4 December 2023

Working Group on Euro Risk-Free Rates: Final Statement

1 Working Group on Euro Risk-Free Rates

The working group on euro risk-free rates (Working Group) was initially established in 2018 by the ECB together with the Belgian Financial Services and Markets Authority (FSMA), the European Securities and Markets Authority (ESMA) and the European Commission to identify and recommend risk-free rates that could serve as an alternative to prevailing interest rate benchmarks.

ECB provided the Working Group's secretariat from its inception[1]. On 13th September 2018, the Working Group recommended[2] that the Euro Short-Term Rate (€STR) be used as the risk-free rate for the euro area. On 11th May 2021, a broad-ranging set of recommendations were published[3] for both EURIBOR fallback trigger events and €STR-based EURIBOR fallback rates. This completed the initial mandate[4] of the Working Group and the secretariat was transferred to ESMA[5].

After the transfer of the secretariat to ESMA, an amended mandate[6] for the Working Group was established aiming to promote interest rate reform in the EU by:

- Fostering the use of €STR in financial products,
- Assessing the availability of EURIBOR fallback rates,
- Identifying impediments to the timely adoption of EURIBOR fallback provisions, and
- Identifying potential issues related to the impact of LIBOR discontinuation in the EU.

2 EURIBOR

A multiple-rate environment operates in the eurozone. The European Money Markets Institute (EMMI) is the administrator of EURIBOR, published in 5 tenors from 1 week to 12 months, while the ECB is the administrator of €STR, an overnight rate.

On 3rd July 2019, EMMI was granted authorisation[7] by the Belgian FSMA under Article 34 of the EU Benchmark regulations (EU BMR) for the provision of EURIBOR with the hybrid methodology. On 1st January 2022, ESMA replaced the Belgian FSMA as supervisor of EMMI.

Robust fallback language enhances legal certainty for market participants by increasing contract robustness and, at the same time, ensures compliance with Article 28(2) of the EU BMR. On 28th July 2023, the Financial Stability Board published[8] key messages reiterating the importance of the adoption of effective fallback provisions.

Given the systemic importance of EURIBOR in the EU, robust EURIBOR fallbacks contribute to preserve financial stability and orderly markets. While EURIBOR is not scheduled to be discontinued, this should not be a justification to avoid or delay implementing suitable fallback provisions.

It remains crucial that market participants continue to work on the incorporation of robust contractual fallbacks in all products referencing EURIBOR. The Working Group has previously stressed the importance of including robust fallbacks in all financial contracts, not just those within the scope of the EU BMR. As explained in the following sections, there is now no impediment to the full implementation of EURIBOR fallback provisions.

3 Euro Short Term Rate

After many years of diligent preparation, the market successfully transitioned from EONIA to €STR at the end of 2021. Since then, the Working Group has continuously monitored market developments, making recommendations[9,10] on improving liquidity in €STR-based derivatives.

Between Q2 2021 and Q3 2023, the percentage of new, euro-denominated interest rate derivative contracts referencing €STR in the EU has increased from less than 10% to more than 30% based on the latest data presented by ISDA to the Working Group.

Furthermore, during significant market volatility at the end of Q1 this year, liquidity in interest rate derivatives referencing both €STR and EURIBOR remained in place throughout the period. This demonstrates improvement in financial stability from both market developments and interest rate benchmark reforms over the last decade.

This increase in market liquidity has enabled providers to publish forward-looking Term Rate versions of €STR (term €STR). Term €STR is a fundamental enabler to the adoption of €STR-based fallbacks, as it is one of the fallback rates recommended by the Working Group on 11th May 2021.

In the bond and loan markets, the predominant benchmark remains EURIBOR reflecting both the continued availability of EURIBOR and preferences of the majority of market participants. However, there has been widespread adoption of €STR in shorter dated products such as securities lending, repurchase agreements, deposits, overdrafts and swingline facilities.

To conclude, there has been an increasing adoption of €STR in derivative markets and further adoption in a variety of financial products meeting the objective of the Working Group to foster the use of €STR.

4 Fallback Triggers

On 11th May 2021, the Working Group issued recommendations[3] on EURIBOR fallback trigger events. The Working Group encourages market participants to ensure these are reviewed and implemented across their portfolios. A summary of the elements of the EURIBOR fallback provisions and their availability was published in Annex I of the minutes[11] of the Working Group meeting of July 2023.

5 Term €STR Rates

The recommendations[3] on €STR-based EURIBOR fallback rates published on 11th May 2021 set out two methodologies for the calculation of the fallback rate: backward-looking term structures (i.e. compounded €STR) and forward-looking term structures (i.e. term €STR). The May 2021 recommendations set out the use cases for a forward-looking term structure. For such use, the Working Group recommended that market participants use a simple two-level waterfall fallback structure with forward-looking term structure on the first level and backward-looking term structure on the second level.

Following a call for interest[12] issued by the Working Group on 3rd March 2022, two administrators presented their plans to the Group and have subsequently gone live with the publication of term €STR rates.

