

Update Working Group on Euro RFR

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thinkforward



Why the market needs Risk Free Rates

FSB recommendations on 'Reforming major interest rate benchmarks':

- Strengthen existing benchmarks by underpinning them to the greatest extent possible with transaction data
- Developing alternative nearly risk-free reference rates

Lack of transactions makes search for alternative RFRs more important

EU Benchmark Regulation article 28.2 on 'Changes to and cessation of a benchmark':

*Supervised entities other than an administrator as referred to in paragraph 1 that use a benchmark shall produce and maintain robust written plans setting out the actions that they would take in the event that a benchmark materially changes or ceases to be provided. Where feasible and appropriate, such plans shall **nominate one or several alternative benchmarks that could be referenced to substitute the benchmarks no longer provided**, indicating why such benchmarks would be suitable alternatives. The supervised entities shall, upon request, provide the relevant competent authority with those plans and any updates and shall reflect them in the contractual relationship with clients.*






→ BMR requirement is effective for new contracts as of 1 January 2018

Status reform critical IBORs

LIBOR	<ul style="list-style-type: none">• Reform showed fully transaction based benchmark is not feasible• ICE developed hybrid methodology for LIBOR contribution• FCA authorised ICE as benchmark administrator under BMR• FCA announced it will not compel panel banks to contribute to LIBOR as of 1 January 2022*
EONIA	<ul style="list-style-type: none">• Reform showed low number of interbank lending transactions• In parallel, ECB announced to develop a new unsecured overnight rate (ESTER) based on a broader set of borrowing transactions• EMMI announced EONIA's compliance with the EU BMR by January 2020 cannot be warranted
EURIBOR	<ul style="list-style-type: none">• Reform showed fully transaction based benchmark is not feasible• EMMI developed hybrid methodology for EURIBOR contribution• April – October 2019: hybrid methodology will go live• April – August 2019: EMMI will file for authorisation, FMSA likely to approve

* Applicable to all LIBOR currencies (USD, GBP, EUR, CHF, JPY)

Recommended Risk Free Rates in various jurisdictions

	Administrator	Working Group	Chosen Rate	Rate type	Tenor	Rate published?
	Federal Reserve Bank of New York	Alternative Reference Rates Committee	SOFR (Secured Overnight Financing Rate)	Secured	Overnight	Yes
	European Central Bank	Working Group on a RFR Rate for the Euro Area	ESTER (Euro Short-Term Rate)	Unsecured	Overnight	Oct-19
	Bank of Japan	Study Group on Risk-Free Reference Rates	TONA (Tokyo Overnight Average Rate)	Unsecured	Overnight	Yes
	Bank of England	Working Group on Sterling Risk-free Rates	SONIA (Sterling Overnight Index Average)	Unsecured	Overnight	Yes
	SIX Swiss Exchange	National Working Group on Swiss Franc Reference Rates	SARON (Swiss Average Rate Overnight)	Secured	Overnight	Yes

Source: Citi Research, ISDA

The Working Group on Euro Risk-Free Rates requested market feedback on EONIA-ESTER transition and ESTER-based term structure methodology

EONIA-ESTER transition path options

1. Parallel run and contractual alternative approaches
2. Pure succession rate approaches
3. **Recalibration approaches**



The recalibration approach roughly encompasses:

- EONIA methodology modified to become ESTER + fixed spread
- Fixed spread should be used to prevent large value transfers
- Evolved EONIA temporarily available for transition until end-2021
- Evolved EONIA will need to be BMR compliant during this period

ESTER-based term structure as fallback to EURIBOR

1. OIS transactions-based methodology
2. **OIS quotes-based methodology**
3. OIS composite methodology
4. Futures-based methodology



- OIS quotes-based method most likely viable at present time

Outcome public consultation on EONIA-ESTER transition

The Working Group Euro RFR consulted the market on 3 potential EONIA-ESTER transition approaches

