Second roundtable on euro risk-free rates

25 September 2019
Frankfurt am Main

Second roundtable on euro risk-free rates

€STR-based term structure methodologies that could serve as EURIBOR fallbacks

# Forward-looking methodologies that could serve as EURIBOR fallbacks

1. Futures-based methodology

2. OIS transactions-based methodology

3. OIS quotes-based methodology

4. OIS composite methodology

Based on the <u>outcome</u> of the <u>second public consultation</u>, the working group <u>recommended</u>

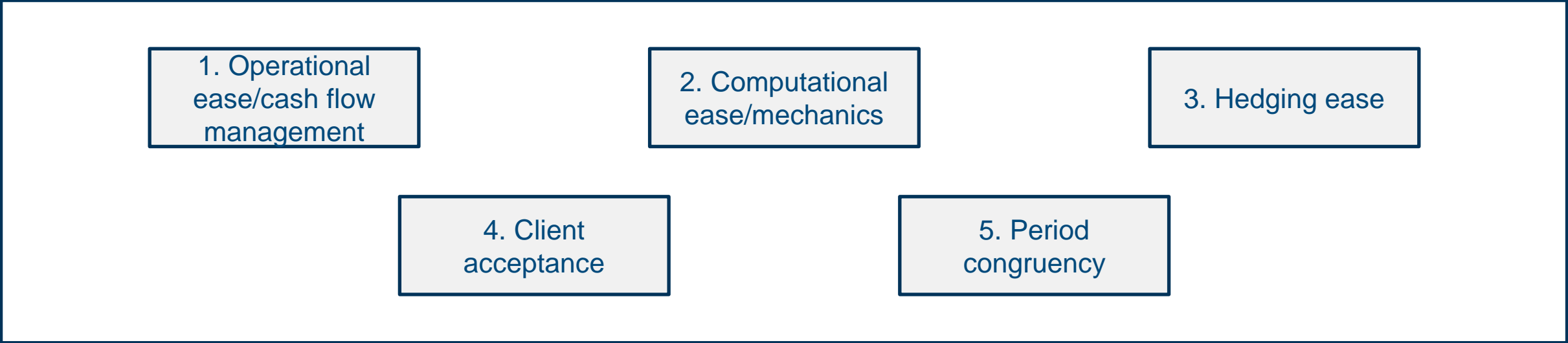**OIS (tradable) quotes-based methodology**

Backward-looking methodologies that could serve as EURIBOR fallbacks

Legend(*)
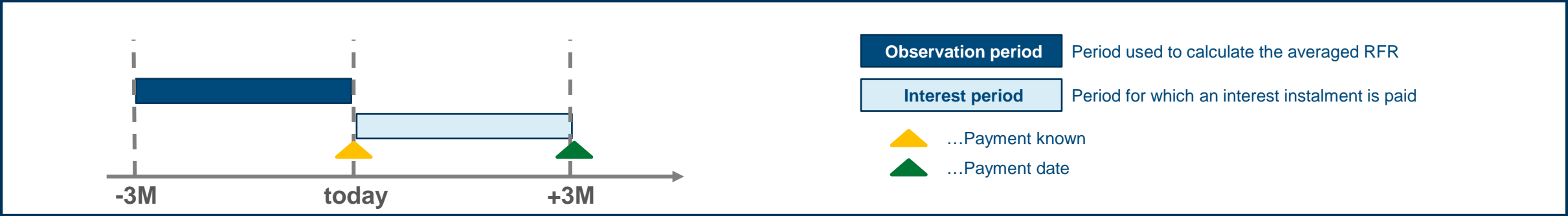
(*) The graphical descriptions of the backward-looking methodologies refer to the user guide to overnight risk-free rates published by the Financial Stability Board (FSB) on 4 June 2019, p. 8.
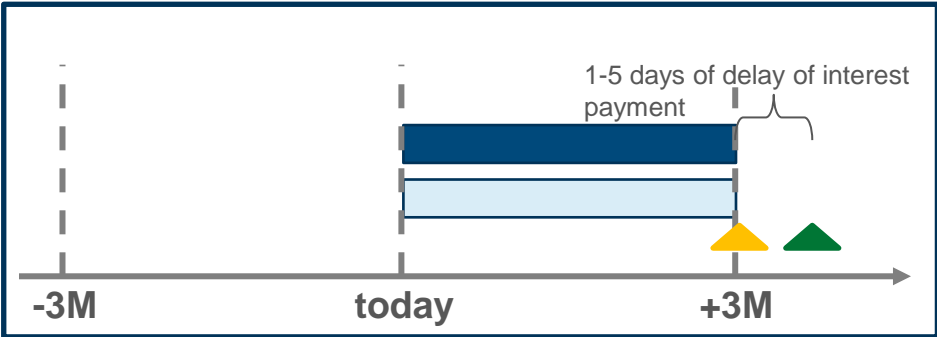
Evaluation parameters

1. Operational ease/cash flow management	2. Computational ease/mechanics	3. Hedging ease
4. Client acceptance	5. Period congruency	

