



eioπα
EUROPEAN INSURANCE
AND OCCUPATIONAL PENSIONS AUTHORITY

IBOR transitions – Way Forward

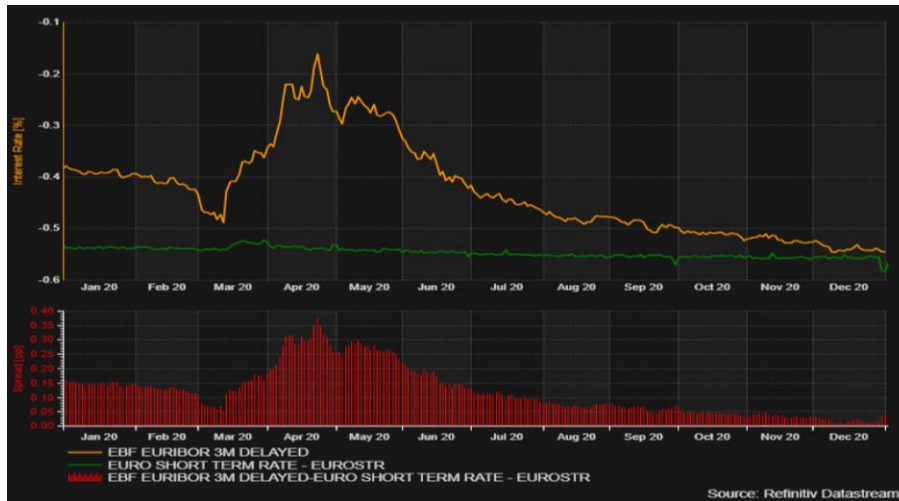
05/02/2021
EIOPA-21/075

- IBOR transitions is a market driven change. EIOPA seeks to adopt a common approach across the EU on the transition to the new rates.
- EIOPA's approach against the IBOR transitions seeks to reflect current market conditions rather than leading them.
- The aim is to continue producing consistent RFR term structures.
- According to the RFR methodology, the choices proposed by EIOPA, are designed to secure the following objectives:
 - (a) Replicability of the methodology by undertakings
 - (b) Market consistency of the RFR term structures produced
 - (c) Stability for insurance undertakings
 - (d) Interests of policyholders (not applied in this case)
 - (e) Feasibility of the implementation within the RFR framework

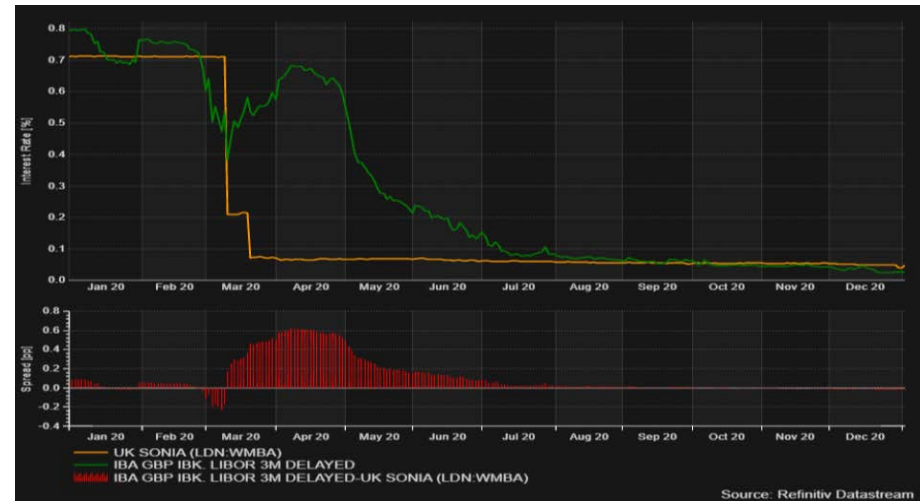
The 'world' is split into three groups:

- IBOR rates which will cease to exist by the end of 2021 (GBP, CHF and JPY)
- IBOR rates which will cease to exist mid 2023 (USD)
- IBOR rates which do not have an expiry date yet (EUR)

EURIBOR VS €STR



LIBOR £ VS SONIA



- The option of blending the curves proposed in the discussion paper in the beginning of 2020 becomes less appropriate given the current small differences between of the two curves

