Repo market: transition from EONIA to €STR

by Andy Hill

On 14 March 2019, the Working Group on Euro Risk-Free Rates, supported by the ECB, published recommendations on transitioning from the euro overnight index average (EONIA) to the euro short-term rate (€STR). The recommendations include the following:

(i) market participants should gradually replace EONIA with €STR for all products and contracts, making €STR their standard reference rate once the period of transitioning to the €STR ends at the end of 2021;

(ii) EONIA's administrator, the European Money Markets Institute (EMMI), should modify the current EONIA methodology to become €STR (plus a spread)[2] for a limited period of time, allowing market participants sufficient time to transition to €STR; and

(ii) market participants should make all reasonable efforts to replace EONIA with €STR as a basis for collateral interest for both legacy and new trades with each participant's counterparties (clean discounting).

The ECB further announced that it will start publishing €STR as of 2 October 2019, reflecting the trading activity of October 1 2019.[3] Additionally, the ECB is ready further to support private sector efforts in the transition away from the euro overnight index average EONIA and will provide the computation of a one-off spread between the €STR and EONIA, which was requested by the Working Group on Euro Risk-Free Rates. This spread (published on 31 May 2019) has been calculated by the ECB according to the methodology publicly recommended by the Working Group on Euro Risk-Free Rates.

Perhaps the most significant consideration from a repo market perspective, in the case of EONIA-based transactions, is the timing of the publication of €STR. Unlike the publication of EONIA today,[1] €STR will only be published the following day of the contributing transactions (no later than 09:00 CET).[2] This is because the MMSR Regulation specifies that data shall be transmitted once per day to the ECB between 18:00 CET on the trade date and 07:00 CET on the first TARGET2 settlement day after the trade date. The complete dataset is therefore only available for the computation of the €STR after 07:00 CET on the following TARGET2 day. There is a provision for the rate to be amended up until 11:00 CET in the event of an error.

This "T+1" publication creates potential challenges for transacting and settling €STR-based repo, since the final rate to be applied in calculating the final repo interest will not be known until the actual repurchase date, which may be too late to send settlement instructions to the (I)CSD in time for settlement.

It should also be noted that the use of EONIA-based repo is largely limited to transactions in French government securities.[3] According to the most recent ICMA ERCC European Repo Market Survey (December 2018), the floating rate repo portion of the overall market is 13.1%.

Recommendation for market best practice

The practicalities of the EONIA/€STR transition for the non-cleared repo market have been discussed at length by the ICMA ERCC and the ERCC Operations Group. The ERCC has agreed on the following recommended best practice to be followed from 1 October 2019:

- The interbank market should transact purely on a fixed rate basis ("classic repo") and should no longer use floating rate repo.
- In the case of non-interbank transactions (such as dealer-to-client), where firms agree to transact on a floating rate basis (using EONIA or €STR), best practice will be to apply the fixing of the penultimate accrual date of the transaction to the final (repurchase) date (ie "crystallizing" the penultimate

1. Currently EONIA is published on the same day, between 18:45 and 19:00 CET.
2. EONIA, represented by €STR + the calculated spread, will be published by EMMI by 9:15 CET.
3. This is very much a legacy, market specific practice that pre-dates the introduction of the euro.

fixing into a fixed rate for the final business day). This will allow for parties to send timely settlement instructions for the repurchase leg of the transaction.

- Where parties transact on a floating basis, using the crystallization methodology, this will create discrepancies between the repurchase price calculated and settled by the parties and the repurchase price that would have applied had it been possible to instruct after the final fixing. In this instance, the disadvantaged party can elect to claim the differential from the advantaged party, so long as the differential is equal to or greater than an agreed threshold per transaction (the exact amount to be determined by the ERCC in the coming weeks following further discussion).

It should be noted that the recommended best practice for floating rate (EONIA or €STR) repo is largely similar to current market best practice for overnight index (OI) based repo in the event that the publication of the OI fixing is too late to send settlement instructions to the (I)CSD in time for settlement.[4]

Other considerations

Averaging vs. compounding

Currently, market practice for EONIA-based repo is to apply the average rate over the life of the trade, rather than compounding, even though daily compounding is used in the EONIA swap market. The ERCC agreed that this practice should continue in the case of EONIA or €STR repo, noting that it is also possible for parties to agree to a compounding methodology.

Reference to EONIA in GMRA annexes

While none of the GMRAs reference EONIA, it is understood that some bilaterally negotiated annexes may make reference to EONIA with respect to interest payable on cash collateral. Where this is the case, firms will need to update these bilateral annexes to reference a suitable alternative benchmark. While ICMA cannot do anything directly to assist firms in identifying or updating any bilateral contractual arrangements that may be impacted, in coordination with the ERCC it will look to raise awareness of the issue so that affected firms can take the steps necessary to prepare for the discontinuation of EONIA.

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4. See paragraphs 2.72, 2.73, and 2.76 of the ERCC Guide to Best Practice in the European Repo Market