

Second roundtable on euro risk-free rates

25 September 2019
Frankfurt am Main



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The transition from EONIA to the euro short-term rate (€STR)



Impact of the transition from EONIA to the €STR on cash and derivatives products

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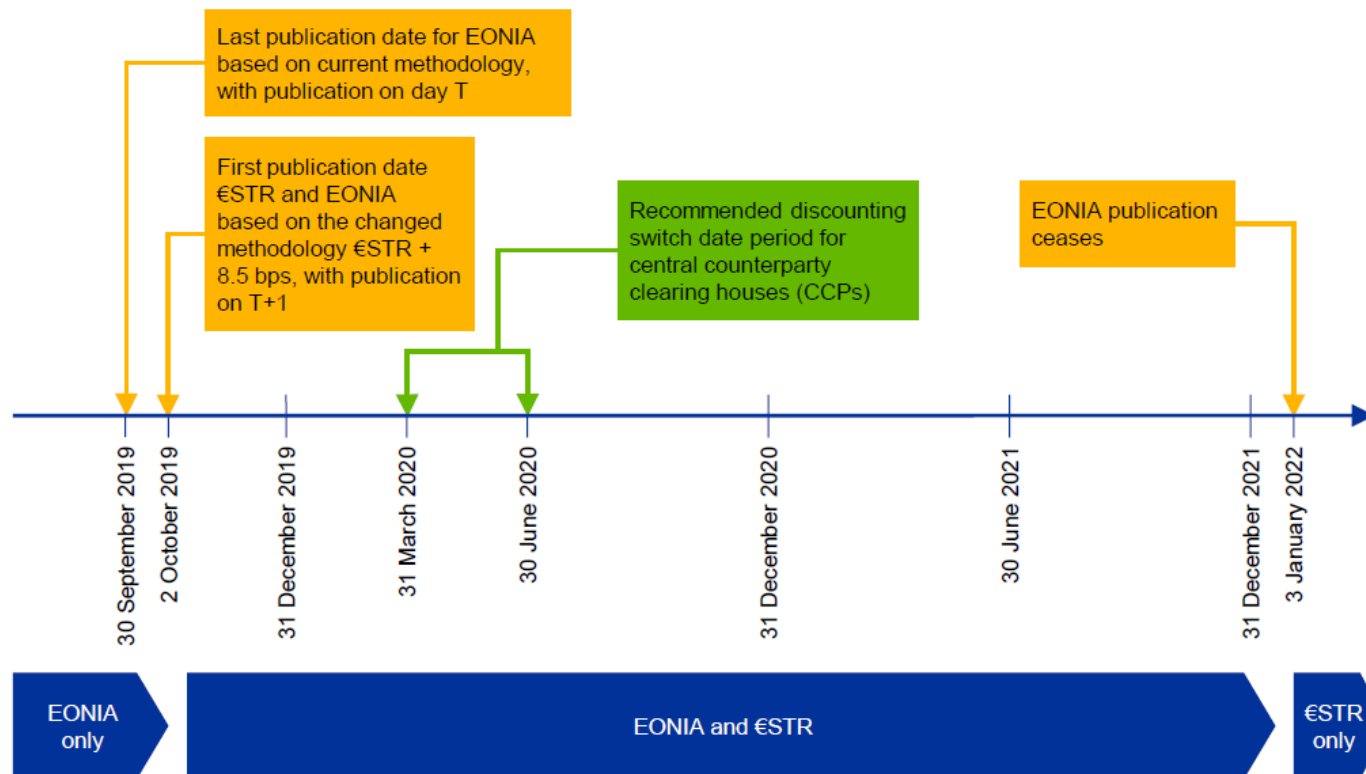
Christian Gau
Deutsche Bank
Co-Chair of subgroup 5

