

Transition from EONIA to €STR

LCH SA

LCH The Markets'
Partner



The impact of Benchmark Reform in Euros in LCH's RepoClear SA Service(s):

LCH Group ("LCH") strongly supports the ongoing industry-wide efforts to reform many of the benchmarks used in Repo markets globally. Given the impact of these reforms on one of the two major benchmarks currently in use in euro markets, EONIA, and given the recent introduction of €STR as its recommended alternative, we wish to summarise RepoClear's transition plan for our users. This circular aims to identify the RepoClear service functionality and products that currently rely on EONIA, and the measures being taken to address the impact of the changes.

Both ECB¹ and EMMI² have issued materials to summarise the roles they respectively play in the reforms, their nature and progress towards their objectives. We will not reproduce this information but recommend that our users familiarise themselves with the salient points and note the key recalibration date.

EONIA at a glance:

EONIA ("*Euro Overnight Index Average*") is the benchmark 1-day interbank interest rate for the Euro zone. It is produced by the European Money Markets Institute. The definition and calculation methodology for EONIA, in its previous form, is not complying with EU benchmark regulations since 1 Jan 2020 and cannot be used for new financial contracts after this date. EONIA will continue to be published until start of Jan 2022. The first publication of EONIA under its new methodology (a fixed 8.5bp spread to €STR) was on 2 October 2019 (referencing business conducted on 1 October 2019).

The ECB recommends that market participants gradually replace EONIA with the €STR for all products and contracts, making the €STR their standard reference rate.

Introduction of €STR (Euro Short Term Rate):

€STR is a new overnight benchmark rate for the Euro zone that will be compliant with EU regulations. €STR is published by the ECB since 2 October 2019 reflecting the trading activity of 1 October 2019.

The ECB publishes €STR with three decimal places no later than 08:00am CET on the next TARGET2 business day ('T+1'). If errors are detected following standard publication that affect the published €STR by more than 2 basis points, the €STR is revised and republished on the same day, no later than 09:00am CET.

¹ https://www.ecb.europa.eu/paym/initiatives/interest_rate_benchmarks/WG_euro_risk-free_rates/shared/pdf/20191016/2019-10-16_WG_on_euro_RFR_meeting_Frequently_Asked_Questions.pdf#_blank

https://www.ecb.europa.eu/paym/initiatives/interest_rate_benchmarks/WG_euro_risk-free_rates/shared/pdf/20191016/2019-10-16_WG_on_euro_RFR_meeting_Checklist.pdf#_blank

² <https://www.emmi-benchmarks.eu/euribor-eonia-org/about-eonia.html>

Main differences between EONIA and €STR:

EONIA is administered by EMMI, and reflects the rate at which credit institutions in the EU lend overnight funds to each other in the unsecured money market in Euro.

The €STR will be administered by the ECB and will reflect the wholesale Euro unsecured overnight borrowing costs of Euro area banks and will complement existing benchmark rates produced by the private sector.

The €STR is calculated based entirely on actual individual transactions in Euro that are reported by banks in accordance with the ECB's money market statistical reporting (MMSR).

The EONIA methodology is redefined as €STR plus a spread, calculated as the difference between the underlying interests of EONIA and the pre-€STR. The ECB has calculated this spread as 0.085% 2(8.5 bps).

	EONIA	€STR
Economic interest of index	Interbank unsecured lending rate	Wholesale unsecured borrowing rate
Number of reporting agents or bank participants	28 panel banks	52 reporting agents
Average Daily Volume	€7,7 bn	€29,8 bn
Lowest Daily Volume	€0,8 bn	€6,8 bn
Publication day	Same day by 19:00 CET	Next day by 9:15 CET
Nature of Administrator	European Central Bank (ECB)	European Money Market Institute (EMMI)

Data from ECB (review period 01/08/2016 -15/01/2018)

RepoClear SA Variable Rate Repo:

Since October 2019, LCH SA clears VRR referencing both €STR and EONIA. The earliest trade date and open leg settlement date for VRR referencing €STR was 1 October 2019. LCH SA will continue to offer clearing in VRR referencing EONIA until end of 2021 or until otherwise notified.

Any VRR trades submitted to LCH for clearing that reference EONIA and have a maturity date beyond end 2021 will not be accepted for clearing. Fixed rate repo will continue to be offered in all markets.

For avoidance of doubt, RepoClear SA currently being a single currency service i.e only clears Euro denominated trades (as opposed to certain LCH businesses) it will be able to accept both VRR trades referencing both EONIA and €STR until EONIA is decommissioned.

Due to the timing of the publication of €STR (and by definition, EONIA) the correct final valuation of an EONIA-referencing repo trade will not be known until after publication of the rate on the following morning at 08:00am CET. If errors are detected following standard publication that affect the published €STR by more than 2 basis points, there is also a

provision to amend the rate until 09:00am CET. This delay will affect the creation of next day settlement instructions for the end-legs.

In order to ensure the instruction of VRR end-legs for settlement continues to occur on a timely basis, and also that the calculated interest payment is accurate, LCH SA is adopting the following process ('**Delta Cash Adjustment**')

- Settlement instructions for VRR end-legs will be instructed in T2S, as normal, on the day prior to settlement using the latest known €STR/EONIA rate. The end-leg of trades will settle in T2S based on this cash value
- Once €STR/EONIA is published on settlement date (T), LCH SA will calculate the relevant delta to the instructed cash values and will, for each member, create a cash debit/credit instruction for the differential amount. This amount will settle on the following day through the usual margin process payable via Target2 account (T+1).
- Details of all cash adjustments related to VRR transactions will be made available via LCH SA's member reporting service.

