

Third public consultation by the working group on euro risk-free rates on the EONIA to €STR Legal Action Plan

Summary of responses

June 2019

1 Executive summary

The public consultation and call for feedback on the report by the working group on euro risk-free rates on the EONIA to €STR Legal Action Plan closed on Wednesday, 12 June 2019. The report drew considerable interest from the financial sector and other interested parties. Altogether, 58 market participants provided responses and comments. The response sample ensures appropriate geographic coverage and reflects the views of relevant sectors. The main messages for each of the questions may be summarised as follows.

- 1. Almost all respondents (57 out of 58) agreed with the working group's recommendation that the €STR plus Spread (subsequently defined as a spread of 8.5 basis points) should be the primary fallback rate to be included in new and legacy contracts referencing EONIA. Respondents considered this fallback rate as the most appropriate primary fallback rate for EONIA and appreciated the clarity provided by such a unified approach for new and legacy contracts across cash and derivative markets as a means of supporting a smooth transition and the avoidance of market disruption. From a user's perspective, the recommended transition path will provide additional time for the transition of legacy contracts and the fixed spread will contribute to a stable framework for mitigating legal risks regarding the continuity of contracts, although several respondents also pointed to the remaining risks if not all contracts can be repapered. Several respondents expressed appreciation for the support already provided by the ECB and other public authorities, such as with the calculation and communication of the shift from EONIA to the €STR plus Spread, but many also stressed the need for further communication and additional support from EU and EU Member State authorities. Only one respondent had no opinion on the proposed fallback rate for EONIA. No respondents answered in the negative and there were no proposals for an alternative fallback rate for EONIA.*
- 2. Respondents concurred with the working group's recommendation that the International Swaps and Derivatives Association (ISDA) consider amending the definition of EONIA in the 2006 ISDA Definitions so as to include a fallback to the €STR plus Spread triggered by the cessation of EONIA (with 56*

respondents out of 58 in favour). Only one respondent answered in the negative, and one other respondent had no opinion on whether the working group should recommend that the ISDA consider amending the definition of EONIA in the 2006 ISDA Definitions so as to include a fallback to the €STR plus Spread.

3. *Almost all respondents (57 out of 58) considered that the working group should encourage central counterparties (CCPs) and Exchanges to clarify their position with respect to the transition to the €STR and modify their rulebooks as detailed in the EONIA to €STR Legal Action Plan. Only one respondent had no opinion on the proposed encouragement to CCPs and Exchanges to clarify their position and modify their rulebooks. No respondents answered in the negative and, while there were comments, there were no proposals for an alternative course of action.*
4. *The vast majority of respondents (51 out of 58) supported the recommendation that the sponsors of European local master agreements should consider amending these agreements to include (i) fallback provisions dealing with the permanent cessation of a benchmark. Many of these respondents also agreed with the introduction of (ii) an acknowledgment that the EONIA methodology is expected to change and that references in contracts to EONIA should be understood to be references to EONIA as changed, as such an acknowledgement would provide greater legal certainty. However, several respondents made clarifications on this latter point and did not see the introduction of such an acknowledgement as strictly necessary, with some respondents even seeing it as risky. Some four respondents answered in the negative and three other respondents had no opinion. There were no proposals for an alternative course of action in general terms, although several respondents stated that, while they supported (i) the proposed introduction of robust fallbacks, they disagreed with or raised considerations related to (ii) the proposed introduction of acknowledgments that the EONIA methodology is expected to change.*
5. *The response to the working group's question about whether market participants would value robust fallback provisions in new collateral contracts was mainly positive. Some 49 respondents out of 58 answered "yes" to the question, with six answering "no" and three respondents not expressing an opinion. By the same token, many respondents qualified their responses, explaining as part of their preference that the introduction of fallback provisions in new collateral agreements was not seen as an urgent priority and/or that a switch to the €STR plus Spread prior to EONIA discontinuation could also be an option; for some respondents it was a preferred option.*
6. *Respondents generally agreed with the working group's proposal that new cash contracts and instruments maturing after December 2021 should include fallback provisions (50 respondents out of 58). One respondent mentioned that this was important, as consistent fallback provisions are needed by everyone in the industry in order to have a clear understanding of the need for a transition from EONIA to the €STR. However, the support for the proposal to include*

fallback provisions in contracts for new cash products differed according to cash product. In this regard, the view was expressed that the short-term nature of some cash products implies that they will roll over before the permanent cessation of EONIA and, for these products, new issuances may simply refer to the €STR. With regard to loans, a preference was expressed that fallback provisions should be LMA market-accepted provisions. There were no respondents who responded “no” to the proposal, although eight respondents expressed no opinion.

- 7. The responses concerning the alternatives for EONIA discontinuation fallback language templates for new cash products referencing EONIA were divided almost equally between the two options described in Annex 1 to the EONIA to €STR Legal Action Plan and “other options”. 48 entities responded to the question and the most common response was alternative 2 (“Unified fallback provision relating to both temporary and permanent unavailability of EONIA”), which was supported by 19 respondents, followed by “other options”, supported by 18 respondents, and alternative 1 (“Different fallback provisions relating to the temporary or permanent cessation of EONIA”), which was supported by 15 respondents. Respondents supplemented their preferences with comments, often with reference to both alternatives 1 and 2, and “other options”, indicating the perceived strengths and weaknesses of the various options. For instance, several respondents noted that, in their view, neither of the options proposed fully covers the diverse situations and rationale that cash products entail. On balance, some respondents thought that it would be best to keep both options, even if they favoured one or other of alternatives 1 and 2.*
- 8. Respondents agreed with the working group’s recommendation that priority should be given to legacy contracts maturing after December 2021. 56 out of 58 respondents supported the prioritisation of legacy contracts maturing after 2021, with no respondent recording a contrary view and two respondents expressing no opinion. With the publication of EONIA expected to stop at the end of 2021, priority should clearly be given to legacy contracts that mature after that date. Several respondents were of the view that the change in EONIA methodology should not require an amendment of the contracts, except in cases where the wording of a contract describes EONIA in too much detail. The insertion of an acknowledgement in legacy contracts – acknowledging that the change of methodology for EONIA will not affect the continuity of the contract – would enhance transparency between the parties but would not be necessary for contractual robustness. Legacy contracts that mature before the end of 2021 may thus continue using EONIA (following the extension of the transitional period under the EU Benchmarks Regulation, BMR), and it is therefore appropriate to give priority to legacy contracts maturing after December 2021. Instead of the inclusion of acknowledgements in legacy contracts that the benchmark methodology is expected to change, many respondents would favour supporting statements by public authorities, for instance that the reformed EONIA represents the same economic reality, or even EU legislation endorsing the EONIA transition.*

9. *For legacy derivative transactions, the vast majority of respondents (56 out of 58) found it useful to have documents and/or protocols that facilitate (i) the incorporation of the EONIA cessation event trigger and related fallbacks, and/or (ii) the amendment of legacy trades to switch from EONIA to the €STR plus Spread (subsequently defined as a spread of 8.5 basis points). Respondents mainly agreed with the working group's recommendation and suggested that any protocol facilitating the incorporation of fallback clauses or the change to the reference rate should also cover collateral agreements referencing EONIA. The need for a specific EONIA protocol was justified by respondents with reference to the fact that the scope of the existing 2018 ISDA Benchmarks Supplement Protocol is very wide and not suited to a specific situation like that of EONIA, and the fact that the existing protocol does not cover collateral agreements, which is a key issue in relation to EONIA. Only one respondent expressed no opinion, and just one negative response was received.*
10. *All the responses were positive with regard to the question of whether the working group should encourage CCPs and Exchanges to clarify their position with respect to the transition to the €STR and to follow the ISDA approach with respect to fallbacks for EONIA, except for two "no opinion" responses. The replies highlighted the key role to be played by CCPs and Exchanges in a successful transition to the €STR. The respondents asked for CCPs and Exchanges to take consistent action in a timely manner and to inform market participants in advance of their actions so that relevant preparatory measures could be taken by all stakeholders.*
11. *With regard to the most feasible option for amending legacy derivative transactions that are already documented using European local master agreements, half of the respondents replied supported the simultaneous development of common templates and a protocol, while the remaining half were split between supporting common templates only, supporting a protocol only, no opinion or proposing different solutions.*
12. *Most respondents (40 out of 58) foresee additional regulatory or legal requirements or costs that may hamper the amendment of legacy contracts and which need to be clarified/waived. The majority of them emphasised the issue that European and EU Member States' competent authorities have not yet clarified whether amendments to legacy derivative contracts require the application of the margin and clearing requirements under the European Market Infrastructure Regulation (EMIR) regime, an issue already mentioned in the EONIA to €STR Legal Action Plan. Another issue mentioned by the respondents is investment fund documentation (prospectuses and Key Information Documents, KIDs) and the implications for it of both the evolution of EONIA methodology and the future shift from EONIA to the €STR. In relation to costs, the responses identified client education as a source of additional costs (and also of potential risks), together with repapering legacy contracts and operational costs such as adopting new discounting curves and updating internal systems.*

13. *Several responses were given as to the critical elements to consider when transitioning from EONIA to the €STR in collateral agreements from a legal, operational and valuation standpoint. For each of these dimensions, respondents mentioned a number of issues that should be considered, the main ones being: the absence of fallback provisions in current collateral agreements; the timing of the transition and its operational implications for the calculation of interest under collateral agreements; and the introduction of a new discount curve that will replace the current curve based on EONIA, with possible value transfer implications.*
14. *Most respondents (37 out of 58) agreed with the bilateral amendment agreement template for cash products (see Annex 2 of the EONIA to €STR Legal Action Plan), although some made suggestions for its improvement, including aligning the fallback clauses of cash products with those clauses that apply to derivatives. Others suggested that the parties intending to use the template should consider dealing with different classes of cash products/assets in separate amendment agreements in order to be more precise.*
15. *A wide range of positive responses (33 out of 58) was given to the question of whether market participants foresee any regulatory or legal requirements that may hamper the amendment of legacy cash contracts and which need to be clarified and/or waived. The most common positive response referred to potential support by public authorities for both the evolution of EONIA's methodology as a tracker of the €STR and the substitution of EONIA by the €STR plus Spread in EONIA-referenced contracts when EONIA is discontinued. Similarly, several positive responses suggested that the EU or national authorities should clarify that the amendment of legacy cash contracts will not alter the tax or accounting treatment of those contracts.*

While respondents contributed through extensive and rich comments in response to the various questions raised in the EONIA to €STR Legal Action Plan, the overall extent of agreement with the proposals submitted via closed-end questions amounted to 86% that responded "yes", 5% responding "no" and 9% expressing "no opinion".

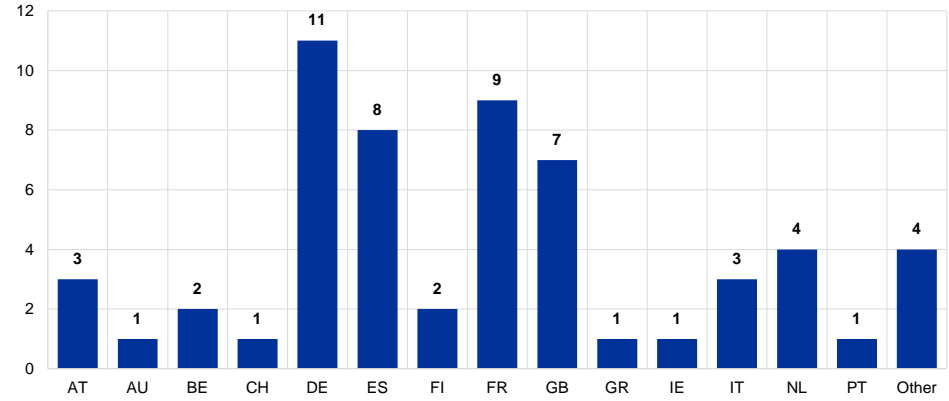
The working group on euro risk-free rates will keep market participants informed regarding the progress of its work so as to support their preparations for the introduction of the €STR. The working group may also seek further input from market participants through additional public consultations.

Chart 1

Geographic coverage of the response sample

June 2019

(number of respondents by geographic area)



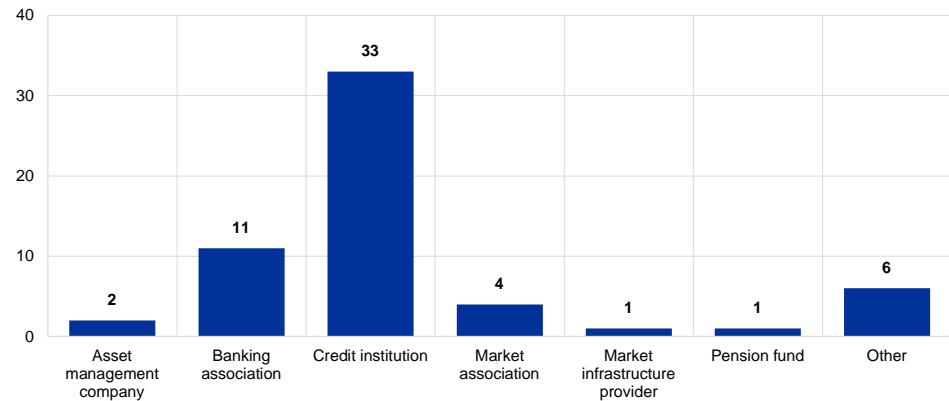
Source: ECB Secretariat to the working group on euro risk-free rates.