Anna Kozhevnikova
Generali
Co-Chair of subgroup 5

Transition timeline

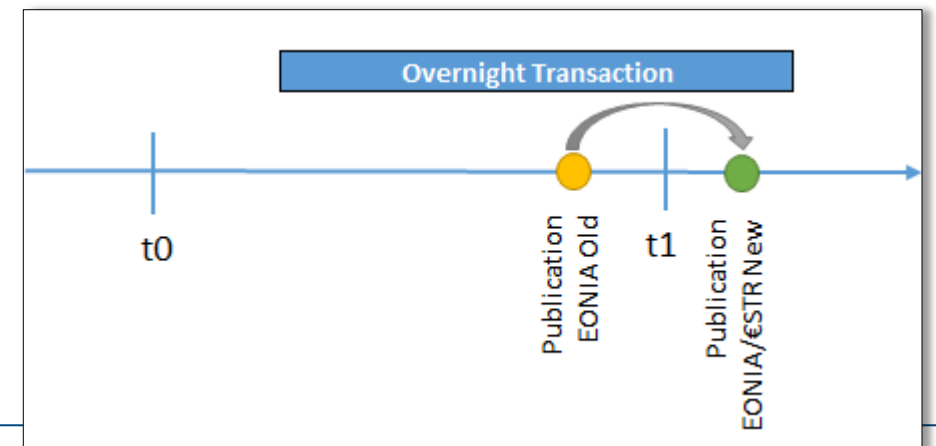
The transition may be represented by two steps:

- Dealing with the change in **EONIA's publication time resulting from the planned recalibration of EONIA as the €STR plus a fixed spread of 8.5 basis points** as at 2 October 2019
- **Transition from EONIA to the €STR between 2 October 2019 and 3 January 2022**, upon which date the publication of EONIA will cease

