

Benchmarks Transition

as of February 27th, 2020



Background

Financial benchmarks, especially benchmark interbank offered rates (“IBORs”) play an important role in the global financial system as they are used as a reference price for financial instruments, financial contracts or to measure the performance of investment funds.

There are millions of benchmarks on many type of underlying assets (please see some example below in the key element section) referenced in a very large volume of contracts that are worth for some of them trillions of dollars (LIBOR and EURIBOR for instance).

A wide scope of instruments ranging from residential mortgages loans to interest rate derivatives are referencing benchmarks. In terms of users, the population is also very wide as it goes from financial institutions to small retail clients.

Reforms are being undertaken by regulators to ensure accuracy, robustness and integrity of benchmarks which are used as a reference price for financial instruments and contracts

Regarding the interest rate benchmarks, the recommendations published by the Financial Stability Board (“FSB”) included the following recommendations¹:

- strengthening the “IBORs” by anchoring them to the greatest extent possible into transactions;
- identifying new alternative risk-free rates (ARR).

Latest developments:

1 – Current benchmarks reform:

- Benchmarks such as the London Interbank Offered Rate (LIBOR), the Euro Interbank Offered Rate (EURIBOR), the Euro Overnight Index Average (EONIA) and other Interbank Offered Rates were reformed or are being reformed.

2 – Identification of new alternative benchmarks:

- Based on the FSB recommendations, the five LIBOR currencies (EUR, USD, GBP, JYP, and CHF) and some other areas worldwide have or are currently taking steps to identify and develop new Alternative Reference Rates (ARR) (please see dedicated section below).
- There are three main differences between these ARR and IBORs:
 - ARR are nearly risk free whereas IBORs reflect the credit risk of major banks
 - ARR are overnight rates whereas IBORs have maturities ranging from overnight to 12 months
 - ARR are calculated only based on transactional data where IBORs are based on contributions from banks selected to be part of panels (the FSB has recommended that these panel banks use real-world transactions as much as possible, but these same banks also have the possibility to use their 'expert judgement' when there are not enough transactions)

3 – New regulatory framework:

- In Europe, among other regulations in the world, a new regulation related to benchmarks was adopted on 8 June 2016, the EU Benchmarks Regulation (BMR)². Most of the provisions of BMR came into effect on 1 January 2018 (subject to transitional measures).

¹ https://www.fsb.org/wp-content/uploads/r_140722.pdf

² Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014.

-
- This regulation affects (i) Benchmarks administrators, (ii) contributors to critical benchmarks, and (iii) benchmarks users.
 - BMR introduces a common framework and consistent approach to benchmark regulation across the EU that aims to ensure benchmarks are robust and reliable.

The reforms are expected to impact some benchmarks which may evolve, transition away from or be replaced.

The benchmarks reforms may have consequences on the products and services provided by Crédit Agricole CIB currently and/or in the near future whether in or outside the EU.

European Benchmarks Regulation – Key elements

What is an index?

An index is a figure published or made available to the public, regularly determined, partially or entirely, by the application of a formula or any other method of calculation and on the basis of the value of one or more underlying assets, prices or estimated prices.

What is a Benchmark?

A benchmark is an index used to calculate interest amounts, to value financial instruments or contracts, or to measure the performance of investment funds³.

How many Benchmarks are there?

There are millions of benchmarks. For instance:

- Dow Jones sponsors 850,000 benchmarks
- MSCI administrates 150,000 benchmarks

Which asset classes? All

- Interest Rate: EURIBOR, LIBOR, EONIA, HIBOR...
- FX: WMR quotes
- Commodities indices: Brent Oil, Gold, Silver, Corn, Salmon index
- Equity indices: CAC 40, Eurostoxx, S&P 500

What are they used for?

- Derivatives, Loans, Mortgages, Deposits, Annuities...
- Determine performance of Funds
- Value Balance Sheets, Stocks and Portfolios
- Determine penalty amounts, tax rates...

How concentrated is the use of Benchmarks?

- EURIBOR/LIBOR: contract volumes are measured in Hundreds of Trillions
- EONIA/SONIA/RFR: contract volumes measured in Trillions
- Equity/Commodity: contract volumes measured in Billions

³ Please note that some Indexes such as the ones administered by public authorities such as central banks or by journalists are out of the scope.

Overnight rates – Eurozone

Recommendations on evolutions have been addressed by the creation of new overnight rates called Risk Free Rates (RFR).

