

**Recommendations of the working group on euro risk-free rates
on the EONIA to €STR legal action plan**

16 July 2019

On 14 March 2019 the working group on euro risk-free rates (the “working group”) recommended that the European Money Markets Institute (“EMMI”), as the administrator of EONIA, modify the current EONIA methodology. As from the first publication date of the €STR, i.e. 2 October 2019, this would see EONIA become the €STR plus a fixed spread (the “Spread”, defined as the spread between the €STR and EONIA based on the methodology recommended by the working group and calculated by the European Central Bank as 8.5 basis points¹). The working group also recommended, among other things, that EMMI consider ceasing publication of EONIA at the end of 2021.² On 31 May 2019 EMMI announced the adoption of the new methodology with effect from 2 October 2019.³

On 15 May 2019 the working group launched a public consultation on its draft recommendations to address the legal implications for new and legacy contracts referencing EONIA arising from the transition from EONIA to the €STR.⁴ A summary of the feedback received in the public consultation was published on 27 June 2019,⁵ and today the working group recommends that market participants implement a series of legal measures (“the Legal Action Plan”) in order to ensure a smooth transition from EONIA to the €STR for both new and legacy contracts referencing EONIA.

While the Legal Action Plan relies to a great extent on the active support of market participants and on private contractual solutions, the continued support and involvement of the European and EU Member States’ public authorities in the implementation of the Legal Action Plan remains critical.

The EONIA to €STR Legal Action Plan was developed by the working group in close cooperation with relevant trade associations and a group of law firms that are members of the subgroup on contractual robustness.

Finally, the working group wishes to draw the attention of all market participants to the fact that the application of the recommendations contained in the EONIA to €STR Legal Action Plan will be entirely voluntary. Each market participant will need to make its own independent decision about whether – and, if so, to what extent – to adopt any suggested recommendations and apply them in its contracts.

1 “ECB provides a one-off spread between €STR and EONIA”, press release dated 31 May 2019.

2 Recommendations of the working group on euro risk-free rates on the transition path from EONIA to the €STR and on a €STR-based forward-looking term structure methodology.

3 Recommendations for EONIA of the Working Group on euro risk-free rates (March 2019).

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

5 Third public consultation by the working group on euro risk-free rates on the EONIA to €STR Legal Action Plan – Summary of responses.

General recommendations

1. The working group recommends that, as from 2 October 2019, whenever feasible and appropriate, market participants should consider avoiding entering into any new contracts referencing EONIA, in particular new contracts maturing after 31 December 2021.
2. In those cases where new contracts still reference EONIA and mature after December 2021 or fall within the scope of the EU Benchmarks Regulation (BMR), market participants should include robust fallback provisions following the recommendations described in paragraphs 8 to 20.
3. For legacy contracts referencing EONIA and maturing after December 2021, market participants should consider replacing EONIA as a primary rate as soon as possible. Alternatively they should embed robust fallback clauses referring to the recommended fallback rate for EONIA following the recommendations described in paragraphs 21 to 34.
4. With a view to achieving a smooth transition from EONIA to the €STR, the working group welcomes the work already done by market associations and encourages them to continue updating their standard documentation to include robust fallbacks and to develop protocols and/or other documentation. Where appropriate, the work done by market associations should be consistent across asset classes.
5. The working group acknowledges that the use of standard market documentation by market participants is voluntary. Nevertheless, where feasible and appropriate, the working group recommends that market participants consider using such standard market documentation for their contractual arrangements on a voluntary basis.
6. The Legal Action Plan relies to a great extent on the engagement of market participants and on private contractual solutions. The working group encourages market participants to implement the Legal Action Plan in a timely and consistent manner and would like to request continued support from European and EU Member States' public authorities for the Legal Action Plan.

Recommendation on an EONIA fallback rate

7. The working group recommends the €STR plus the Spread as the EONIA fallback rate for all products and purposes.⁶

Recommendations on new contracts referencing EONIA

8. In order to comply with the BMR (to the extent applicable) and to enhance transparency regarding the change of EONIA methodology taking effect on 2 October 2019 and the proposed EONIA discontinuation in December 2021, any new contracts still referencing EONIA should include robust

⁶ Among other things, in making this recommendation, the working group intends for the €STR to constitute the Alternative Post-nominated Index in relation to EONIA and for the Spread to constitute the Adjustment Spread (in the absence of agreement to the contrary between the parties) for the purposes of any derivative transaction which incorporates the terms of the ISDA Benchmarks Supplement.

fallback provisions which would switch the reference rate to the €STR plus the Spread upon the permanent discontinuation of EONIA.

9. Additionally, for the purpose of enhancing transparency, though not strictly necessary for ensuring a smooth transition, new contracts signed before October 2019 may include clarification that the EONIA methodology is expected to change as of 2 October 2019 and that references in contracts to EONIA shall be understood to be references to EONIA as changed, unless otherwise agreed by the parties.⁷
10. In order to facilitate the transition from EONIA to the €STR, the working group recommends several measures for specific asset classes.

