

Benchmark Regulations: Operational roadmap and timelines

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Benchmark Regulations...

Article 51.4

- The EU Benchmark Regulation (BMR) has set the deadline of 1 January 2020 for new compliant benchmarks.
- After the 1 January 2020 deadline, only EU BMR compliant benchmarks may be used in new contracts.
- For existing contracts, non-compliant benchmarks can still be used subject to a decision by the competent authority of the Member State where the index provider is located.

Article 28.2

- As of 1 January 2018, benchmark users are required to produce and maintain robust written plans setting out the actions they would take in the event that a benchmark they are using materially changes or ceases to be provided.
- ESMA considers that users are required to reflect such plans in contracts entered into after 1 January 2018.
- For contracts closed before 2018, ESMA expects that contracts will be amended where practicable and on a best-effort basis.

...require actions for both EONIA and EURIBOR within tight timelines.

Potential scenarios for EONIA and EURIBOR				Timelines and required actions under the Benchmark Regulations	
Benchmark	Scenario	BMR compliant by 2020	Continuing and FSMA approved*	From 2018 to 2020	As of 2020
EONIA	1	X	✓	Under all scenarios for EONIA and EURIBOR: <ul style="list-style-type: none"> As of 1 January 2018, benchmark users are required to produce and maintain robust written plans setting out the actions they would take in the event that a benchmark they are using materially changes or ceases to be provided. 	<ul style="list-style-type: none"> New O/N RFR + Term Structure and fall back levels are required for new contracts as of 2020. Contracts closed before 2020 could still use EONIA under the condition that this benchmark is continuing and accepted by the FSMA.
	2	X	X		<ul style="list-style-type: none"> New O/N RFR + Term Structure and fall back levels are required for both legacy and new contracts.
EURIBOR	3	✓	✓	<ul style="list-style-type: none"> ESMA considers that users are required to reflect such plans in contracts entered into after 1 January 2018. For contracts closed before 2018, ESMA expects that contracts will be amended where practicable and on a best-effort basis. 	<ul style="list-style-type: none"> Reformed EURIBOR can be used for legacy and new contracts. New O/N RFR + Term Structure are required for fall back purposes.
	4	X	✓		<ul style="list-style-type: none"> New O/N RFR + Term Structure** and fall back levels are required for new contracts as of 2020. Contracts closed before 2020 could still use EURIBOR under the condition that this benchmark is continuing and accepted by the FSMA.
	5	X	X		<ul style="list-style-type: none"> New O/N RFR + Term structure** and fall back levels are required for both legacy contracts and new contracts. This scenario would give rise to large transition challenges (refer to appendix for high level overview).

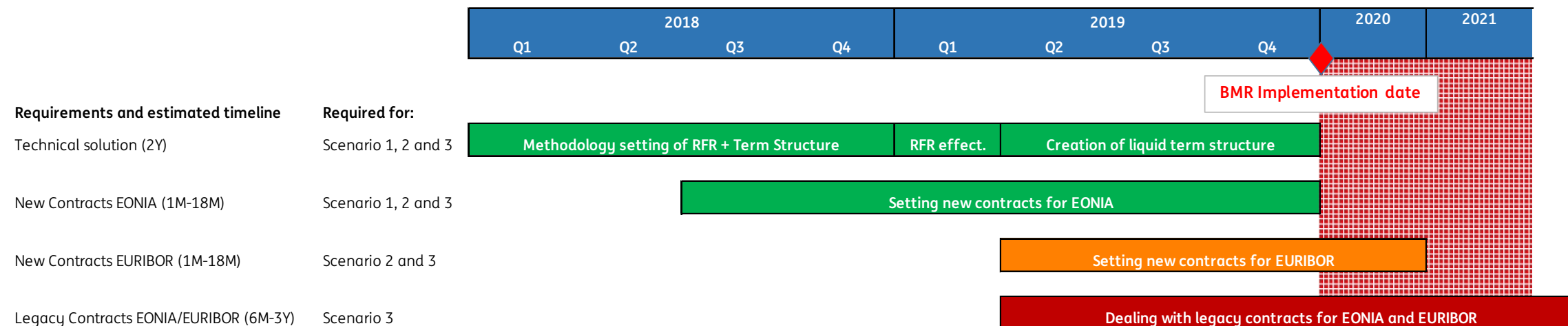
* If EONIA or EURIBOR will not become BMR compliant per 1 January 2020, it is at the discretion of FSMA to permit the usage of these benchmarks in legacy contracts as of that date. However, the continuation of EONIA and EURIBOR will mostly depend on the appetite of panel banks to stay in the EONIA and EURIBOR panels.

** Note that discussions in the Working Group have learned that it is generally believed that the new RFR + Term Structure could also replace EURIBOR for new contracts and we would not need term rates that include bank credit and term risk for this purpose. Transition spreads would however be required for transition purposes.

The actual scenario is not yet clear, making it difficult to foresee all potential implications but...

