



EUROPEAN CENTRAL BANK

EUROSYSTEM

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risk-free rates

Update on the working group on euro risk-free rates

FXCG, 20 March 2019

Global reform of benchmarks in progress

- New international standards (IOSCO principles), owing to
 - past incidents of manipulation and
 - decline in underlying volumes (unsecured interbank market)→ Robust benchmarks to be transactions-based, reflecting active market
- FSB recommendation: Identifying alternative risk-free rates (RFRs)

Euro area

- EU Benchmarks Regulation (EU BMR): As of 1 January 2020, non-compliant benchmarks cannot be used in new contracts *however deadline postponement is highly likely ([political agreement](#))*
- ECB involvement as of Sep 2017:

Euro short-term rate:

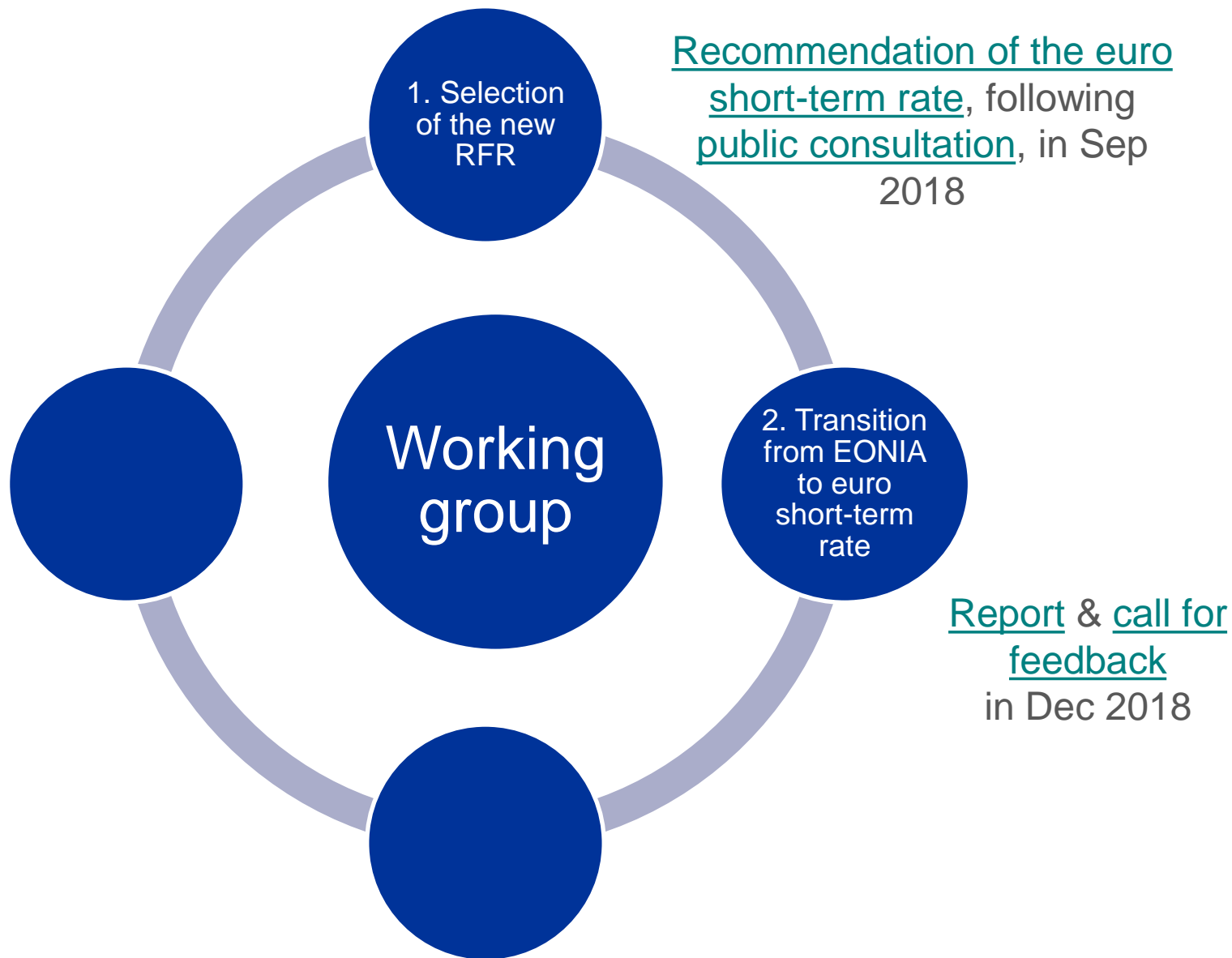
Production of an overnight unsecured rate by October 2019