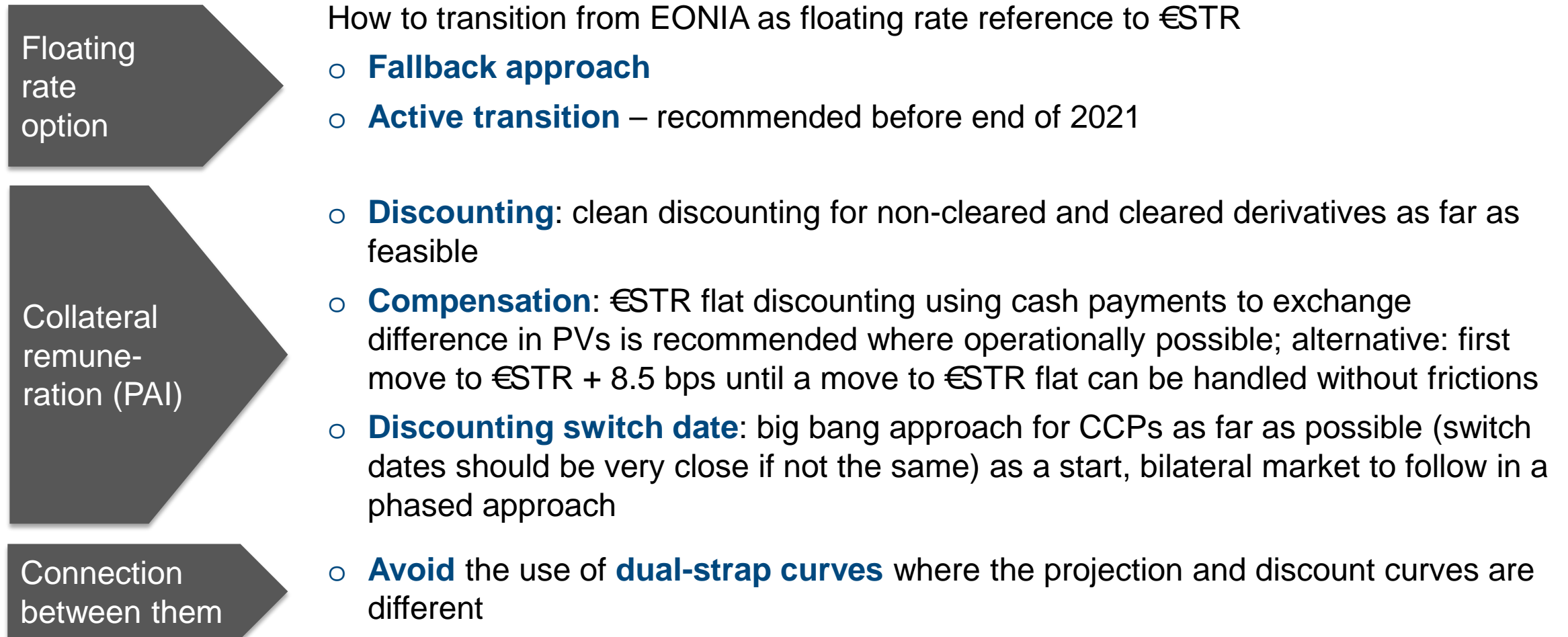


Implications for operational procedures

- ▶ The change in the publication time **will not affect the availability of EONIA via the usual distribution channels**
- ▶ The **unique EONIA identifiers** on platforms will also remain the same
- ▶ The **change in the publication time will not create time series gaps**, because EONIA published on 2 October will represent transactions executed on 1 October 2019 but will mainly **affect the data storage process**
- ▶ Market participants are encouraged **to align their main processes with the 08:00 CET publication time for the €STR, and 09:15 CET for EONIA**, respectively, and maintain exceptional procedures for €STR re-publication events
- ▶ **Settlement procedures** will be impacted by the change in the publication time, *from T to $T+1$* , for all products: **derivatives, cash accounts, loans, investment funds, securities**



How are derivatives impacted?



Caution required for valuation of **options on derivatives with physical settlement** as – after the discounting switch date – the option will refer to a €STR-discounted derivative, triggering re-evaluation and compensation measures

How are cash products impacted?

Securities

Necessary operational modifications should be introduced in order **to be able to issue, buy, trade and manage new securities indexed to the €STR**

Market participants should **avoid issuing new securities indexed to EONIA with maturities going beyond the transition period**

Investment funds

For **funds using EONIA as a benchmark or a hurdle rate**, the transition from EONIA to the €STR will require amendments to the **calculation formulas and operational procedures**, and will also trigger **fund prospectus updates**

Cash products

For secured cash products, the interbank market should **transact purely on a fixed rate basis** (“classic repo”) and should no longer use floating rate repos

For **loans**, when referencing the €STR directly in new contracts, market participants should consider whether any compensation mechanism is required

Client communication, especially for mass retail products, plays an essential role

Are models affected by the EONIA-€STR transition?

- ▶ Until the €STR swap curve becomes directly observable, the **fixed spread relation between EONIA and €STR** fixings can be applied **to derive a full term structure for the €STR from EONIA-linked overnight index swaps**
- ▶ It is recommended to use a single curve for valuation purposes per counterparty for all types of contract (i.e. new and legacy contracts). However, the working group acknowledges that **during the transition period** it could be necessary to use **different interest rate curves**, which gives rise to specific requirements with regard to **operations, IT systems and valuation models**
- ▶ Market participants should be aware that **EURIBOR par swap rates** will be affected due to the change in the discounting curve
- ▶ Switching the PAI rate from EONIA flat to the €STR flat will have an **impact on non-linear interest derivatives** such as caps/floors and swaptions

Need more information?

For a more detailed overview of the expected impact of the EONIA-€STR transition on cash and derivatives products, market participants can refer to the ***Report on the impact of the transition from EONIA to the €STR on cash and derivatives products*** published on **19 August 2019**



Report by the working group on euro risk-free rates

On the impact of the transition from EONIA to the €STR on cash and derivatives products