Chart 2

Representation of stakeholder groups in the response sample

June 2019

(number of respondents by sector)



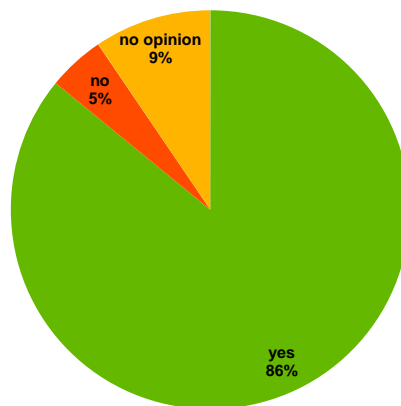
Source: ECB Secretariat to the working group on euro risk-free rates.

Chart 3

Overarching representation of extent of agreement with all proposals submitted via closed-end questions (yes/no/no opinion)

June 2019

(share of respondents)



Source: ECB Secretariat to the working group on euro risk-free rates.

The working group intends to recommend the €STR plus Spread (subsequently defined as a spread of 8.5 basis points) as the primary fallback rate to be included in new and legacy contracts referencing EONIA. Do you agree with that fallback rate for EONIA? If applicable, please elaborate on the reason for choosing “no” and propose an alternative fallback rate for EONIA.

Almost all respondents (57 out of 58) agreed with the working group’s recommendation that the €STR plus Spread (subsequently defined as a spread of 8.5 basis points) should be the primary fallback rate to be included in new and legacy contracts referencing EONIA. Respondents considered this fallback rate as the most appropriate primary fallback rate for EONIA and appreciated the clarity provided by such a unified approach for new and legacy contracts across cash and derivative markets as a means of supporting a smooth transition and the avoidance of market disruption. From a user’s perspective, the recommended transition path will provide additional time for the transition of legacy contracts and the fixed spread will contribute to a stable framework for mitigating legal risks regarding the continuity of contracts, although several respondents also pointed to the remaining risks if not all contracts can be repapered. Several respondents expressed appreciation for the support already provided by the ECB and other public authorities, such as with the calculation and communication of the shift from EONIA to the €STR plus Spread, but many also stressed the need for further communication and additional support from EU and EU Member State authorities. Only one respondent had no opinion on the proposed fallback rate for EONIA. No respondents answered in the negative and there were no proposals for an alternative fallback rate for EONIA.

Almost all respondents (57 out of 58) agreed with the recommendation of the working group that the €STR plus Spread (subsequently defined as a spread of 8.5 basis points) should be the primary fallback rate to be included in new and legacy contracts referencing EONIA.

Respondents considered the recommended fallback rate as the most appropriate primary fallback rate for EONIA and appreciated the clarity provided by such a unified approach to new and legacy contracts across cash and derivatives markets. The clear recommendation of a primary fallback rate for EONIA will be important for the many financial contracts referencing EONIA relating to derivatives transactions, Credit Support Annexes (CSAs) and cash products, as market participants could otherwise end up in lengthy negotiations on various fallback options. A unified application of the recommended approach across asset classes and contracts can thus support a smooth transition and the avoidance of market disruption, which will be essential in reducing risks related to the transition from EONIA to the €STR.

From a user's perspective, the recommended transition path will also provide additional time for the transition of legacy contracts and the fixed spread will contribute to a stable framework for mitigating legal risks regarding continuity of contracts, although several respondents also pointed to the remaining risks if not all contracts can be repapered.

Some of these respondents argued that it would be useful in the establishment of market practice and the reduction of litigation risk under some national laws if there were an official endorsement by a regulatory authority of the recalibrated EONIA, expressed as the €STR plus Spread, as the "replacement index" for EONIA. The idea expressed was to counter the risk that a contract be rescinded or revised by a judge if a change of circumstances that was unpredictable at the time the agreement was entered into renders its performance excessively onerous for one of the parties. Other respondents suggested that EU Member States should be encouraged to envisage national legal initiatives to address this issue.

While supportive of the recommended primary fallback rate, some respondents also pointed out that in some particular cases market players might, in any event, need the flexibility to select another fallback rate. Others qualified their support for the recommended primary fallback rate and stated that it is subject to all participants in the financial markets (cash, bonds, loans, repos, bilateral derivatives, CCPs) adopting the same position, which would contribute towards a smooth transition from EONIA to the €STR plus Spread.

Respondents supported the €STR plus Spread as the primary fallback rate also with regard to legacy contracts, but again noted the need for all relevant market participants to adopt the €STR plus Spread as the fallback rate for EONIA in order to avoid market disruption. It was noted that this will be more difficult to achieve for some cash products given the potential consent requirements for legacy contracts for certain cash products (e.g. syndicated loans and bonds). To minimise the requirements to repaper legacy contracts, it was also suggested that, if a legacy contract refers to a particular screen rate or rate source in the definition of EONIA, it would be helpful if the rate or source referenced automatically translated to the €STR rate published by the ECB on the relevant day plus the fixed Spread.

One respondent noted that the EONIA to €STR Legal Action Plan (Chapter 4.1, paragraph 4), reads as if a general switch to the €STR plus Spread is recommended and pointed out that, eventually, the future should be the "€STR flat". Another respondent mentioned that the approach should take into consideration certain situations where a fallback to the €STR without a spread would be relevant, for instance where EONIA is not referenced at the transaction level but at the general terms level (e.g. CSAs; the cleared market may transition to the €STR flat and it may be preferable for non-cleared CSAs to adopt the same approach). In such cases, the fallback would apply to all future new transactions post-2021. CCPs, for example, could replace EONIA with the €STR before the EONIA cessation date.

Yet another respondent, who agreed with the general recommendation to use the €STR plus Spread as a primary fallback rate for contracts referencing EONIA, noted that a solution at the industry level for the fallback to the €STR (as opposed to

EONIA) is still needed in order to avoid double repapering and to ensure compliance with the BMR post EONIA discontinuation (i.e. at the end of 2021).

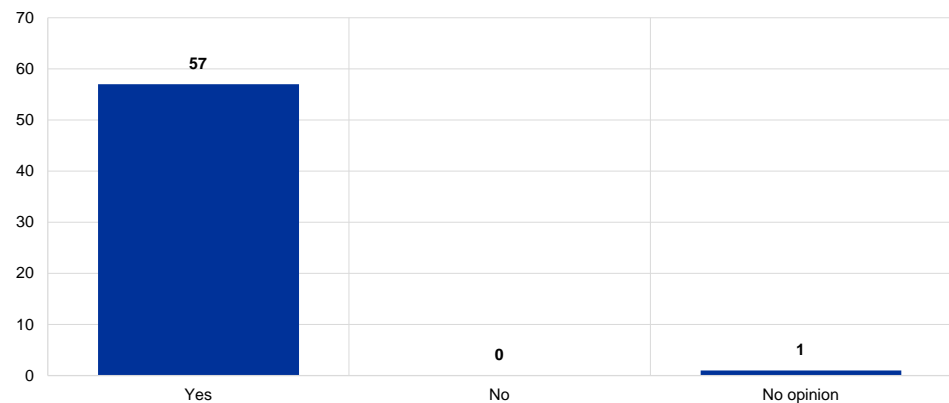
Some respondents expressly welcomed the support already received from the public authorities, including the ECB's calculation and communication of the EONIA-to-€STR Spread, and stated that they would welcome additional support from the public authorities in respect of the recommended measures for the transition from EONIA to the €STR, which could be achieved through public statements. For instance, it was emphasised that continued and reinforced communication to all market participants concerning the transition from EONIA to the €STR is of the utmost importance, especially regarding smaller market players and on operational issues, such as the change in the time of publication for the €STR compared with EONIA (from T to T+1). It was noted that the working group will address the need for increased communication related to the transition and that individual banks will also need to increase communication with their clients, but it was also stressed that the continued support of public authorities remains vital.

Chart 4

Extent of agreement with the working group's recommended primary fallback rate for EONIA

June 2019

(number of respondents)



Source: ECB Secretariat to the working group on euro risk-free rates.

3 New derivative transactions

Do you agree in principle that the working group should recommend that the ISDA consider amending the definition of EONIA in the 2006 ISDA Definitions so as to include a fallback to the €STR plus Spread (defined as a spread of 8.5 basis points) triggered by the cessation of EONIA? If applicable, please elaborate on the reason for choosing “no” and propose an alternative course of action.

Respondents concurred with the working group’s recommendation that the ISDA consider amending the definition of EONIA in the 2006 ISDA Definitions so as to include a fallback to the €STR plus Spread (defined as a spread of 8.5 basis points) triggered by the cessation of EONIA (with 56 respondents out of 58 in favour). Only one respondent answered in the negative, and one other respondent had no opinion on whether the working group should recommend that the ISDA consider amending the definition of EONIA in the 2006 ISDA Definitions so as to include a fallback to the €STR plus Spread.

Almost all respondents (56 out of 58) agreed that the working group should recommend that the ISDA consider amending the definition of EONIA in the 2006 ISDA Definitions so as to include a fallback to the €STR plus Spread (subsequently defined as 8.5 basis points) triggered by the cessation of EONIA.

It was noted that the use of protocols is the most efficient way to incorporate fallback provisions without bilateral renegotiation, even if this will not resolve the issue with regard to counterparties and clients who may not voluntarily adhere to such protocols. In this regard, one respondent noted that the proposal only works for parties that have incorporated the 2006 ISDA Definitions in their documentation and also raised the question of whether the working group has any proposals for managing the amendment of the EONIA definition in derivatives documentation that does not apply the 2006 ISDA Definitions.

Another respondent stated that the floating rate option may need to be amended in the 2006 ISDA definitions in any case, owing to the switch from T to T+1, in order to make sure that EONIA matches the overnight period. The evolved EONIA will be published on the next day and will reference the previous night, whereas, currently, the publication matches the upcoming night. In the definition, it seems to be implicitly assumed that "today's" fixing is for the following night, and this needs to be clarified.

Yet another respondent suggested that the ISDA should consider amending any other ISDA definitions that reference EONIA (such as EUR-EONIA-OIS-Compound) so that the €STR plus Spread (as defined) is the fallback to EONIA where EONIA is referenced in the relevant definition. This respondent also noted that the support to the recommended approach is subject to all participants across financial markets adopting the same approach to contribute towards a smooth transition and avoid market disruption.

Another respondent pointed out that the amendment to the definition of EONIA in the 2006 ISDA Definitions would need to be drafted to impact only new trades referencing EONIA and not legacy transactions, unless the relevant regulators provide clarification in respect of clearing and margining obligations for derivatives for legacy contracts. It will also be important to guarantee that the €STR plus Spread is published and easily available for market participants to use, as not all market participants will have the technical capacity to compute it in their systems.

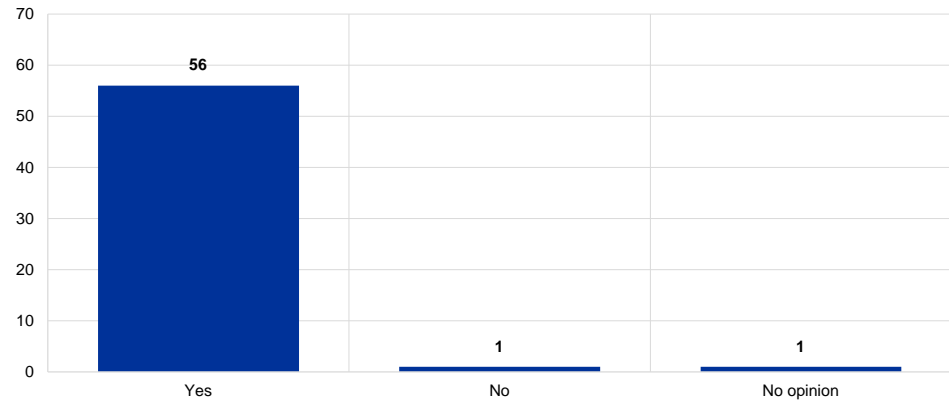
Yet another participant noted that the proposal only works for parties that have incorporated the 2006 ISDA Definitions in their documentation and also raised the question of whether the working group has any proposals for managing the amendment of the EONIA definition in derivatives documentation that does not apply the 2006 ISDA Definitions.

Chart 5

Extent of agreement with the recommendation that the ISDA consider amending the definition of EONIA in the 2006 ISDA Definitions so as to include a fallback to the €STR plus Spread (as defined) triggered by the cessation of EONIA

June 2019

(number of respondents)



Source: ECB Secretariat to the working group on euro risk-free rates.

Do you agree that the working group should encourage CCPs and Exchanges to clarify their position with respect to the transition to the €STR and modify their rulebooks as detailed in the EONIA to €STR Legal Action Plan? If applicable, please elaborate on the reason for choosing “no” and propose an alternative course of action.

Almost all respondents (57 out of 58) considered that the working group should encourage CCPs and Exchanges to clarify their position with respect to the transition to the €STR and modify their rulebooks as detailed in the EONIA to €STR Legal Action Plan. Only one respondent had no opinion on the proposed encouragement to CCPs and Exchanges to clarify their position and modify their rulebooks. No respondents answered in the negative and, while there were comments, there were no proposals for an alternative course of action.