New derivative transactions

11. For new over-the-counter (OTC) derivative transactions using the 2006 ISDA Definitions published by the International Swaps and Derivatives Association (“ISDA”), the working group considers the ISDA Benchmarks Supplement as providing a convenient way for market participants to implement the recommended steps. In particular, the working group notes that its recommendation that the EONIA fallback rate should be the €STR plus the Spread will result in that fallback being ‘hardwired’ into the ISDA Benchmarks Supplement unless otherwise agreed by the parties.
12. In addition, for the benefit of parties who do not incorporate the ISDA Benchmarks Supplement into their transactions, the working group recommends that ISDA considers updating the definition of EONIA in the 2006 ISDA Definitions so as to include a specific “index cessation event” trigger which would result in a fallback to the €STR plus the Spread upon the cessation of EONIA.
13. For new derivative transactions executed under European master agreements,⁸ the working group recommends that the sponsors of European master agreements consider amending these agreements to include robust fallback provisions dealing specifically with the permanent cessation of EONIA. For new derivative transactions executed under European master agreements, the working group considers that the use of standard documentation published by the relevant European sponsor provide a convenient way for market participants to implement the recommended steps in cases where the sponsor has published benchmark trigger events and fallback provisions similar to the ISDA Benchmark Supplement.
14. For new cleared OTC derivatives and exchange-traded derivative transactions referencing EONIA, the working group encourages the clearing houses and exchanges to clarify their position on the

⁷ Since the reform of EONIA's methodology does not involve the transition of existing contracts to a new benchmark, but rather a point-in-time evolution of the existing EONIA, the motivation behind this proposal is to enhance transparency for market participants and to ensure compliance with Article 28(2) of the EU Benchmarks Regulation. Market participants should form their own views (in conjunction with their legal advisors) on these issues.

⁸ These are: the Master Agreement for Financial Transactions, commonly known as the European Master Agreement (EMA) sponsored by the European Banking Federation, in cooperation with the European Savings Bank Group and the European Association of Cooperative Banks; the French Master Agreement relating to transactions on forward financial instruments sponsored by the French Banking Federation (Fédération Bancaire Française – FBF); the Spanish Master Agreement (Contrato Marco de Operaciones Financieras – CMOF) sponsored by the Spanish Banking Association (Asociación Española de Banca) and the German Master Agreement for Financial Derivative Transactions (Deutscher Rahmenvertrag für Finanztermingeschäfte – DRV) developed by German banks with the support of the Association of German Banks (Bundesverband Deutscher Banken).

transition to the €STR as early as possible, and to amend their rulebooks and specific regulations in a timely and coordinated manner, informing market participants in advance.

New collateral agreements

15. For new derivative and cash collateral agreements using EONIA to specify the interest rate payable, the working group recommends the introduction of robust and standardised fallback provisions in new collateral contracts to enhance transparency and legal certainty upon the discontinuation of EONIA.
16. The working group recommends that, wherever practical, relevant market associations work with their members to develop solutions to enhance the contractual robustness of new collateral agreements entered into: for example, ISDA for the ISDA collateral documentation suite (such as the Credit Support Annex (CSA)), the International Capital Markets Association (ICMA) for the Global Master Repurchase Agreement (GMRA), and the International Securities Lending Association (ISLA) for the Global Master Securities Lending Agreement (GMSLA).

New cash products

17. The working group recommends that new cash contracts that mature after December 2021 or that fall within the scope of the BMR should include fallback provisions.
18. The working group acknowledges that a significant number of short-term cash contracts and instruments – such as European commercial paper, certificates of deposit, repurchase transactions and securities lending transactions – will roll over before December 2021, and new issuances should therefore simply reference the €STR instead of EONIA as soon as this is feasible.
19. For syndicated loans, the working group recommends that market participants consider using the standard market documentation to be provided by the Loan Market Association (LMA).
20. When including fallback clauses (except for syndicated loans), the working group provides – as a starting point for drafting and negotiation – two alternatives for EONIA discontinuation fallback language templates for new cash products. These templates can be found in Annex 1 of the public consultation on the EONIA to €STR Legal Action Plan dated 15 May 2019.⁹ Market participants may wish to apply them on a voluntary basis and to tailor the wording to take into account, among other things, the terms and conditions of each particular asset class, any interactions with derivative contracts, and the legal requirements of each applicable governing law and relevant jurisdiction.

