



Money market benchmarks and the on-going reform process

ECB Bond Market Contact Group

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Key themes

- 1 Euribor reform: toward a transaction-based Euribor
- 2 The development of a new pan-European repo benchmark
 - [a] Significance of the Euro repo market
 - [b] Design principles of a New Repo Index
 - [c] Analyzing the Euro repo market: the St Gallen report
 - [d] Market consultation
 - [e] Next steps
 - [f] Topics for discussion

- » Notional volumes of outstanding financial contracts linked to Euribor: **greater than \$180 trillion** (cf. FSB Report on *Reforming Major Interest Rate Benchmarks*).
- » Main type of contracts indexed to Euribor include:
 - Over-The-Counter (OTC) and exchange traded derivatives;
 - Corporate loans;
 - Retail mortgages;
 - Floating rate bonds
 - Securitized products.
- » **Euribor as a critical benchmark is of systemic importance for financial stability.** Therefore, uncertainty regarding the integrity of these reference rates represents a potentially serious systemic vulnerability and risk.
- » In this context, the official sector has an important role to play in ensuring that widely-used benchmarks have robust governance frameworks and meet appropriate standards in terms of transparency, reliability and representativeness.

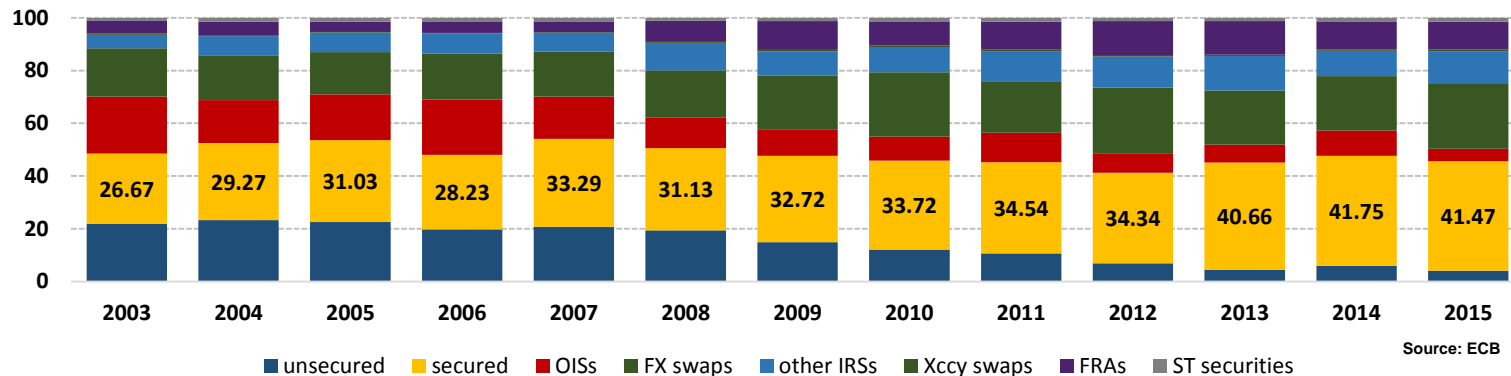
- » In late 2013 EMMI initiated the “**Euribor+ Project**” with the aim of developing and implementing a transaction-based determination methodology for Euribor. A special Task Force, consisting of market participants and supported by the European Central Bank, was formed to undertake the new methodology design.
- » **Transactional data from 2012/13** were gathered through two extensive data collection exercises from over 50 banks. Based on these data, various design alternatives were evaluated, and the final proposed design was published by EMMI in the October 2015 Public Consultation.
- » The consultation period closed on January 29. EMMI received feedback from 46 respondents.
- » EMMI asked for market’s feedback regarding a number of issues:
 - Discontinuation of tenors
 - Inclusion/Exclusion of non financial corporates
 - Publication time
 - Methodology
 - Product modifications
 - Transition strategy and planning
 - Feasibility of the proposed target switch-over
 - Communication and outreach

- » EMMI has analyzed the feedback obtained from the market in response to the consultation and has already gathered the Euribor+ Task Force to address comments and questions.
- » EMMI's response to the consultation responses will be published in the coming weeks and will make public EMMI's next steps towards the transition of Euribor to a transaction-based methodology.
- » EMMI considers that a more substantial Pre-Live Verification Exercise, covering approximately a six-month period prior to the launch of the new methodology, is needed. The main objective of such an exercise is to guide EMMI's decision as to whether it is appropriate to proceed with the implementation of the transaction-based methodology.

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- » The secure segment is the largest in the Euro money market.
- » The latest ECB Euro Money Market Survey (published in September 2015) indicated a total turnover of **29 trillion EUR** during the second quarter of 2015.
- » The secured segment represents the 41% of total turnover across all segments.



- » For the benefit of market participants and the wider public, it comes out as necessary to build a unique pan-European daily repo index. While EMMI acknowledges the challenge given the liquidity structure of the Euro repo markets, extracting information from the deepest and most liquid segment is a worthwhile goal.

- » The ICMA European Repo Committee established the following as the guiding principles for a New Repo Index reflective of the European repo market

Guiding Principles for a Euro Repo Index

Based on actual market transactions

- ✓ Objective
- ✓ Transparent
- ✓ Credible

Overnight and term fixing

- ✓ Useful alternative to unsecured short term indices
- ✓ Current reality of the liquidity is on the overnight

Anchored in existing liquid markets

- ✓ Accurate pan-European picture
- ✓ Displays both trends and tiering

Capturing only centrally cleared transactions

- ✓ Accurate representation of the cost of collateral

Broad section of market and participants

- ✓ Broader representation of secured transactions
- ✓ Transparent

Governed by an industry body

- ✓ Highly representative
- ✓ Sustainability
- ✓ Experience
- ✓ Credibility

- » In September 2013, EMMI invited market participants, the European Repo and Collateral Council, and an observer from the ECB too meet and establish the **Joint Repo Task Force**, with the objective of studying the feasibility of a new pan-European transaction-based repo benchmark.

