EURIBOR fallback rates – current discussions

Overview

Term €STR + Spread adjustment = EURIBOR fallback rate

- forward-looking calculation
- backward-looking calculation
- forward spread calculation
- historic spread calculation
- dynamic spread calculation
Forward-looking €STR-based Term Structure

- 77% of respondents during the second public consultation by the working group on euro risk-free rates agreed with the working group's assessment that the OIS quotes-based methodology offered the best prospect of producing a viable fallback rate within a reasonable time period following the launch of the daily ESTER publication.

- Market liquidity in the underlying €STR derivative markets

- Access to transaction data for a benchmark administrator

- Interested administrators to present their proposals in next WG meeting (mid Oct)

- While it is recognized also by working groups in other jurisdictions (ARRC, NWG, Sterling WG, etc.) that a forward-looking rate would offer attractive features, it is also questioned whether a robust forward-looking benchmark rate would be available in time to replace LIBOR. Therefore there is a clear push in those working groups to find solutions for a backward-looking rate for all asset classes (incl. consumer loans)
# Backward-looking €STR-based Term Structure

## Evaluation overview

<table>
<thead>
<tr>
<th>Methodologies</th>
<th>Operational ease / cash flow mgmt.</th>
<th>Computational ease / mechanics</th>
<th>Hedging ease</th>
<th>Client acceptance</th>
<th>Period congruency</th>
<th>Examples of usage</th>
<th>Conclusion</th>
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<tbody>
<tr>
<td>2. Payment delay</td>
<td><strong>Operational complexity</strong> due to small interest payment delay</td>
<td>Simple and transparent calculation, rate can be published</td>
<td><strong>Limited hedging issues</strong></td>
<td>High for specific asset classes/users</td>
<td>Consistent</td>
<td>OIS derivative market</td>
<td>[ ]</td>
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<tr>
<td>4. Lookback</td>
<td>Sufficient time lag between fixing and payment for many users</td>
<td>Simple and transparent calculation, rate can be published</td>
<td><strong>Minor risk</strong> due to small mismatch</td>
<td>High for specific asset classes/users</td>
<td>Small mismatch</td>
<td>SONIA FRN market</td>
<td>[ ]</td>
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<tr>
<td>5. Last reset</td>
<td>Payment rate known in advance, so operationally straightforward</td>
<td>Simple and transparent calculation, rate can be published</td>
<td><strong>Hedging more complex</strong></td>
<td>Potentially only workable solution for retail and smaller corporate users</td>
<td>Inconsistent</td>
<td>Proposed solution by other working groups for Retail Mortgages</td>
<td>[ ]/ [ ]</td>
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ECB Money Market Contact Group Meeting, 24th Sep 2019, Frankfurt
Discussions regarding backward-looking term-€STR

- calculation period vs. payment date (which payment lag is acceptable?)

- for consumer products fixing in advance (last reset) might be the only practicable method
  - How to deal in such a case with 6M or 1Y term structures?

- compounding issues around this calculation
  - individually calculated
    - IT infrastructure need to support compounding in arrears
    - Initiatives in other working groups to approach vendors
  - Index
    - would be helpful for certain market participants
    - has to be published by trusted, publicly available source
    - challenge that on certain end-dates (publication dates) several possible start dates exist
      (calendar convention, public holidays, month-ends, etc.)
## Credit spread calculation methodologies

### Overview

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<th>Historic Credit spread methodology</th>
<th>Forward Credit spread methodology</th>
<th>Dynamic Credit spread methodology</th>
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<tr>
<td><strong>High level description</strong></td>
<td>Historical difference between EURIBOR and €STR/EONIA</td>
<td>Simplification of €STR/EURIBOR forward derivative curve</td>
<td>Replication of the credit/liquidity risk in another index</td>
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<tr>
<td><strong>Fixed or variable</strong></td>
<td>Fixed at point of benchmark cessation</td>
<td>Fixed at point of benchmark cessation</td>
<td>Remains variable over life of the contract</td>
</tr>
<tr>
<td><strong>Key issues</strong></td>
<td>What historic period to reference?</td>
<td>Reference data at point of cessation</td>
<td>Data collection dependent</td>
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</table>

Another public consultation on credit spread calculation by WG on Euro RFR in preparation. Timing? Parallel consultations by ISDA and potentially by Sterling WG.
Further topics in discussion

- How to deal with different approaches in different asset classes/jurisdictions?
  - ISDA consultation showed a clear majority of respondents prefer a "compounded setting in arrears" for the term-RFR and "historical mean/median approach" for the spread adjustments as fallback to LIBOR in multiple currencies
  - Although it is expected that ISDA will only launch a consultation for EURIBOR at the end of 2019 or begin of 2020 the respondents of the last consultations already stated that they have a strong desire to use the same fallback methodology across all benchmarks
  - ARRC and Swiss NWG recommend to use a compounded RFR as term rate were possible
  - Sterling floating rate financial issues are now already dominated by compounded SONIA linked FRN
  - Consumer products vs. wholesale market: is there a need to apply different methodologies?
  - Use of term-RFR in new products, not only as fallback solution?