Working group on euro risk-free rates (WG):

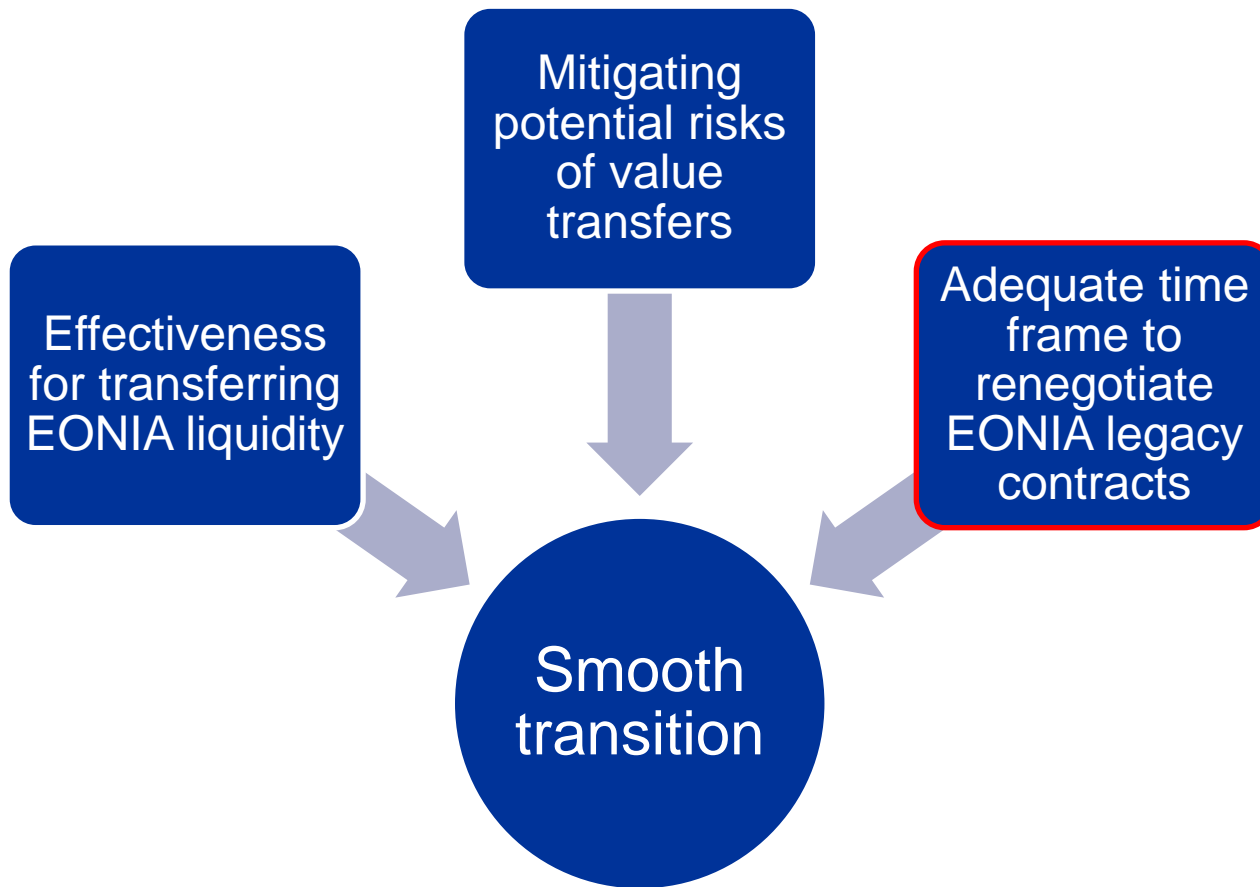
Set up with ESMA/FSMA/EC, ECB providing the secretariat

EONIA vs. the Euro Short-term Rate

EONIA	Euro short-term rate
EUR	EUR
Overnight	Overnight
Unsecured	Unsecured
Transaction Based	Transaction Based
Unstable Panel	Stable Reporting Agents
Interbank	Wholesale
Bank Lending	Bank Borrowing
Published on T	Published on T+1