There was broad support for the recommendation that CCPs and Exchanges should clarify in advance their proposed course of action in respect of the transition to the €STR. One respondent clarified that it would be helpful, in order to achieve an orderly transition from EONIA to the €STR, to encourage CCPs and Exchanges to consider amending their rulebooks and specific regulations in order to: (1) introduce the €STR as a potential reference in the contracts cleared or traded by them; and (2) incorporate in new contracts referencing EONIA (a) an acknowledgment that the methodology of EONIA is expected to change during the period of the contract and that references to EONIA shall be understood to be references to EONIA as changed, and (b) robust and specific fallback terms that will apply upon EONIA cessation. Another respondent mentioned that CCP Margining Rulebooks and CCP Valuation Rulebooks have to be updated simultaneously. Furthermore, changes to the Price Alignment Interest (PAI) that CCPs pay on collateral should take into consideration what is viable for the swaptions market.

It was suggested that this should apply not only in respect of amendments to CCPs' rulebooks, but also with regard to whether – and, if so, how – they would amend existing transactions that they have cleared. For example, issues identified for clarification included: (i) whether CCPs will change EONIA to the €STR or to the €STR plus Spread; (ii) if CCPs change to the €STR, whether there will be any compensation between the CCP and clearing members; (iii) at what moment CCPs intend to start using the €STR and change the reference; (iv) if there is a change in EONIA's definition in the 2006 ISDA Definitions to include a fallback, whether CCPs will accept contracts referring to such new definitions; and (v) if existing contracts at the time of the definition of EONIA are changed and are to be amended so as to incorporate the corresponding new definition.

Another respondent stated that it is particularly important that CCPs confirm: (1) whether EONIA becomes the €STR plus Spread or the €STR flat; (2) whether PAI remains consistent with the discounting methodology; and (3) that parallel discounting regimes are avoided as much as possible.

The working group should encourage CCPs and Exchanges to communicate on their position and intentions in respect of the transition to the €STR as early as possible in their transition planning, in particular, the timing and whether any amendments are required in the member documentation (direct and indirect) to the extent that such amendments need to be anticipated (in terms of resources). Apart from fallbacks, CCPs should also clarify the compensation mechanism among participants when shifting from EONIA to €STR discounting to compute fair values. This would provide legal clarity on the expected rulebook changes in relation to the trigger events and fallback provisions for individual CCPs and Exchanges. The working group should also encourage CCPs and Exchanges to adopt consistent timelines for this transition to allow as much transparency and consistency as possible within the industry.

Emphasis was placed on coordination among the main CCPs and Exchanges in adapting their rulebooks, as it would pave the way to a smoother transition to the €STR. However, one respondent made the comment that, if what is meant by "clarify their position with respect to the transition to the €STR" is that CCPs and Exchanges should have a united approach and rulebooks should be modified in a unified

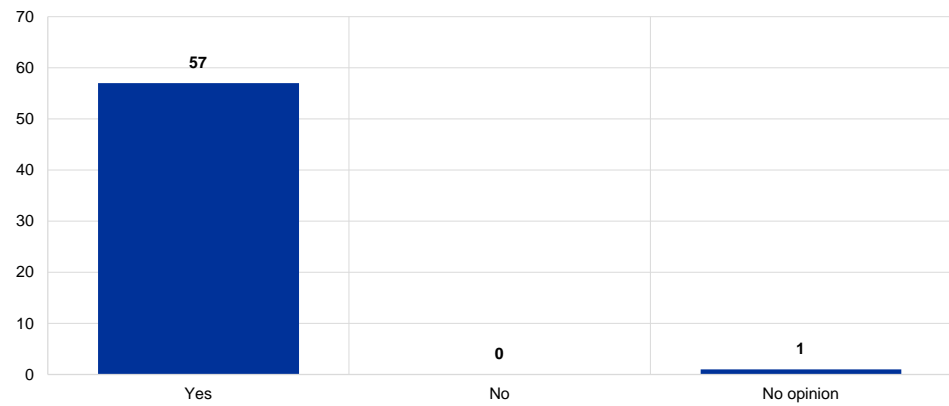
manner, this would be relatively difficult to coordinate. On the other hand, if what is meant is that each individual CCP and Exchange should amend its rulebook on its own in order to introduce the €STR as a potential reference in contracts, incorporate an acknowledgement that the methodology of EONIA is expected to change, and that robust fallback terms will apply upon the cessation of EONIA, then “yes”, this should be recommended.

Chart 6

Extent of agreement with the proposal that the working group should encourage CCPs and Exchanges to clarify their position with respect to the transition to the €STR and modify their rulebooks as detailed in the EONIA to €STR Legal Action Plan

June 2019

(number of respondents)



Source: ECB Secretariat to the working group on euro risk-free rates.

4 European local master agreements

Do you agree that the working group should recommend that the sponsors of European local master agreements consider amending these agreements to include (i) fallback provisions dealing with the permanent cessation of a benchmark and (ii) an acknowledgment that the EONIA methodology is expected to change and that references in contracts to EONIA shall be understood to be references to EONIA as changed? If applicable, please elaborate on the reason for choosing “no” and propose an alternative course of action.

The vast majority of respondents (51 out of 58) supported the recommendation that the sponsors of European local master agreements should consider amending these agreements to include (i) fallback provisions dealing with the permanent cessation of a benchmark. Many of these respondents also agreed with the introduction of (ii) an acknowledgment that the EONIA methodology is expected to change and that references in contracts to EONIA should be understood to be references to EONIA as changed, as such an acknowledgement would provide greater legal certainty. However, several respondents made clarifications on this latter point and did not see the introduction of such an acknowledgement as strictly necessary, with some respondents even seeing it as risky. Some four respondents answered in the negative and three other respondents had no opinion. There were no proposals for an alternative course of action in general terms, although several respondents stated that, while they supported (i) the proposed introduction of robust fallbacks, they disagreed with or raised considerations related to (ii) the proposed introduction of acknowledgments that the EONIA methodology is expected to change.

The vast majority of respondents agreed with the recommendation to include (i) fallback provisions for the cessation of a benchmark (51 out of 58), while they agreed to a lesser extent or only in a qualified manner with the recommendation to add (ii) an acknowledgment that references to EONIA will refer to EONIA under the new methodology.

Respondents supporting item (i) and the inclusion of fallback provisions for EONIA, agreed that any industry organisation acting as “sponsor” for developing and maintaining a standard market documentation for financial contracts will need to review their documentation and consider whether to introduce changes to existing standard elements of the documentation or develop special documents/provisions allowing the counterparties to address the issue that a benchmark used under the documentation is no longer available or suitable for the intended contractual purpose.

However, it needs to be taken into account that the development of a fallback provision for certain standard industry documentation will not necessarily mean that all counterparties will actually introduce such fallback provisions in their agreements.

A sponsor of standard market documentation can only make available the provision/supplement/amendment agreement containing the provision, and it is still up to the individual counterparties to agree on inclusion in their contractual agreements. Specifically, a sponsor cannot impose such changes on the contractual documentation or induce the counterparties to make such changes. This holds true regardless of whether a protocol system exists for the relevant contractual documentation (which is not the case for most local master agreements). In other words, the existing protocol systems still require the adherence of market participants (more specifically, their willingness to agree to the changes introduced by the protocol). Experience has shown that acceptance and participation rates differ and that, in particular, smaller market participants are reluctant to use a protocol system (especially if subject to a foreign law). While a protocol system facilitates the introduction of changes, especially between more experienced market participants, a portion of contractual arrangements will need to be addressed on an individual/bilateral basis and there will be cases where it will not be possible to agree on the amendment of the existing agreement and introduce the contractual changes. Accordingly, without a legislative solution, it will not be possible to ensure that all currently outstanding transactions referencing EONIA can be amended to include fallbacks to the €STR.

Any recommendation should also leave the addressees sufficient room for discretion to identify and offer the solution best suited to the standard documentation under the relevant applicable law. The recommendation should therefore not include a detailed proposal or template for a specific provision (the current proposed templates are all strongly influenced by English law and existing English law solutions, which cannot be easily/directly transposed into other national laws and the contractual documentation under non-English law). Furthermore, any recommendation would also need to take into consideration that there may be cases where it may not be appropriate to introduce or make available a contractual fallback provision: for example, with regard to the client clearing documentation for the German Master Agreements (the Clearing Framework Agreement/ Clearing Rahmenvereinbarung, CRV) the introduction of a fallback provision would actually be counterproductive as this contractual documentation and any transactions governed by it need to mirror the transaction cleared at the CCP level and the relevant rules and regulations of the various CCPs. Under these circumstances, it is more appropriate not to include an independent fallback provision at the client clearing documentation level in order to avoid potentially differing or conflicting rules in case of a cessation or material changes to a benchmark.

When it comes to item (ii) and the proposed acknowledgment regarding the change of the methodology for EONIA, the following clarifications and additional considerations were raised.

Many respondents did not consider inclusion of an acknowledgement to be strictly necessary for the purposes of contractual robustness in that modified EONIA would be a continuation of EONIA. If the contract only refers to EONIA, specifying the date and hour of publication, without mentioning the underlying methodology, then it should not be necessary to mention the change in methodology. This would however

depend on the type of clause used to reference EONIA and the change in methodology could, in some cases, be dealt with outside the contract, rather than through an amendment of the contracts.

The acknowledgement could be useful for the purposes of enhancing transparency but was not seen as required for legal continuity given that EONIA would continue to measure the same economic reality. In this regard, it would be helpful for the public sector to emphasise this in public statements, as it is unlikely to be feasible to include such an acknowledgement in all contracts in the time available. It was also suggested more generally that European local master agreements include an acknowledgement that (unless otherwise agreed by the parties) references to a benchmark are to that benchmark as amended from time to time.

It was underlined that the analysis as to whether or not the introduction of the new methodology constitutes a “material change” requiring an amendment of the terms of a transaction cannot be determined by the sponsors of the documentation, but is an assessment to be made by the counterparties (or by the legislator or regulator). The sponsor of a certain set of documentation cannot impose a specific interpretation of the legal effects of changes to the methodology of a benchmark on the counterparties and market participants. It would also not be possible or permissible to make a formal (non-binding) recommendation to this effect. What a sponsor can do is develop a supplement/amendment agreement or proposed language for additional provisions that counterparties may elect to use in order to contractually agree that the changes in the methodology are not material for the purposes of their existing contract and/or do not (as such) trigger any contractual rights or obligations. In any event, any acknowledgement, if deemed necessary to be included in contractual agreements, would be of limited effect, insofar as it will not be possible to cover all transactions referencing EONIA until the publication of the €STR (and even then only when both parties agree, which is not always the case). Accordingly, only a statement by regulators that the changes do not constitute a material change for regulatory purposes or a legislative initiative to this end could achieve broad, market-wide acceptance.

Other respondents stated that local master agreements used in Europe should include robust fallback provisions dealing with the permanent cessation of a benchmark, an acknowledgment that the EONIA methodology is expected to change and that references in contracts to EONIA shall be understood to be references to EONIA as changed. New fallback provisions should, at least, include a permanent cessation trigger event and minimise any potential transfer of value between parties when the fallback is implemented, by including (if needed) a provision for an adjustment spread to be applied to the fallback rate. It will be particularly important for local master agreements to be consistent with the approach adopted by the ISDA, with respect to recommendations for both new contracts and legacy contracts.

Several respondents emphasised that, in their view, the change of EONIA's methodology should not be considered a substantial modification of the rate or a risk to contract continuity triggering any existing fallback or repapering requirement. With this understanding, i.e. that the methodology changes are not regarded as material in a legal sense, any acknowledgment might be helpful in providing further

transparency but should not be seen as necessary for legal reasons. If it becomes apparent that this view on immateriality of the change is not shared by market participants, a legislative clarification could be necessary, as it will otherwise not be possible to definitively amend all outstanding transactions.

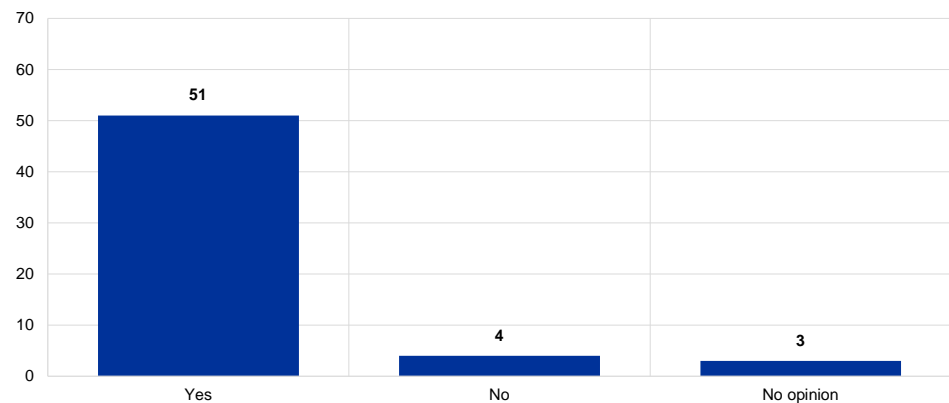
Some other respondents stated that such acknowledgments could even send the opposite message to the markets, considering that legacy contracts might not include such wording, and they therefore suggested that this issue might be addressed on an extra-contractual basis (e.g. client information). In addition, several respondents stated their wish for more public sector support of initiatives (e.g. public statements) to address this issue.

