

Interest rate benchmarks in 2020

7th February 2020

Tomáš Kvapil

REGULATION

Why? - Well documented loss of credibility in Benchmark rates following 2008 Financial crisis required a rigorous overhaul to restore credibility and public trust.

How? - IOSCO & FSB recommendations offer a set of governance guidelines which have been interpreted in a variety of ways:

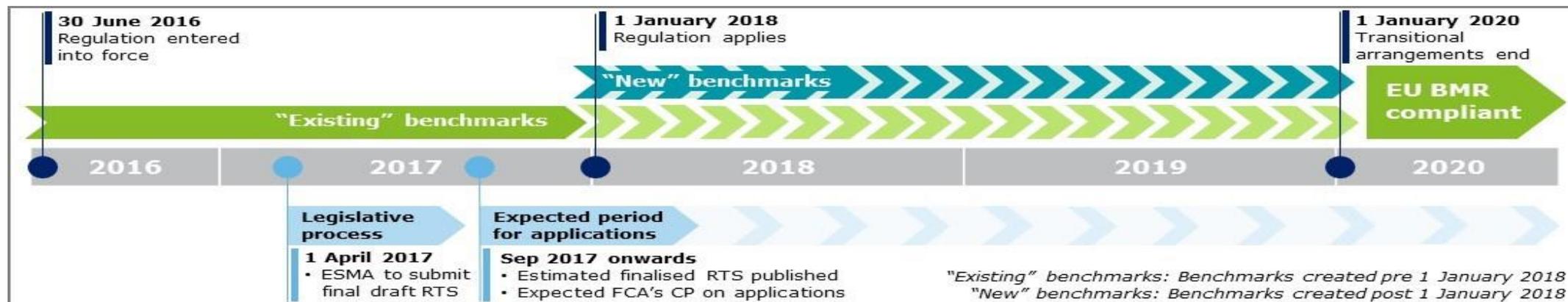
- Central Bank control
- Mandated transaction window
- Panel Bank supporting evidence
- Detailed waterfall methodologies
- UK FCA MAR 8 regulation

EU Parliament endorsed law detailing requirements known as Benchmark Regulation (BMR) intended to provide "a preventive regulatory framework" for the administration of benchmarks and indices used in the EU.

- **Primary focus of BMR is the identification, reduction and management of conflicts of interest with implications for:**

- Administrators
- Contributors/submitters
- Regulators/Competent Authorities
- Users

Timeline:



BMR definition of Benchmarks and indices is Broad

The EU BMR defines an index as a figure that is publicly available and is regularly determined, either by applying a formula or other calculation or making an assessment on the basis of the value of one or more underlying assets/prices (including estimated prices, actual or estimated interest rates, quotes and committed quotes, or other values or surveys).

An index becomes a benchmark within the scope of the EU Benchmarks Regulation where:

- it is used to determine the amount payable under a financial instrument or financial contract, or the value of a financial instrument
- it is used to measure the performance of an investment fund for the purpose of:
 - tracking the return
 - defining the asset allocation or a portfolio, or
 - computing the performance fees

Summary of Administrator Responsibilities

- **Establish the classification of Benchmark(s) under management.**

- Critical >€500bn Significant €50-500bn Non Significant <€50bn + Other provisions

- **Establish appropriate corporate and governance structures.**

- Board
 - Oversight Committee
 - Stakeholder Committee(s)
 - Compliance function
 - Secretariat
 - Operations

- Review benchmark methodologies and input data versus established guidelines

- Establish precise Panel bank compliance controls and issue Code of Conduct

- Secure/develop compliant technology to calculate and distribute

- Draft required policy & procedural documentation

- Consider evolution and upgrade existing methodologies for calculation linked to transactional data

- Develop and implement communication plans

- License benchmark

- Register with, or seek authorisation from, Regulator (Competent Authority)

- External Assurance (Auditors)

- Administrators from outside the EU need consider equivalence, recognition or endorsement to enable their benchmarks to be used within the EU after 2020

The expertise, systems and independence required to operate as an Administrator, make this increasingly a specialist activity

Impact to Contributor/Submitter

- Assess provision of ongoing support for benchmarks currently submitting to
- Risk & Compliance assessment versus issued code(s) of conduct
- Incorporate new methodology guidelines
- Establish ongoing internal control measures
 - Process transparency
 - Compliance tools
 - Training
 - Internal audits
- External audits from Administrator

Impact to Users

- Assess what benchmark data is used and for what purpose?
- Do they need rely upon this data ongoing?
- Is the Administrator prepared for BMR implementation?
- Will alternative data sources need be identified?
- Are there a new data license costs to consider?