- The WG analysed possible transition paths and recommended:
 - To use an evolved EONIA methodology, i.e. $\text{EONIA} = \text{euro short-term rate} + \text{Spread}$, until December 2021
 - To replace EONIA with euro short-term rate for new and legacy trades



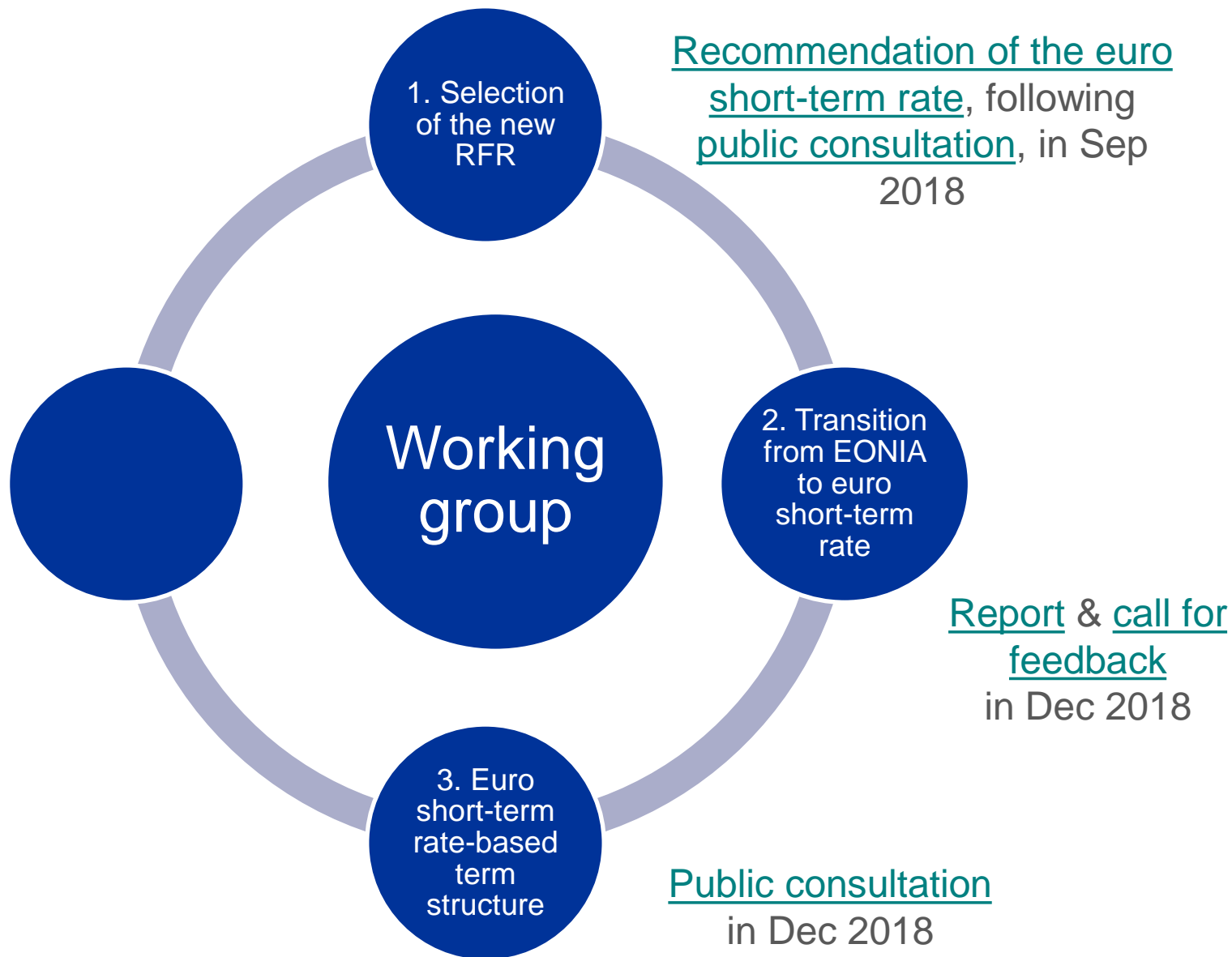
- The WG recommended that market participants:

