MEMORANDUM

ICMA ERCC Committee
Repo market best practice with respect to the transition from EONIA to €STR
July 2, 2019 [updated September 27 2019]

Background

On March 14 2019, the ECB supported private sector Working Group on euro risk-free rates published recommendations on transitioning from the euro overnight index average (EONIA) to the euro short-term rate (€STR). The Working Group's 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, should modify the current EONIA methodology to become €STR (plus a spread)[1] for a limited period of time, allowing market participants sufficient time to transition to €STR; and
(iii) 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 the €STR as of October 2 2019**, reflecting the **trading activity of October 1 2019**.[2] 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 May 31 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,[3] €STR will only be published the following day of the contributing transactions (no later than 09:00 CET).[4] 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.

[1] On May 31 2019 the ECB confirmed that this spread will be 0.085%
[2] Note that this means that there will be no published rate on October 1 2019.
[3] Currently EONIA is published on the same day, between 18:45 and 19:00 CET.
[4] EONIA, represented by €STR + the calculated spread, will be published by EMMI by 9:15 CET.

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.[5] 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 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 October 1 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 (i.e. "crystalizing" the penultimate 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 the Repurchase Price of a floating-rate repo indexed to an overnight index has to be calculated and instructed before the fixing and publication of the final rate and the parties decide to make retrospective reimbursements for any difference between the actual and correct Repurchase Prices, it is best practice to document this agreement and the deadline for reimbursement, if necessary in the Confirmation of the transaction, and for any reimbursement to be made immediately following the Repurchase Date, but no later than 30 days afterwards. Where several reimbursements are to be claimed on the same day, a single net amount should be claimed from a counterparty, rather than separate claims for each transaction. **The net claim per day per counterparty should not be for less than EUR 500 or the approximate equivalent in other currencies**.

These recommendations will be included in the next update of the **ERCC Guide to Best Practice in the European Repo Market**.[6]

[5] This is very much a legacy, market specific practice that pre-dates the introduction of the euro.
[6] See: https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/repo-and-collateral-markets/icma-ercc-publications/icma-ercc-guide-to-best-practice-in-the-european-repo-market/

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 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.

About the ERCC

The ICMA European Repo Council (ERC) was established in December 1999, to represent the cross-border repo market in Europe. In 2015, the ERC's name was changed to European Repo and Collateral Council (ERCC) in recognition of the increasingly intimate relationship between repo and collateral and the group's substantial focus on collateral.

The ICMA ERCC is today the main industry representative body for repo and collateral markets, developing consensus solutions for issues arising in a rapidly evolving marketplace and consolidating and codifying best market practice. The Council also plays a significant role in nurturing the development of the repo market and supporting its wider use in Europe and globally by providing educational courses and market information, such as the bi-annual survey of the European repo market which has become established over the past two decades as the authoritative indicator of market size and structure and the dominant trends.

The ICMA ERCC Committee is the governing board of the ERCC which is elected on an annual basis by all ERCC member firms.

Membership of the ERCC is open to ICMA members who transact repo and associated collateral business in Europe. The ICMA ERCC currently has around 100 members, comprising the majority of firms actively involved in this market.

For more information on the ICMA ERCC **download the ERCC brochure** or contact **ercc@icmagroup.org**