

Benchmark rates are essential for determining the price of numerous financial instruments and financial contracts. Of these benchmarks, EONIA is particularly significant in derivatives contracts and the overnight indexed swap (OIS)¹ market as well as for the transmission of monetary policy.

EONIA is calculated as a weighted average rate of all overnight unsecured lending transactions in the interbank market reported voluntarily by 28 panel banks. The decrease in activity on its underlying markets and the reduction in the number of banks participating in the panels have affected adversely the integrity and robustness of this index. In fact, it does not meet the requirements of the new European Benchmarks Regulation² (BMR) and, consequently, needs to be reformed by 1 January 2020, the deadline set for indices used as benchmarks to comply with this Regulation.

EMMI,³ the administrator of EONIA, initially sought to align this index with the BMR requirements. However, in 2017 it announced that it would not continue the reform of EONIA and undertook to provide this critical benchmark⁴ until the end of the BMR transition period. It stated that it could not guarantee that EONIA would comply with the BMR, in which case, it would not be able to use it as a benchmark as from 2020. Accordingly, a proposal was made to EMMI to modify the methodology used to calculate EONIA to facilitate the transition to the new risk-free rate.

Central banks are developing risk-free overnight rates which may complement private-sector indices, given their key role for monetary policy transmission. Against this background, the ECB is the administrator of an index called €STR, which it has developed.

€STR is a representative benchmark of the euro area reflecting the borrowing costs for euro area banks of raising funds in the wholesale market on overnight deposits on an arm's length basis. The rate will be published daily based on individual deposit transactions in the European money market which 50 agents must report to the ECB within the arrangements of the money market statistical reporting (MMSR) regulation.⁵ The underlying market is that of banks' deposits from financial institutions and not only those from other banks. €STR and EONIA are based on unsecured overnight transactions, but there are important economic differences between them since EONIA includes the rate at which banks lend funds to each other on the interbank market whereas €STR includes the rate banks pay for deposits from other counterparties which are not necessarily banks. These differences explain the spread existing between the two rates. €STR rates are between 7 bp and 9 bp lower than EONIA rates, as can be seen in Chart 2.11.D.

In September 2018 the working group on euro risk-free rates⁶ recommended that €STR be used as the new euro area risk-free rate to replace EONIA. Nevertheless, EONIA will continue to exist and may be used in contracts in force during a limited period of time to facilitate a smooth transition to €STR. On 14 March 2019 the ECB announced that it will begin to publish €STR on 2 October 2019, three months before the deadline for replacing EONIA, to reflect the previous day's operations.

With the €STR identified as the recommended benchmark, it is important that banks work to ensure an orderly transition from EONIA to €STR and to resolve the risks and problems which may arise with the contracts and instruments currently using EONIA as a benchmark (legacy assets). Accordingly, the working group recommended that EMMI, as its administrator, modify the current methodology for calculating EONIA to facilitate the transition to the new risk-free rate to give market participants sufficient time to transition to €STR.⁷ Thus, for a limited period of time until end-2021, EONIA will be calculated by applying a fixed spread to €STR,⁸ to be published by the ECB instead of being based on the data provided by a panel of credit institutions.

The ECB also stated on 14 March that it supports private-sector efforts for a successful transition from EONIA and will provide the calculation of the spread between EONIA and €STR on a specific date before publication of €STR begins. Thus, the EMMI is projected to begin publishing EONIA under the recalibrated methodology based on €STR on 2 October at the same time as the ECB publishes €STR. Parallel publication is expected to last until end-2021 and thereafter only €STR will be published.

Finally, the working group also recommended that market participants gradually replace EONIA by €STR and that €STR be used in all new products and contracts signed as from January 2020.

- 1 It is estimated that the outstanding volume of unsecured money market instruments using EONIA as a reference rate stood at around €450 trillion at end-2017. Use of the OIS market is estimated to exceed €5.2 trillion.
- 2 Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks. The Regulation, implemented due to cases of benchmark manipulation, seeks to improve the method for calculating benchmarks. It does so by requiring that the calculation be based on real transactions and that governance and controls in the provision of benchmarks be strengthened, thus avoiding conflicts of interest.
- 3 The European Money Market Institute (EMMI) is a private institution responsible for administering EONIA. It is a non-for-profit association under Belgian law founded in 1999. Its members are national banking associations in EU Member States.
- 4 EONIA was designated as a critical benchmark in June 2017. EURIBOR and LIBOR are also critical benchmarks which were designated in August 2016 and December 2017, respectively.
- 5 Regulation (EU) No 1333/2014 of the European Central Bank of 26 November 2014 concerning statistics on the money markets (ECB/2014/48). The main purpose of collecting such statistics is to provide the ECB with comprehensive, detailed and harmonised statistical information on the money markets in the euro area which provide information on the transmission mechanism of monetary policy decisions.
- 6 It is an industry-led group established in 2018 by the ECB, the Belgian Financial Services and Markets Authority (FSMA), the European Securities and Markets Authority (ESMA) and the European Commission and comprises 21 large European banks, including BBVA and Santander, and five industry associations.
- 7 EMMI was also requested to engage with the relevant authorities to ensure that EONIA, revised in accordance with the new methodology, complies with the BMR.
- 8 On 14 March 2019 the working group made a recommendation to EMMI for a specific formula to calculate this spread between €STR and EONIA which should be based on public data.