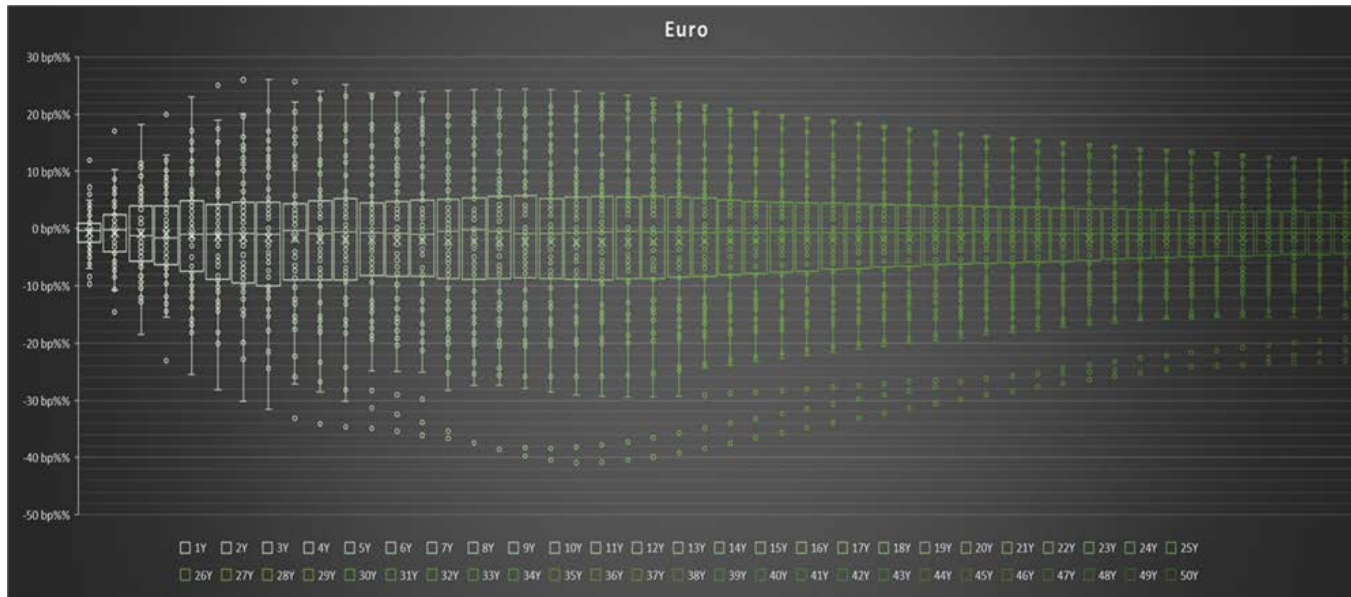
- Based on the latest market observations we reconsidered the available options for the transition to the new set of curves
- We now propose the instant change option (mentioned also in the discussion paper) - subject to certain preconditions
- We believe that this option has the advantage that the change can take place quickly and that the drawback of a potentially significant impact could be mitigated
- Impact on CRA: The new rates are practically risk free. When the floating rate of the interest rate swap is changed from IBOR to OIS, based on the definition of the CRA, the spread of the two rates would become zero and hence no credit risk adjustment would be needed

'Proximity' Precondition



- The timing of the switch should be restricted to a point in time when there is relatively close alignment between IBOR and OIS curves in order to minimise the impact.
- We have plotted all published curves since the introduction of SII for all relevant currencies in the form of Box-plots where we can observe the monthly volatility in the rates.
- The idea is to perform the switch when the difference of the two curves is smaller than the average monthly variations, which already exist using the current RFR curve observations.
- A trigger can be set when for instance for three consecutive months the difference between the IBOR and the OIS curves is no more than the interquartile range of month-to-month changes.
- This way, when the switch takes place undertakings would face a change smaller than they face 50% of the time from shifts in the existing curve.
- The aim is to be able to identify an optimal timing when the majority of the undertakings will be able to absorb to a certain extent the impact of the switch without serious disturbance in their balance sheet positions