Gradually replace EONIA with the euro short-term rate as a reference for all products and contracts and make all necessary adjustments for using the euro short-term rate as their standard benchmark after the transition period

- Since 1 Jan 2018, supervised entities using benchmarks are required to fulfil [Article 28\(2\) of the EU BMR](#):

*Supervised entities [...] 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***

- The WG published a [paper](#) in Jan 2019 on **guiding principles for fallback provisions** and intends to recommend more detailed fallback language for legacy and new euro-denominated contracts



EURIBOR and euro short-term rate-based fallbacks

- Base case for the WG: EURIBOR to become BMR compliant

EMMI

(EURIBOR's administrator)

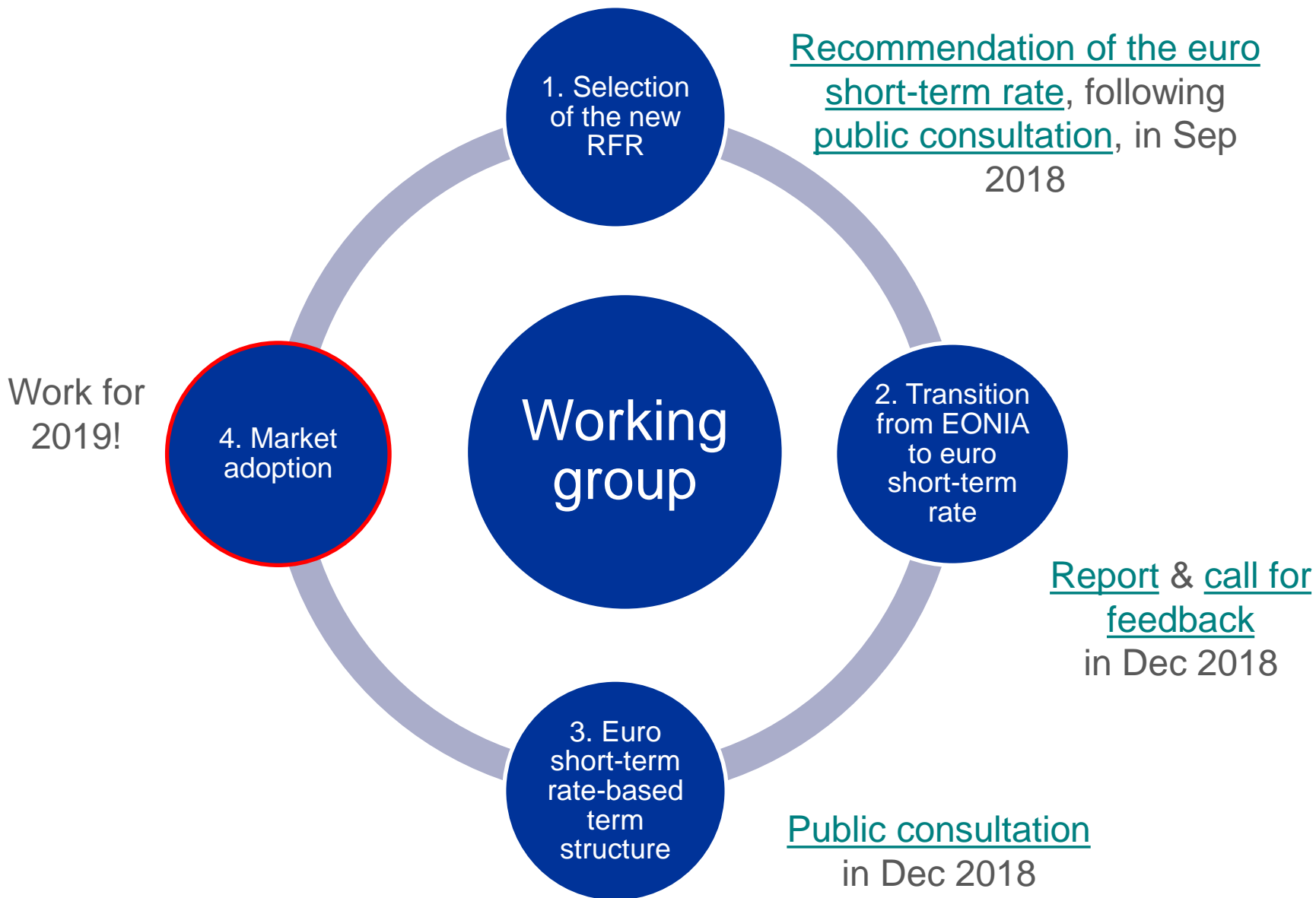
- Ongoing reform of EURIBOR to move to hybrid methodology
- Q2 2019: apply for authorisation to FSMA, phasing in of hybrid methodology