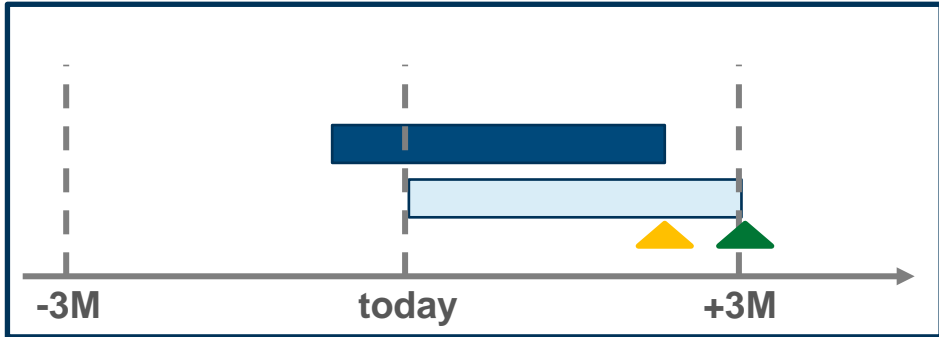# Backward-looking methodologies that could serve as EURIBOR fallbacks

Viable options

Payment delay

1-5 days of delay of interest payment

-3M   today   +3M

Lookback

-3M   today   +3M

Last reset

-3M   today   +3M

● …viable option   ● …concerns / issues
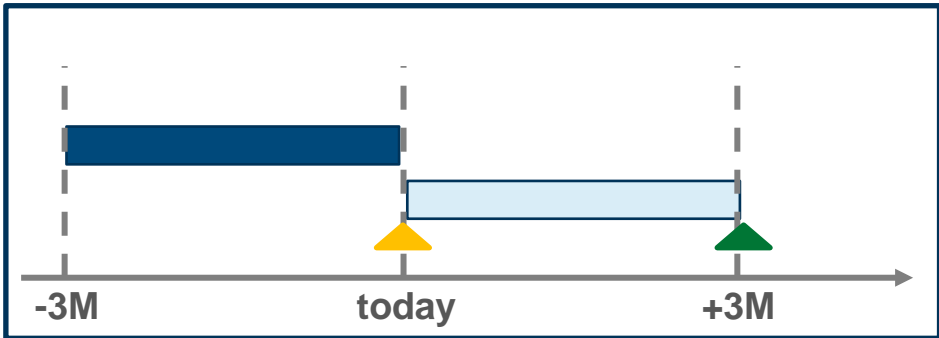
Backward-looking methodologies that could serve as EURIBOR fallbacks

Evaluation overview

Methodology	Operational ease / cash flow mgt.	Computational ease / mechanics	Hedging ease	Client acceptance	Period congruency	Examples of usage	Conclusion
Payment delay	**Operational complexity** due to small interest payment delay	Simple and transparent calculation, rate can be published	**Limited hedging issues**	High for specific asset classes/users	**Consistent**	OIS derivative market	🟢
Lookback	Sufficient time lag between fixing and payment for many users	Simple and transparent calculation, rate can be published	**Minor risk** due to small mismatch	High for specific asset classes/users	**Small mismatch**	SONIA FRN market	🟢
Last reset	Payment rate known in advance, so **operationally straightforward**	Simple and transparent calculation, rate can be published	**Hedging more complex**	Potentially the **only workable solution for retail and smaller corporate users**	**Inconsistent**	Proposed solution by other working groups for retail mortgages	🟢/🟡

🟢 …viable option 🟡 …concerns / issues

ISDA's IBOR fallbacks

- ISDA's IBOR Fallbacks are being developed at the request of the OSSG

- Triggered by announcement or publication of information confirming the permanent cessation of the IBOR

- Fallback will be to RFRs selected by the RFR Working Groups

- RFR will need to be adjusted for term and credit spread

- ISDA's consultations on the adjustment methodologies have so far covered USD, JPY, GBP, CHF, CAD, HKD and AUD IBORs.

- EURIBOR and Euro LIBOR supplemental consultation will be held after €STR commences publication on 2 October 2019

- Methodologies on which consultations were held did not include a forward-looking term rate

- Feedback coalesced around compounding in arrears and historical mean/median credit spread adjustment

- ISDA consultation on parameters launched with feedback due by 23 October 2019

  - 10-year trimmed mean or 5-year median

  - Lag or lock-out methodology

- Pre-cessation event supplemental consultation to be launched in coming months

- Bloomberg Index Services Limited to calculate and publish the compounded RFR, spread and 'all-in-rate' (i.e. compounded RFR + spread).

Next steps for the working group

1. Recommend which backward-looking and forward-looking term structure methodologies would be suitable for each cash and derivatives product, including their co-existence

2. Issue a recommendation on credit spread methodology

3. Analyse the impact of the inclusion of EURIBOR fallbacks on systems and infrastructure

4. Analyse the impact of the inclusion of EURIBOR fallbacks on risk management and financial accounting

5. Issue recommendations on fallback language for new and legacy contracts referencing to EURIBOR