PRIBOR

- Under Regulation (EU) 2016/1011 (BMR) Transitional Provisions current benchmark providers shall apply for authorisation or registration until 1st January 2020.
- The CFBF as administrator of PRIBOR is authorized and regulated by the Czech National Bank as the competent authority responsible for providing authorization and registration of benchmarks under BMR within the Czech Republic.
- The CFBF is committed to operating the PRIBOR benchmark in compliance with BMR and is recognized by The European Markets and Securities Authority (ESMA) on its register of approved Benchmark Administrators.

PRIBOR evolution – prior to BMR

- Administered by ACI CR based on CNB Notification (Rules for Reference Banks) in co-ordination with CBA
- Thomson Reuters as calculation agent
- Code of Conduct issued in January 2016 broadly in line with BMR principles
- CoC processed in co-operation with CBA
- As a result of LIBOR scandal number of panel banks reduced to 6

PRIBOR evolution – BMR impact

- Detailed description of administrator responsibilities (BMR and Regulatory Technical Standards issued by ESMA)
- ACI CR and CBA looking for candidate very soon
- Global Rate Set System came with proposal to set up CFBF primarily focused on PRIBOR administration
- Backed by experiences to serve as calculation agent for Euribor since 2014
- Need for robust governance structure
- Transitional Committee formed for secure transition
- Oversight Committee based on basics of the former Transitional Committee
- Structure of the OC reflects past and new regime
- July 2017 – CFBF smoothly took over PRIBOR administration
- 1.January 2018 PRIBOR became fee liable

Changes made

- New Code of Conduct brings more detailed description in line with BMR/RTS terminology but basics are very similar to the old CoC
- Re-determination Policy introduced (defined rules for dealing with erroneous input data with material impact to the fixing)
- New Non Quorum rule – in case Quorum is not reached then yestarday's rate is published. It can last for maximum 3 consecutive days, until then OC needs to decide about further course of action
- In force from December 2018
- In line with subscription policy use of PRIBOR data strictly limited based on contractual conditions
- Redistribution strictly prohibited

Further CFBF progression

- Complex operational experiences (calculation agent of Euribor and Eonia and administrator of PRIBOR) allowed the CFBF/GRSS to look for new opportunities (Denmark, Norway, Sweden)
- Authorisation of an administrator granted by CNB allowed the CFBF to serve as a benchmark provision centre for other EU states
- EU authorisation will also allow the CFBF/GRSS to expand to non-EU states (third country benchmark)

Evolution of Benchmark methodology

Similar pattern emerging globally in the search for a 'Risk-Free-Rate' which proves very difficult if not impossible to find.

Analysis undertaken in other jurisdictions for an alternative to 'IBOR', most notably OIS or REPO rates, provide the same issue in the lack of fixed-term liquidity on which to base a transaction only derived rate.

What is in no doubt however is :

- BMR came into effect to the published timeline – European IBOR's needed to conform

- Administrators are compelled to apply all necessary regulations establishing rigorous control mechanisms

- Adjustments will be necessary to methodologies to establish 'best practice' determined by experts of the local market

- Cost of appropriate governance is an ongoing issue – smaller economies consider alternative solutions (?)

However very important to be seen to be proactive :

- Committees/working groups established including market experts to determine the most appropriate process under stewardship of the Administrator

- Transparency to the market at large on progress being made to avoid 'contract frustration'.

Current trends and questions

Seeking RFR : €STR, SONIA, SARON, SOFR, TONIA

IBORs : switch from Offer – Bid (funding rate)

RFR vs IBORs = fallback vs transition ?

Q&A