'Proximity' Precondition

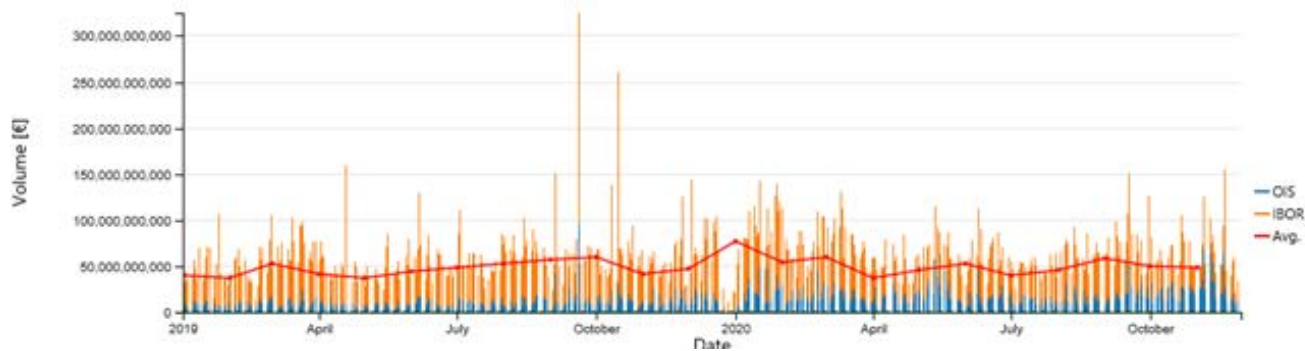


Currency	GVT/SWP	LLP	Interquartile range	1st Quartile
			Avg(Q3-Q1)	Abs(Avg(Q1))
EUR	SWP	20	11,54	7,37
CHF	SWP	25	13,79	7,24
GBP	SWP	50	17,46	10,27
JPY	SWP	30	6,59	3,41
USD	SWP	50	19,89	9,36

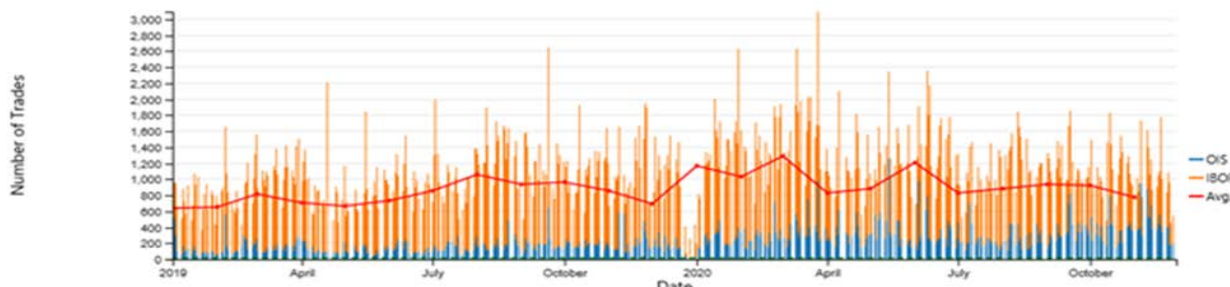
'Liquidity' Precondition

- The swaps traded under the new OIS rate would need to be 50% of the total traded volume. Currently the only instrument, which approaches this amount, is the GBP OIS rate: the SONIA.

Daily notional amounts



Daily trades



- If both preconditions are met we will proceed with the switch to the new OIS curve
- If the 'liquidity' precondition is not met we would need to consider a fall back solution. This could be a change of instrument (swaps to government bonds) which may have a small impact. We believe that this could happen for the CHF and the JPY (for the GBP it is very unlikely) at the end of the year.
- If the 'proximity' precondition is not met and there is an expiry date for the IBOR curve we would need to proceed with the switch. If no expiry date is in place we would be able to delay the switch until the timing is optimal.
- If none of the preconditions are met then we would need to consider the change of instrument proposed in the second bullet point.

- For the IBOR transitions project we perform continuous monitoring of market volumes in order to determine if, and to what extent, the new OIS instruments satisfy the Deep Liquid and Transparent criteria (DLT) for all maturities up to Last Liquid Point (LLP).
- However, we perform the same exercise on annual basis for the DLT-ness of the curves which are used in production.
- In order for the curve to be considered DLT the majority of DLT points (including especially the LLP and the first liquid point) for each curve must be liquid
- This year we intend to perform this exercise earlier (2021Q2) in order to be able to identify the changes which would need to be implemented within the IBOR transition project. We expect to see changes in the LLPs of the GBP, JPY and CHF.

- We are in the process of designing a balance sheet impact assessment with focus on the euro.

Euro	85.85%
Pound Sterling	1.56%
US Dollar	1.42%
Swiss Franc	0.16%
Yen	0.10%
Other	10.91%
Total	100.00%

- Two scenarios: Magnitude of average interquartile range and a scenario for a larger difference (e.g. +5bps).
- This is needed in order to be able to quantify the impact more realistically.
- The impact of the change to SONIA is expected to be limited to certain number of companies.
- We intend to test the impact of a change of instrument and a change to the LLP.

- Aim is to be able to do the switch if the preconditions are met in 2021
- Full balance sheet impact assessment
- Consultation



eiopa
EUROPEAN INSURANCE
AND OCCUPATIONAL PENSIONS AUTHORITY

Thank you for your attention!
