

IBORs: EONIA to €STR transition started today



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The transition from the Euro OverNight Index Average ("EONIA") to a new interest rate based exclusively on actual transactions – the euro short-term rate ("€STR") – has begun earlier today at the occasion of the first publication of €STR by the European Central Bank ("ECB").

At the same occasion, the methodology of EONIA has been amended, so that EONIA becomes €STR plus a fixed spread of 8.5 basis points ("bps"), determined on the basis of the differences between EONIA and €STR observed during historical simulations of €STR.

Both €STR and the "recalibrated" EONIA are published on T+1, which differs from the publication time of the EONIA, as calculated until 30 September 2019 (such publication time having always been T).

The EONIA to €STR transition will need to be completed for all market participants on 3 January 2022, when EONIA will be discontinued and replaced by €STR, the latter being considered by policymakers as meeting the highest standards in terms of transparency and governance.

As explained in our previous newsflash on this topic, the transition away from EONIA falls within the ambit of a broader shift in the interbank offered rates (“IBORs”) framework. In this context, EONIA, which qualifies as a “critical benchmark” under Regulation (EU) 2011/1016 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds (the “BMR”), has been deemed as not sufficiently “transactions-based”, as it is calculated using input data from 28 panel banks (one contribution per bank). €STR is itself built on daily individual transactions data submissions of all banks reporting in accordance with the Regulation (EU) 1333/2014 of the European Central Bank of 26 November 2014 concerning statistics on the money markets, thus reflecting much more closely the actual market activity.

Recommendation to begin working on the switch from EONIA to €STR immediately

Since the transition from EONIA to €STR will potentially require significant adjustment across IT infrastructure, accounting systems, existing contracts, client facing documents etc. the working group on euro risk-free rates (“Euro RFR WG”) recommends to start moving away from EONIA as from today and immediately reference €STR instead of the recalibrated EONIA when entering into new contracts.

To avoid operational complexity and the need to potentially do a two-steps switch, i.e. first moving from EONIA to €STR plus spread (economically equivalent to the “recalibrated” EONIA referred to above) and then moving from €STR plus spread to €STR flat, i.e. without the 8.5 bps spread, the Euro RFR WG recommends, when repapering existing contracts and adjusting internal systems, to directly transfer from EONIA to €STR flat. Because of the 8.5 bps difference between €STR and the recalibrated EONIA, the value transfer arising from an anticipated switch to €STR should be mitigated through a one-off balancing payment. Such payment will have an impact on the cash flows of each counterparty to the relevant agreement and should hence be planned in advance.

The Big Bang Switch: automatic replacement of EONIA by €STR

In respect of all centrally cleared derivatives, the Euro RFR WG is working in close consultation with central clearing counterparties (“CCPs”) to plan for an upcoming “Big Bang Switch”, i.e. a particular date on which all CCPs would switch their discounting curves from EONIA to €STR, ideally in the course of the second quarter of 2020.

Increased regulatory scrutiny on market participants’ contingency plans

According to the ECB, around 13 trillion euros in assets are governed by contracts currently referencing EONIA, out of which 3.7 trillion have a maturity date after 3 January 2022, i.e. the last day EONIA will be published. In addition, following the commencement of publication of €STR, the Euro RFR WG is expected to develop €STR-based term rates, which could be used as

fallback rates to EURIBOR (also qualifying as a “critical benchmark” under the BMR). Unlike EONIA, EURIBOR is not expected to be discontinued but, for the purpose of contingency planning, market participants should identify appropriate fallback rates.

As reiterated by the Chair of the European Securities and Markets Authority (“ESMA”) during the [second roundtable on euro risk-free rates held at ECB on 25 September 2019](#), it is a legal obligation of users of benchmarks, including EONIA and EURIBOR, to have robust contingency plans (article 28 of the BMR). ESMA interprets this obligation to include having contractual fallback provisions in case of discontinuation of any benchmarks used.

Following such comments it is not unlikely that there will be increased scrutiny from the regulatory authorities as regards contingency planning by benchmark users in the coming months.

Additional guidance

For further details on the expected impact of the EONIA to €STR transition, market participants can refer in particular to:

the [Final recommendations of the working group on euro risk-free rates on the EONIA to €STR legal action plan published on 16 July 2019](#); and
the [Report on the impact of the transition from EONIA to the €STR on cash and derivatives products published on 19 August 2019](#).

Additional useful materials are also made available on the Euro [RFR WG’s website](#).