



European Money Markets Institute

POSITION PAPER
SETTING OUT THE LEGAL GROUNDS
FOR THE PROPOSED REFORMS TO EURIBOR

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Preface

- EMMI is in the process of reforming the EURIBOR benchmark. Indeed, EMMI has been working on the development of a transaction based methodology for Euribor to ensure that it stays representative of the market conditions and results in a more robust and transparent benchmark.
- Section 2 of this position paper intends to explain the background for five reforms that constitute the reform process as presented on the “*Consultative¹ Position Paper on the Evolution of Euribor*” published in October 2015, and detail the legal grounds for undertaking them.
- The proposed reforms seek to clarify the Euribor specification and align the current methodology with the recently adopted EU Benchmarks Regulation, IOSCO Principles and other regulatory recommendations, as well as to adapt the methodology to better reflect current market conditions. As set out in section 2, the proposed reforms find strong legal support in the Benchmark Regulation and the IOSCO Principles.
- As detailed in section 3, EMMI has analysed the different transition paths identified in the MPG Report that could be used to implement the proposed reforms to the Euribor Benchmark methodology and specification, and noted that the seamless transition path is the preferred option when feasible.
- EMMI is aiming to evolve the current quote based methodology to a transaction based methodology. To this end, EMMI has been conducting a six-month Pre-Live Verification Programme² running from September 2016 to February 2017, to test the proposed methodology under the current market conditions.
- The results of the Pre-Live Verification Programme will inform the roll-out of the new transactions-based methodology and enable EMMI to assess the feasibility of a fully transaction based methodology via a seamless transition path. Once EMMI’s analyses of the Pre-Live Verification Program are complete, EMMI will seek the FSMA’s guidance before finally deciding on the transition path. While EMMI acknowledges that upon the outcome of the Pre-Live Verification Programme further revisions could be deemed necessary, reforming the Euribor methodology to ensure that it better reflects the underlying interest it intends to measure, is one of its major obligations as an administrator of a critical benchmark.
- As set out in section 4, EMMI sees the Euribor reform as an inclusive process and therefore will continue with its stakeholder outreach efforts aimed at informing, engaging and consulting all key stakeholders at national, European and international level.
- This paper is not intended to provide legal analysis or to replace the due diligence required from Euribor stakeholders in their role as benchmark users. It seeks to offer a high degree of transparency to enable stakeholders to conduct independent analyses to facilitate market preparation and to establish their arrangements to address or mitigate potential migration issues if required.

¹ Consultative Position Paper on the Evolution of Euribor https://www.emmi-benchmarks.eu/assets/files/Euribor_Paper.pdf

² <https://www.emmi-benchmarks.eu/assets/files/D0465A-2016>

EMMI%20announces%20that%20the%20euribor%20plve%20is%20well%20on%20track.pdf



DISCLAIMER

This position paper presents EMMI's analysis with respect to the legal grounds for the proposed reforms to the Euribor benchmark. It has been drafted for informational purposes only, deriving from EMMI's fiduciary duties as the benchmark administrator of the Euribor benchmark.

This position paper is not intended to be a legal opinion. EMMI does not give any warranties or representations concerning this paper and the information contained in it. Neither EMMI nor any persons or entities acting on EMMI's behalf will accept any responsibility for the information contained in this paper or the use made thereof.

EMMI wishes to stress in particular that this paper does not intend to predict, forecast or give any indication of the results of the Pre-Live Verification Program. Given the market sensitivity and confidentiality of the transaction data used in this exercise and the data derived thereof, any results obtained by EMMI throughout the course of the Pre-Live Verification Program will not be disclosed to stakeholders but will be restricted to public authorities until a final decision is made.

EMMI POSITION PAPER

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1. INTRODUCTION

1) Over the past three years EMMI has been in the process of reforming the EURIBOR benchmark. EMMI has been working towards a transaction-based benchmark methodology and the introduction of four clarifications to the EURIBOR specification to ensure that EMMI complies with its legal obligations and to ensure that the EURIBOR benchmark remains representative of the market conditions.