Communication from LCH SA:

LCH SA has proactively consulted with its Members, especially on Repoclear business line for several months through dedicated calls and meetings with bank repo traders.

LCH SA is also present active on this topic within various associations. LCH SA has shared its proposed approach alongside general information regarding the transition to €STR on its website and via direct communication to its membership.

Testing phase:

LCH SA has been keen to adapt to the variety of levels of readiness and approaches of its membership by accepting both the recalibrated EONIA rate until its decommissioning and the new €STR rate as early as possible.

LCH SA offered to its Membership two testing periods end of 2019 to ensure a successful and smooth transition from EONIA to the €STR based Variable Rate Repo.

LCH SA has been accepting VRR trades indexed on €STR in production since **29th October 2019**

Focus on Collateral (applicable for all LCH SA businesses):

Regarding Collateral Management, LCH SA has been using the re-calibrated EONIA rate (incorporating the T+1 new methodology) since 1 October 2019. Cash collateral balances are remunerated based on the new rate available since 2 October 2019.

Q&A:

Please find below a Q&A aiming at ensuring best understanding from members on how LCH is transitioning from EONIA to €STR.

1/ How will the “delta cash adjustment” be settled on our account? Will this be a separate amount or included into another amount?

The debit/credit difference is actually folded into the overnight margin call at EOD on VRR end date so effectively it won't be paid/received until the following morning (i.e. VRR end date + 1).

2/ The “delta cash adjustment” will be included in the daily margin process, but will we receive a report regarding the composition of this amount?

Yes, you will be notified of the cash adjustments via existing member reports (which breakdown on different levels):

KOND report – adjustment amount per transaction

REGU report – adjustment amount per ISIN, per clearing member/compartment

SFEU report – aggregated payment for all adjustments per clearing member/compartment (section AC102)

The process is the same today in the case of an adjustment to the Eonia.

3/ If we need a report that provides the trade level detail for the adjustment, what report should we look at?

The KOND report Section 8

4/ Could you please let us know when exactly during the day this payment/debit will be done? Will you do that on trade basis (trade by trade)?

Settlement instructions for VRR end-legs will be instructed in T2S on T-1, as per usual practice, on the day prior to settlement using the latest known €STR/EONIA rate. The end-leg of trades will settle in T2S based on this cash value. Once €STR/EONIA is published on T, LCH will calculate the relevant delta to the instructed cash values and will, for each member, include the global amount in the following day initial margin call (T+1 @ 8:30 am CET) through TARGET2.

Please see below examples:

In the **REGU report**, the adjustment amount is reported per ISIN as per the below example:

;INT;XX;M;SKGB;SK4120007204;-161.24;-160.89;-0.35;Debit;EUR;
;INT;XX;M;SKGB;SK4120007543;-394.82;-394.12;-0.70;Debit;EUR;

In the SFEU report (section AC0102), the adjustment is visible in the VARIABLE RATE record:

2. **Euro Cash collateral remuneration:** LCH SA will continue to use the re-calibrated EONIA rate until further notice (LCH LTD is targeting a change to €STR, aligned with SwapClear, to be communicated in due time).

9/ Are you going to continue to use EONIA for EUR cash collateral remuneration in LCH SA?

Regarding cash collateral management, LCH SA uses the re-calibrated EONIA rate (incorporating the T+1 new methodology) since 1 October 2019. Euro cash collateral balances are remunerated based on the new rate available since 2 October 2019 and this will be the case until further notice.

Please contact Treasury.Ops.FR@lch.com with any questions.

10/ What are the impacts expected on Variation Margin calls?

For RepoClear:

No impact is expected as the benchmark currently used for VM discounting calculation is EURIBOR for all Repo trades. There is no plan to change it.

For CDSClear:

The discounting is driven by ISDA, and there is no plan to change it. Indeed, Credit Default Swaps are valued using the ISDA pricer, which comes with an associated interest rate curve that is used by all market participants. So far, market participants have chosen to not introduce any change on the back of the €STR transition.

13/ Could you please confirm the date that LCH SA will start clearing €STR repos, is it the 29 October 2019?

As per the latest LCH SA communication, LCH SA started clearing €STR repos since 29 October 2019.

13/ Could you please confirm if LCH SA will continue to clear Variable Repos rates indexed on EONIA?

EONIA will continue to be published until start of 3 Jan 2022.

Hence, LCH will continue to offer VRR referencing EONIA until this time (unless instructed otherwise).

Need more information?

Please contact LCH teams:

- ❖ Fixed income Operations: Fixedincome.Ops.SA@lch.com
- ❖ Fixed Income testing Operations: ops_client_support_sa@lch.com
- ❖ Collateral Operations: Treasury.Ops.FR@lch.com
- ❖ Relationship Management: repocleargroupsales@lch.com

Useful links:

<https://www.icmagroup.org/assets/documents/Regulatory/Benchmark-reform/A-quick-guide-to-the-transition-to-risk-free-rates-in-the-international-bond-market-February-2020-27022020.pdf>