Chart 7

Extent of agreement with the proposed recommendation that the sponsors of European local master agreements consider amending these agreements to include (i) fallback provisions dealing with the permanent cessation of a benchmark and (ii) an acknowledgment that the EONIA methodology is expected to change and that references in contracts to EONIA shall be understood to be references to EONIA as changed

June 2019

(number of respondents)



Source: ECB Secretariat to the working group on euro risk-free rates.

5 New collateral agreements

Would market participants value robust fallback provisions in new collateral contracts? Please elaborate on your preference.

The response to the working group’s question about whether market participants would value robust fallback provisions in new collateral contracts was mainly positive. Some 49 respondents out of 58 answered “yes” to the question, with six answering “no” and three respondents not expressing an opinion. By the same token, many respondents qualified their responses, explaining as part of their preference that the introduction of fallback provisions in new collateral agreements was not seen as an urgent priority and/or that a switch to the €STR plus Spread prior to EONIA discontinuation could also be an option; for some respondents it was a preferred option.

The working group identified two options for consideration when preparing new collateral agreements referencing EONIA: (1) the inclusion of fallback provisions in new collateral agreements, and (2) not including fallback provisions and switching to the €STR plus Spread prior to EONIA’s discontinuation. The working group also indicated that these two options are not mutually exclusive and that market participants may wish to use one or both of these options on a voluntary basis.

Nevertheless, the view was expressed that, from a practical perspective, encouraging the entire market – or at least a large part of it – to choose the same option would help to define a unique methodology. This decision would avoid future discussions between the parties, standardise conditions and provide transparency and simplicity, smoothing the transition. Other benefits would be related to costs and bureaucracy, avoiding or diminishing the workload involved in bilateral negotiations.

The majority of respondents agreed that fallback provisions in new collateral contracts would be useful for derivatives and repurchase agreements. The introduction of fallback provisions would help enhance legal certainty upon the discontinuation of EONIA in December 2021. Otherwise, contracts that have not been amended would still reference EONIA by December 2021, which would entail uncertainty and risks. It is important that all parties make informed decisions and feel confident they are adequately protected, so the introduction of fallbacks would promote transparency and a fair negotiation among parties, despite the fact that the inclusion of fallbacks has not so far been a market standard. Moreover, EONIA is sometimes used to specify the interest rate payable on euro cash collateral in repurchase transactions and securities lending transactions, and it would be very useful to have the involvement of both the International Capital Markets Association (ICMA) and the International Securities Lending Association (ISLA) for the development of solutions to facilitate the transition to the €STR for transactions entered into under the Global Master Repurchase Agreement (GMRA) and the Global Master Securities Lending Agreement (GMSLA) respectively, either through protocols, standard template documentation or otherwise.

The preference of these respondents is therefore to have robust fallbacks for collateral contracts, considering that discounting of future cash flows is an important part of derivatives valuation. Having a similar fallback for all collateral contracts would also reduce disruption from moving to a unique discounting method (EONIA currently). These respondents also value having standardised fallback provisions in collateral contracts between the ISDA and the CCPs and Exchanges. Standardisation of contracts would avoid having different discounting between legacy contracts and new contracts, or between centrally cleared securities and bilateral securities, which would create operational difficulties and risk value transfer or a change in economic exposure.

Many respondents qualified their responses and explained as part of their preference that the introduction of fallback provisions in new collateral agreements was not seen as an urgent priority and/or that a switch to the €STR plus Spread prior to EONIA discontinuation could also be an option, including a preferred option. In this sense, some respondents qualified their “yes” with provisos, including: (i) that on the date on which the fallback provision is included in the collateral contract, it is already clear what clearing houses are going to admit, and (ii) market participants would like to wait until the permanent discontinuation of EONIA in order to apply such a fallback. If these provisos are not met, it would be preferable to follow option (2) and directly switch to the €STR or the €STR plus Spread prior to EONIA’s discontinuation (for example, when clearing houses change their price alignment interest and discounting rate).

It was also noted that EONIA is commonly used as a reference rate for variable rate products with contractual maturity dates that may exceed 30 years. EONIA is therefore often used to specify the interest rate payable in derivative transactions (EONIA swaps or overnight index swaps (OIS)), to determine the collateral remuneration for cleared and non-cleared derivatives and also in specific euro cash products, like repurchase transactions and securities lending transactions. Historically, such agreements have tended not to include fallback provisions, be subject to the BMR or be covered by the 2006 ISDA Definitions or by the ISDA Benchmarks Supplement. Some respondents therefore see merit in having the option of a transition to the €STR or the €STR plus Spread prior to EONIA’s discontinuation – with no introduction of a fallback provision – as an alternative for market participants in some cases.

Other respondents are of opinion that the question of fallback provisions for new collateral contracts is not a priority, as the potential issue seems limited due to the following circumstances: (i) there are very few new collateral agreements owing to the clearing obligation under EMIR; (ii) new bilateral collateral agreements concluded between the current date and the date on which a liquid derivatives market using the €STR emerges should still refer to EONIA, as it will still be the (most) liquid curve; consequently, they would need to be considered as all previous “legacy” collateral agreements, as they can potentially cover transactions maturing beyond 2021 priced in an EONIA (the €STR plus Spread) environment; (iii) new collateral agreements concluded after the market has performed its transition to the €STR will directly refer to the €STR.

One respondent was of the opinion that the proposal to have a fixed spread essentially indefinitely would be problematic and suggested that the fallback should be to the €STR flat (with no spread) from the very beginning of the transition in order to avoid inconsistencies further down the line.

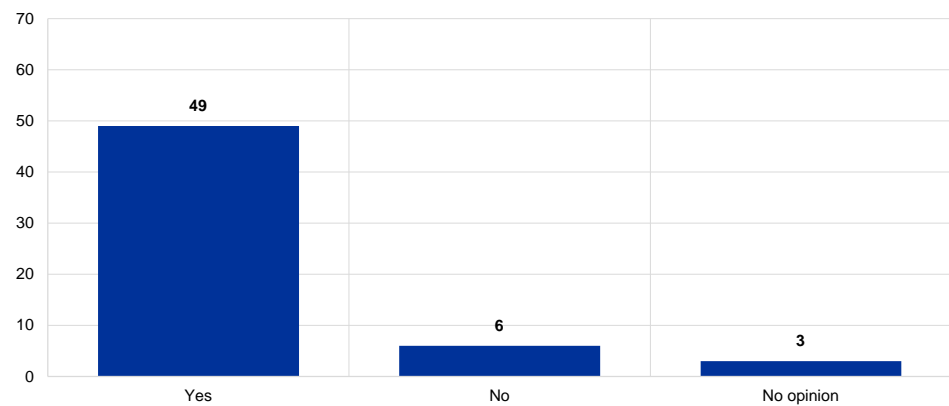
Another question raised by one respondent was on which fallback language should be used in the case of a potential unavailability / material modification / discontinuation of the €STR in the future.

Chart 8

Extent of support for robust fallback provisions in new collateral contracts

June 2019

(number of respondents)



Source: ECB Secretariat to the working group on euro risk-free rates.

6 New contracts for cash products

Do you agree that new cash contracts and instruments that mature after December 2021 should include fallback provisions? If applicable, please elaborate on the reason for choosing “no”.

Respondents generally agreed with the working group’s proposal that new cash contracts and instruments maturing after December 2021 should include fallback provisions (50 respondents out of 58). One respondent mentioned that this was important, as consistent fallback provisions are needed by everyone in the industry in order to have a clear understanding of the need for a transition from EONIA to the €STR. However, the support for the proposal to include fallback provisions in contracts for new cash products differed according to cash product. In this regard, the view was expressed that the short-term nature of some cash products implies that they will roll over before the permanent cessation of EONIA and, for these products, new issuances may simply refer to the €STR. With regard to loans, a preference was expressed that fallback provisions should be LMA market-accepted provisions. There were no respondents who responded “no” to the proposal, although eight respondents expressed no opinion.

Respondents generally agreed with the working group’s proposal that new cash contracts and instruments that mature after December 2021 should include fallback provisions (50 respondents out of 58). However, the support for the proposal differed between different cash products, which can be divided into four categories: (1) debt securities, including, among others, commercial paper and certificates of deposit; (2) repurchase transactions and securities lending transactions; (3) loans, including, among others, swingline loans, business loans and syndicated loans; and (4) other cash products, such as current accounts, overdraft facilities and savings accounts and guarantees.

In general, respondents agreed that new cash contracts and instruments that mature after December 2021 should include fallback provisions wherever practical. One respondent mentioned that this was important, as consistent fallback provisions are needed for everyone in the industry to have a clear understanding of the need to transition from EONIA to the €STR. According to this view, the inclusion of fallback provisions in new cash products will be essential to reinforce awareness that the publication of EONIA will be discontinued.

One respondent referred to the short-term nature of debt securities, repurchase transactions, securities lending transactions and swingline loans, and stated that it was likely that a significant number of new contracts for these cash products would roll over before the permanent cessation of EONIA. The view was therefore expressed that, in those cases, rather than including detailed fallback provisions, it seemed more likely that new issuances would simply reference the €STR as soon as feasible. Another respondent noted that the volume of cash products referencing EONIA and maturing after December 2021 was relatively limited.

One respondent stated that repurchase transactions would benefit from the inclusion of fallback provisions on the basis that EONIA was referenced as a price source for market value in the actual master agreement that may cover repo transactions entered into post December 2021 (i.e. the master agreement would require amendment to replace the EONIA reference with an alternative price source benchmark, e.g. the €STR).

With regard to loans, one respondent stated that there would be support of fallback provisions only if these are Loan Market Association (LMA) market-accepted provisions. Swingline facilities are usually included in documentation covering other types of facilities too (e.g. term and/or revolving credit facilities) and any fallback provisions should cover all these facilities. Seeking to create and insert bespoke wording (i.e. a wording which is not widely accepted in the market), particularly in large syndicated transactions, is unlikely to be accepted by the borrower or other lenders. On the basis that the market appears to be moving towards EONIA being replaced by the €STR plus a spread, it seems likely that an LMA market-agreed wording will be available sooner rather than later.

Some respondents recommended that LMA modify its trigger event in relation to a material change in the methodology, as they considered it to be contrary to and inconsistent with the approach adopted by ISDA or the Federal Reserve Bank of New York and they were concerned that legal problems could be caused by triggers for benchmarks that have only changed methodology. They also cited Article 5(3)(a) of the EU Benchmarks Regulation as establishing an obligation for the administrator to “[review] the benchmark’s definition and methodology at least annually” and, therefore, were concerned about the disruption and potential impact for parties to an LMA agreement if they were required to go through the process annually, as currently drafted, or whenever the administrator decided to amend the methodology.

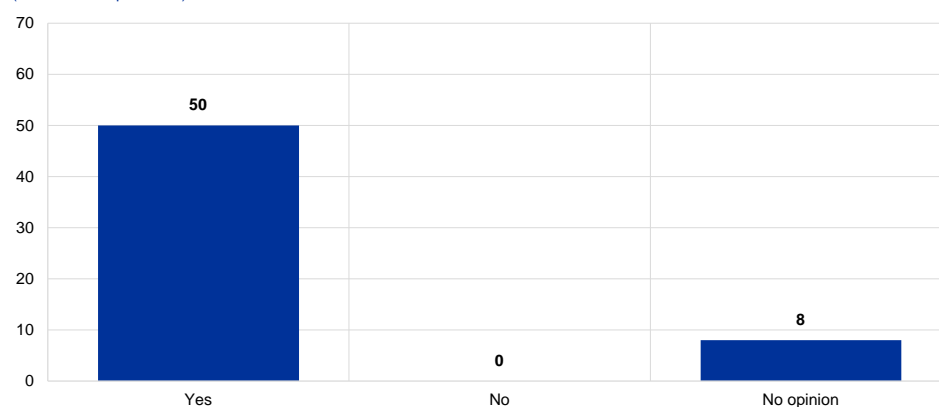
Respondents also emphasised that any solution or fallback for new cash products should be consistent with developments in the derivatives market and expressed support for alignment and consistency between cash product and derivatives approaches from a risk management perspective.

Chart 9

Extent of agreement with the proposal that new cash contracts and instruments that mature after December 2021 should include fallback provisions

June 2019

(number of respondents)



Source: ECB Secretariat to the working group on euro risk-free rates.

Regarding the EONIA discontinuation fallback language templates described in Annex 1 for new cash products referencing EONIA, which alternative do you prefer? (alternative 1 / alternative 2 / other options) If applicable, please elaborate on the reason for choosing “other options”. Do you have any further comments or suggestions regarding the suggested templates? (yes / no)

The responses concerning the alternatives for EONIA discontinuation fallback language templates for new cash products referencing EONIA were divided almost between the two options described in Annex 1 to the EONIA to €STR Legal Action Plan and “other options”. 48 entities responded to the question and the most common response was alternative 2 (“Unified fallback provision relating to both temporary and permanent unavailability of EONIA”), which was supported by 19 respondents, followed by “Other options”, supported by 18 respondents, and alternative 1 (“Different fallback provisions relating to the temporary or permanent cessation of EONIA”), which was supported by 15 respondents. Respondents supplemented their preferences with comments, often with reference to both alternatives 1 and 2 and “other options”, indicating the perceived strengths and weaknesses of the various options. For instance, several respondents noted that, in their view, neither of the options proposed fully covers the diverse situations and rationale that cash products entail. On balance, some respondents thought that it would be best to keep both options, even if they favoured one or other of alternatives 1 and 2.

