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Eurozone Benchmark Rates Reform: The Transition from EONIA to €STR

- The Eurozone Benchmark interest rates, i.e. the short-term (overnight) EONIA rate and the EURIBOR rates' family (with maturities from 1 week up to 12 months), by the end of 2019 will either be replaced or their calculation methodology will be radically reformed. Their current calculation methodology is not compliant with the EU Benchmarks Regulation (BMR), the new regulation applied to the EU from January 1st, 2018 on rates used as benchmarks in financial markets, which emerged in the aftermath of the LIBOR and EURIBOR market manipulation scandals and the 2008 financial crisis.¹
- In what follows we will present the EONIA related developments. The new methodology for the calculation of the EURIBOR will be covered in a future note.
- On September 14th, 2018, the working group on euro risk-free rates (the working group in what follows), set up jointly by the ECB, the Belgian Financial Services and Markets Authority, the European Securities and Markets Authority and the European Commission, following the completion of its 1st public consultation, proposed the ECB's euro short term rate (€STR) as the replacement of EONIA² (Box 1 below).
- According to the ECB the publication of €STR will start in October 2nd, 2019.
- On March 14th, 2019, the working group recommended to the European Money Markets Institute (EMMI), the administrator of EONIA, the modification of the current EONIA methodology, so as to become €STR plus a fixed spread from the first publication date of €STR and to consider ceasing publication of EONIA at the end of 2021.³
- On March 20th, 2019, following the working group's recommendation, the EMMI launched a public consultation on the recalibration of the EONIA methodology and also proposed January 3rd, 2022 as the last publication date of EONIA.
- More recently, on May 15th, 2019, the working group published a consultation paper on the legal action plan for the transition from EONIA to €STR. In the paper the various legal options, available for the aforementioned transition, were described along with the group's recommendations.
- On the basis of the above, the main recommendations of the group are the following:
 - New contracts: referencing EONIA should include robust fallback provisions and an acknowledgement that references to EONIA will be understood to be references to EONIA as modified after the change to its methodology on 2nd, October 2019.
 - New contracts post October 2nd, 2019: whenever operationally feasible, market participants should consider no longer entering into new contracts referencing EONIA, in particular new contracts maturing after December 31st, 2021.
 - Legacy contracts maturing after December 31st, 2021: market participants should consider replacing EONIA as a primary rate as soon as possible or embedding robust fallback clauses with reference to the recommended fallback rate for EONIA.
- The working group intends to recommend €STR plus a spread as the EONIA fallback rate.
- For the full list of the working group's recommendations and questions that require the feedback of the market participants please refer to the aforementioned consultation paper (consultation deadline: June 12th, 2019).⁴

¹ Recent review of the LIBOR-EURIBOR reform process: https://www.bis.org/publ/qtrpdf/r_qt1903e.pdf

² <https://www.ecb.europa.eu/press/pr/date/2018/html/ecb.pr180913.en.html>

³ <https://www.emmi-benchmarks.eu/euribor-eonia-org/eonia-consultations.html>

⁴ <https://www.ecb.europa.eu/press/pr/date/2019/html/ecb.pr190515~4cdfb209ce.en.html>

Box 1: The euro short term rate (€STR)⁵

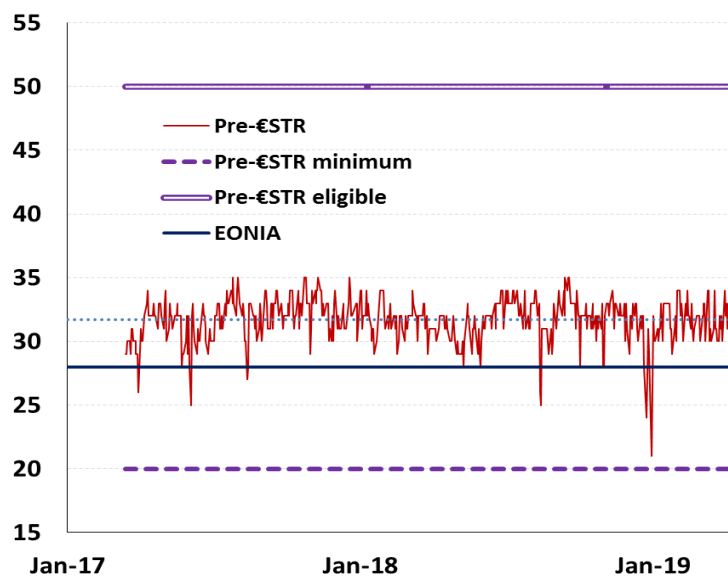
The euro short term rate (€STR), that is currently developed by the ECB (**official launch date: October 2nd, 2019**) aims to reflect the wholesale euro unsecured overnight borrowing costs of euro area banks. The rate will be published for each TARGET2 business day based on transactions – and not offered quotes as the ones used in the EONIA rate – conducted and settled on the previous day (reporting date T) with a maturity date of T+1 and which will be deemed to be executed at arm's length and thereby to reflect market rates in an unbiased way.

The €STR will be calculated as a volume weighted trimmed mean rounded to the third decimal. The steps needed for the calculation of the volume-weighted trimmed mean include:

1. The ordering of the transactions from the lowest rate to the highest rate (date T);
2. The aggregation of the transactions occurring at each rate level (date T);
3. The removal of the top and bottom 25% in volume terms (date T)
4. The calculation of the mean of the remaining 50% of the volume-weighted distribution of rates (date T). This mean constitutes the €STR for the following day (Date T+1).

