

Working Group on euro risk-free rates

Newsletter July 2020



This newsletter provides an update on the work of the working group on euro risk-free rates (hereafter the working group or WG), and also refers to developments in international markets. If you have questions about the content or would like to subscribe, please contact CommunicationsEuroRFR@ecb.europa.eu. Feel free to share this newsletter with others!

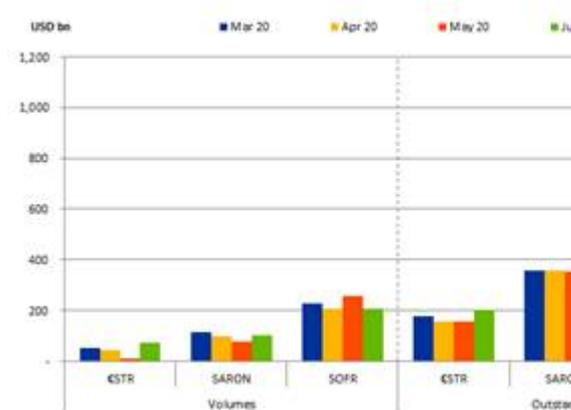
Recent WG developments

- On 16 June 2020, the working group [endorsed a recommendation](#) that counterparties voluntarily exchange compensation for legacy swaption contracts affected by the transition of central counterparty discounting from the euro overnight index average (EONIA) to the euro short-term rate (€STR). Several potential modalities were also identified for implementing the voluntary compensation.
- The working group has been discussing the potential impact of the current COVID-19 and decided to amend the [planning](#) for its upcoming deliverables: the public consultations on (i) Euribor fallbacks, and (ii) trigger events have been scheduled for this autumn, with the corresponding recommendations being expected by early 2021.
- On 2 July 2020, Mr Van Rijswijk chaired his last meeting of the working group on euro risk-free rates, following his appointment as ING's Chief Executive Officer as of 1 July 2020. Mr Phutrakul, ING's Chief Financial Officer, took over the

Market developments

- **Transition to €STR Discounting – Reminder: the go-live date for the €STR discounting environment and the Price Alignment Interest (PAI)/Price Alignment Amount (PAA) will take place on 27 July 2020.**
- The European Association of CCP Clearing Houses (EACH) announced a postponement of the EONIA to €STR discounting regime switch date for cleared trades to Monday 27 July 2020 due to concerns over operational risks created by COVID-19 (see [statement](#)).
- LCH [published](#) their monthly swap clearing data for June. After observing a downward trend over the last months due to COVID-19, both cleared volumes and outstanding amounts for OIS contracts linked to €STR increased again in June 2020:

Chart: Notional volumes and outstanding



- **2 June 2020:** ISDA announces that it will publish a supplement to the 2006 ISDA Definitions in July to incorporate new fallbacks for

role as chair of the working group.

- On 8 July 2020, the working group sent a [letter to the IASB](#) to express concerns in relation to potential accounting issues that could be considered as a direct consequence of the IBOR reform. With this letter, the working group asks the IASB for relief on the use of basis swaps in IFRS9/IAS39 hedge accounting, and for guidance on the use and form of regulated rates in the context of IFRS9 Solely Payment of Principal and Interest (SPPI) testing.

Working group recommendations on EONIA to €STR transition

- The working group highlights that contracts referenced to EONIA with maturities beyond 3 January 2022 would entail significant risks. It therefore recommends that market participants should replace EONIA products with €STR products and reduce their EONIA-linked legacy exposures as soon as possible.
- In order to accelerate the transition process, market-makers are encouraged to proactively price in the €STR rather than EONIA as their

derivatives that reference certain key interbank offered rates.

Simultaneously, ISDA will publish a protocol that will allow market participants to choose to incorporate the revisions into their legacy derivatives trades. Ahead of the publication, ISDA has published a [new factsheet](#) that explains why changes to fallbacks are necessary.

Non-euro working groups status

- **9 Mar 2020:** The Federal Reserve Bank of New York is now [publishing](#) 30-, 90- and 180-day SOFR Averages and a SOFR Index. Each business day, the New York Fed publishes the SOFR Averages and SOFR Index on the New York Fed's website, shortly after the SOFR is published at approximately 8:00 a.m.
- **14 May 2020:** The ARRC released its recommendations that a voluntary exchange of cash compensation take place between counterparties to legacy swaptions referencing USD LIBOR and that counterparties specify an agreed discount rate using the SOFR for new swaptions expiring after October 16, 2020.
- **23 June 2020:** The UK Government announced its intention to give the FCA enhanced powers to amend the Benchmark Regulation (BMR). FCA would be able to stabilise certain LIBOR rates during a wind-down period. Most notably, it could require a modification of the LIBOR

default, and central counterparties are recommended to consider developments in the nettability (compression) of the €STR and EONIA.

- The working group has published a [report](#) on the transfer of liquidity from EONIA's cash and derivatives products to the €STR.

Communication toolkit

- To enable a smooth transition, the working group made available [communication material](#) which interested parties can use in their own communication and education efforts.

methodology for its use only on though legacy contracts after December 2021.

- **1 July 2020:** the FSB published a statement on the impact of COVID-19 on global benchmark reform. The FSB maintained its view that financial and non-financial sector firms across all jurisdictions should continue their efforts in making wider use of risk-free rates in order to reduce reliance on IBORs where appropriate and in particular to remove remaining dependencies on LIBOR by the end of 2021.
- **9 July 2020:** the FSB published a report on Supervisory issues associated with benchmark transition. The report highlights that most FSB jurisdictions have a strategy in place to address LIBOR transition, as opposed to only half of the surveyed non-FSB jurisdictions. Financial institutions in these jurisdictions have shown better progress, although significant challenges remain. In light of the expected cessation of LIBOR after end-2021, authorities should strengthen their efforts in facilitating financial and non-financial institutions to transition away from LIBOR.

The working group on euro risk-free rates was established in February 2018 to identify and recommend risk-free rates that could serve as a basis for an alternative to current benchmarks used in a variety of financial instruments and contracts in the euro area, such as the euro overnight index average (EONIA) and the euro interbank offered rate (EURIBOR).