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EURIBOR-EBF
DRAFT PROPOSALS ON CLARIFICATIONS OF THE EURIBOR DEFINITION
- EBA/ESMA RECOMMENDATION N°4 -

A. Background

On 11 January 2013, the European Securities and Markets Authority (ESMA) and the European Banking Authority (EBA) addressed a joint set of recommendations to Euribor-EBF aiming to improve the governance and transparency of the rate-setting process.

The 4th recommendation from EBA/ESMA is as follows:

The Euribor definition should be adjusted for more clarity. In particular, the term "prime bank" needs a clear definition. The term "interbank transactions" also needs to be clarified and, if needed, to be broadened and adjusted.

Currently, Euribor is defined as *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.*

Following the last Euribor Steering Committee meeting on 24 January 2013 in Berlin, Euribor panel banks were invited to comment on proposed clarifications (letter of 14 February 2013). The Euribor Task Force and the ECB money market contact group have extensively discussed the proposed clarifications. A summary of the discussion points is available hereunder.

Euribor-EBF acknowledges that there is no single solution which would suit all stakeholders' expectations. This exercise has been conducted with the aim of preserving the continuity of the index as much as possible.

B. "Prime bank" clarification

1. Initial proposal

A prime bank should be understood as the G-SIFIs[1] having good market access and access to monetary-policy instruments at the ECB.

2. Discussion points

- **Suggestion to include a crating rating dimension in the "prime bank" clarification** → there has been a strong opposition to the introduction of a rating dimension into the

[1] Global Systemically Important Financial Institutions as listed by the Financial Stability Board.

prime bank clarification, considering that ratings are changing very often and depend very much on countries' domestic situation, and that using ratings established by rating agencies could contain an intrinsic risk, as proved during the 2007 crisis. In this context, even G-SIFIs may have different ratings, which would make the "prime bank" clarification very unstable.

- **Suggestion to restrict the prime bank definition to the top 5 G-SIFIs**, e.g. in terms of rating (with no thresholds as mentioned - could include other factors such as market access). This top 5 list would be a dynamic one to be reviewed by the Steering Committee on a bi-monthly basis. → The principle of establishing a short list of "prime bank" to take into account in Euribor submissions would lead to very converging submissions and would provide panel banks with an excuse for exiting the panel[2].

3. <u>Revised proposals</u>

In light of the above-mentioned discussion points, the following revised clarifications have been proposed. It was agreed that the second proposal would be the most appropriate solution in order to preserve the continuity of the index.

Proposal n°1:

<u>*A prime bank should be understood as a credit institution carrying out interbank transactions at interest rate levels in line with the best G-SIFIs, with good market access and access to ECB market operations*</u>

<u>Pros:</u>

- GSIFI banks are more solid by construction, having stronger capital ratios (than other banks), contingency and recovery plans with much higher requirements set by the Regulators; they are "prime" when considering the possibility of not being able to repay their debt ("too critical to fail"). For the sake of continuity of the benchmark, the definition of prime bank has to transmit the idea of a solid bank among the peers, but independently from its rating.

<u>Cons:</u>

- The list of G-SIFIs may be seen as too restrictive and excludes local SIFIs or domestically active banks with good market access and access to ECB market operations which would otherwise qualify.
- The term "best" is too vague and the given possibilities for a verification of the G-SIFIs' market access are not clear enough.

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[2] "How Do I know at which rate GSIFI bank A lends to GSIFI bank B? Just ask them and you will get the perfect answer"

Proposal n°2:

A prime bank should be understood 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.

Pros:

- This proposal is broad enough to respect the current Euribor definition (estimation of the market by experts of the market) while including more specific criteria: access to the Eurosystem's market operations, high creditworthiness, activity in euro-money market instruments and lending at competitive market related interest rates.
- The following items can be monitored in order to assess whether a bank is eligible for this designation: bank's balance sheet (loans/deposits with other banks), outstanding amounts in short-term papers, Bloomberg pages DOCP/BOOM/ECPX and through brokers.

Cons:

- This proposal may not be considered as precise enough.

There is a balance to find between restricting the prime bank terminology to a list of banks, which would leave less room for interpretation, and preserve the Euribor definition and, consequently, the continuity of the index.

C. "Interbank transactions" clarification

1. Initial proposal

"Interbank transactions" should be understood as any cash transaction in the money market, including short-term debt issued by a bank.

2. Discussion points

- Changing the focus on the issuer would implicitly mean focusing on the bid rate of issuing banks, rather than the offering rate.
- In the short-term market for bank funding, the investor is not necessarily a bank. Panel banks may not be able to differentiate if debt issued by a prime bank has been bought by a bank or another type of investor.
- Most banks disagreed with this proposal, considering that **such clarification would imply a change in the current Euribor definition and methodology and, consequently, jeopardize the continuity of the index**.

3. Revised proposal:

In light of the above-mentioned discussion points and in order to preserve the continuity of the index and, therefore, reduce the impact of potential changes on existing contracts based on Euribor, we recommend the following clarification of the term “interbank transactions”:

“Interbank transaction” should be understood as a cash deposit between two credit institutions maturing by one year from inception[3].

D. “Panel bank” clarification

Separately, with a view to clearly differentiate the “prime bank” and “panel bank” terminology it was also recommended to add a clarification of “panel bank”:

A panel bank should be understood as a bank contributing to the Euribor index, by providing daily quotes of the rate, rounded to two decimal places; each bank belonging to the panel submits the rates that it believes one prime bank is quoting to another prime bank for interbank term deposits within the euro zone.

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[3] A list of credit institutions is published by the ECB at: http://www.ecb.int/stats/money/mfi/general/html/dla/MFID/euccid_130314.txt.