2) As part of the reform process, EMMI has assessed the legal grounds for those proposed reforms on the basis of advice by Allen & Overy and discussions with various stakeholders. This paper sets out EMMI's analysis with respect to the legal grounds for the proposed reforms, the different transition paths that may be used and EMMI's stakeholder outreach program.

3) This paper is based on (i) the Consultative Position Paper on the Evolution of EURIBOR and its annexes published by EMMI on 30 October 2015 (**Consultative Position Paper**), (ii) the Path Forward to Transaction-Based EURIBOR on 21 June 2016 (**Revised Roadmap Paper**) and (iii) the Pre-Live Verification Guidelines for a Transaction-Based EURIBOR published by EMMI on 21 June 2016 (**Pre-Live Verification Guidelines**) and it should be read together with those documents. Capitalised terms not otherwise defined in this paper have the same meaning as set out in the Consultative Position Paper, the Revised Roadmap Paper or Pre-Live Verification Guidelines.

4) This paper consists of three main sections:

- Section 2 of this paper sets out the background of the proposed reforms and the legal grounds for the evolution from a quote-based methodology towards a transaction-based methodology and the four clarifications to the EURIBOR specification.
- Section 3 analyses the different transition paths that can be used to implement the proposed reforms. This analysis leads to the conclusion that, when feasible, the Seamless Transition path is the preferred path to evolve the EURIBOR benchmark.
- Section 4 describes the efforts that EMMI has already undertaken to inform and consult the stakeholders concerning the reform process of the EURIBOR benchmark. This section also sets out the further steps EMMI will take to engage the stakeholders in this process.

2. LEGAL GROUNDS FOR THE REFORMS TO THE EURIBOR METHODOLOGY AND SPECIFICATION

2.1 Background of the Reforms

- 5) EMMI is reforming its benchmarks for multiple reasons:
- to comply with Regulation 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 (**Benchmark Regulation** or **BMR**) which sets out the legal framework for benchmarks¹;
 - to comply with the recommendations of the Belgian Financial Services and Markets Authority (**FSMA**). The FSMA is the Belgian authority competent for supervision of the rules set out in the BMR by virtue of article 37quinquies of the Act of 2 August 2002 on the oversight of the financial sector and on financial services²;
 - to follow the guidelines of international organisations on the administration of benchmarks such as the International Organization of Securities Commissions (**IOSCO**), the Financial Stability Board (**FSB**), the European Securities and Markets Authority (**ESMA**) and the European Banking Authority (**EBA**). These guidelines include, among others, the IOSCO Principles for Financial Benchmarks (**IOSCO Principles**), the FSB Market Participants Group's final report on Reforming Interest Rate Benchmarks (**MPG Report**) and the EBA/ESMA Principles for Benchmark-Setting Processes in the EU³; and
 - to adapt the EURIBOR methodology to the evolving market circumstances as there has been a steady decline in interbank activity and banks increasingly rely on broader wholesale funding from a range of transactions with different counterparties in different markets.
- 6) EMMI is planning to reform the EURIBOR benchmark determination methodology by evolving from the current quote-based methodology towards a transaction-based methodology.
- 7) In October 2015, EMMI published the Consultative Position Paper on the Evolution of EURIBOR. This paper summarised EMMI's plans for the evolution of the benchmark's determination methodology towards a transaction-based methodology, the clarifications to the EURIBOR specification as well as EMMI's plan for the implementation of the reforms. It further provided EMMI's rationale to implement the new methodology via the Seamless Transition path.
- 8) Stakeholders were invited to provide their feedback to the consultative position paper by 30 January 2016. Based on the results of this public consultation, EMMI published the Path Forward to Transaction-Based EURIBOR in June 2016. This document provides an update of EMMI's plan for the

¹ Most articles of the Benchmark Regulation will only enter into force on 1 January 2018. EMMI believes however that a normal, prudent benchmark administrator should work towards implementing the underlying principles as soon as possible.

² Loi relative à la surveillance du secteur financier et aux services financiers/wet betreffende het toezicht op de financiële sector en de financiële diensten. Article 37quinquies was introduced by article 68 of the Act of 18 December 2015 concerning various financial provisions (loi portant des dispositions financières diverses/wet houdende diverse financiële bepalingen).