The working group proposed two different alternatives regarding the EONIA discontinuation fallback language templates described in Annex 1 for new cash products referencing EONIA:

Alternative 1: Different fallback provisions relating to the temporary or permanent cessation of EONIA.

Alternative 2: Unified fallback provision relating to both temporary and permanent unavailability of EONIA.

Several respondents noted that, in their view, neither of the proposed alternatives fully covered the diverse situations and rationale that could be found in cash products. Alternative 1 differentiates between temporary and permanent cessation. In the case of temporary cessation, the last EONIA published should be used instead of redirecting automatically to another fallback. If on a single day EONIA is not published for technical, operational or administrative reasons, it may be preferable to apply the last EONIA published, rather than using a new fallback, especially as the temporary cessation may occur before publication of the €STR starts. However, alternative 1 may not cover 100% of the needs and essentials of different cash products and alternative 2 provides the advantage of a homogeneous solution, avoiding bilateral negotiations. On balance, some respondents thought that it would be best to keep both options, even if they favoured one or other of alternatives 1 and 2.

Respondents favouring alternative 1 found it clearer and more robust from a legal standpoint. In particular, they found alternative 1 to be more specific in defining EONIA trigger events than alternative 2. Other respondents supporting alternative 1 found that it was reasonable to distinguish between a discontinuation for an administrative/operational reason and a permanent discontinuation. With respect to alternative 2, such respondents found that switching to the €STR plus the Spread, even when, for example, EONIA has not been published for one day for technical reasons, and then reverting to EONIA when the problem has been solved could cause misunderstandings and, potentially, operational problems (for instance, systems may not be prepared for the €STR at the time of the temporary/technical cessation) and would not help the smooth transition to the €STR.

Others noted that alternative 1 was appropriate due to operational considerations and limitations at the time of the issue. Although they value the uniform approach proposed under alternative 2 (“€STR plus the Spread” as fallback in any trigger event, whether permanent or not), it requires a new fallback operational process to be set up instead of using current practices (IT systems developments or operational impacts and costs). This is disproportionate considering the temporary nature of the issue, as the €STR should rapidly supersede EONIA in new contracts.

When it comes to the arguments in favour of alternative 2, respondents pointed out that EONIA will become the €STR plus the Spread from 2 October 2019 and market participants are being encouraged to move over to the €STR as soon as possible from that date. This means that there will be limited time to write new contracts on the unreformed EONIA and, on that basis, the respondents would prefer alternative 2 and a unified fallback for temporary and permanent unavailability of EONIA.

Moreover, several respondents who supported alternative 2 expressed a preference that the EONIA fallback language should be as close as possible to the language

proposed by the other industry bodies and reference rate working groups for cash instruments, as having inconsistent triggers and fallback options across various interbank offered rate (IBOR)-linked cash products would mean transition at different times and under different conditions. They also noted that consistency with derivatives fallbacks was desirable given the hedging relationships and, if not practicable, then the permanent cessation triggers were considered to be the key issue in the IBOR transition. They noted that current documentation may already contain temporary cessation fallbacks, as it was market practice in the past, and the use of alternative 1 would require assurance that there are no inconsistencies with current agreements. This reasoning led to a preference for alternative 2 or another wording aligned to the cash fallbacks (to be) produced by other industry associations and reference rate working groups for the relevant cash products and currencies that they cover. Accordingly, consideration should be given to fallback language templates developed or recommended by industry forums and trade associations for certain products (e.g. LMA for loans and ICMA for floating rate notes).

Moreover, respondents noted that the suggested templates were long and detailed and suggested that it would be preferable to use shorter and simpler forms and that differentiation may be needed for different jurisdictions, such as the use of alternative 2 for English law products and “other options” for German law products, such as a standard defined by the German Banking Industry Committee, and similarly for other relevant European banking associations, to ensure broad acceptance.

Respondents who preferred Alternative 2 also noted that temporary disruptions in the publication of a benchmark are dealt with under the 2006 ISDA Definitions (without having to look to an alternative rate) and that cash products usually follow the ISDA fallbacks. These respondents did not agree with the express reference to the Eurosystem deposit facility rate (DFR) in the waterfall of fallbacks and their strong preference was for the fallbacks to expressly refer to “the fallback/replacement rate for €STR” in order to avoid (unintentional) bifurcation in the future. In addition to picking up the replacement rate for the €STR, the fallback language should include the Spread. The waterfall should be consistent with that used in the derivatives market, where ISDA is currently considering a draft definition of the €STR for inclusion in the 2006 ISDA Definitions, including considerations as to which fallbacks to include.

Some respondents made drafting comments applicable to both alternative 1 and alternative 2, including a proposal to replace the definition of the €STR with the following:

“€STR means, with respect to a relevant day, the short-term interest rate in euros calculated and published by the European Central Bank (or any successor thereto) and which reflects, with respect to that day, the overnight financing costs of the banks in the Euro zone in the wholesale markets according to the methodology in place at that moment.”

The reasons for the proposed changes refer to the IBOR reform, which has shown that including operational or methodological aspects in the definition of the benchmark could create a problem for the future. A benchmark’s methodology

should be continuously reassessed in order to check whether the benchmark still measures the same underlying interest. If some changes are needed, it would be preferable to avoid any impact on the definition of the index for the sake of legal certainty.

The proposed changes entail, inter alia:

The removal of the reference to the ECB's website to avoid potential issues in the future if the rate is published by other means.

The removal of the reference to a specific time of publication to avoid potential issues if it is decided in the future that the index should be published at a different time.

Although an acknowledgment of the change in methodology is already included, it is worth adding a reference to the methodology on each occasion.

Respondents also suggested that the definition of adjustment spread could be replaced with 0.085%.

One respondent who supported "other options" stated that it had some preference for alternative 2, but questioned whether it could be applied to cash products with retail clients, as retail contracts typically use generic wording. They proposed that such wording could be expanded so that a suitable replacement rate could be determined in accordance with recommendations of regulatory bodies, central banks or official working groups established by such central banks or any other replacement rate determined as suitable by the relevant bank.

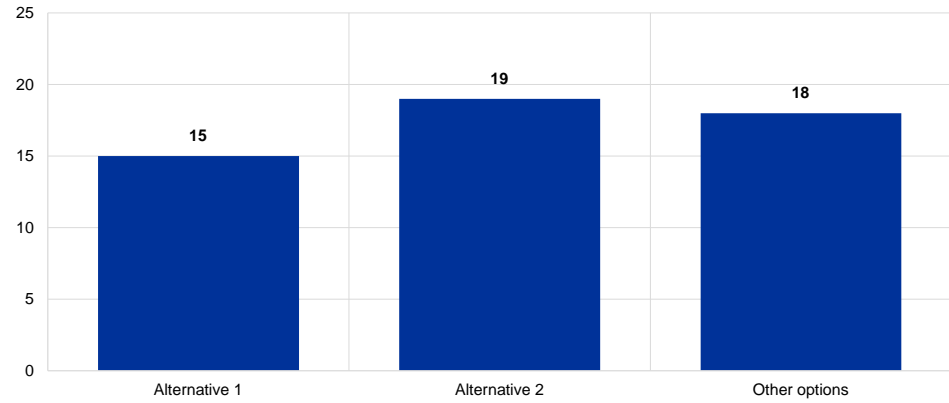
Other respondents who supported "other options" were in favour of a flexible approach that also considers generic fallback language introduced in January 2018 to meet the requirements of Article 28(2) of the BMR. These respondents noted that local regulations or case law may also provide for replacement of an index without specific contractual provisions and proposed that in such cases the party determining the fallback rate should use the €STR plus 8.5 basis points without the need for repapering of documentation, as in some cases repapering requires the consent of all or a majority of noteholders.

Chart 10

Respondents' preferences with regard to the alternatives for the EONIA discontinuation fallback language templates for new cash products referencing EONIA described in Annex 1 to the EONIA to €STR Legal Action Plan [alternative 1 / alternative 2 / other options]

June 2019

(number of respondents)



Source: ECB Secretariat to the working group on euro risk-free rates.

Note: The number of respondents is not equal to the total number of respondents, as ten entities did not respond to this question.

7 Legacy contracts

Do you agree with the proposed recommendation that priority should be given to legacy contracts maturing after December 2021? (yes / no / no opinion) If applicable, please elaborate on the reason for choosing “no”.

Respondents agreed with the working group’s recommendation that priority should be given to legacy contracts maturing after December 2021. 56 out of 58 respondents supported the prioritisation of legacy contracts maturing after 2021, with no respondent recording a contrary view and two respondents expressing no opinion. With the publication of EONIA expected to stop at the end of 2021, priority should clearly be given to legacy contracts that mature after that date. Several respondents were of the view that the change in EONIA methodology should not require an amendment of the contracts, except in cases where the wording of a contract describes EONIA in too much detail. The insertion of an acknowledgement in legacy contracts – acknowledging that the change of methodology for EONIA will not affect the continuity of the contract – would enhance transparency between the parties but would not be necessary for contractual robustness. Legacy contracts that mature before the end of 2021 may thus continue using EONIA (following the extension of the transitional period under the BMR), and it is therefore appropriate to give priority to legacy contracts maturing after December 2021. Instead of the inclusion of acknowledgements in legacy contracts that the benchmark methodology is expected to change, many respondents would favour supporting statements by public authorities, for instance that the reformed EONIA represents the same economic reality, or even EU legislation endorsing the EONIA transition.

The vast majority of respondents (56 out of 58) agreed that legacy contracts maturing after December 2021 should be prioritised. Respondents considered that the change in EONIA methodology should not require an amendment of legacy contracts, except in cases where the wording in a contract describes EONIA in too much detail. With the publication of EONIA expected to stop at the end of 2021, the priority should clearly be given to legacy contracts that mature after that date. No respondents recorded a contrary view and only two expressed “no opinion”.

Respondents noted that legacy contracts that mature before the end of 2021 may continue using EONIA, following the extension of the transitional period under the BMR and considering the fact that EONIA is not scheduled to be discontinued before the end of 2021. Respondents expressed the view that the insertion of an acknowledgment in legacy transactions entered into before 2 October 2019 – acknowledging that the change of methodology for EONIA during the period of the contract will not affect the continuity of the contract – would support transparency between the parties, but was not necessary for contractual robustness.

One respondent noted that it had received legal advice that a modified EONIA (as of October 2019) would be a continuation rate and suggested that it would be helpful for the working group to issue a clear statement that it should be treated as such. This respondent also noted that, in its view, it would be helpful if the working group and/or the European Money Markets Institute (EMMI) recommended that parties continue referencing the €STR plus the Spread even after EONIA ceases to be published, until such time as parties have been able to amend their contracts.

Another respondent noted that priority should be given to all legacy contracts maturing after 30 September 2019 if the ISDA definition of EONIA needs to be amended to reflect the recalibrated methodology. If the ISDA definition of EONIA does not require amending, it would support the proposed recommendation that priority should be given to legacy contracts maturing after December 2021. One respondent expressed a preference to avoid amendments at an individual transaction level and another noted a preference for minimal impact pre and post transition, e.g. having global regulators confirming that the transition of legacy contracts to the new risk-free rates (RFRs) will not require the parties to mandatorily clear or margin legacy transactions post transition.

One respondent stated that, where contracts are subject to hedge accounting relationships, there may be reluctance to modify such contracts before the International Accounting Standards Board (IASB) has completed Phase II of its project, so, while they need to be amended prior to December 2021, such contracts may have lower priority than those not subject to hedge accounting.

One respondent expressed agreement that, from a practical point of view, priority should be given to legacy contracts maturing after December 2021, although remediation of all legacy contracts would better respect Article 28(2) of the BMR.

On the other hand, respondents were concerned about the need to amend their stock of legacy contracts and the view was expressed that the management of contractual amendments (“repapering”) is likely to raise significant operational issues leading to legal and regulatory risks. It was also suggested that a legislative initiative at EU level could endorse the EONIA transition (e.g. considering consent to be implicit once the client has been informed in advance and in the absence of objections) and that this would be the best way forward to facilitate contractual remediation and respond to risks. In the absence of a legislative initiative, strong public support and education provided by EU authorities (regarding the rationale for change and the impact of the modification) would materially help client communication and provide an adequate basis for chasing the clients.

Another respondent, who did not support the recommendation to include an acknowledgment that the benchmark methodology is expected to change during the lifetime of the legacy contract, suggested that the working group should recommend instead a statement by the competent authorities or central bank that the reformed EONIA represents the same economic reality as the current EONIA.

