

BBVA Corporate & Investment Banking

€STR: initial market reaction

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Creating Opportunities

€STR transition: operational challenges for the financial sector

The new rate led to a series of challenges for the industry. Most of them were related to legal and technical issues about updating previous documentation or contracts linked to the new index (and despite being time consuming they were not very relevant). However, the **most important ones were related to the new discount curve, the change in publication time from T to T+1 and the outstanding trades linked to the EONIA index**.

New discount curves

Banks have to establish a new discount curve based on the €STR and re-evaluate all of their positions

Live EONIA-linked trades

CCPs are still thinking about this issue but it seems the most probable outcome will be to adapt EONIA trades to €STR +8.5bp

In bilateral contracts, banks are still discussing the best approach, but it seems that they will likely adopt the same methodology as CCPs.

Change in publication time from T to T+1

- Asset valuation: banks decided to use a provisional rate
- Collateral remuneration: settlement is at the end of month, thus there is less time to adjust levels and cash flows

Settlement:

Derivatives – no impact as settlement is on T+2 Repo-according ICMA best practice: apply the fixing of the penultimate accrual date to the final date and then make retrospective reimbursements for the differences between the actual and correct repo price (net claims per day per counterparty should not be less than EUR500)

€STR transition: collateral revaluations

We are now in a transition stage where financial market participants will have to get ready for the full implementation of €STR. The most relevant aspects of the transition are as follows:

Bilateral contracts

A new CSA and link all operations to this new document – an initial cash settlement to adjust previous contracts from EONIA to €STR

Two CSA: In case of no agreement for the initial adjustment, there would coexist two CSAs

CCP contracts

During 2H19, clearing houses will move to the €STR rate for their collateral revaluations

Initial cash payments for the collateral adjustment will be made

Derivatives linked to €STR: first recorded trades

Despite the fact that volumes remain contained, **financial markets have started to trade the new index** and the first trades linked to the €STR have appeared

Oct 2019 - USD29.66bn* open swap contracts

*According reported volume on LCH as the first CCP to start trading €STR (Eurex started on the 19 Nov)

Oct 2019 - USD24.96bn* outstanding at the month end *According reported volume on LCH as the first CCP to start trading €STR (Eurex started on the 19 Nov)

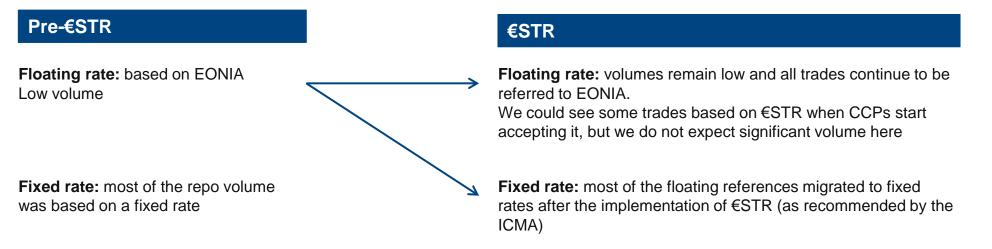
- c.5bn contacts matured during the month of October
- c.90% of volume had a maturity of <1 year</p>
- Contracts maturing in the short term lead us to think that some trades are part of the tests carried out by Banks to check their capacity to trade the new index
- Banks are ready to start trading €STR but some clients might still be getting ready, leading volumes to remain contained

2 Oct- €STR kicks off First operations related to €STR 2H20 CCPs start using €STR as the discount and remuneration curves -Significant increase in volume January 2022 Discontinuation of EONIA –slight increase in trading volume

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Repo: how to deal with the new reference

Most of the floating references migrated to fixed rates (as recommended by the ICMA). Levels of floating repo have remained very low after the implementation of \in STR and all of the trades continue being linked to EONIA. In the coming months, as CCPs start accepting trades linked to \in STR, we could see an increase in this kind of trades but we do not expect significant levels of repo trades linked to \in STR

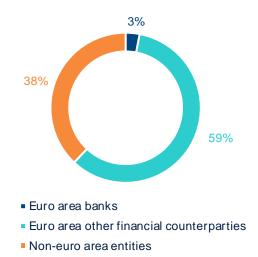


And now, the €STR

One of the main changes vs. the EONIA rate is that **unsecured overnight operations between banks and other financial counterparties are now included**, while when calculating the EONIA rate only operations between selected banks were considered. It is worth highlighting that with €STR: i) **transactions between euro area banks have so far represented just 3%** of the unsecured overnight borrowing; and ii) there seems to be a de-facto dualization of the money markets between the entities with access to the depo facility and those without

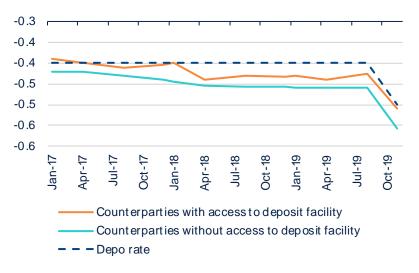
Share of unsecured overnight borrowing (%)

Note: chart indicates average of all €STR transactions from 1 Oct. to 31 Oct. Source: BBVA GMR based on ECB (Coeuré 12 Nov speech)



Unsecured overnight borrowing rates (%)

Note: Chart indicates average of all €STR transactions from 1 Oct. to 31 Oct. Source: BBVA GMR based on ECB (Coeuré 12 Nov speech)



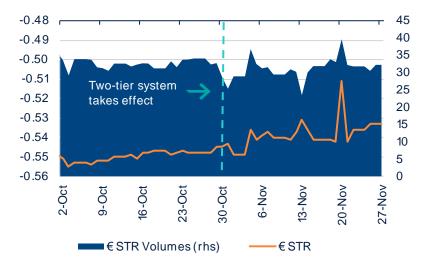
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And now, the €STR

The non-secured market has not experienced a significant reactivation (volumes) since tiering/€STR was introduced. This reflects the fact that it is in the secured (repo) market where most of the cross-banking system activity is taking place. All in all, the **€STR has proved to be a bit volatile with a slightly upward bias in its first stage.** Furthermore, index has proved to be sensitive to contributed volume and concentration amongst the top 5 banks.

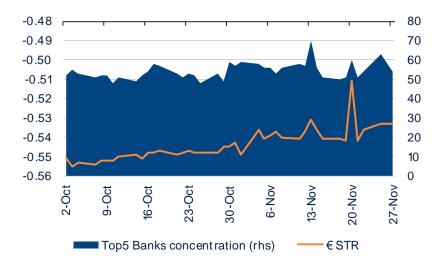
€STR rates (%) and volumes (EUR bn)

Source: BBVA GMR based on Bloomberg



€STR rates (%) and concentration amongst the top 5 banks (%)

Source: BBVA GMR based on Bloomberg



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