³ These are soft law documents, i.e. non-binding recommendations. EMMI believes however that a normal, prudent benchmark administrator should take these recommendations into account, especially given the fact that there is currently no specific binding legal framework for benchmarks as most articles of the Benchmark Regulation have not yet entered into force.

evolutionary transition of EURIBOR from the current quote-based determination methodology to a fully transaction-based methodology based on the feedback to the Consultative Position Paper, providing a timeline for the deliverables for each respective work stream.

9) The next phase of the reform process consists of the Pre-Live Verification Program which is described in the Pre-Live Verification Guidelines that EMMI published on 21 June 2016. The Pre-Live Verification Program started in September 2016 and will run until February 2017. During the Pre-Live Verification Program banks will send their transaction data to EMMI. EMMI will then analyse those transaction data to assess the new transaction-based methodology under the current market conditions to ensure the soundness and representativeness of the new methodology. Based on the results of the Pre-Live Verification Program, certain methodological parameters will be set (e.g. contingency thresholds triggering fall-back arrangement). It is also possible that the transaction-based methodology may need to be further adapted to the current market conditions. A subsidiary objective of the Pre-Live Verification Program is to test the contribution and calculation infrastructure.

10) In addition to the reform of the determination methodology, four clarifications will be made to the EURIBOR specification to remedy shortcomings in the current specification and to adapt the EURIBOR specification to the evolving market conditions.

11) The current definition of the EURIBOR benchmark in the EURIBOR specification (Code of Conduct) reads:

“EURIBOR® is the rate at which Euro interbank term deposits are being offered within the EMU zone by one prime bank to another at 11.00 a.m. Brussels time.”

A prime bank is defined as:

“a credit institution of high creditworthiness for short term liabilities, which lends at competitive market related interest rates and is recognised as active in euro-denominated money market instruments while having access to the Eurosystem’s (open) market operations.”

12) In EMMI’s view, there are three shortcomings in the current EURIBOR specification:

- The specification does not distinguish between the Underlying Interest and the determination methodology. The Underlying Interest is the economic variable (the market) that a benchmark seeks to measure. The determination methodology is the means to practically measure the Underlying Interest.
- The concept that EURIBOR intends to measure a cost of funding, i.e. a borrowing rate, is not immediately evident in the current specification.
- The term “prime bank” is not fully defined, leading to variations in interpretation.

13) In conclusion, the reform process will consist of five reforms:

1. evolution towards a transaction-based methodology;
2. reformulating the EURIBOR definition;

3. re-emphasising that the EURIBOR benchmark reflects a borrowing rate;
4. expanding the eligible types of transactions and counterparties; and
5. reformulating the concept of “prime bank”.

2.2 First Reform: Evolution towards a Transaction-based Methodology

14) The first and most important reform is replacing the current quote-based methodology with a transaction-based methodology. The new methodology is described in detail in the Consultative Position Paper, the Revised Roadmap Paper and the Pre-Live Verification Guidelines. During the Pre-Live Verification Program the reformed methodology will be tested to ensure its soundness and representativeness. It is possible that the transaction-based methodology will be further refined on the basis of the results of the Pre-Live Verification Program.

15) The main reason why EMMI wishes to reform its calculation methodology is because the Benchmark Regulation and the IOSCO Principles state that benchmarks should be based on arm's length transactions to the extent possible. This is clear from article 11.1 (a) BMR and principles 7 and 8 of the IOSCO Principles. The main rationale for this preference is that benchmarks anchored in transactions are much less likely to be subject to manipulation.

16) Article 11.1 (a) of the Benchmark Regulation:

“The input data shall be sufficient to represent accurately and reliably the market or economic reality that the benchmark is intended to measure.

The input data shall be transaction data, if available and appropriate. If transaction data is not sufficient or is not appropriate to represent accurately and reliably the market or economic reality that the benchmark is intended to measure, input data which is not transaction data may be used, including committed quotes, indicative quotes and estimates;”

17) Principle 7 of the IOSCO Principles:

“The data used to construct a Benchmark determination should be sufficient to accurately and reliably represent the Interest measured by the Benchmark and should: (...)

b) Be anchored by observable transactions entered into at arm’s length between buyers and sellers in the market for the Interest the Benchmark measures in order for it to function as a credible indicator of prices, rates, indices or values. (...)

