EURIBOR fallback rates – current discussions

Overview

Term €STR



Spread adjustment



EURIBOR fallback rate

- forward-looking calculation
- backward-looking calculation

- forward spread calculation
- historic spread calculation
- dynamic spread calculation

Forward-looking €STR-based Term Structure

- o 77% of respondents during the second public consultation by the working group on euro risk-free rates agreed with the working group's assessment that the OIS quotes-based methodology offered the best prospect of producing a viable fallback rate within a reasonable time period following the launch of the daily ESTER publication.
- o market liquidity in the underlying €STR derivative markets
- access to transaction data for a benchmark administrator
- interested administrators to present their proposals in next WG meeting (mid Oct)
- while it is recognized also by working groups in other jurisdictions (ARRC, NWG, Sterling WG, etc.) that a forward-looking rate would offer attractive features, it is also questioned whether a robust forward-looking benchmark rate would be available in time to replace LIBOR. Therefore there is a clear push in those working groups to find solutions for a backward-looking rate for all asset classes (incl. consumer loans)

Backward-looking €STR-based Term Structure

Evaluation overview

Methodologies	Operational ease / cash flow mgmt.	Computational ease / mechanics	Hedging ease	Client acceptance	Period congruency	Examples of usage	Conclusion
2. 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	
4. 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	
5. Last reset	Payment rate known in advance, so operationally straightforward	Simple and transparent calculation, rate can be published	Hedging more complex	Potentially only workable solution for retail and smaller corporate users	Inconsistent	Proposed solution by other working groups for Retail Mortgages	



Discussions regarding backward-looking term-€STR

- calculation period vs. payment date (which payment lag is acceptable?)
- for consumer products fixing in advance (last reset) might be the only practicable method
 - O How to deal in such a case with 6M or 1Y term structures?
- compounding issues around this calculation
 - individually calculated
 - IT infrastructure need to support compounding in arrears
 - Initiatives in other working groups to approach vendors
 - Index
 - would be helpful for certain market participants
 - has to be published by trusted, publicly available source
 - challenge that on certain end-dates (publication dates) several possible start dates exist (calendar convention, public holidays, month-ends, etc.)

Credit spread calculation methodologies

Overview

	Historic Credit spread methodology	Forward Credit spread methodology	Dynamic Credit spread methodology
High level description	Historical difference between EURIBOR and €STR/EONIA	Simplification of €STR/EURIBOR forward derivative curve	Replication of the credit/liquidity risk in another index
Fixed or variable	Fixed at point of benchmark cessation	Fixed at point of benchmark cessation	Remains variable over life of the contract
Key issues	What historic period to reference?	Reference data at point of cessation	Data collection dependent

Another public consultation on credit spread calculation by WG on Euro RFR in preparation Timing? Parallel consultations by ISDA and potentially by Sterling WG

Further topics in discussion

- How to deal with different approaches in different asset classes/jurisdictions?
 - ISDA consultation showed a clear majority of respondents prefer a "compounded setting in arrears" for the term-RFR and "historical mean/median approach" for the spread adjustments as fallback to LIBOR in multiple currencies
 - Although it is expected that ISDA will only launch a consultation for EURIBOR at the end of 2019 or begin of 2020 the respondents of the last consultations already stated that they have a strong desire to use the same fallback methodology across all benchmarks
 - ARRC and Swiss NWG recommend to use a compounded RFR as term rate were possible
 - Sterling floating rate financial issues are now already dominated by compounded SONIA linked FRN
 - o consumer products vs. wholesale market: is there a need to apply different methodologies?
- Use of term-RFR in new products, not only as fallback solution?