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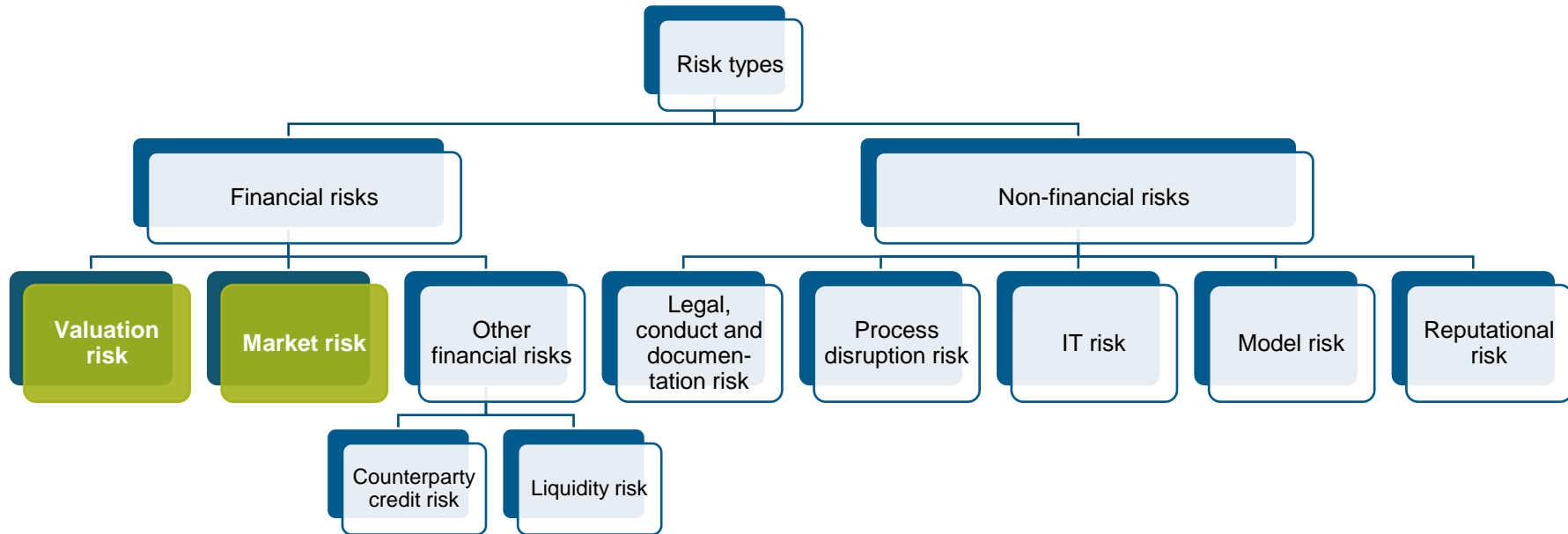
BMR: Risk management and financial accounting implications

**Second roundtable on euro risk-free rates
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**Markus Schmidtchen
KfW
Chair of subgroup 6**