Finally, one respondent expressed the view that the recommendation on page 28 of the EONIA to €STR Legal Action Plan, according to which “market participants are

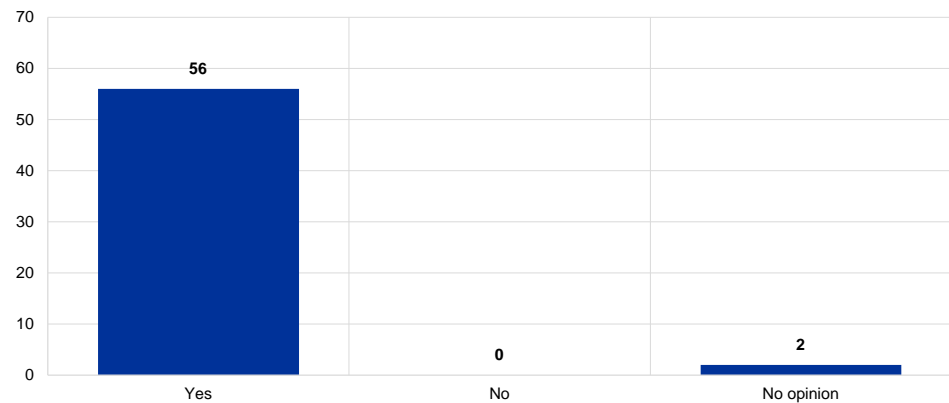
recommended to consider substituting EONIA or embedding a robust fallback in all contracts, when applicable, feasible and appropriate" should be removed as this could represent, for legacy contracts maturing before 2022, a huge operational burden for little or no added value, considering that EONIA will be published until the end of 2021 and there is no risk to contract continuity. This respondent was of the opinion that, at most, this recommendation should only apply to contracts subject to the BMR which do not already include a fallback.

Chart 11

Extent of agreement with the proposal that priority should be given to legacy contracts maturing after December 2021

June 2019

(number of respondents)



Source: ECB Secretariat to the working group on euro risk-free rates.

For legacy derivative transactions, would it be useful to have documents and/or protocols which facilitate (i) the incorporation of the EONIA index cessation event trigger and related fallbacks, and/or (ii) the amendment of legacy trades to switch from EONIA to the €STR plus the Spread (as defined)? (yes / no / no opinion)

For legacy derivative transactions, the vast majority of respondents (56 out of 58) found it useful to have documents and/or protocols that facilitate (i) the incorporation of the EONIA cessation event trigger and related fallbacks, and/or (ii) the amendment of legacy trades to switch from EONIA to the €STR plus Spread (subsequently defined as a spread of 8.5 basis points). Respondents mainly agreed with the working group's recommendation and suggested that any protocol facilitating the incorporation of fallback clauses or the change to the reference rate should also cover collateral agreements referencing EONIA. The need for a specific EONIA protocol was justified by respondents with reference to the fact that the scope of the existing 2018 ISDA Benchmarks Supplement Protocol is very wide and not suited to a specific situation like that of EONIA and the fact that the existing protocol does not cover collateral agreements, which is a key issue in relation to EONIA. Only one respondent expressed no opinion, and just one negative response was received.

All responses to this question were positive, with the exception of one negative response and one "no opinion" response.

In supporting the production of EONIA-related protocols, most of the replies identified ISDA as the appropriate body to develop these EONIA protocols (unless reference was made to a local master agreement, for which local organisations would be responsible). One respondent argued that, in the suggested EONIA protocols, deviations from the ISDA language that will be used for the dedicated protocols of other IBORs should be avoided to ensure maximum consistency among protocols dealing with interest rates globally.

On the other hand, one respondent stated that, while an EONIA fallback protocol is key, it should be taken into consideration that publication of a specific and separate EONIA fallback protocol (i.e. to incorporate a specific EONIA fallback trigger) may create confusion among derivatives end-users and disincentives to adhere to multiple protocols at different points in time, as different protocols are under development for a number of IBORs globally. Similarly, another respondent argued that ISDA should clarify the interaction between the existing ISDA Benchmarks Supplement and the possible protocols that ISDA will deliver in relation to EONIA. Otherwise, some market participants may mistakenly incorporate only one set of provisions and not the other (e.g. only EONIA fallback and not the Benchmarks Supplement). The proliferation of similar protocols was identified as a possible

source of confusion, especially for smaller market participants who are less well informed about global developments.

In addition, two respondents argued that the benefits of a transition ahead of the EONIA cessation, while EONIA is effectively calculated as the €STR plus the Spread, may not outweigh the drawbacks of the large repapering exercise. Therefore, market participants may take the view that incorporating a robust fallback language to switch to the €STR plus the Spread upon EONIA cessation at the end of 2021 is a more suitable solution for legacy contracts.

Four respondents suggested that the EONIA protocol should also apply to local master agreements and that, in the context of local master agreements, protocols should also cover collateral.

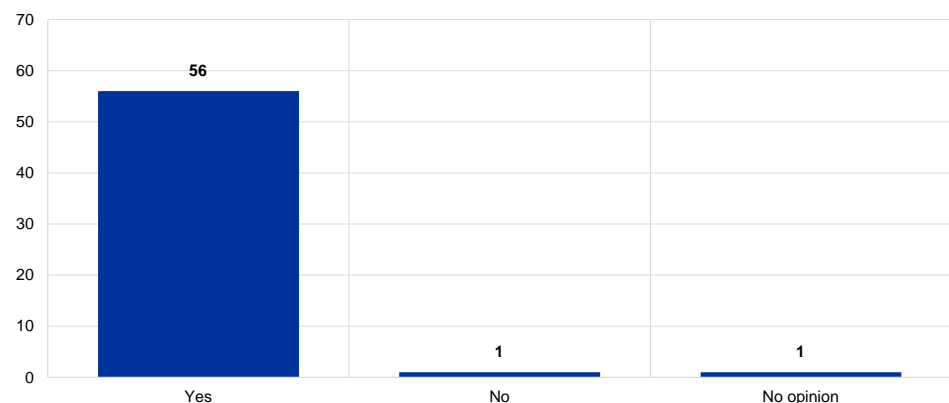
Although respondents largely agreed with the working group's recommendation, two respondents highlighted the fact that, because adherence to the protocol is always voluntary, even the creation of a specific protocol will not ensure that all transactions are covered. The success of the protocols depends on the adherence of relevant market participants, which is not guaranteed without a regulatory steer. Another respondent suggested that the best solution would be for the authorities to facilitate the transition through legislative measures. Finally, one respondent pointed out that the protocol solution is not enforceable under German law.

Chart 12

Extent of agreement with the proposal that it would be useful to have documents and/or protocols for legacy derivative transactions which would facilitate (i) the incorporation of the EONIA index cessation event trigger and related fallbacks, and/or (ii) the amendment of legacy trades to switch from EONIA to the €STR plus the Spread (as defined)

June 2019

(number of respondents)



Source: ECB Secretariat to the working group on euro risk-free rates.

Do you agree that the working group should encourage CCPs and Exchanges to clarify their position with respect to the transition to the €STR and to follow the ISDA approach with respect to fallbacks for EONIA? (yes / no / no opinion)

All the responses were positive with regard to the question of whether the working group should encourage CCPs and Exchanges to clarify their position with respect to the transition to the €STR and to follow the ISDA approach with respect to fallbacks for EONIA, except for two “no opinion” responses. The replies highlighted the key role to be played by CCPs and Exchanges in a successful transition to the €STR. The respondents asked for CCPs and Exchanges to take consistent action in a timely manner and to inform market participants in advance of their actions so that relevant preparatory measures could be taken by all stakeholders.

In all, 56 out of 58 replies to this question were positive. Some respondents argued that a consistent and timely approach by CCPs and Exchanges would greatly facilitate the transition methodology and reduce complications due to processing differences. Respondents explained that the roles of CCPs and Exchanges would be fundamental in determining an orderly migration of most of the market participants to the new €STR environment. Therefore they strongly supported the suggestion that the working group should encourage them to clarify and, where possible, coordinate their positions in respect of the transition to the €STR. Respondents noted that the terms of cleared over-the-counter (OTC) derivatives and exchange-traded derivatives are highly standardised and the rules and regulations of the relevant CCP or Exchange will determine the applicable fallbacks and how cleared OTC derivative contracts might be amended. Therefore, it would be helpful if the relevant CCPs and Exchanges clarified their plans with respect to the transition to the €STR and followed ISDA’s approach with respect to fallbacks for EONIA.

The advance communication by CCPs/Exchanges of plans in respect of EONIA transition should be encouraged, according to one of the responses. Similarly, another respondent said that it would also help if the CCPs/Exchanges clarified in good time how they intend to treat legacy cleared contracts and new cleared contracts.

respondents asked CCPs and Exchanges to clarify whether their contracts would refer to the €STR plus the Spread or to the €STR only and whether in the latter scenario there would be any compensation mechanism between the CCP and market participants. Other questions that should be clarified by CCPs and Exchanges are the following: at what moment do they intend to start using the €STR and change the reference; if there is a change in the definition of EONIA in the 2006 ISDA Definitions to include a fallback, will they accept contracts referring to the new definition; and will existing contracts at the time the definition of EONIA is changed be amended so as to incorporate the corresponding new definition.

Finally, one of the respondents who provided a “no opinion” reply argued that, until ISDA clarifies its plans regarding a fallback to EONIA, it is difficult to say whether CCPs and Exchanges should follow ISDA’s approach with respect to fallbacks for

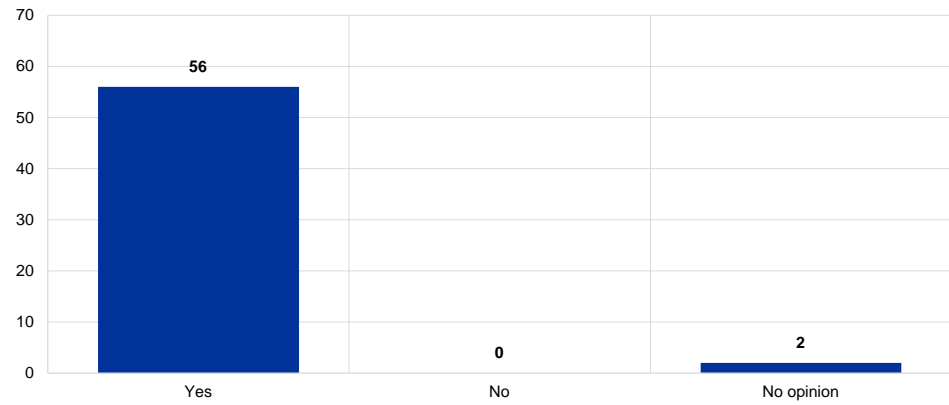
EONIA. A precise opinion on this matter can only be formulated once ISDA's approach is made public.

Chart 13

Extent of agreement with the proposal that the working group should encourage CCPs and Exchanges to clarify their position with respect to the transition to the €STR and to follow the ISDA approach with respect to fallbacks for EONIA [yes / no / no opinion]

June 2019

(number of respondents)



Source: ECB Secretariat to the working group on euro risk-free rates.

For legacy derivative transactions that are already documented using European local master agreements, which is the most feasible option for amending them? (develop common templates / develop a protocol / both / another option / no opinion)

With regard to the most feasible option for amending legacy derivative transactions that are already documented using European local master agreements, half of the respondents supported the simultaneous development of common templates and a protocol, while the remaining half were split between supporting common templates only, supporting a protocol only, no opinion or proposing different solutions.

Some 29 replies to this question supported the development of both common templates and a protocol, ten supported only the common templates, five were in favour of a protocol, seven preferred another option and seven expressed no opinion.

Supporters of both the templates and the protocols mentioned the importance of consistency between local master agreements and ISDA master agreement in terms of the language used. It was argued that it would also be very helpful if ISDA, when considering the development of a protocol covering ISDA master agreements and collateral agreements, also took into consideration local master agreements (and their collateral agreements). Reference was made also to the fact that ISDA could open the door to parties choosing to apply the protocol to local agreements. Other supportive respondents noted, however, that, although extension of the ISDA protocol to non-ISDA master agreements may be considered by ISDA, such protocols may not be enforceable in certain jurisdictions. Indeed, some respondents supportive of both solutions highlighted the fact that in some jurisdictions a protocol solution is not feasible (e.g. Germany), while it could work very well in others (e.g. Spain).

A number of positive responses supporting both the protocol and the templates highlighted possible issues related to them. In particular, one respondent supportive of both the common templates and the protocol commented that it is challenging to envisage a common template if the underlying agreements are different. The same respondent suggested envisaging a common “core language” to be adapted to the relevant agreements and principles to be followed in the transition process (e.g. timing, fallback versus switch approach). Similarly, in relation to the protocol, one respondent said that such a project may prove difficult within realistic timelines because the local associations generally do not have the structures/resources in place to administer protocols.

Another respondent supporting both templates and a protocol argued that, to the extent that there are proposals in local markets for language to deal with the substitution of EONIA, it would be important that these proposals are aligned across

industry associations so that they are consistent not only with the ISDA work but also with each other, i.e. across different jurisdictions.

A supporter of using only templates as a solution argued that the production of protocols requires extensive resources which may not be available to all local industry organisations. In any event, protocols would probably not capture all counterparties (or in some cases would not even capture most), so, in the absence of legislative clarification, either a protocol solution or the developed templates will only work insofar as they are agreed to by counterparties. This meant that a legislative measure by EU authorities was again identified as the only comprehensive solution.

A supporter of the protocol argued that the simplest approach to amending legacy derivative transactions documented under European local master agreements would be for the ISDA protocol to also cover such transactions. The working group should work with ISDA to accomplish this.

A respondent who replied with “no opinion” stated that this is an issue that must be discussed with the users of the European Master Agreement, the Spanish Master Agreement, the French Master Agreement and the German Master Agreement, as well as with their respective developers, i.e. the European Banking Federation (EBF), the Spanish Banking Association (*Asociación Española de Banca – AEB*), the Spanish Confederation of Savings Banks (*Confederación Española de Cajas de Ahorros – CECA*), the French Banking Federation (*Fédération Bancaire Française – FBF*), and the Association of German Banks (*Bundesverband deutscher Banken*).