Certain contingency procedures will be used in cases where the number of reporting banks is less than 20 (the number of the banks eligible for €STR participation is 50) or 5 banks account for 75% or more of total transaction volumes (plus the usual operational risk procedures (for example a system break down)).

Figure 1: Number of banks participating in the pre-€STR and EONIA calculation

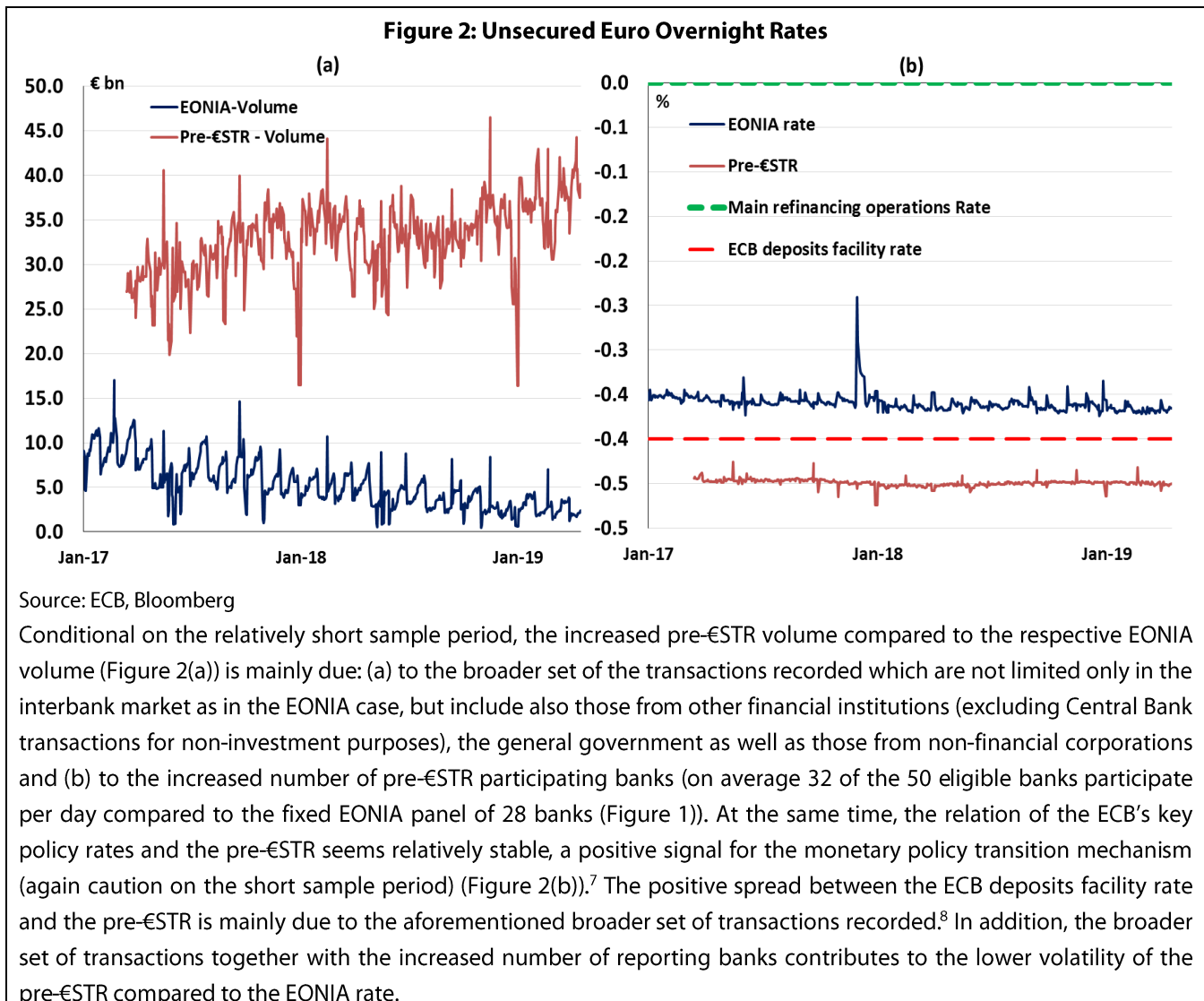


Source: ECB, EMMI

In Figure 1 we present the number of banks eligible for pre-€STR participation, the actual number of banks participating in the pre-€STR calculation on a daily basis, the minimum acceptable participation of banks in the pre-€STR calculation and the number of banks participating in the EONIA calculation panel. In Figure 2 we present the main unsecured euro overnight rates i.e. the EONIA rate, the ECB's main refinancing operations and the deposits facility rates as well as the pre-€STR, a rate that is calculated and published by the ECB on the basis of the aforementioned €STR rules, from January 1st, 2017 onwards with the aim of reducing market uncertainty, allowing market participants to assess the suitability of the new rate and familiarize themselves with its statistical properties, and providing them with the opportunity to adjust processes and procedures adequately to ensure a seamless transition to the new rate.⁶

⁵ For more information on €STR: https://www.ecb.europa.eu/paym/initiatives/interest_rate_benchmarks/euro_short-term_rate/html/index.en.html

⁶ For more information on pre-€STR: https://www.ecb.europa.eu/paym/initiatives/interest_rate_benchmarks/shared/pdf/ecb.Pre-ESTER.en.pdf



⁷ For information on the monetary policy transition mechanism <https://www.ecb.europa.eu/mopo/intro/transmission/html/index.en.html> and <https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op191.en.pdf>

⁸ https://www.bis.org/publ/qtrpdf/r_qt1903e.pdf

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