FSMA

(EMMI's supervisory authority)

- “represents a significant step towards a BMR-compliant Euribor”
- “FSMA will make an effort to expedite the authorisation process”

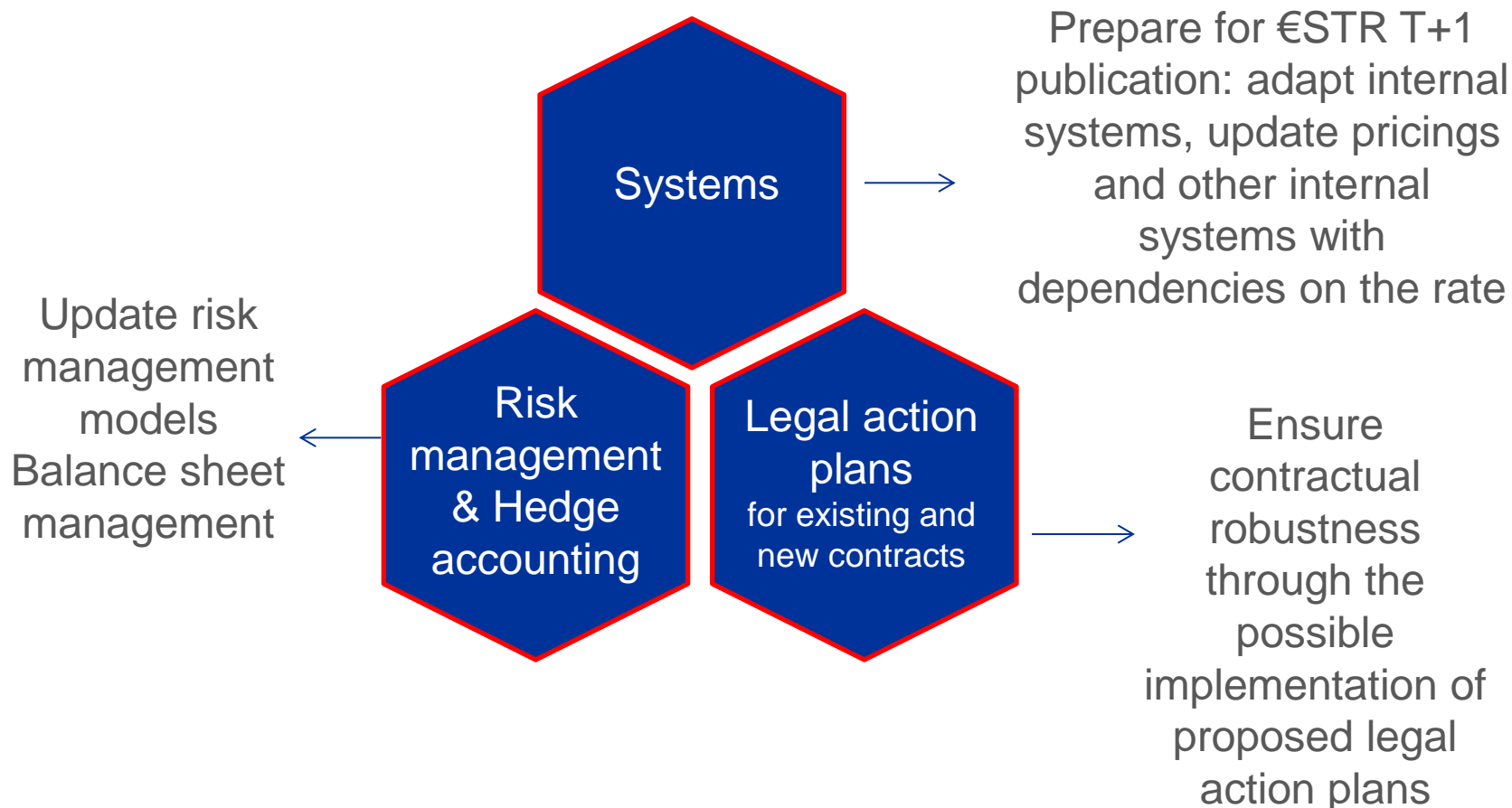
- WG to identify euro short-term-based fallbacks for EURIBOR
- Public consultation on forward-looking term structure methodologies based on euro short-term rate derivatives markets recently closed:
 - Based on tradeable OIS quotes offers the best prospect of producing a viable forward-looking fallback
 - Challenges: consistency across asset classes, jurisdictions