- **Parallel run and contractual alternative approaches***: EONIA and ESTER will be published in parallel, market participants can gradually move from EONIA to ESTER
 - **Successor rate or big bang approach***: EONIA will stop to be published once ESTER goes live by October 2019
 - **Recalibration approach***: EONIA's methodology modified to become ESTER + fixed spread, but publication stops as of 1 January 2022
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- Summary of the replies was published in December 2018
 - The Working Group Euro RFR will publish the recommended EONIA-ESTER transition approach on 14 March 2019

⁷* For details on the EONIA-ESTER transition approaches, please refer to the executive summary (p. 3-5) and transition approaches (p. 18-25) of the 'Report by the working group on Euro RFR risk-free rates on the transition from EONIA to ESTER'

Outcome public consultation on EONIA-ESTER transition

97% of responses viewed the recalibrated approach as most appropriate, ensuring a smooth and orderly transition

Compared to other candidates, the recalibrated approach will:

- Be effective for transferring current EONIA liquidity;
- Mitigate potential value transfers;
- Provide an adequate time frame to renegotiate EONIA legacy contracts;
- Reduce technical complexity;
- Allow for clear communication to clients; and
- Be achievable within the relevant time frame.

However, many respondents would appreciate if the working group provides more clarity on:

- The applicable discounting regime; and
- The methodology on closing out or transition legacy contracts once EONIA's publication stops as of 1 January 2022.

**Outcome public consultation on
ESTER-based term structure
methodology as fallback to
EURIBOR**

The Working Group Euro RFR consulted the market on 4 potential ESTER-based term structure methodologies

- **OIS transaction-based methodology***: Based on OIS transactions, a forward looking term structure will be created that could serve as a fallback to the current 1w, 1m, 3m, 6m and 1yr EURIBOR tenors
- **OIS quotes-based methodology***: Based on OIS committed/tradable quotes, a forward looking term structure will be created that could serve as a fallback to the current 1w, 1m, 3m, 6m and 1yr EURIBOR tenors
- **OIS composite methodology***: Based on a combination of OIS transactions (if available) and committed/tradable quotes, a forward looking term structure will be created that could serve as a fallback to the current 1w, 1m, 3m, 6m and 1yr EURIBOR tenors
- **Futures-based methodology***: Based on futures transactions, a forward looking term structure will be created that could serve as a fallback to the current 1w, 1m, 3m, 6m and 1yr EURIBOR tenors

- Summary of the replies was published in December 2018
- The Working Group Euro RFR will publish the recommended term structure methodology on 14 March 2019

* For details on the ESTER-based term structure methodologies, please refer to the executive summary (p. 2-4) and term structure methodologies (p. 12-30) of the 'Consultation on determining an ESTER-based term structure methodology as a fallback in EURIBOR-linked contracts'

Outcome public consultation on ESTER-based term structure methodology that could function as a fallback to EURIBOR

77% of responses viewed the OIS quotes-based methodology offers the best prospect of producing a viable fallback rate

Compared to other candidates, the OIS quote-based methodology scores the best on:

- Data sufficiency and robustness;
- Transparency;
- Simplicity (both in understanding and the implementation of the methodology); and
- Timing.

Challenges ahead in finding:

- An administrator for this new benchmark; and
- Market participants that are willing to quote.

Appendix

Links to the consultations of the Working Group on Euro RFR

Consultation on EONIA-ESTER transition:

https://www.ecb.europa.eu/paym/pdf/cons/euro_risk-free_rates/ecb.eoniatransitionreport201812.en.pdf

Summary responses to the consultation on EONIA-ESTER transition:

https://www.ecb.europa.eu/paym/pdf/cons/euro_risk-free_rates/ecb.summaryofresponses02_201902.en.pdf

Consultation on ESTER-based term structure methodology that could function as fallback to EURIBOR:

https://www.ecb.europa.eu/paym/pdf/cons/euro_risk-free_rates/ecb.consultation_details_201812.en.pdf

Summary responses to the consultation on ESTER-based term structure methodology that could function as fallback to EURIBOR :

https://www.ecb.europa.eu/paym/pdf/cons/euro_risk-free_rates/ecb.summaryofresponses01_201902.en.pdf