This Principle requires that a Benchmark be based upon (i.e., anchored in) an active market having observable Bona Fide, Arms-Length Transactions. This does not mean that every individual Benchmark determination must be constructed solely of transaction data.”

18) Principle 8 of the IOSCO Principles:

“An Administrator should establish and Publish or Make Available clear guidelines regarding the hierarchy of data inputs and exercise of Expert Judgment used for the determination of Benchmarks. In general, the hierarchy of data inputs should include:

- a) Where a Benchmark is dependent upon Submissions, the Submitters’ own concluded arms-length transactions in the underlying interest or related markets;*
- b) Reported or observed concluded Arm’s-length Transactions in the underlying interest;*
- c) Reported or observed concluded Arm’s-length Transactions in related markets;*
- d) Firm (executable) bids and offers; and*
- e) Other market information or Expert Judgments.”*

19) The BMR and the IOSCO Principles require that the input data for benchmarks should consist – to the extent possible – of data derived from observable transactions entered into at arm’s length. Therefore EMMI has decided to reform the EURIBOR methodology so that transaction data can – to the extent possible – be used as input data for the calculation of the EURIBOR rates.

2.3 Second Reform: the EURIBOR Definition

20) The second reform concerns the definition of the EURIBOR benchmark. The current definition mixes the concept of the Underlying Interest that EURIBOR seeks to represent and the determination methodology used to actually measure the rate. The second reform seeks to clarify the EURIBOR specification by making a clear distinction between the Underlying Interest and the determination methodology. EMMI will define the Underlying Interest for EURIBOR as *“the rate at which banks of sound financial standing could borrow funds in the EU and EFTA countries in the wholesale, unsecured money markets in euro”*.

21) As explained in more detail in the Consultative Position Paper, the EURIBOR benchmark has always sought to measure banks’ costs of borrowing unsecured funds in wholesale funding markets so that the Underlying Interest will remain the same. This is not a substantive reform but a clarification of the EURIBOR definition.

2.4 Third Reform: the EURIBOR Benchmark Reflects a Borrowing Rate

22) The third reform relates to the fact that the EURIBOR benchmark reflects a borrowing rate. As set out in the Consultative Position Paper, the original intent of the EURIBOR benchmark was to reflect a borrowing rate because the family of IBOR benchmarks are based upon and aimed at representing the cost of funds for banks⁴.

⁴ See International Monetary Fund, *What Is LIBOR?* <http://www.imf.org/external/pubs/ft/fandd/2012/12/basics.htm>; IOSCO, *Review of the Implementation of IOSCO’s Principles for Financial Benchmarks by Administrators of EURIBOR, LIBOR and TIBOR*, p. 64, http://www.fsb.org/wp-content/uploads/r_140722a.pdf.

23) The current terminology of the EURIBOR specification does not state this point expressly. By referring to “*deposits (...) being offered (...) by one prime bank to another*”, the current specification does not make it fully clear that the Underlying Interest is the rate at which the second prime bank could borrow the funds offered by the first prime bank.

24) The goal of the third reform is to re-emphasise that EURIBOR reflects a borrowing rate to ensure that the EURIBOR specification is in line with the Underlying Interest.

25) It should also be noted that the London Inter Bank Offered Rate (**LIBOR**) undertook the same reform in 1998. The 1998 reform involved a shift from a rate which was perceived to involve a subjective assessment by contributors to one which was more objective and capable of being evidenced by market transactions. Thus, LIBOR as a “*prime bank rate*” – where contributors were asked to submit a rate at which they believed a prime bank would be offered deposits in the market – was replaced by LIBOR as a rate measuring banks’ “*own cost of funds*”. The new definition introduced at that time stipulated that “*an individual BBA LIBOR panel bank will contribute the rate at which it could borrow funds, were it to do so by asking for and then accepting inter-bank offers in a reasonable market size just prior to 1100*”. Although this evolution did not manage to anchor the methodology of BBA LIBOR (as it was then called) wholly in transactions – it left significant scope for expert judgment – the move did reflect an attempt to introduce a method for calculating submissions which could, where necessary, be supported by, and analysed against, transaction data.

