WG Euro RFRs Subgroup 4

EONIA-ESTER Transition

Frankfurt, 27 February 2019
I. SG4 conclusions following feedback
II. Further SG4 Clarifications
III. Additional steps to be considered
I.- **SG4 recommendations following feedback: Unchanged**

Having considered market feedback which is largely in line with the report, SG4 does not suggest to change its recommendations:

**Recommendations to EMMI:**

1. The working group recommends that the European Money Markets Institute (EMMI), as the administrator of EONIA, takes the following steps before 1 January 2020:

   (a) Modify the current EONIA methodology to become ESTER plus a spread for a limited period, in accordance with Financial Stability Board (FSB) recommendations and IOSCO Principles for Financial Benchmarks to further anchor EONIA’s methodology in transactions;

   (b) Engage with the relevant authorities to ensure the compliance of EONIA, under its evolved methodology, with the EU Benchmarks Regulation;

   (c) Consider and consult market participants on discontinuing the publication of EONIA under its evolved methodology, after a transition period that ensures firms can achieve transition to ESTER in a smooth manner and that pays due regard of the existing EONIA legacy book. This transition period should last until the end of 2021, which is consistent with benchmarks transitions in other jurisdictions.

2. The working group also invites EMMI to take the following considerations into account:

   (a) Consider an EONIA-ESTER spread methodology based on a simple average with an observation period of at least 12 months, combined with a 15% trimming mechanism;

   (b) That the recalibration methodology and the effective determination of the spread are announced at the same time before ESTER’s first day of publication;

   (c) That the recalibration date is on the first day of ESTER’s publication for simplicity reasons.
I. - SG4 recommendations following feedback: Unchanged

Recommendations to Market Participants:

3. The working group recommends that market participants gradually replace EONIA with ESTER as a reference rate for all products and contracts and make all adjustments necessary for using ESTER as their standard benchmark after the transition period (including making the appropriate changes to their systems to enable a T+1 publication).

4. The working group encourages market participants to make all reasonable efforts to replace EONIA with ESTER as a basis for collateral interest for both legacy and new trades with each of its counterparties (clean discounting).
II.- Further SG4 Clarifications- Clean discounting regime

• The concept of “clean discounting” was not sufficiently understood and we believe the report needs further clarity.

• We propose the following drafting: “Clean discounting applies at counterparty level. This means that for each counterparty only one curve shall be used. For example counterparts A and B can choose either EONIA or ESTER as the basis for discounting. Once they agree, a single curve will be used for all their bilateral transactions whether for their legacy or for their forward book. The agreement between A and B does not prevent counterparty B to use a different benchmark with counterparty C as long as a single curve is used for all transactions between B and C”.

• Rationale for this path: its simplicity, the protection of less sophisticated users that may not be prepared to use ESTER right away and the encouragement to transition in one single step per counterparty once they are ready.
II.- Further SG4 Clarifications: Trimming and time window

• Although they are intuitive, the definitions of “trimming” and the 12m time window used to calculate the spread were not sufficiently explained

• A “15 % trimming” may be interpreted in two ways:

  A. 85% of the total data will be used to compute the average as the top 7.5% and bottom 7.5% will be excluded OR

  B. 70% of the total data will be used to compute the average as the top 15% and bottom 15% will be excluded

• A 15% trimming means “B”

• Recommended time window of 12 months shall use the most recent historical data
III.- Additional steps to be considered

Awaiting for new reorganization, SG4 believes that two additional steps may be considered to further smooth EONIA – ESTER transition:

1- **Standard Compensation Payment**

To facilitate the calculation of compensation payment when moving computation framework from EONIA (recalibrated) to ESTER, EUR RFR may consider further guidance on:

a) drafting a standard written procedure that determines the high level steps and standard parameters to compute a compensation payment such as valuation dates and times, settlement dates, zero coupon methodology, spreads...

b) identification of standard data sources as the inputs to the computation methodology

c) determination of a high-level standard formulae with some high level examples

2- **EONIA – ESTER transition Protocol**

- A standard documentation protocol that helps coordinating transition of legacy contracts from EONIA to ESTER