- On September 13, 2018, the European Central Bank (ECB) announced that the €STR (Euro Short Term Rate) would be the new overnight monetary reference rate for the Eurozone. €STR is expected to replace EONIA which, as announced by its administrator EMMI, will no longer be published after January 3, 2022.
- As from October 2, 2019, €STR will be published by the ECB on each TARGET2 business day at 08:00 am CET (if errors are detected following the publication of €STR that affect €STR by more than 2 basis points, the ECB will revise and re-publish €STR on the same day at 09:00 am CET) based on transactions that occurred on the previous business day.
https://www.ecb.europa.eu/paym/initiatives/interest_rate_benchmarks/euro_short-term_rate/html/index.en.html
- During this transition period, from October 2, 2019 to January 3, 2022, EONIA will continue to be published; its calculation methodology will become "EONIA=€STR + 8.5 bps" and its publication by EMMI will be changed from 7:00 pm on D to 9:15 am (" or shortly after ") on D+1.
- The 8.5 bps spread between EONIA and €STR, determined to ensure the economic equivalence of EONIA before and after its recalibration on 02nd of October, was announced and calculated by ECB on the 31st of May 2019. This spread will be fixed until the last EONIA publication on the third of January 2022.
<https://www.ecb.europa.eu/press/pr/date/2019/html/ecb.pr190531~a3788de8f8.en.html>

Term rates (IBORs)

EMMI has been authorised by the Belgian Financial Services and Markets Authority (FSMA) on 2 July 2019 for the administration of EURIBOR, and has been included in the ESMA register of benchmark administrators¹ on 4 July 2019.

EURIBOR is now considered BMR-compliant and was added to the ESMA benchmark register. This means that European Union (EU) supervised entities will be able to use EURIBOR also after the end of the applicable BMR transitional period.

As indicated by EMMI in its Benchmark Statement on 17 July 2019, the authorisation by the FSMA came as a recognition of EMMI's in-depth reforms over the last years to meet EU Benchmarks Regulation (EU BMR) requirements, including the development of a new hybrid methodology for EURIBOR.

- https://europa.eu/newsroom/content/authorisation-euribor-under-benchmark-regulation_en
- https://www.emmi-benchmarks.eu/assets/files/D0251A-2019%20-%20PR%20Benchmark%20Statement_Final.pdf
- <https://www.emmi-benchmarks.eu/euribor-org/about-euribor.html>

In the European Union, the European authorities have indicated that EURIBOR is European Benchmark Regulation (BMR) compliant meaning that there would be no restriction for its use after 2021. No indication has currently been given by these same authorities that this benchmark would cease anytime soon.

In addition, an alternative benchmark rate called Euro Short-Term Rate (€STR) has also been already developed. It has been published since 2nd October 2019 by the European Central Bank (ECB). €STR will replace the Euro Overnight Index Average (EONIA) as its publication is expected to cease on 3rd of January 2022.

Regulators and public and private sector working groups in several jurisdictions, such as the International Swaps and Derivatives Association (ISDA), the Working Group on Euro Risk-Free Rates, the Sterling Risk-Free Rates Working Group, and the Alternative Reference Rates Committee (ARRC), have been discussing alternative benchmark rates to replace IBORs.

LIBOR has been used since the 1980s to calculate the interest rate in financial products (loans, bonds, mortgages, and many other contracts). It is one of the most common interest rate benchmarks and it is today referenced in trillions of dollars of financial contracts and is used by a wide variety of clients from financial institutions to retail customers.

As indicated by the UK regulators, a primary reason why LIBOR might cease is an ongoing reduction of available reference data.

In parallel, alternative benchmark rates have been established for the five currencies where LIBOR is available (USD, CHF, GBP, EUR and JPY). For GBP LIBOR, Sterling Over Night Index Average (SONIA) has been designated as the alternative reference rate. SONIA is administered by the Bank of England (BoE) and is already available.

Unlike LIBOR which is fixed in advance for a set period (e.g. 3 months), SONIA is an overnight rate, measured on each day over the interest period to produce a final interest rate at the end of that period. Any difference between SONIA and LIBOR will impact how interest is calculated. We encourage you to perform your own due diligence on the way this affects your own activity.

Public authorities, in the UK and internationally, have been clear that LIBOR is expected to cease to exist after 2021.

More specifically, in a January 2020 joint letter (<https://fca.org.uk/publication/correspondence/dear-smf-letter-next-steps-libor-transition.pdf>), the BoE and the UK Financial Conduct Authority (FCA) have stated that “2020 will be a key year for transition” and have reminded all major UK-supervised banks of the following:

- switch in the convention for sterling interest rate swaps from 2 March 2020 from LIBOR GBP to SONIA
- for loans, LIBOR products may not be offered beyond Q3 2020
- significantly reducing the stock of LIBOR referencing contracts by Q1 2021

This transition may have an impact on nearly all financial products including bonds, derivatives, equities and financing products. Consequently, CACIB has set up a cross functional program with Senior Management oversight to coordinate its efforts for the transition.