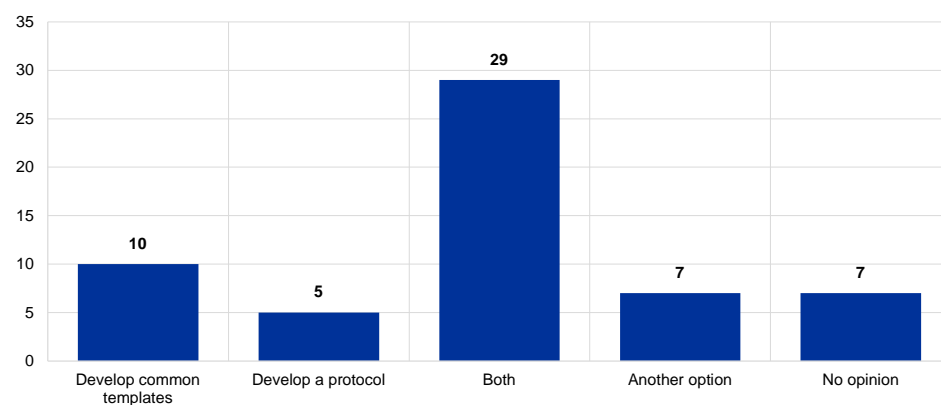
Two respondents who replied with “another option” argued that only a legislative solution can guarantee comprehensive reach. Another respondent argued that none of the proposed solutions are needed because local derivatives master agreements already include, or will soon include, a BMR fallback process which is generic but could be considered sufficient as a robust fallback without adding another amendment with the same effect.

Chart 14

Respondents' preferences with regard to the most feasible option for amending legacy derivative transactions that are already documented using European local master agreements [development of common templates / development of a protocol / both / another option / no opinion]

June 2019

(number of respondents)



Source: ECB Secretariat to the working group on euro risk-free rates.

Do you foresee any additional regulatory or legal requirements or costs that may hamper the amendment of legacy contracts and which need to be clarified / waived? (yes / no / no opinion)

Most respondents (40 out of 58) foresee additional regulatory or legal requirements or costs that may hamper the amendment of legacy contracts and which need to be clarified/waived. The majority of them emphasised the issue that European and EU Member States' competent authorities have not yet clarified whether amendments to legacy derivative contracts require the application of the margin and clearing requirements under the EMIR regime, an issue already mentioned in the EONIA to €STR Legal Action Plan. Another issue mentioned by the respondents is investment fund documentation (prospectuses and KIDs) and the implications for it of both the evolution of EONIA methodology and the future shift from EONIA to the €STR. In relation to costs, the responses identified client education as a source of additional costs (and also of potential risks), together with repapering legacy contracts and operational costs such as adopting new discounting curves and updating internal systems.

Some 40 replies to this question were positive, mentioning a wide spectrum of diverse issues still to be clarified by the official sector, while nine were negative and nine expressed no opinion.

In line with what was already stated in the EONIA to €STR Legal Action Plan, many respondents welcomed the BCBS/IOSCO statement of 5 March 2019 stating that amendments to legacy derivative contracts pursued solely for the purpose of addressing interest rate benchmark reforms do not require the application of the margin requirements. However, the respondents asked European public authorities to confirm this waiver vis-à-vis EMIR requirements, both in relation to clearing and bilateral margining obligations. Multiple replies argued that it is imperative that EU regulators confirm that any amendments to derivative contracts for the purposes of the EONIA/€STR transition will not result in transactions losing their legacy status under the margin and clearing rules. If this does not happen, the EONIA transition plan could be jeopardised.

One respondent specifically suggested a legislative clarification by the European Securities and Markets Authority (ESMA) along the lines of a BCBS/IOSCO statement, as this would be indispensable in ensuring a successful transition. A small number of respondents also argued that it would be important that the regulators confirm officially that the successor of EONIA will be the €STR plus the Spread.

Some respondents raised the issue of investment fund documentation – prospectuses and key information documents (KIDs). These respondents urged authorities to confirm that the change in EONIA methodology and the future shift from EONIA to the €STR is not a significant change, since it is aimed at improving

the reference to the same overnight rate and, for this reason, should not require investors to be informed individually. One of the respondents argued in relation to KIDs for packaged retail and insurance-based investment products (PRIIPs) that if there is an obligation to prepare a new KID, it should be sufficient to comply with the PRIIPs Regulation¹ that it is modified on the website of the PRIIP manufacturer (in accordance with recital 22 of Commission Delegated Regulation (EU) 2017/653²). The PRIIP manufacturer may not have access to the identity of its underlying retail investors. In such a case an active model (sending the new KID to investors) would need to address the entire distribution chain, and obligations placed solely on the PRIIP manufacturer would be unlikely to achieve the impact desired by the PRIIPs Regulation. The same respondent quoted the Joint Consultation Paper on PRIIPs Key Information Documents (JC 2015 073) issued by the European Supervisory Authorities (ESAs) on 11 November 2015, stating that “it could be very costly therefore to put in place a requirement for active communication, in that this could require the creation of single registers of retail investors for all PRIIPs, irrespective of their legal form”.

Also in relation to investment funds, another respondent argued that the transition from EONIA to the €STR may require amendments to a significant number of fund documents. This entails the risk that national competent authorities will seize upon the occasion of such an update to require compliance with other regulatory guidance or developments with which compliance would not otherwise be required until a later date. Thus, it would be very useful to add to the recommendation on amending legacy derivatives a clear statement that any update to fund documents made for the transition to the €STR should not be considered a trigger for compliance with other non-related rules or regulations with which compliance at a later date would otherwise be possible.

In addition, a number of respondents referred to potential accounting issues, such as valuation models, IFRS and hedge accounting. In particular, one respondent explained that banks usually refrain from touching derivatives in an active hedge accounting relationship because that is often associated with the realisation of losses or profits from the derivatives which should have been avoided through the hedge accounting. The respondent would prefer the development of a legal framework on handling benchmark reform-related amendments to legacy derivative contracts used in hedge accounting relationships to address this issue. Another respondent stated that adverse accounting consequences (e.g. for hedge accounting) may be deemed a significant modification under applicable tax rules and may be subject to punitive prudential capital treatment. Regulators should therefore consider relief from these adverse accounting, tax and prudential impacts in the introduction of RFRs.

¹ Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs) (OJ L 352, 9.12.2014, p. 1).

² Commission Delegated Regulation (EU) 2017/653 of 8 March 2017 supplementing Regulation (EU) No 1286/2014 of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products (PRIIPs) by laying down regulatory technical standards with regard to the presentation, content, review and revision of key information documents and the conditions for fulfilling the requirement to provide such documents (OJ L 100, 12.4.2017, p. 1).

Several respondents mentioned client education as a source of additional costs and risk. One respondent argued that client education should come not only from the relevant financial institutions but also from regulators and market associations. In relation to this, another market participant argued that, because client communication is expected to entail additional costs and in order to ensure consistent and adequate information, a common client communication pack would be very helpful. Yet another respondent identified the risk that clients may not agree to any amendments to their existing contracts owing to a lack of education on or understanding of the issues. Similarly, one respondent stated that legal/contractual uncertainty would increase because a counterparty could refuse to use the €STR after EONIA is discontinued. This situation could arise in particular for derivatives used to hedge cash products, such as bonds or credit facilities.

Repapering of legacy contracts was mentioned by many respondents as a source of extra costs. One respondent argued that it foresaw obvious legal and documentary requirements linked to the fact that an amendment agreement (to be signed by all parties to the underlying agreement) would need to be prepared for each agreement containing a reference to EONIA. Given the very high number of agreements referring to EONIA, this is a massive repapering exercise which will generate material costs and resources (both internal and in law firms/consultants) and whose outcome depends on the full cooperation of all parties. It cannot be excluded that certain parties might not sign such amendment agreements or might take the opportunity to try to renegotiate other commercial terms of the underlying transactions, which could trigger endless discussions.

In relation to costs, one respondent said that firms would also incur a number of operational costs, such as for making new curves (EONIA to the €STR plus the Spread construction, followed by a transition to the €STR flat construction) and updating internal systems (processing new products, payment systems, moving from T+0 to T+1 rates publication). The same market participants argued that firms could also incur licensing fees for access to new rates.

In addition, one respondent argued that, where parties experience losses in the context of the RFR transition, they may lodge formal complaints or make a legal claim for compensation. The public sector may have to take action to mitigate the future litigation/enforcement risk where market participants are acting in good faith.

A separate issue raised by some respondents is the Fundamental Review of the Trading Book (FRTB). Four replies mentioned that there is not sufficient historical data for the FRTB.

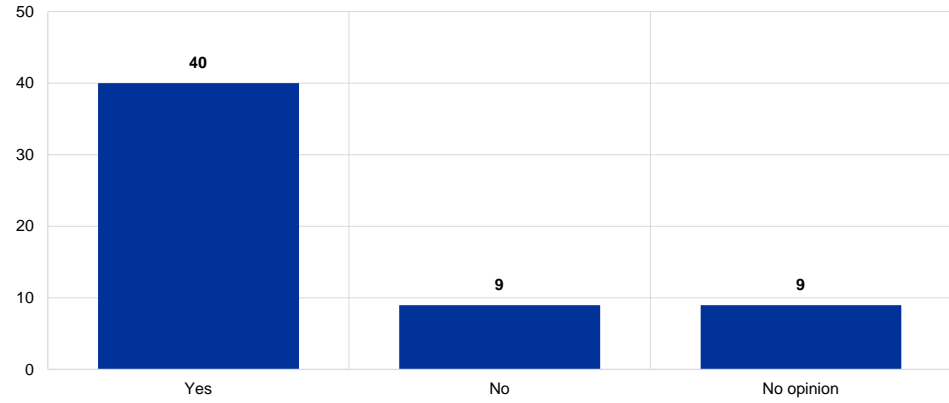
Finally, one respondent argued that one risk is potential antitrust risk emanating from the industry's participation in industry working groups. While the participation of regulators in these working groups provides comfort, regulators should provide further reassurances to market participants in this regard.

Chart 15

Number of respondents who foresee additional regulatory or legal requirements or costs which may hamper the amendment of legacy contracts and which need to be clarified/waived? [yes / no / no opinion]

June 2019

(number of respondents)



Source: ECB Secretariat to the working group on euro risk-free rates.

Which are the critical elements to consider when transitioning from EONIA to the €STR in collateral agreements from a legal, operational and valuation standpoint?

Several responses were given as to the critical elements to consider when transitioning from EONIA to the €STR in collateral agreements from a legal, operational and valuation standpoint. For each of these dimensions, respondents mentioned a number of issues that should be considered, the main ones being: the absence of fallback provisions in current collateral agreements; the timing of the transition and its operational implications for the calculation of interest under collateral agreements; and the introduction of a new discount curve that will replace the current curve based on EONIA, with possible value transfer implications.

Most of the responses raised questions related to legal, operational and valuation issues.

In relation to the legal standpoint, some respondents noted that the majority of collateral agreements do not have either termination date or fallback provisions. Therefore, existing collateral agreements should be amended in particular to include robust fallback provisions. This would ensure consistency with other financial contracts mentioned in this consultation.

On the other hand, another respondent argued that, from a legal perspective, if market participants have to amend legacy collateral agreements, it may be more efficient to amend them to switch from EONIA to the €STR (plus an appropriate adjustment) instead of embedding a fallback provision based on the three complementary options in this section of the consultation paper. Two different respondents argued that, if there is a choice to be made between improving EONIA fallbacks and facilitating transition to the €STR, they would prefer the latter to be prioritised. They also suggested that a critical element to ease the transition would be the development of an ISDA protocol so as to avoid the proliferation of bilateral renegotiations. Thus, in terms of whether prioritisation should be given to fallback provisions or transitioning from EONIA to the €STR in collateral agreements, the feedback from the respondents was mixed.

Many respondents mentioned the possibility of disputes between parties as a source of legal risk. One of them stated that it was really important to ensure that both parties agreed to use the new reference rate in order to avoid any potential dispute. A possible solution would be to have official confirmation (e.g. a level 2 text) from the regulators that the €STR plus the Spread is the official successor to EONIA. The other option is to use a protocol, but that would require all market participants to adopt the protocol instead of entering into complicated bilateral negotiations.

One respondent listed the following elements that may assist market participants from a legal perspective with respect to the transition of bilateral agreements from

EONIA to the €STR plus the Spread: discussion with relevant rate information sources and providers to ensure that any webpage which publishes the €STR plus the Spread is the successor to the one on which the EONIA was published; if necessary, the sponsors of master agreements should provide either a protocol or a form of bilateral amendment agreement which the parties can use to transition to the €STR plus the Spread; explicit confirmation by ISDA that the spread element will not stop the application of the negative interest rate protocol to CSAs which are subject to the protocol at the time the methodology for EONIA changes or when EONIA ceases to be published.

Other critical elements mentioned by market participants in relation to the legal standpoint are: the date on which the clearing houses change their PAI rate and the decisions of major market participants regarding the date for the transition and the relevant replacement rate (the €STR or the €STR plus the Spread).