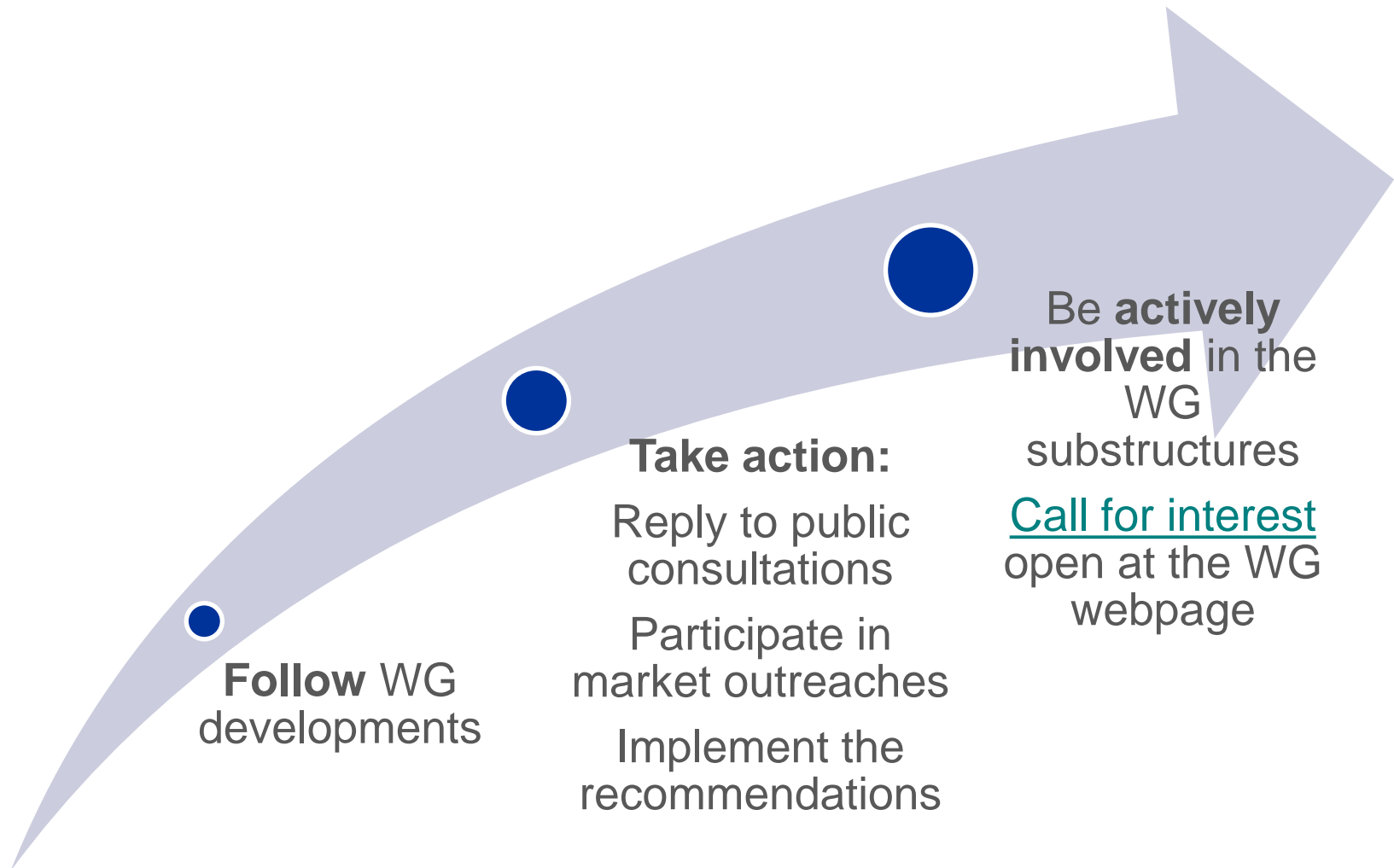
Issues to be addressed by the WG in 2019 ... and relevant also for market participants