Global overview of main Alternative Risk Rates (ARR)

| ZONE | Initial benchmark | Anticipated Replacement benchmark | Administrator | New benchmark 1 st publication |
|---|------------------------|---|----------------------------------|---|
| Overnight rates¹ → New Risk Free Rates Benchmarks (RFR)² | | | | |
| USD | Fed Fund O/N LIBOR | Secured Overnight Financing Rate (SOFR) | Federal Reserve Bank of New York | 03/04/2018 |
| GBP | SONIA | SONIA | Bank of England | 23/04/2018 |
| JPY | TONAR S/N LIBOR | TONAR | Bank of Japan | Already published |
| CHF | TOIS S/N LIBOR | SARON | Six Swiss Exchange | 29/12/2017 |
| EUR | EONIA O/N LIBOR EUR | €STER ³ | European Central Bank | 02/10/2019 |
| Term rates⁴ → ? | | | | |
| USD | Term US LIBOR | TBD | | |
| GBP | Term GBP LIBOR | | | |
| JPY | Term TIBOR | | | |
| CHF | Term CHF LIBOR | | | |
| EUR | EURIBOR | See below | | |

¹ *Overnight rates: interest rate at which a depository institution can lend or borrow funds that are required to meet overnight balances.*

² *Risk-Free Rate (RFR) must be based on robust underlying markets & have proper design / governance to present adequate safeguards against manipulation.*

³ *During the transition period, from October 2, 2019 to January 3, 2022, EONIA will continue to be published; its calculation methodology will become "EONIA=€STR + 8.5 bps" and its publication by EMMI will be changed from 7:00 pm on D to 9:15 am (" or shortly after ") on D+1.*

⁴ *Term rates: interest rate at different terms or maturities.*

For more information

Should you require any further information, please do not hesitate to contact your Relationship Manager.

FAQ

- **What is Crédit Agricole CIB doing?**

In coordination with the Crédit Agricole Group, Crédit Agricole CIB participates in several official industry workgroups especially the ECB Working Group on EU RFR.

A bank-wide project has been set up to prepare a smooth transition for our clients and processes.

- **Which index to choose?**

To replace IBORs currently used in both existing and future trades, the industry is working on alternative and fallback rates. Crédit Agricole CIB is closely monitoring or directly participating to their evolution and replacement.

- **What do the reforms mean for contractual documentation?**

For any documentation using a benchmark, already signed or about to be signed with Crédit Agricole CIB, some clauses may, if necessary, have to be modified to comply with the applicable regulations.

- **What will happen on 1.1.2022?**

Critical benchmarks and third-country benchmarks must be compliant with BMR by that date. If not, some alternative benchmarks will need to be identified as a replacement like with the non-critical European benchmarks.

- **What will happen on 1.3.2022?**

On 3 January 2022, the EONIA administrator (EMMI) will stop publishing the recalibrated EONIA. The €STR will still be published by the ECB ([link](#)).

- **Are there other important dates to look for on other benchmarks?**

As previously mentioned, other benchmarks may evolve, transition away from or be replaced. Crédit Agricole CIB is closely monitoring these developments and should communicate on them in due course.

More information relating to interest rate reform and transition can be found on the websites of the European Central Bank ([link](#)), the EMMI ([link](#)), the FCA ([link](#)), the US alternative references rate committee dealing with SOFR ([link](#)), the Working Group on Sterling Risk-Free Reference Rates dealing with SONIA ([link](#)), the National Working Group on Swiss Franc Reference Rate dealing with SARON ([link](#)), the Study Group on Risk-Free Reference Rates dealing with TONA ([link](#)), the U.S. Commodity Futures and Trading Commission, the International Organization of Securities Commissions and some of the industry working groups.

The content of this page is based on information relating to benchmarks reforms made available to the public, in particular from regulatory authorities and public and private sector working groups and does not purport to be exhaustive. The information provided above is an overview of Crédit Agricole CIB's current understanding of benchmarks reform and is subject to modifications, clarifications and/or changes depending on regulatory evolution and guidance in this respect.

This page does not constitute any advice and clients should consider making their own assessment as to whether they need professional guidance on the possible impacts of the changes that may result from benchmarks reforms.