>>> Overview of risk types affected

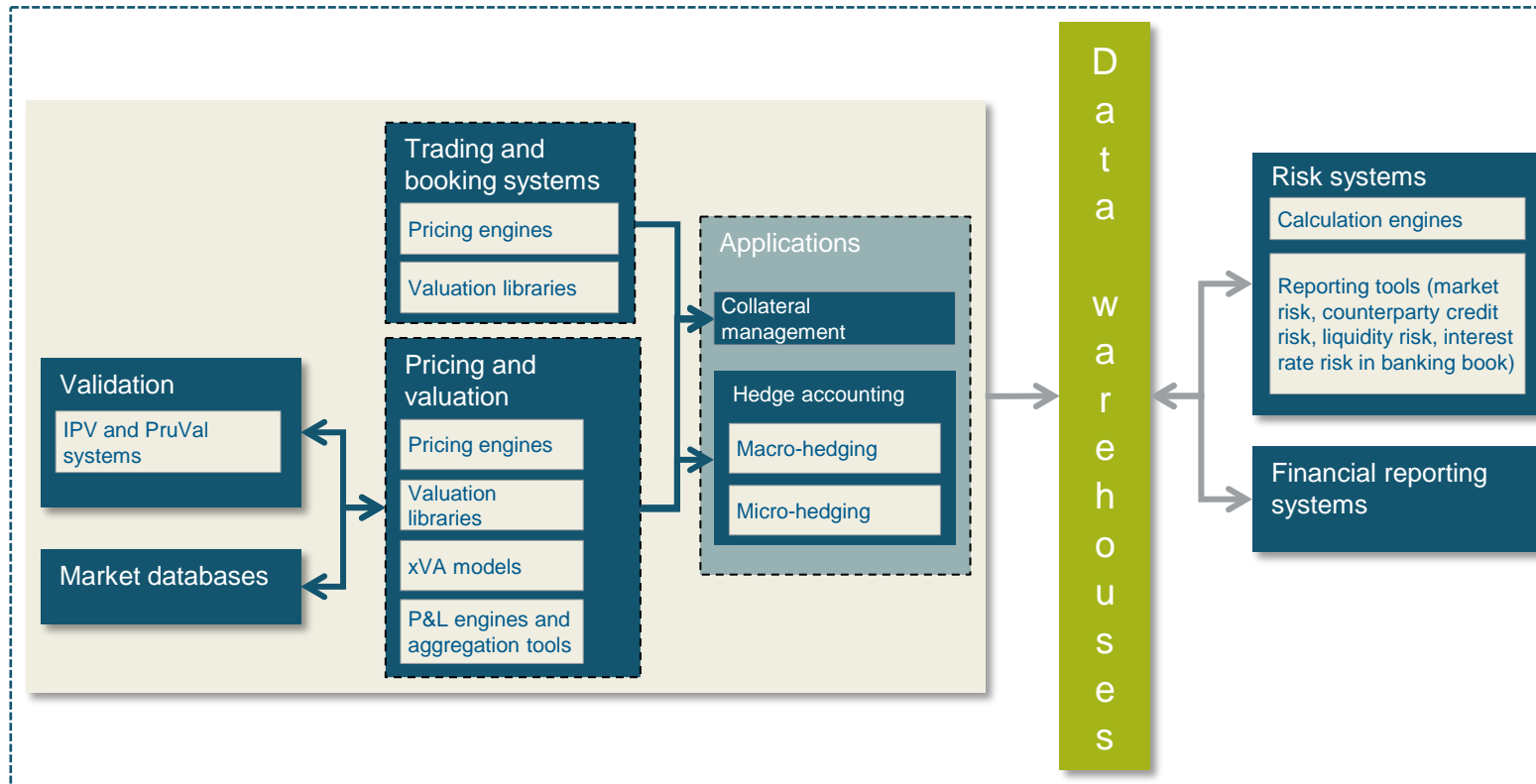
BMR affects a variety of risk types within financial institutions



Valuation and market risks are most impacted risk types and adaptations to risk management practices and IT systems are necessary

