

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

Dear Mr Lueder,

I am writing to you on behalf of the Euro Risk Free Rates Working Group (“RFRWG”) to thank you for the support with regards to the transition from EONIA to the Euro Short Term Rate (“€STR”). The draft Implementing Act designating EONIA as a critical benchmark in cessation is an important component of a clear and comprehensive solution for cash and derivative products.

As outlined in my previous letter to you in July, the transition from EONIA to €STR continues to face impediments with market participants and clients facing uncertainty on the future performance of their contracts ahead of EONIA’s discontinuation on 3 January 2022. This may lead to confusion and the need for parties to implement divergent operational solutions. The European Commission’s designation will provide legal certainty to all affected stakeholders and ensure the replacement of EONIA in contracts and financial instruments in the absence of a successful renegotiation.

The RFRWG welcomes this initiative and the proposed scope and replacement rate detailed in the draft Implementing Act. In order to ensure the market successfully transitions away from EONIA, we recommend that the Implementing Act highlight the importance of continued active transition to €STR for all contracts and financial instruments currently referencing EONIA. In addition, we would like to suggest some refinements relating to the scope of the statutory replacement rate and date of application of the designation. These suggestions do not negatively prejudice or preclude any responses that members of the RFRWG might send bilaterally in response to the consultation.

The first relates to further clarification that the statutory replacement rate is not intended to displace replacements or suitable fallback provisions agreed between parties, as outlined in Article 23b(3) of the revised Benchmarks Regulation. We propose that the Implementing Act clarify that the statutory rate would not prohibit bilateral amendments to collateral agreements with an alternative to €STR+8.5bps. We recommend clarification in the Implementing Act that existing spreads currently applied to EONIA in collateral agreements are maintained (e.g. the current spread is EONIA-3.5bps, following application of the statutory replacement rate (€STR+8.5bps), resulting in the economic effect being €STR+5bps). The reference to “Credit Support Annexes” could be replaced by “Collateral Agreements” to further specify that the statutory replacement is intended to address all forms of collateral agreements, beyond ISDA Credit Support Annexes.

The second suggestion pertains to the precise scope of the Commission’s designation powers covering contracts subject to a third country law. While Article 23a(2) of the Benchmarks Regulation scopes in contracts where counterparties are subject to the law of a third country and where that law does not provide for the orderly wind down of a benchmark, there is no further specification on which laws of third country jurisdictions are considered as providing for the orderly wind down of a benchmark. The impact of the Commission’s designation of EONIA may not be clear particularly in cases where a contract is exclusively between two EU-established entities referencing EONIA and subject to the laws of a third country jurisdiction. We recommend the Commission provide

interpretative guidance on the application of its statutory powers for contracts subject to third country laws.

I appreciate your intention and initiative in providing an efficient legal solution regarding the transition away from EONIA, and the consultation in gathering views from market participants ahead of such designation. On behalf of the RFRWG, I would like to highlight the importance of having a statutory solution in place before the end of Q3 2021 to ensure market participants can focus on the deliverables required to achieve a successful transition away from EONIA before its cessation. I look forward to your consideration of our suggestions regarding the draft Implementing Act and would welcome further discussion in due course.

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