⁹ Third public consultation by the working group on euro risk-free rates on the EONIA to €STR Legal Action Plan

Recommendations on legacy contracts referencing EONIA

21. The working group recommends that market participants consider focusing their efforts on amending legacy contracts maturing after December 2021. Legacy contracts with EONIA as the underlying/reference rate that mature before December 2021 will be covered by the ongoing publication of EONIA until the end of 2021.
22. The working group wishes to highlight the potential challenges involved if those derivative transactions, collateral agreements and cash products referencing EONIA that mature after 2021 are not amended or cancelled before December 2021.
23. For legacy contracts maturing after December 2021, parties might agree to:
 - (a) enter into a bilateral negotiation to cancel or restructure existing contracts before the date of their termination, where feasible and appropriate, so that the same parties may enter into a new contract using the €STR instead of EONIA.
 - (b) Where parties agree to amend legacy contracts and transactions, the working group recommends that parties:
 - (i) replace EONIA as a primary rate as soon as practicable; or
 - (ii) embed robust fallback provisions, which would switch the reference to the €STR plus the Spread upon the permanent discontinuation of EONIA; and
 - (iii) consider acknowledging that the EONIA methodology is expected to change in October 2019 and that references in contracts to EONIA shall thereafter be understood to be references to EONIA as changed, unless otherwise agreed by the parties; although such acknowledgement is not strictly necessary for ensuring a smooth transition, it enhances transparency.¹⁰
24. In order to facilitate the transition, the working group recommends several measures for specific asset classes as set out below.

Legacy derivative transactions

25. For legacy OTC derivative transactions using the 2006 ISDA Definitions, the working group considers that the ISDA Benchmarks Supplement Protocol provides a convenient way for market participants to implement the recommended steps. In particular, the working group notes that its recommendation that the EONIA fallback rate should be €STR plus the Spread will result in that fallback being 'hardwired' into the ISDA Benchmarks Supplement unless otherwise agreed by the parties.
26. In addition, for the benefit of market participants who do not incorporate the terms of the ISDA Benchmarks Supplement into their legacy OTC derivative transactions, the working group recommends that ISDA considers developing new documents and/or protocols that facilitate the incorporation of the specific EONIA cessation event trigger and related fallbacks, and/or the amendment of legacy trades to switch from EONIA to the €STR plus the Spread or such other form of compensation as the parties may agree.

¹⁰ See footnote 7.

27. For legacy derivative transactions executed under European master agreements, the working group recommends that the sponsors of European master agreements consider developing either amendment agreement templates or protocols to amend legacy trades, in order to facilitate the incorporation of an EONIA cessation event trigger and a related fallback provision and/or to switch to referencing €STR plus the Spread.
28. For legacy cleared OTC derivatives and exchange-traded derivative transactions referencing EONIA, the working group encourages the clearing houses and exchanges to clarify their position on the transition to the €STR as early as possible, and to amend their rulebooks and specific regulations in a timely and coordinated manner, informing market participants in advance so that all stakeholders are able to take preparatory measures.
29. In order to facilitate the amendment of legacy derivative transactions in a timely and efficient manner, the working group would welcome statements and/or clarifications from the European Commission and/or ESMA, confirming that the incorporation or effect of fallback provisions designed to (a) enhance the contractual robustness of derivatives and other trades referencing a benchmark, and (b) to amend or replace transactions which currently reference EONIA, would not by and of themselves (whether individually or in combination) have the effect of:¹¹
 - (a) imposing a margin or clearing obligation under EMIR, or
 - (b) requiring investors to be informed individually in relation to financial instruments documentation (prospectuses and key information documents – KIDs) for packaged retail and insurance-based investment products (PRIIPs).

Legacy collateral agreements

30. For legacy derivative and cash collateral agreements using EONIA to specify the interest rate payable, the working group acknowledges that from a legal, operational and valuation standpoint there are several elements to consider when transitioning from EONIA to the €STR.
From a legal perspective, as the majority of collateral agreements do not have either termination dates or fallback provisions, the working group recommends that, wherever practical, relevant market associations – such as ISDA, ICMA, ISLA and European associations sponsoring European master agreements – work with their members to develop new documents and/or protocols, where applicable, for legacy collateral agreements entered into under the Credit Support Annex (CSA), the Global Master Repurchase Agreement (GMRA), the Global Master Securities Lending Agreement (GMSLA) and the European master agreements, respectively.

Legacy cash products

31. Although the majority of legacy cash contracts and instruments are short-dated and mature before December 2021, there will be some cash contracts and instruments that need to be amended or canceled through the bilateral renegotiation of contracts.

¹¹ European authorities should also liaise with third country competent authorities in order to obtain similar clarifications or waivers so as to facilitate cross-border activity.

32. To help launch those discussions, the working group recommends that the LMA considers developing an amendment agreement template to be used when amending syndicated loans which are based on the LMA standard documentation.
33. For other cash contracts and instruments, market participants may consider using the bilateral amendment agreement template included in Annex 2 of the public consultation on the EONIA to €STR Legal Action Plan dated 15 May 2019. Market participants may wish to apply it on a voluntary basis and to tailor the wording to take into account, among other things, the terms and conditions of each particular asset class, any interactions with derivative contracts, and the legal requirements of each applicable governing law and relevant jurisdiction.

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