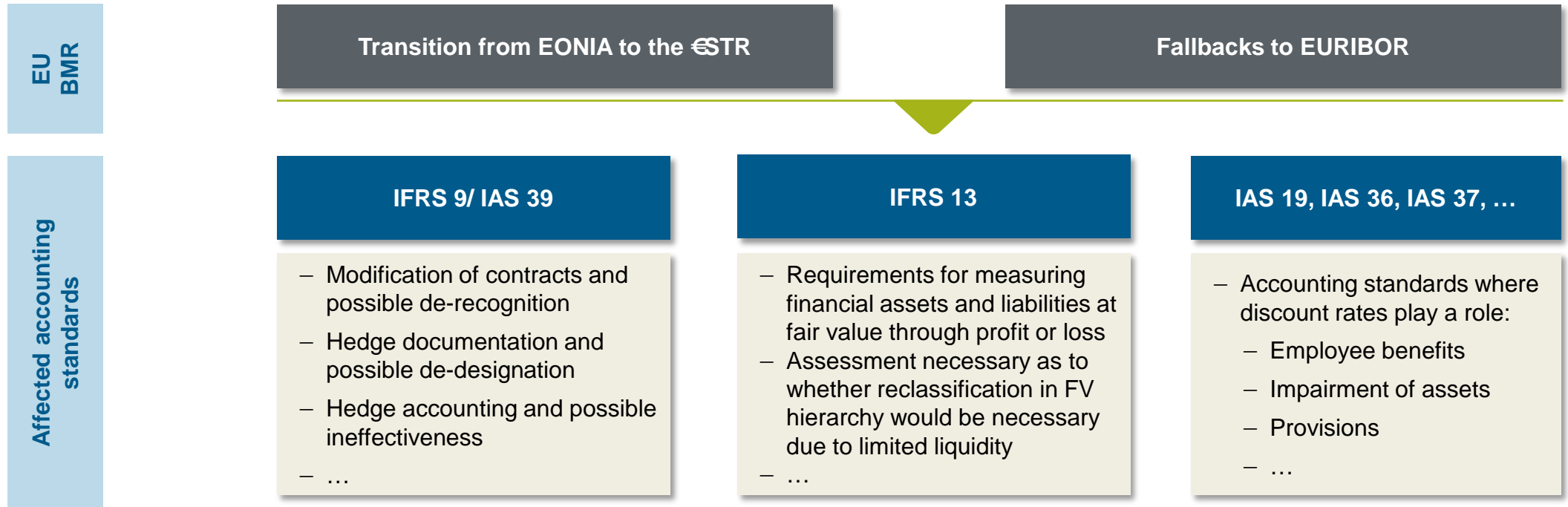
Implications for IT systems

In order to cope with the implications for various risk types, IT infrastructure needs to be adapted



Simplified and stylized illustration of IT system supporting various risk management functions ranging from market data and valuation to operational and reporting systems

»»» Effects of the BMR on financial accounting



The BMR can affect financial accounting, especially in the fields of hedge accounting and valuation

»» IASB's (temporary) relief for issues caused by the BMR

IASB is expected to publish phase 1 amendments in September 2019

Applicability of phase 1 amendments

- Apply to annual periods beginning on or after 1 January 2020, with earlier application permitted. Applicability for the financial year 2019 is expected, depending on IASB balloting and EU endorsement process
- Amendments predominantly deal with pre-replacement aspects of benchmark rates with respect to the uncertainty of timing and amount of future cash flows
- They also cover aspects of hedge relationships during the transition period, until the uncertainty from migrating to new benchmark rates is resolved

Retrospective effectiveness test

Prospective effectiveness test

Highly probable requirement

Separately identifiable risk components

Disclosure requirements

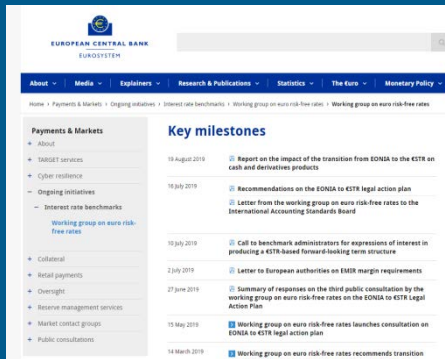
»»» Need more information on how the BMR affects risk management and financial accounting?

3 documents (to be) published by the working group on euro risk-free rates

1

Letter to the IASB

- Published on 16 July 2019, accessible on the [ECB's website](#)



2

Report on risk management implications

- To be published beginning of October
- Will be accessible on the [ECB's website](#)

3

Report on Accounting Implications

- To be published end of October
- Will be accessible on the [ECB's website](#)

How to transition from EONIA to the €STR: the legal action plan

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Frankfurt, 25 September 2019

José Carlos Pardo (Checa)
BBVA
Chair of subgroup 3

EONIA to €STR legal action plan – main recommendations

On 2 October, the EONIA methodology will be modified to become the €STR plus a fixed spread



At the end of 2021, EMMI will cease publication of EONIA

- 1** As from 2 October 2019, whenever feasible and appropriate, market participants should consider **avoiding entering into any new contracts referencing EONIA**, in particular those maturing after December 2021.
- 2** In **new contracts still referencing EONIA** and maturing after December 2021 or falling within the scope of the EU Benchmarks Regulation, market participants should **include robust fallback provisions**.
- 3** For **legacy contracts referencing EONIA** and maturing after December 2021, market participants should consider **replacing EONIA** as soon as possible, or **embedding robust fallback clauses**.

