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# Hot Topics

**Banking & Finance**
Eurozone Hub

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## Building new benchmark rates: ECB launches new working group and start of EUOIR from 2018

Benchmark interest rates serve an important role for financial markets and monetary policy implementation. Benchmark submitters and administrators have also attracted a high degree of supervisory scrutiny due to compliance breaches around LIBOR and EURIBOR etc. The financial crisis that started in 2007 highlighted cultural shortcomings and led to a raft of new rules to reshape the governance around how rates are compiled, administered and communicated.

On 21 September 2017, the European Central Bank **(ECB)** announced[1] that it was launching a central bank led alternative which would also serve as a "backstop to private sector benchmark rates". This new benchmark rate is currently referred to as the "Euro unsecured overnight interest rate" **(EUOIR)**. Whilst this working title and its pronunciation ('Eeyore'?) are yet to be finalised, the ECB Governing Council's decision to develop a rate based on data available to the Eurosystem is promising and quite welcome. Further details on how EUOIR will operate are set to be released to "market participants in the course of 2018", followed by a consultation process with a view to finalising and having EUOIR implemented by 2020.

### RFOR Working Group launched

The ECB also announced[2] the creation of a new working group tasked with developing new risk-free overnight reference rates for the Eurozone (the **RFOR Working Group**). This working group is currently comprised of the ECB, the European Commission, the European Securities and Markets Authority **(ESMA)** and the Belgian Financial Services and Markets Authority. The RFOR Working Group is chaired by a "private sector representative", who at present is unknown, and will have a permanent 'Secretariat' i.e., admin support provided by the ECB. The aims of the RFOR Working Group are to consult market participants, end-users and to gauge feedback from public authorities in relation to the breadth of new risk free rates that are to be developed. This includes work in respect of EUOIR.

Whilst the RFOR Working Group is tasked with coordinating with public sector stakeholders, it will also invariably over time be charged with coordinating supervision of transition arrangements as well as supervisory coordination more generally. The main objective is that any transition from current rates, including interbank offer rates, runs smoothly and free from disruption to markets, end-users and consumers. Despite this, it will remain to be seen both during the consultation

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[1] See Press Release: http://www.ecb.europa.eu/press/pr/date/2017/html/ecb.pr170921.en.html
[2] See ECB version of the Joint Press Release: http://www.ecb.europa.eu/press/pr/date/2017/html/ecb.pr170921_1.en.html

phases as well as during the finalisation of EUOIR's methodology what specific safeguards are put forward and how this will interrelate with the ECB and ESMA in their existing and any new supervisory mandates. In this respect, the Commission is proposing that the authorisation and supervision of critical benchmarks falls within ESMA's direct supervision mandate. The same applies in relation to any other rates developed by the RFOR Working Group.

**Next steps for documentation**

With a host of 'rate replacement workstreams' taking off in the Eurozone, the wider EU-27, the United Kingdom and globally the first step for affected firms will likely be to assess where they, or where relevant industry bodies, will want to engage in terms of policymaking and lobbying. Firms will want to also take note of relevant rate replacement dates as these dates will vary.

Equally, affected firms will possibly want to assess what existing rates are in place with counterparties and clients as well as clients of clients. This assessment will likely apply across documented and undocumented trading relationships, financial products and transactions. Secondly, relevant affected firms will want to assess how those affected exposures are capable of being amended and what consents or legal and regulatory, including disclosure, steps are required. This process will apply to wide range of affected exposures and relationships. In particular, it will apply to those relationships that are, are likely to be or are capable i.e., due to any restructuring or maturity extension, of being in place following any rate replacement date.

**Next steps for models**

Aside from the impact that replacement rates will have on transactional and product documentation, replacing rates may impact financial, regulatory and asset quality models. That in turn may impact regulatory capital in some areas but more pressingly may also trigger a need to calibrate various models. Model changes may not only require national authority level approval but that of the ECB in its supervisory role.

**Outlook to 2020**

These developments of course come on top of a busy workload of regulatory and BREXIT-driven reforms to relationships and documentation. Consequently, early engagement or at least commencing an issue and gap analysis and the corresponding process of allocating resources both internally and in relation to contacts across major counterparties is encouraged. This is especially the case as, in particular for dealer entities, supervisory scrutiny may increase[3] as the countdown to successor rates accelerates. Moreover, given that in addition to the ECB's role in the RFOR Working Group and monetary policy as well as supervisory impacts this will have for the Eurozone-19 and its Banking Union, one might expect that ESMA will publish its own supervisory expectations which would apply across the EU-27.

[3] Including due to changes to the way on-site inspections and internal model investigations are conducted in the Banking Union as well as the on-going ECB-led Targeted Review of Internal Models (TRIM) see our recent Client Alert on this available here: http://www.bakermckenzie.com/en/insight/publications/2017/08/consultation-launched-on-draft-ecb-ssm

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