

Transition from IBORs to Risk Free Rates

Background and status update

Jaap Kes, Global Head of Market Risks & Execution ING Group
Treasury

Paris • 13 September 2019

thinkforward



Why the market needs alternative Risk Free Rates

FSB recommendations on 'Reforming major interest rate benchmarks':

- Strengthen existing benchmarks by underpinning them with transaction data to the greatest extent possible
- Developing alternative nearly risk-free reference rates

Lack of transactions makes search for alternative RFRs more important

EU Benchmarks Regulation sets additional requirements for:

Administrators

- Effective governance and control framework to ensure the integrity and reliability of the benchmark (methodology)
- Apply for and obtain registration or authorization from NCA

Contributors

- Effective governance and control framework to ensure the integrity and reliability of all contributions of input data to the administrator

Users






- Robust written plans if benchmark ceases to exist, including fallbacks in contracts
- Only registered or authorized benchmarks can be used

Status reform critical IBORs

LIBOR	<ul style="list-style-type: none">• Reform showed fully transaction based benchmark is not feasible• ICE developed hybrid methodology for LIBOR contribution• FCA authorised ICE as benchmark administrator under BMR• FCA announced it will not compel panel banks to contribute to LIBOR as of 1 January 2022*
EONIA	<ul style="list-style-type: none">• Reform showed low number of interbank lending transactions• In parallel, ECB announced to develop a new unsecured overnight rate (ESTER) based on a broader set of borrowing transactions• EMMI announced that, <u>in its current form</u>, EONIA's compliance with the EU BMR cannot be warranted• EMMI will recalibrate EONIA to €STR + fixed spread as of 2 October 2019, with publication until 2 January 2022
EURIBOR	<ul style="list-style-type: none">• Reform showed fully transaction based benchmark is not feasible• EMMI developed hybrid methodology for EURIBOR contribution• April – October 2019: hybrid methodology will go live• FMSA authorised EMMI as administrator of hybrid EURIBOR under BMR

* Applicable to all LIBOR currencies (USD, GBP, EUR, CHF, JPY)

Recommended Risk Free Rates in various jurisdictions

	Administrator	Working Group	Chosen Rate	Rate type	Tenor	Rate published?
	Federal Reserve Bank of New York	Alternative Reference Rates Committee	SOFR (Secured Overnight Financing Rate)	Secured	Overnight	Yes
	European Central Bank	Working Group on a RFR Rate for the Euro Area	ESTER (Euro Short-Term Rate)	Unsecured	Overnight	Oct-19
	Bank of Japan	Study Group on Risk-Free Reference Rates	TONA (Tokyo Overnight Average Rate)	Unsecured	Overnight	Yes
	Bank of England	Working Group on Sterling Risk-free Rates	SONIA (Sterling Overnight Index Average)	Unsecured	Overnight	Yes
	SIX Swiss Exchange	National Working Group on Swiss Franc Reference Rates	SARON (Swiss Average Rate Overnight)	Secured	Overnight	Yes

Source: Citi Research, ISDA

Recommendations of Working Group on Euro Risk-Free Rates on EONIA-€STR transition and €STR-based term structure

EONIA- €STR transition path options

1. Parallel run and contractual alternative approaches
2. Pure succession rate approaches
3. **Recalibration approaches**



The recalibration approach roughly encompasses:

- EONIA methodology modified to become €STR + fixed spread
- Fixed spread should be used to prevent large value transfers
- Evolved EONIA temporarily available for transition between 2 October 2019 and 31 December 2021
- Evolved EONIA will be published on T+1 instead of T
- Evolved EONIA will become BMR compliant during this period

€STR-based term structure as fallback to EURIBOR

1. OIS transactions-based methodology
2. **OIS quotes-based methodology**
3. OIS composite methodology
4. Futures-based methodology



- OIS quotes-based method most likely viable at present time

Next steps for Working Group on Euro RFR – market adoption

