2019.

IBA launched a survey on the use of LIBOR on 4 December 2018. The survey was open to all users of LIBOR and was designed to identify the LIBOR settings that are most widely used. The survey closed on 15 February and the results have been published on IBA's website.

On 22 February, the summaries of responses on the feedback received on the €RFR WG's report on the

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transition from EONIA to ESTER and to the second public consultation on determining an ESTER-based term structure were published on the ECB website.

On 25 February, the European Commission issued a press release welcoming agreement on a new generation of low-carbon benchmarks. Importantly, this announcement includes confirmation that, "separately, the EU institutions also agreed to grant providers of "critical benchmarks" – interest rates such as EURIBOR or EONIA – two extra years until 31 December 2021 to comply with the new Benchmark Regulation requirements. Given the crucial importance of third-country benchmarks for EU companies, the extra two years for benchmarks produced outside the EU was also introduced to provide additional time for work with non-EU regulators on how these benchmarks can be recognised as equivalent or otherwise endorsed for use in the EU."

Further technical talks follow from this political agreement, for the finalisation of the text, and COREPER and the European Parliament will have to formally adopt the new rules before they can enter into force. This agreement is also affirmed in a parallel announcement from the European Council, which states that, "finally, the text reviews existing provisions of the benchmarks regulation by providing an extension of the transition regime for critical and third-country benchmarks until the end of 2021."

On 5 March, the BIS published its latest quarterly review, which includes a special feature *Beyond LIBOR: A Primer on the New Benchmark Rates*. In this, the authors provide an overview of RFRs that will form the backbone of the new benchmark regime and compare some of their key properties with IBORs. Finding a one-size-fits-all benchmark for every currency may be neither feasible nor desirable, so that several types of reference rate may ultimately coexist.

A letter to ISDA, dated 12 March, from the Co-Chairs of the FSB's Official Sector Steering Group (OSSG) of regulators and central banks addressed the topic of derivative contract robustness to risks of interest rate benchmark discontinuation. The OSSG thank ISDA for its engagement and work so far in consulting on options for adopting more robust fallback language for derivatives referencing key IBORs.

The Co-Chairs welcome the very thoughtful and comprehensive responses that ISDA has received from market participants in its consultation for sterling LIBOR, Swiss franc LIBOR, Japanese yen LIBOR and TIBOR, and the Australian dollar BBSW. As ISDA now moves towards it final decisions for these currencies with this feedback in hand, three issues are raised which the OSSG views as particularly important and that they believe ISDA is moving to address: (i) the addition of other trigger events; (ii) the timing for an ISDA consultation on US dollar LIBOR and certain other IBORs; and (iii) the governance and transparency necessary as ISDA makes its final decisions.

On 12 March, the ECB announced that ESTER will henceforth be known as €STR. Following on from this, on 14 March, the ECB issued a press release confirming that it will start publishing €STR as of 2 October 2019, reflecting the trading activity of 1 October 2019. Additionally, the ECB is ready to further support private sector efforts in the transition away from EONIA and will provide the computation of a one-off spread between €STR and EONIA, as requested by the €RFR WG and calculated by the ECB according to the methodology publicly recommended by the €RFR WG. The resulting spread will be communicated on the day on which the change in the methodology of EONIA is announced and will be based on the pre-€STR and EONIA data as publicly available.

Also on 14 March, the ECB reported that the €RFR WG has endorsed recommendations to market participants regarding (i) the transition from EONIA to €STR; and (ii) the calculation of a €STR-based term structure. Among other things,

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the €RFR WG recommends that market participants gradually replace EONIA with €STR for all products and contracts, making €STR their standard reference rate and making certain adjustments to their IT systems. The €RFR WG recommended that EONIA's administrator, EMMI, modify the current EONIA methodology to become €STR plus a spread, for a limited period of time in order to give market participants sufficient time to transition to €STR. EMMI is also requested to engage with the relevant authorities to ensure that EONIA, under its evolved methodology, complies with the EU BMR. The €RFR WG also recommended a methodology for calculating that spread.

Finally, the €RFR WG recommended a methodology for calculating a forward-looking term structure based on €STR derivatives markets that could be used as a fallback in EURIBOR-linked contracts. The €RFR WG will now analyse further both the backward- and forward-looking approaches as potential fallbacks for EURIBOR, acknowledging work being done in other currency areas as well as by ISDA, which has announced the launch of a consultation on determining a fallback for EURIBOR-linked derivatives contracts following the start of the publication of €STR.

On 20 March, EMMI announced a public consultation on the change in the methodology of EONIA, as recommended by the €RFR WG. By conducting this consultation, EMMI intends to raise awareness of the implications of the suggested changes and ensure a timely preparation for the upcoming changes by EONIA's users.

On 19 December 2017, ESMA issued an announcement that it would, as from 3 January (ESMA's first working day of 2018), begin publishing registers of administrators, with over 30 now duly registered, and third country benchmarks, with 65,749 benchmarks (of which 10 relate to a Swiss administrator, with the BaFin as the relevant EU authority, and the remainder all relate to a single US administrator, with the AFM as the relevant EU authority) now duly registered, in accordance with Article 36 of the EU BMR.

In view of ESMA's statutory role to build a common supervisory culture by promoting common supervisory approaches and practices, ESMA has established a process for adopting Q&A documents which relate to the consistent application of the BMR. The most recent update was published on 30 January.

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