On 13th June 2022 EMMI, started publishing[13] the beta version of its own term €STR rate EFTERM (Euro Forward Looking Term Rate). EFTERM went live on 14th November 2022 with ICE Benchmark Administration Limited acting as calculation agent.

On 20th September 2022, Refinitiv started publishing[14] the beta version of the Refinitiv Term €STR rate. Refinitiv Term €STR went live on 26th September 2023. Following this launch the benchmark has been renamed FTSE Term €STR.

The Working Group encourages market participants to consider their choice of reference rates and use benchmarks, whether as principal interest rates or as fallbacks, that are robust, suitable, sustainable, and compatible with the relevant guidance and regulation. More Information on both term €STR rates is set out in a comparative table published by the Working Group[15].

To conclude, now that forward-looking €STR rates (term €STR rates) are available alongside the already existing backward-looking €STR, the Working Group has met its objective of assessing the availability of EURIBOR fallback rates and there is no impediment to the full implementation of the Working Group May 2021 recommendations on EURIBOR fallbacks provisions.

6 €STR-based fallbacks

In Q3 2023, the secretariat of the Working Group launched among the Working Group members a survey on the adoption of fallback provisions in EURIBOR contracts. The goal of the survey was to measure the level of adoption of EURIBOR fallback provisions across different asset classes and gather the views of market participants on any residual obstacles towards the incorporation of fallbacks. The following observations are based on the aggregate information received in this survey which may provide useful orientation but not in all circumstances be representative of all outstanding transactions across the market.

In derivatives, we observe broad-based adoption of robust fallbacks in new and legacy transactions with strong market-wide mechanisms in place to facilitate transition. These are driven by the protocols delivered by ISDA on this matter[16]. Market participants are encouraged to review transactions with less standard documentation in order to ensure fallback clauses are robust.

According to the results of the survey, among the cash products, mortgages and loans are the asset classes with the lower implementation of robust fallbacks provisions in line with recommendations of this Working Group. This means that additional effort is needed to increase their contractual robustness.

In relation to mortgages, since their features differ across EU Member States, the Working Group encourages market participants and the public sector at national level to work together on the necessary steps to be taken for the adoption of robust fallbacks in mortgages in their local jurisdictions.

In relation to bilateral and syndicated loans, on 4th May 2023 the Working Group published[17] Guidance on EURIBOR Fallbacks for Corporate Lending Products. The Loan Market Association (LMA) have subsequently published[18] updated loan documentation which reflects this guidance. The Working Group Guidance and the updated LMA loan documentation should contribute to an increased adoption of fallbacks in new and refinanced corporate lending products.

While the Working Group does not represent the totality of the market and not all Working Group members replied to the survey, the results clearly indicate the need for all stakeholders to continue focusing on the inclusion of fallbacks in all types of contracts. Cash products, including mortgages, must embed suitable fallback provisions to increase legal certainty, enhance financial stability and, when applicable, comply with Article 28(2) of BMR.

7 Looking Forward

It was a remarkable achievement that the discontinuation of all panel-based LIBOR settings, including USD LIBOR on 30th June 2023, passed so smoothly. This represents a testament to the partnership and focus of market participants and the public sector for over a decade.

For market participants in the EU that continue to use non-representative 1, 3, 6 months synthetic USD LIBOR, the Working Group recommends transitioning contracts to appropriate alternatives well in advance of their permanent cessation in September 2024[19].

In relation to EURIBOR, while this rate is not scheduled to be discontinued, market participants have additional work to do in the adoption of viable fallbacks in line with the Working Group recommendations.

Summary

Regulators, industry bodies and market participants have prepared and cooperated for more than a decade to anchor financial markets to more robust, transparent and sustainable interest rate benchmarks. The Working Group encourages all firms to consider the use of €STR across asset classes and to increase their efforts in adopting €STR-based fallbacks in line with the recommendations of this Working Group, other relevant guidance and regulation.

The global interest rates reform has been a multi-year international effort underpinned by a strong common interest between the private and public sectors. In the EU, the Working Group has represented the forum in which public authorities and market participants (including banks, market infrastructures and industry associations) collaborated towards a common goal: sounder and more resilient interest rate benchmarks. At its meeting on 13th November 2023, the Working Group agreed that the current mandate had been completed and that the Group in its current form will cease. However, ESMA will continue to monitor developments in the EU benchmarks landscape (including in respect of areas noted above where market participants need to take further action) and will contact the Working Group’s participants again in the future where necessary, depending on market developments related to interest rate benchmarks.

The Chair and the secretariat of the Working Group would like therefore to thank all members, observers, guests, and contributors to the Working Group, in both private and public sectors, for their participation to the achievements of the Working Group’s goals.

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This paper discusses a variety of options relating to the introduction of fallback trigger events and fallback rates for contracts and financial instruments referencing EURIBOR. Recipients of this paper are responsible for making their own assessments as to the suitability of the various options discussed herein. Recipients must continue to operate in an independent and competitive manner and they should not use the content of this document to coordinate their activities in breach of applicable law.

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