2.5 Fourth Reform: Expanding the Eligible Types of Transactions and Counterparties

26) The fourth reform relates to the eligible types of transactions and counterparties to determine the rate of the EURIBOR benchmark. The current specification and methodology refers to interbank transactions which reflects the structure of the money markets in the 1980s and 1990s when bank-to-bank activity was a predominant source of bank wholesale funding. The last decade has witnessed a steady decline of interbank activity. There has been a significant shift in banks’ funding sources as banks have increased their reliance on broader wholesale financing.

27) With the fourth reform, EMMI wishes to adapt the EURIBOR specification and methodology to the evolving market circumstances by clarifying that the Underlying Interest needs to be understood as a wholesale funding rate. Consequently, the eligible types of transactions and counterparties will be expanded to reflect the broader range of funding sources which are broader than only interbank loans. In other words, the current reference to interbank rates in the EURIBOR specification is a methodological consideration, reflecting the predominant source of bank funding at the time of EURIBOR’s creation, and is not a part of the Underlying Interest.

28) For the fourth reform, the following articles of the Benchmark Regulation and the following IOSCO Principles are relevant:

Article 11.4 of the Benchmark Regulation:

“Where an administrator considers that the input data does not represent the market or economic reality that a benchmark is intended to measure, that administrator shall, within a reasonable time period, either change the input data, the contributors or the methodology in order to ensure that the input data does represent such market or economic reality, or else cease to provide that benchmark”.

Article 12.2 of the Benchmark Regulation:

“When developing the benchmark methodology the benchmark administrator shall:

(a) take into account factors including the size and normal liquidity of the market, the transparency of trading and the positions of market participants, market concentration, market dynamics, and the adequacy of any sample to represent the market or the economic reality that the benchmark is intended to measure;”

Principle 10 of the IOSCO Principles:

“The administrator should periodically review the conditions in the Underlying Interest that the Benchmark measures to determine whether the Interest has undergone structural changes that might require changes to the design of the Methodology”.

Principle 6 of the IOSCO Principles:

“Benchmark design should take into account the following generic non-exclusive features, and other factors should be considered, as appropriate to the particular Interest:

a) Adequacy of the sample used to represent the Interest;

b) Size and liquidity of the relevant market (for example whether there is sufficient trading to provide observable, transparent pricing);

c) Relative size of the underlying market in relation to the volume of trading in the market that references the Benchmark;

d) The distribution of trading among Market Participants (market concentration);

e) Market dynamics (e.g., to ensure that the Benchmark reflects changes to the assets underpinning a Benchmark).”

29) It is clear from article 11.4 of the Benchmark Regulation and Principle 10 of the IOSCO Principles that benchmark administrators such as EMMI should periodically review whether the market their benchmark intends to measure (the Underlying Interest) has undergone changes that require changes to the methodology. Article 12.2 of the Benchmark Regulation and Principle 6 of the IOSCO Principles

also explicitly provide that the distribution of trading among market participants (market concentration) and the market dynamics need to be taken into account in the benchmark design. EMMI is thus under an obligation to adapt its benchmarks to the changing market circumstances. The fourth reform is made to meet that obligation by adapting the EURIBOR specification and methodology to the changing market circumstances.

2.6 Fifth Reform: The Concept of “*prime bank*”

30) The fifth reform relates to the concept “*prime bank*” in the current EURIBOR specification. Currently, this term is not precisely defined. The concept “*prime bank*” historically represented both a concept of the sound financial standing of the party borrowing the funds (a concept related to the Underlying Interest) as well as of a substantial party supplying funds (a concept related to the determination methodology).

31) The first concept of “*prime bank*” as the sound financial standing of the party borrowing funds will be retained. The notion that the banks that form the EURIBOR panel (the sample of borrowing banks) are of sound financial standing will now be explicitly incorporated in the definition of the Underlying Interest: “*the rate at which banks of sound financial standing could borrow funds in the EU and EFTA countries in the wholesale, unsecured money markets in euro*”.