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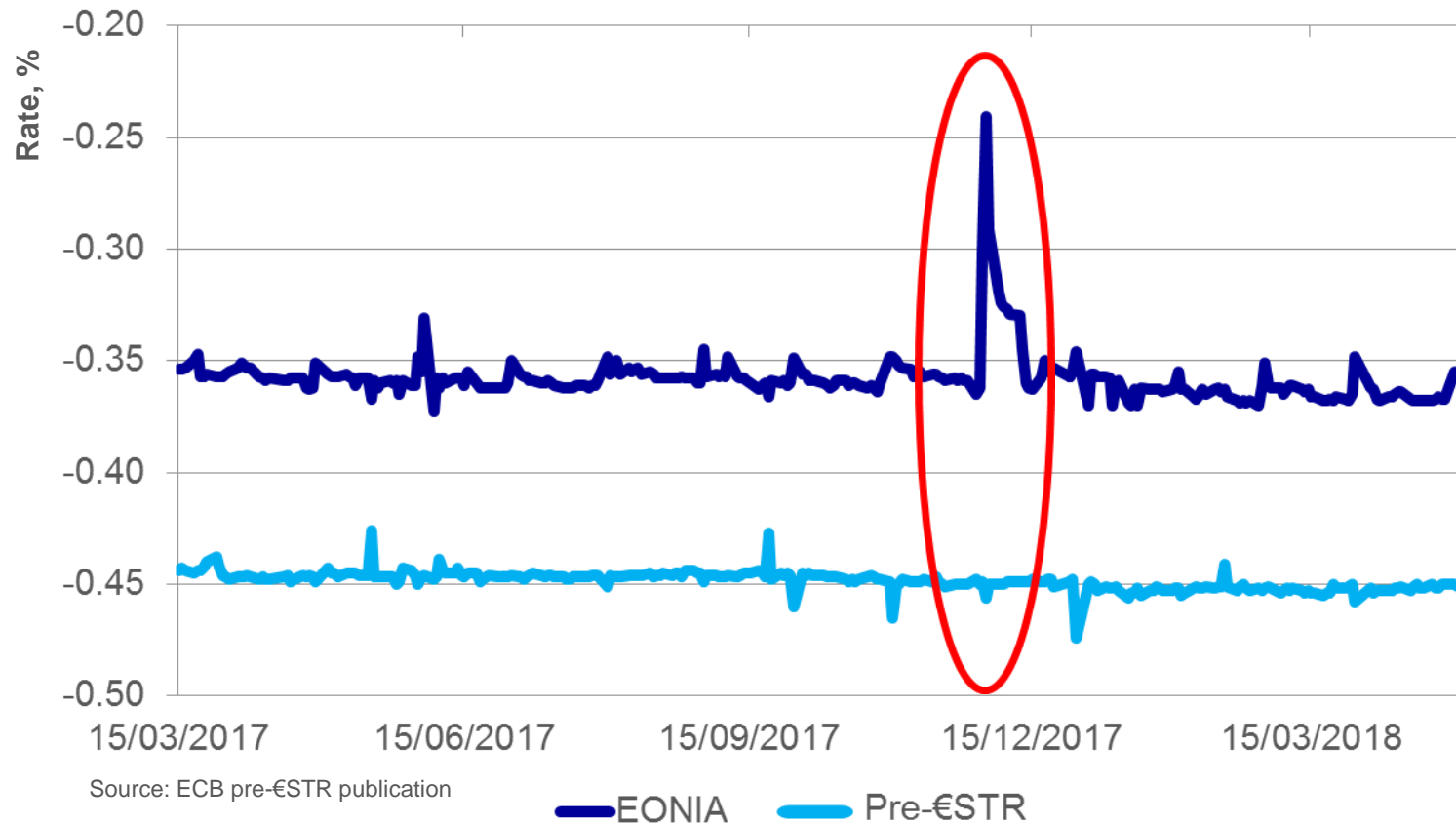


What else market participants could do?



Questions & Answers

EONIA vs. the Euro Short-term Rate



- Rate reacts to market factors (excess liquidity, rate falls at quarter-ends)
- While being less vulnerable to outliers
- Pre-€STR (post corrections) very similar to €STR (based on 7:00 data)

How to square this?