Finally, some respondents noted that, from a legal perspective, even if common templates or protocols are developed and used as a market standard, it cannot be excluded that some counterparties will reject the changes and negotiate alternative rates. It will therefore not be possible to ensure that all transactions currently outstanding and referencing EONIA can be amended to include fallbacks to the €STR.

From an operational standpoint, it was noted that renegotiating the amount to be exchanged upfront for amending collateral agreements from EONIA to the €STR (flat) would be extremely cumbersome, and potentially difficult for some institutions to calculate. A protocol giving participants the option to amend collateral agreements from EONIA to the €STR plus the Spread would be helpful for participants.

In addition, the transition will require internal technology changes to allow existing loan and deposit accounts to be updated with the new rate and interest reimbursement. These changes require market participants to start their planning and process management now. Another big challenge from an operational standpoint is the timing within the month of the transition. Protocols and amendments usually become effective on the day they are published or executed, whereas interest is generally calculated and settled on a monthly basis under collateral agreements. In order to reduce the manual effort of reconciling the interest rate calculation, the working group on euro risk-free rates was asked to take this into consideration in the effective timing of the transition.

In relation to timing, some respondents mentioned that the ideal situation would be to leave the options open to the discretion of the parties adhering to the protocol (using the standardised templates) or, alternatively, to link the amendment to the moment when one, two or more clearing houses move to the €STR.

One respondent added that if the collateral arrangements for various products and rates have to be amended at different times, this would create a significant operational burden, hindering the transition ahead of the benchmark cessation. Unless there is a way to combine the EONIA switch with the transition of other IBORs and across various product agreements, market participants may be

discouraged from transitioning ahead of the EONIA cessation for legacy contracts (indeed, the risk is different from that for other IBORs, as EONIA will in fact be calculated as the €STR plus the Spread for a long time in advance of EONIA's discontinuation). The provisions adopted for the reference rates of the transactions should apply consistently to the interest rate on collateral exchanged with respect to those transactions so that it is not necessary to amend the agreements at two different levels.

In relation to valuation, many respondents mentioned as the most critical issue the discount curve that will replace the current curve based on EONIA to determine whether a transfer of value will happen when switching to the new curve. If the new discount curve is based on the €STR plus the Spread, no transfer of value will happen. If the new discount curve is based on the €STR flat, there will be a transfer of value (because the discount curve is lower) and the resulting process needs to be clarified. Some respondents suggested that there are two possibilities: either a one-off payment from one of the two parties for the valuation change or the addition of an EONIA/€STR basis swap to maintain the value of the portfolio. In relation to the discount curve issue, one respondent replied that, without a general replacement, many different valuation curves will have to be set up and, as they will differ from the original curve (EONIA) with bilaterally agreed spreads, jumps in valuation are likely. This could have a big profit and loss impact that should be avoided at any price.

One respondent pointed out that a possible misalignment may arise (between cleared and bilateral collateralised instruments) between the PAI rate of the cleared instruments and the CSA interest rate of the bilateral collateralised instruments which define the discounting curve regime to be applied. In fact, if the PAI rate and the CSA interest rate are changed from EONIA to the €STR, this may have an impact on the valuation of both cleared and bilaterally collateralised instruments. In this case, too, it is very important that a preliminary alignment among the relevant actors in the market (CCPs, regulators, settlement systems etc.) takes place through the relevant trade associations/industry bodies in order to understand their individual opinions/intentions on the matter and to evaluate individual risk positions and contractual approaches.

Another respondent mentioned that the transition to the €STR could lead to differences in the valuation of transactions/portfolios among the parties to a contract, primarily owing to the potential lack of liquidity in the €STR, particularly during the first months/years after October 2019. The same respondent added that it would be very helpful if ISDA (and any other relevant association) would consider developing solutions to this, such as a specific mechanism for dispute resolution in such cases.

Do you agree with the bilateral amendment agreement template for cash products (see Annex 2)? (yes / no / no opinion). Do you have any suggestions regarding it?

Most respondents (37 out of 58) agreed with the bilateral amendment agreement template for cash products (see Annex 2 of the EONIA to €STR Legal Action Plan), although some made suggestions for its improvement, including aligning the fallback clauses of cash products with those clauses that apply to derivatives. Others suggested that the parties intending to use the template should consider dealing with different classes of cash products/assets in separate amendment agreements in order to be more precise.

Some 37 replies to this question were positive, 19 expressed no opinion and two were negative.

of the positive replies suggested that the template should also cover repurchase and securities lending transactions, which should be amended through bilateral renegotiation of the contracts, assisted by a bilateral amendment agreement template in Annex 2.

A few respondents remarked that the template should take into account the fallback language templates developed or recommended by the relevant industry forums or trade associations (e.g. LMA for loans and ICMA for floating rate notes). For some products, counterparties may also wish to tailor the templates to take into account the terms and conditions of a particular securitisation. For syndicated loans, counterparties will probably use the LMA's own form of amendment agreement.

It was suggested that the template should include an offsetting clause. This is because it is expected that the shift from EONIA to any of the alternatives which may be provided for by the amendment agreement may result in a transfer of value between the parties. Therefore it was suggested that an additional clause be included in the template amendment agreement with the aim of offsetting any transfer of value resulting from the shift from EONIA to the alternative rate through balancing payments to the party detrimentally affected by the rate modification.

In addition, it was also suggested that the definition of the Affected Covered Transaction Document be aligned with the definition of the Affected Covered Credit Support Document, as it is not clear why documents not mentioning EONIA should still fall within the scope of this definition.

Finally, one respondent suggested that the definition of Discontinuation Date should be further refined on the basis of the definition of "Availability/Unavailability" in Annex 1 by including in the Discontinuation Date definition those trigger events included in the "Availability/Unavailability" definition that are not of a purely temporary nature.

A general comment shared by one negative response was that one-size-fits-all clauses risk being over simplistic, i.e. not capturing the specific features of the heterogeneous and individual legal requirements of each European jurisdiction. Hence, relying on such an approach may lead to implementation difficulties, especially with respect to timelines.

Another negative response pointed out that, as long as cash products relate to debt products, the bilateral amendment agreement does not seem relevant, as any change in the terms of the debt products will be handled pursuant to the relevant provisions of the legal documentation and/or in accordance with the governing law.

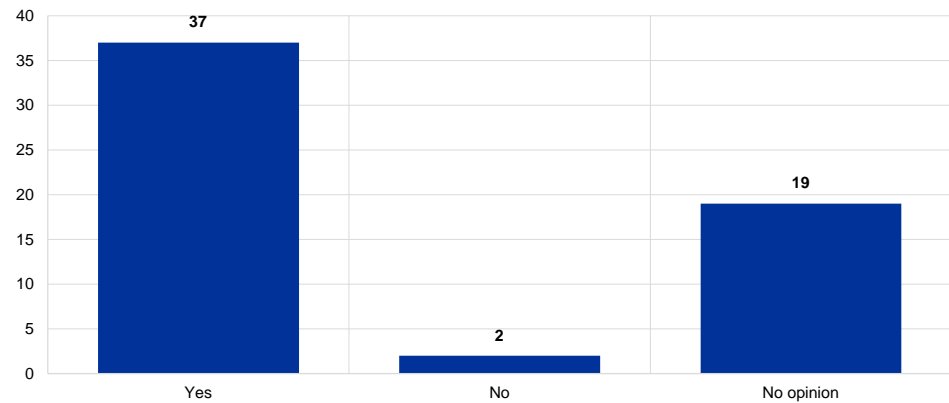
Finally, one respondent pointed out that market participants would replicate in their bespoke agreements insofar as possible the fallbacks and transition clauses that will be set by the industry bodies for the relevant cash product type. Therefore, a better approach would be to make sure that the industry bodies and reference rate working groups covering various cash products work together to produce consistent and harmonised fallback and transition languages insofar as possible given the differences in the underlying cash agreements.

Chart 16

Extent of support for the bilateral amendment agreement template for cash products (see annex 2 of the EONIA to €STR Legal Action Plan) [yes / no / no opinion]

June 2019

(number of respondents)



Source: ECB Secretariat to the working group on euro risk-free rates.

Note: The number of respondents is not equal to the total number of respondents, as one did not respond to this question.

Do you foresee any regulatory or legal requirements that may hamper the amendment of legacy cash contracts and which need to be clarified / waived? (yes / no / no opinion) If applicable, please elaborate on the reason for choosing “yes”.

A wide range of positive responses (33 out of 58) was given to the question of whether market participants foresee any regulatory or legal requirements that may hamper the amendment of legacy cash contracts and which need to be clarified and/or waived. The most common positive response referred to potential support by public authorities for both the evolution of EONIA’s methodology as a tracker of the €STR and the substitution of EONIA by the €STR plus the Spread in EONIA-referenced contracts when EONIA is discontinued. Similarly, several positive responses suggested that the EU or national authorities should clarify that the amendment of legacy cash contracts will not alter the tax or accounting treatment of those contracts.

In all, 33 replies to this question were positive, 16 expressed no opinion and nine were negative.

Many respondents who provided positive responses called on public authorities to play an even larger role. They argued that introducing fallback provisions in all affected contracts or, alternatively, agreeing on the index to replace EONIA after its discontinuation may be difficult to achieve in view of the large number of contracts currently linked to the benchmark. At the same time, a lack of agreement to replace EONIA when it is discontinued might lead to disputes over the interpretation of contracts which could largely be avoided if there were clear support from the public sector for both the evolution of EONIA’s methodology as a tracker of the €STR and the substitution of EONIA by the €STR plus the Spread in EONIA-referenced contracts when EONIA is discontinued.

The same respondents argued that, because these requirements are due to the implementation of the BMR, the enactment of a European regulation would be the safest way to ensure legal certainty and avoid potential litigation. Should that not be possible, or in case it might be delayed, these market participants suggested that, in the interim, it would be advisable to have a public statement from the Financial Services and Markets Authority (FSMA), ESMA, the ECB and the European Commission confirming that EONIA is the same benchmark both before and after the amendment of its calculation methodology.

Many respondents also highlighted the need for clarifications and/or waivers by any relevant competent authority (whether European or local) about the impact of the amendment of legacy contracts on existing regulatory and legal obligations, including tax and accounting treatment. Tax and accounting treatment was another subject in need of clarification, together with the previously mentioned clearing and margining obligations.

In relation to debt products, one respondent argued that amending the legal documentation of debt products which do not include any relevant fallback provisions could be very difficult, in particular within a short period of time, as it may require, depending on the terms of the product, either a qualified majority or unanimity of the holders to proceed with such an amendment.

Similarly, another respondent argued that obtaining consent from multiple bondholders, lenders and other parties, such as trustees and agents involved in the transactions, may present an obstacle to implementing these amendments.

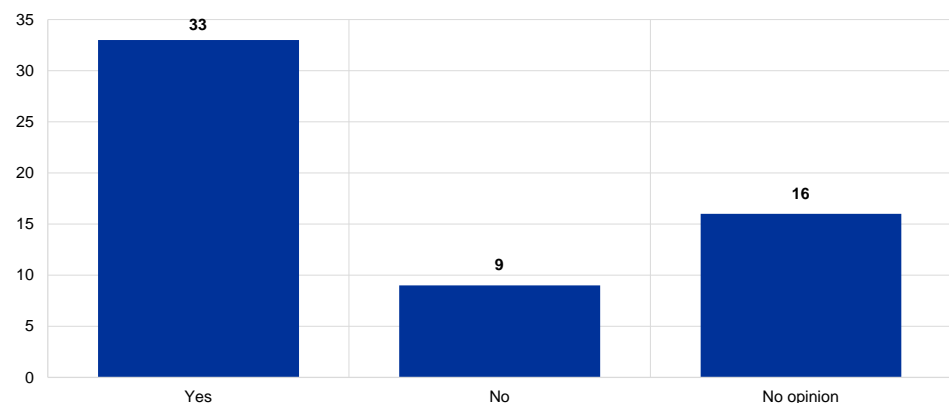
Some respondents mentioned the following additional issues to be considered in this context: legal concerns that may limit the issuer's/lender's ability to amend legacy contracts, such as where a rate change may cause fluctuations to consumer payments that are prohibited by consumer protection laws; conduct risk resulting from value transfer upon EONIA transition; the workload associated with the bilateral repapering of cash contracts, given the lack of a protocol and/or the multilateral nature of cash agreements; the need for clarity as to what additional documentation requirements or other legal or regulatory impact there might be; official sector messaging that a lack of express fallbacks would not lead to frustration of contracts; cumbersome consent/notification requirements; that the amendment of legacy cash products might result in notary costs and the question of when, pursuant to a regulatory requirement, it is mandatory to pay certain fees/costs; clients will need to be notified that the calculation basis for EONIA will be changing as of 2 October 2019, and this may potentially drive some contract renegotiation; the €STR as a new risk factor will need to be incorporated into risk and capital calculations, including revaluation functionality, as the €STR will potentially have different risk characteristics from EONIA; there may be additional operational, system and data considerations to be contemplated for the methodology change.

Chart 17

Number of respondent who foresee regulatory or legal requirements that may hamper the amendment of legacy cash contracts and which need to be clarified/ waived

June 2019

(number of respondents)



Source: ECB Secretariat to the working group on euro risk-free rates.

Note: The number of respondents is not equal to the total number of respondents, as one did not respond to this question.

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