32) The current definition of EURIBOR reads “*EURIBOR® is the rate at which Euro interbank term deposits are being offered within the EMU zone by one prime bank to another at 11.00 a.m. Brussels time.*” The current definition of prime bank reads “*a credit institution of high creditworthiness for short term liabilities, which lends at competitive market related interest rates and is recognised as active in euro-denominated money market instruments while having access to the Eurosystem’s (open) market operations.*” In EMMI’s view, the current definition of “*prime bank*” already implies the concept of sound financial standing. Consequently, the current definition of EURIBOR already includes the concept that the banks used to determine the rate should be of sound financial standing, albeit in an indirect way. Practically, the notion of sound financial standing will be expressly incorporated in the eligibility criteria to become a Panel Bank. The current eligibility criteria specified in the Code of Conduct implicitly embed this requirement. The Euribor Steering Committee already considers the financial standing of panel candidates in reviewing applications for panel membership.

33) The first concept of “*prime bank*” will be retained and will be stated more explicitly. It is not a substantive reform, but a clarification

34) The second concept of “*prime bank*” as a substantial party supplying funds is a methodological consideration; it is not a part of the Underlying Interest. This second concept is related to the structure of the money markets in the 1980s and 1990s when interbank borrowing was the predominant source of bank wholesale funding. As the structure of the money markets has changed, this second concept will be replaced by the different sources of wholesale funding as set out under section 2.5. These sources include interbank transactions but also other sources of funding for banks such as unsecured cash deposits from official sector institutions, insurance corporations, pension funds, etc. The reasons for the reform of the second concept are thus the same as for the fourth reform explained under section 2.5. EMMI needs to adapt the EURIBOR benchmark to the evolving market circumstances by expanding the types of transactions and counterparties used for the calculation of the EURIBOR benchmark.

3. THE IMPLEMENTATION PATH FOR THE PROPOSED REFORMS

35) Section 2 sets out the different reforms and the legal grounds for each of those reforms, explaining that EMMI is required to make those reforms to ensure that it is in compliance with its legal obligations and to reflect the evolving market circumstances.

36) This section focuses on the different transition paths that could be used to implement the proposed reforms to the EURIBOR benchmark methodology and specification. One of the purposes of the FSB Market Participants Group's final report on Reforming Interest Rate Benchmarks was to propose strategies for transitions from existing benchmarks towards evolved or alternative benchmarks. Therefore, the MPG Report contains an in-depth study of the different possible transition paths and their respective advantages and disadvantages. This section 3 will briefly explain the different transition paths and EMMI's reason for choosing to use the Seamless Transition Path if feasible.

3.1 The Four Transition Paths

37) The MPG Report identified four different transition paths: Seamless Transition, Successor Rate Transition, Market-Led Transition and Parallel with Cut-Over Transition. The first two transition types are Type I transitions (i.e. transitions to an evolved or alternative IBOR benchmark). The last two transition types are Type II transitions (transitions to benchmarks that are materially different from an IBOR). These four transition paths are described in detail on pages 40-45 of the MPG Report.

38) The Seamless Transition is an evolutionary transition where changes are made to the methodology of the existing benchmark but where the definition, value and volatility of the benchmark remain sufficiently similar after the reforms have been implemented.

39) The Successor Rate Transition is a transition where, after a long lead-in period, the publication of the existing benchmark will cease and the successor benchmark will be published the next day.

40) The Market-Led Transition refers to a transition where the parties voluntarily switch from the existing benchmark to a new benchmark.

41) The Parallel with Cut-Over Transition refers to a transition where the new benchmark will run in parallel with the existing benchmark for a certain period of time before the forced final transition towards the new benchmark.

3.2 MPG Report Expresses Preference for the Seamless Transition Path

42) EMMI notes that the MPG Report has a preference for the Seamless Transition path if feasible.⁵ The main reasons are that a Seamless Transition requires the least amount of transition measures and because it is preferable from a legal and accounting point of view. While the Seamless Transition path is the preferred path for the reasons set out below, the use of other transition paths is also conceivable.

43) From a legal point of view, contract continuity is likely under the Seamless Transition path. This transition path is an evolutionary path where the methodology of the benchmark is reformed. The main existing features (the Underlying Interest) of the benchmark are retained under this transition path.