The working group recommends the **€STR plus the 8.5 basis points spread as the EONIA fallback rate** for all products and purposes

EONIA to €STR legal action plan – derivative transactions

New derivative transactions

- The **ISDA Benchmarks Supplement** provides a convenient way to implement a robust fallback.
- It is recommended that ISDA considers updating the 2006 ISDA Definitions to include a **specific “EONIA cessation event” trigger**.
- For **European master agreements**, their sponsors should consider amending their agreements to include robust fallback provisions.

Legacy derivative transactions

- The **ISDA Benchmarks Supplement Protocol** provides a convenient way to transition to the €STR.
- ISDA is recommended to consider developing **new documents and/or protocols** to embed an EONIA cessation event trigger, and/or to switch to €STR plus the spread.
- For **European master agreements**, their sponsors should consider developing amendment agreement templates or protocols for amending legacy trades.
- **Public authorities** are recommended to clarify that amending legacy transactions does not entail margin or clearing obligations, or requiring investors to be informed individually.

EONIA to €STR legal action plan – collateral agreements

Collateral agreements...

- ... do not, generally have a **termination date**.
- ... have tended not to **include fallback provisions**.
- ... are not subject to the **Benchmarks Regulation**.

New derivative & cash collateral agreements

- The **introduction of robust and standardized fallback provisions** would enhance transparency and legal certainty upon the EONIA discontinuation.
- Market associations (ISDA, ICMA, ISLA and sponsors of European master agreements) are recommended to develop solutions to **enhance the robustness of new collateral agreements**.

Legacy derivative & cash collateral agreements

- The working group recommends that, wherever practical, market associations (ISDA, ICMA, ISLA and sponsors of European master agreements) work with their members **to develop new documents and/or protocols**.

EONIA to €STR legal action plan – cash products

New cash contracts

- Many **short-term cash contracts and instruments** will roll over before December 2021. New issuances should therefore simply reference €STR instead of EONIA as soon as possible.
- For syndicated loans, the **standard market documentation of the Loan Market Association** is a convenient way to implement a robust fallback.
- As a starting point for drafting and negotiation, the working group is providing two alternative **templates for EONIA discontinuation fallback language**.

Legacy cash contracts

- The majority of legacy cash contracts and instruments mature before December 2021, but some will **need to be amended or canceled through bilateral renegotiation**.
- The use of ISDA-style **protocols to amend legacy contracts** is not market standard, so market participants may consider using the **bilateral amendment agreement template**.
- As a starting point for drafting and negotiation the working group is providing an amendment agreement template.

EONIA to €STR legal action plan – comprehensive view

For a comprehensive analysis of the legal implications and the recommendations to ensure a smooth transition from EONIA to the €STR, market participants can consult these three documents.

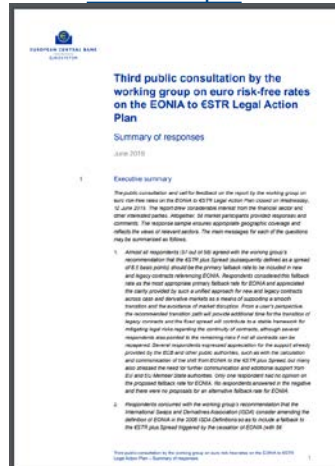
1 Public consultation – 15 May

https://www.ecb.europa.eu/paym/pdf/cons/euro_risk-free_rates/ecb.consultation_details_201905_en.pdf



2 Summary of feedback received – 28 June

https://www.ecb.europa.eu/paym/pdf/cons/euro_risk-free_rates/ecb.summaryofresponses01_201906_en.pdf



3 Final recommendations – 16 July

https://www.ecb.europa.eu/paym/pdf/cons/euro_risk-free_rates/ecb.eurostr_eonia_legal_action_plan_20190716_en.pdf