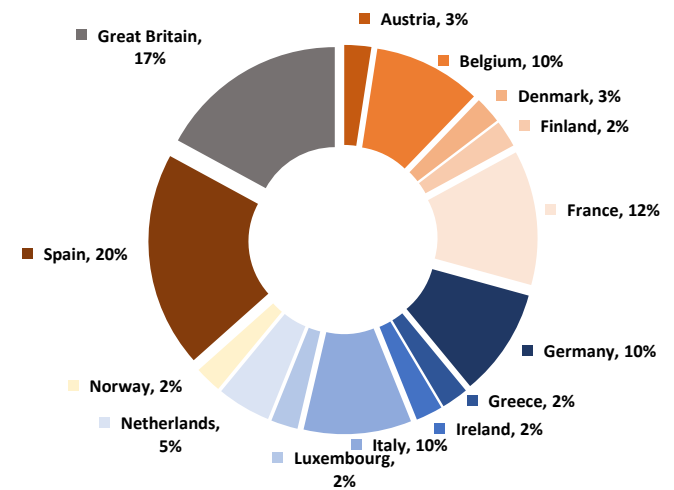
- » The preliminary design envisaged the index as a single **pan-European daily index**, based on
 - › **electronically traded**
 - › **secured funding transactions** in EUR
 - › cleared on a **qualifying CCP**,
 - › **collateralized by ECB eligible paper**.

- » In November 2014, EMMI held a meeting with potential project partners: automatic trading systems (ATS), clearing houses, and existing index providers, securing a high-level agreement to jointly develop a new transaction-based repo index.

- » In July 2015, three European Automatic Trading Systems (ATS) provided transactional data to EMMI to study the feasibility of a transaction-based benchmark. The data spanned 8 years of activity (2006 – 2014) covering a total trading volume of EUR 464.4 trillion.

- » EMMI commissioned an extensive analysis of this data to experts in the Swiss Institute of Banking and Finance at the University of St. Gallen to guide and inform the development of a robust benchmark methodology.

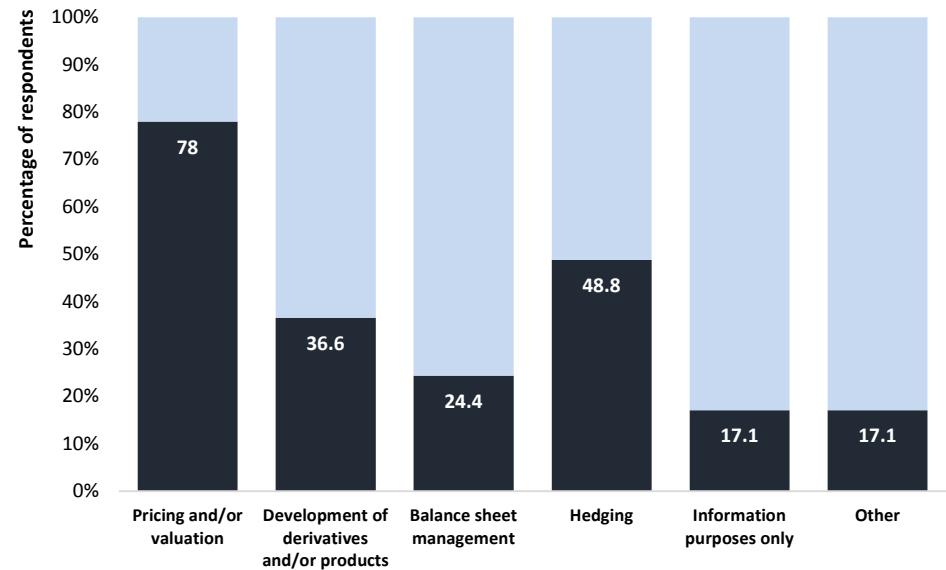
- » In December 2015, a public consultation was launched by EMMI, asking the market for feedback regarding the:
 - Potential **need** and **use** of a pan-European repo benchmark;
 - Underlying transactions supporting the determination of the index.
- » The consultation period closed at the end of January 2016. EMMI received feedback from 41 institutions across Europe.



Respondents geographical breakdown

On benchmark applications

- » Pricing and valuation seem to be the most foreseeable potential uses of the New Index.
- » A number of respondents indicated that the New Repo Index could be regarded as a possible substitute of the Eonia index.
- » Other possible uses are as benchmark of historical performance and internal transfer pricing.



Potential uses of the pan-European repo benchmark

On the underlying data

- » The majority of respondents indicated a preference for the transactions underlying the determination of the New Repo Index to consist of
- Anonymous ATS executed and
 - OTC's (i.e. voice-brokered and bilateral)
- euro repo trades centrally cleared through a qualifying CCP made against ECB eligible collateral.
- » While EMMI acknowledges the market's appetite for an index whose underlying data includes all ATS executed, voice-brokered, and bilateral transactions cleared through qualifying CCPs, due to data availability issues, the preliminary design of the benchmark will be focused on **anonymous ATS executed trades, cleared through qualifying CCPs.**

- » EMMI will soon be holding a meeting with all involved data providers to confirm their commitment and participation in the project.
- » After this meeting, EMMI will start the development of the determination methodology for the index, addressing all issues pointed out by the academic study performed by St Gallen:
 - Treatment of extreme observations and filtering of outliers,
 - Alignment of repos with different number of forward days,
 - Implication of including floating rates repos...