⁵ The detailed reasons for the preference for the Seamless Transition path are set out on pages 42-45, 47, 48, 50-52, 54, 58 and 68-70 of the MPG Report.

Furthermore, the rate and the volatility of the benchmark will remain materially similar. This increases the chances that, from a legal point of view, the reference to EURIBOR in existing agreements will be understood to refer to the evolved benchmark as well.

44) The Successor Rate Transition relies on the assumption that courts would rule that the new reference rate can be deemed a successor rate for the discontinued benchmark. In other words, it relies on the assumption of contract continuity. While this can be a viable strategy (with successful precedents), there are drawbacks. Different legal systems may handle the implementation of the successor rate in existing contracts in different ways. There exist a number of mitigation strategies for these differences but in some countries this might require legislation to ensure contract continuity. At this moment, EMMI thinks that it is unlikely that legislation will explicitly approve the reforms.

45) The main drawbacks to a Market-Led Transition are, on the one hand, inertia by the market participants in moving to the new benchmark and, on the other hand, bifurcated liquidity between contracts referring to the existing benchmark and contracts referring to the new benchmark. The existing benchmark would also need to run for a long time until discontinuation no longer represents a systemic risk. The MPG Report also indicated that there may also be accounting and tax issues with a Market-Led Transition.⁶

46) The Parallel with Cut-Over Transition may lessen the inertia risk of a Market-Led Transition, but the risk of bifurcated liquidity between contracts referring to the existing benchmark and contracts referring to the new benchmark remains. Moreover, just as with a Successor Rate Transition, legislation could be required in order to ensure contract continuity. Finally, the MPG Report also mentions that running benchmarks in parallel may create problems with tax and accounting, portfolio management and corporate treasury systems.

47) The Markets Participants Group thus concluded that the Seamless Transition path is in principle the preferred transition path. Furthermore, the Markets Participants Group published an interim report on the implementation of its recommendations in the MPG Report under the title “*Progress in Reforming Major Interest Rate Benchmarks*”. In this interim report, the Markets Participants Group notes that it was recommended that the proposed reforms to the EURIBOR benchmark would be implemented via a Seamless Transition path.

3.3 EMMI’s Choice for the Seamless Transition Path

48) EMMI has decided to try to use the Seamless Transition path because it requires the least amount of transition measures and because it is preferable, from a legal and accounting point of view, for the reasons set out in the MPG Report.

49) A Seamless Transition requires that the definition, value and volatility of the benchmark remain sufficiently similar after the changes in the methodology are implemented.

As set out in the Consultative Position Paper, the Underlying Interest (what the benchmark seeks to measure) of the EURIBOR benchmark will not undergo any changes (even though the definition of EURIBOR will be reformulated). The goal of the new definition is to define the Underlying Interest more explicitly. The Underlying Interest will be defined as “*the rate at which banks of sound financial standing*

⁶ See page 50 of the MPG Report.

could borrow funds in the EU and EFTA countries in the wholesale, unsecured money markets in euro". Therefore, the condition that the definition of the new benchmark should be sufficiently similar to the definition of the existing benchmark will be met.

In order to be able to use the Seamless Transition, the rate level and the volatility of the reformed benchmark should remain similar after the changes in the methodology are implemented. EMMI has been conducting a six-month Pre-Live Verification Program, running from September 2016 to February 2017, to test the proposed methodology under the current market conditions. The results of the Pre-Live Verification Program will enable EMMI to assess the feasibility of a fully transaction-based methodology via a Seamless Transition path. This process is closely monitored by the FSMA which will provide EMMI with guidance on the basis of the program's results. EMMI acknowledges that, depending on the outcome of the Pre-Live Verification Program, further revisions to the methodology could be made.

The MPG Report mentions that even if there is a material difference in rate level and the volatility, in some situations a case could be made that the new rate is more representative of the intended legal definition of the benchmark.⁷

⁷ See page 42 of the MPG Report.

