Letter from the Chairman of the EUR Risk Free Rates Working Group to the European Commission

Dear Mr Lueder,

I am writing to you on behalf of the Euro Risk Free Rates Working Group ("RFRWG") to request your support with regards to the transition from EONIA to the Euro Short Term Rate ("€STR"). One of the mandates of the RFRWG is to identify impediments to the transition to €STR and to recommend workable solutions. The challenge described forthwith relating to the transition of financial products to €STR was identified in the last RFRWG meeting on 1 July 2021 and it was unanimously agreed that we propose to the European Commission the designation of a statutory replacement rate for EONIA as part of a comprehensive solution for cash and derivative products.

In its "**Recommendations on the EONIA to €STR legal action plan**"[1], the RFRWG recommended that:

(1) the primary objective of market participants should be to actively transition EONIA exposures to €STR flat; and

(2) a robust fallback to €STR+8.5 basis points should be incorporated into new and legacy contracts that continued to reference EONIA.

Despite many quarters of focussed effort and active engagement, including from key central counterparties such as LCH and Eurex and trade associations such as ISDA, many market participants have faced long bilateral renegotiation processes with their clients. The global pandemic and Brexit have also hindered efforts to effectively and efficiently conclude these renegotiations, with many clients being unable to prioritise requests, unable to commit to transitioning before the end of the year or simply unresponsive. With EONIA's discontinuation on 3 January 2022 less than 6 months away, contingency plans will have to be triggered for contracts and transactions referencing EONIA without successful renegotiation. Clients would face uncertainty on the future performance of their contracts leading to potential confusion and the need for parties to implement divergent operational solutions.

Whilst there is no readily available public data repository for the scale of the challenges identified, the RFRWG conducted a short survey to assess exposures across the derivative market making community in order to provide an estimate of the size of the risk. Across the 19 members of the RFRWG who provided data across all jurisdictions (not solely in the EU) we report 40,564 derivative contracts with direct EONIA exposure, 34,378 Credit Support Annexes (CSA) with EONIA references and a total of EUR 16,967 billion notional across the two. On average these members estimate that they are 46% of the way through their EONIA derivative transition effort with 6 months remaining. If the Commission would like additional data to support its decision making the RFRWG members are more than willing to provide it.

Given the slow pace of transition resulting from these challenges, the RFRWG identified the designation of €STR plus 8.5 basis points as the replacement for EONIA as a workable and essential next step in mitigating the transition risk ahead of the rapidly approaching cessation event. The

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[1] https://www.ecb.europa.eu/pub/pdf/annex/ecb.sp190314_annex_recommendation.en.pdf

RFRWG did explore alternative options, including but not limited to the potential EONIA Collateral Agreement Fallbacks Protocol currently under ISDA assessment, but given the primary issue is engagement from counterparties more generally and the fact that such ISDA Protocol is not intended to cover local collateral agreements or non-derivative agreements, it was concluded that these would not materially reduce the transition risk the market faces.

The proposed replacement rate of €STR plus 8.5 basis points has been recommended by the RFRWG since 2019,it has received broad support by market participants and importantly, it ensures that there is no day 1 value transfer between two counterparties at cessation. The RFRWG recognises that the primary objective of market participants should remain to actively transition to €STR flat which is in line with the approach of key central counterparties such as the LCH and Eurex and ensures homogeneity in risk management across the market. Any decision made by the Commission to designate a statutory replacement should not impede progress of market participants actively transitioning to €STR flat.

The new designation powers accorded to the Commission under recent amendments to the Benchmarks Regulation is a welcome step in ensuring benchmark transition does not cause undue disruption to the economy and provides clarity and transparency to market participants and end users. I appreciate your willingness to consider designating the replacement rate for EONIA, which will provide legal certainty and assurances to in-scope market participants that the proposed replacement rate is appropriate, and does not result in disadvantageous outcomes for end users. We recognise that based on Article 23a of the Benchmark Regulation, not all contracts would be in scope of a statutory replacement decision, however, in combination with on-going industry initiatives, such as ISDA's forthcoming EONIA Collateral Agreement Protocol and the scheduled transitions at key central counterparties, this designation will also maintain the ongoing market integrity in the EEA when EONIA is discontinued on 3rd January 2022.

Given that the discontinuation of EONIA is less than six months away, I would like to highlight the importance of having a statutory solution in place before the end of Q3 2021 to enable reprioritisation of resources across the market to focus on the many critical deliverables required to achieve a successful transition to risk free rates for benchmarks ceasing at the end of the year. I look forward to your consideration of this point and would welcome feedback in due course.

Yours Sincerely
James von Moltke
Chairman of the EUR Risk Free Rates Working Group