Scenario	Required actions	Consequences in case actions are not completed in time
<p>1. "Rosy" scenario:</p> <ul style="list-style-type: none"> EONIA will continue (although not BMR compliant) and be accepted by the FSMA for usage in legacy contracts. EURIBOR will continue and become BMR compliant. 	<p>Main challenges under this scenario will be to both replace EONIA and to find a fall back to this replacement rate. Additionally, a term structure should be created all to be widely accepted and ready for usage in new contracts by 2020 (as primary benchmark and also as fall back for contracts based on the reformed EURIBOR)</p>	<ul style="list-style-type: none"> For existing contracts prior to 2020, EONIA can still be used. Banks would however be restrained from transacting new EURO denominated financial instruments with a O/N index as underlying (e.g. OIS swaps, EONIA linked CD/CP, collateral exchanges for derivatives, etc) as of 2020. The OIS curve derived from EONIA and widely used for valuation of derivatives would also no longer be available as of 2020.
<p>2. "Gloomy" scenario:</p> <ul style="list-style-type: none"> EONIA and EURIBOR will not become BMR compliant but will continue and be accepted by the FSMA for usage in legacy contracts. 	<p>Additional challenge under this scenario will be now to also replace EURIBOR and its term structure (and again to create fall backs to these replacement benchmarks) to be widely accepted and ready for usage in new contracts by 2020.</p>	<ul style="list-style-type: none"> For existing contracts prior to 2020, EONIA and EURIBOR can still be used. Banks would however be restrained from transacting new EURO denominated financial instruments with both an O/N index and an index based on the typical EURIBOR interest cycles as of 2020. Fixed rate contracts on the other hand would leave the banks with unmanageable risk positions. By which banks as of 2020 would in fact no longer be able to transact the majority of their EURO denominated on- and off balance instruments and products (both for new business purposes but also for rebalancing purposes on the existing book).
<p>3. "Dark" scenario:</p> <ul style="list-style-type: none"> EONIA and EURIBOR will not become BMR compliant and will either not be continued or not be accepted by the FSMA for usage in legacy contracts. 	<p>Also under this scenario the challenge will be replace EONIA, EURIBOR, derived term structures and fall back levels. Under this scenario these should be ready for new and existing contracts however by 2020. The additional challenge under this scenario would be to come to a transition from the old to the new benchmarks that is fair to all market participants.</p>	<ul style="list-style-type: none"> Both for existing and new contracts, EONIA and EURIBOR can no longer be used as of 2020 leaving the EURO denominated financial industry in a mess.

...timelines do not fit all possible scenarios.



- Having the technical solution ready in the form of setting a new RFR and subsequently have a liquid term structure available is expected to be completed by the end of 2019.
- Questionnaire showed timelines for setting up new contracts range between 1M and 18M and for amending legacy contracts range between 6M and 3Y (or not feasible at all).
- More clarity on the sustainability of EURIBOR and whether it will be BMR compliant is only expected by Q1 2019 at the earliest (Q4 2019 at the latest).
- Anticipating already now on the potential scenario where EURIBOR would not become BMR compliant in time and might not even be continued or disapproved by the FSMA, is only to a limited extent possible (as the potential successor is not yet available).
- This leads to the timelines presented above from which it can be concluded that under the scenarios that EURIBOR could no longer be used for new and/or legacy contracts (scenarios 2 and 3), the timelines are too tight.

Management summary

Rosy scenario:

- Under the rosy scenario that EONIA would be continued and accepted by the FSMA and EURIBOR would become BMR compliant, timelines look very challenging (especially for the creation of a term structure on the new O/N RFR) but could still work.
- Without a term structure for the new O/N RFR rate, banks would be limited in certain activities (e.g. banks could be limited in transacting OIS swaps for a period of time potentially leading to some basis risk and the issuance of EONIA-linked liabilities could be hampered) and banks would face valuation issues (e.g. OIS curve is widely used for the valuation of derivatives). Whilst this would cause all kinds of complications, we believe this scenario would not necessarily lead to financial stability issues.

Gloomy scenario:

- Under the gloomy scenario that both EONIA and EURIBOR would not become BMR compliant but would still continue and be accepted by the FSMA, timelines already look too challenging.
- Having all market participants to accept a relatively new RFR and Term Structure for all new products that are currently traded on the basis of EONIA and EURIBOR (e.g. from IR swaps to mortgages) does not seem feasible under the tight timelines we currently face.
- As result banks could be constrained in transacting certain EURO denominated fixed and floating contracts both for new business as for the hedging of the existing book which would obviously have negative consequences from a financial stability perspective.

Dark scenario:

- Under the dark scenario that both EONIA and EURIBOR would not continue or not be accepted by the FSMA, timelines are clearly too short.
- Having all market participant to accept a relatively new RFR and Term Structure for all existing and new products that are currently traded on the basis of EONIA and EURIBOR and to deal with all the transition issues is not feasible in the tight timelines we currently face. This scenario would result in serious financial stability issues.

Points for discussion

1. Do WG members agree that scenario 1 where EONIA would continue to exist, though not BMR compliant, and be accepted by the FSMA for usage in legacy contracts and EURIBOR would be come BMR compliant by 2020, should be feasible/manageable?
2. Would scenario 2 where EONIA and EURIBOR can only be used for legacy contracts and alternative benchmarks must be installed for new contracts, be feasible and manageable within the given timelines (i.e. 2020 where clarity around BMR compliancy would be provided by Q4 2019 at the latest)?
3. Do WG members agree that scenario 3 where both EONIA and EURIBOR would not be continued or not be accepted by the FSMA for usage in legacy contracts, is not feasible/manageable within the given timelines due to the large transition challenges?
4. Which mitigating measures do WG members foresee that should be taken already now to avoid we run into financial stability risks? E.g.:
 - Request to get more clarity in the short term on the continuance of EONIA after 2020 and the potential acceptance by the FSMA.
 - Request to get more clarity, in an earlier stage than currently foreseen, on the sustainability of EURIBOR and potential BMR compliancy.