4. ONGOING STAKEHOLDER OUTREACH PROGRAM

50) Evolving towards a transaction-based benchmark represents a critical element of EMMI's efforts to conclude the EURIBOR reform and maintain the stability and transparency of the Euro area financial markets. EMMI, as the administrator of EURIBOR, believes the development of a transaction-based methodology for EURIBOR is an inclusive process whereby the engagement of all stakeholders is essential.

51) Article 13 of the Benchmark Regulation provides that benchmark administrators such as EMMI should give advance notice of proposed material changes and should consult the stakeholders on the proposed changes. The MPG Report also states that “[i]n order to be successful, a major benchmark transition will require the support and coordination of leading market participants, financial services industry organizations, legal associations, and a range of official sector entities. A broadly coordinated approach is essential to avoid significant disruption and to promote wide market adoption of alternative benchmarks.”

To achieve this, deploying a proactive stakeholder outreach program within the communication strategy to ensure that internal and external stakeholders are not only informed, but also on board with the evolutionary transition process, is essential. EMMI considers this outreach as one of the main tools to increase legal certainty for users of the EURIBOR benchmark.

52) As such, EMMI has been taking the following actions aimed at **informing, engaging** and **consulting** all key stakeholders at national, European and international level:

- As part of its stakeholder outreach program EMMI has developed an in-depth **consultation process** comprising written consultations and workshops. EMMI has organised, since 2014, several workshops with Panel Banks and end-user associations to consult on and present the proposed transaction-based methodology for EURIBOR.
- On 30 October 2015, EMMI published its Consultative Position Paper on the Evolution of EURIBOR outlining EMMI's proposals for the **reform of the determination methodology for EURIBOR**, as well as EMMI's plans to evolve towards a transaction-based methodology for EURIBOR through a **Seamless Transition** path. To ensure an outmost outreach of this proposal, EMMI distributed its consultative paper widely among all EURIBOR stakeholders, including market participants, financial services regulators, benchmark users and other interested parties.
- In addition, aiming to raise the greatest stakeholder awareness possible, the publication of the consultative position paper was accompanied by **national roundtable meetings** in key EURIBOR constituencies (Finland, Portugal, Germany, the United States, France, Spain, Italy, the United Kingdom, and Brussels – for stakeholders from the Benelux). Stakeholders were generally supportive of EMMI's proposal for the overall design of a transaction-based determination methodology and its evolution strategy.
- Aiming to obtain a **wider distribution among the user community**, in addition to making information on the state of play of the project and the next steps available on its website, EMMI has reached out to the vendors to publish information about the project on their screens.

- EMMI has also worked on the development of a **preliminary mapping of stakeholders** to assess the use of EURIBOR on different typologies of contracts throughout different jurisdictions to serve as a basis for the stakeholder outreach program.
- EMMI will continue its efforts to increase stakeholder awareness with respect to the changes to the EURIBOR methodology given the critical use of EURIBOR in a vast number of contracts (i.e. derivative contracts, retail mortgages, corporate loans, among others...). For this purpose, EMMI is **organising for webinars** to take place throughout 2017, targeted at end-user organisations in key EURIBOR constituencies to achieve maximum coverage.

5. CONCLUSION

53) The proposed reforms are made to bring the EURIBOR benchmark in line with regulatory requirements such as the Benchmark Regulation, the requirements of the FSMA (the Belgian competent authority for the BMR) and the recommendations published by IOSCO, the FSB, ESMA and EBA as well as to adapt the EURIBOR benchmark to the changing market circumstances. As set out in section 2, the proposed reforms find strong legal support in the Benchmark Regulation and the IOSCO Principles.

54) Furthermore, EMMI is in close contact with the FSMA concerning the proposed reforms. Accordingly, we inform the FSMA of all material decisions we take regarding the methodology, so that, in due course, the FSMA is able to assess whether EMMI is compliant with the authorisation requirements of the Benchmarks Regulation. Once EMMI's analyses of the Pre-Live Verification Program are complete, EMMI will seek the FSMA's guidance before finally deciding on the transition path.

55) EMMI will continue to further reach out to the stakeholders and to encourage EURIBOR users to consider the impact of the Benchmark Regulation and the proposed reforms on their use of the EURIBOR benchmark and, if required, to establish their arrangements to address or mitigate potential migration issues.