

EONIA → €STR TRANSITION

**« ASSET MANAGERS : ARE YOU READY FOR
OCTOBER 2019 ? »**

Benchmark regulation



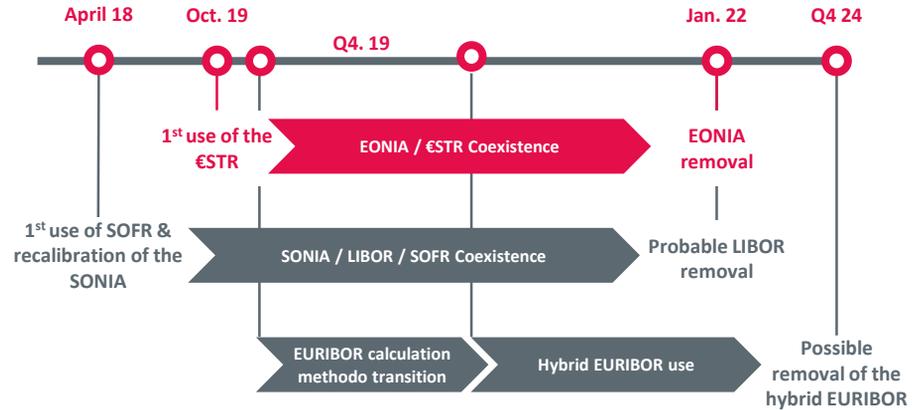
Your Needs. Our Expertise.

A quick background IBORs scandal: Multiple penalties and a global regulation on benchmarks

- Since the 2012 first tremor, multiple aftershocks of the earthquake related to **IBORs benchmark rates' scandal** have occurred. Globally, over **10 billion penalties** have been announced against the main banks or their staff (City, Société Générale, HSBC, ...).
- Against this manipulation, the BMR regulation is the European answer, aiming to **reinforce the regulatory background** related to the benchmark indices and to **reshape their calculation methodology**, especially the IBORs rates.
- To this end, the regulation notably suggests to supervise the benchmarks' administrators in order to avoid the manipulation and to **guarantee the reliability of the methodology** and the **data** used to provide the index.

Why changing the EONIA and which planning?

- The main goal is to replace the **"declared" rates**, subject to fraud and less used in the inter-bank operations since the scandals, by the **"observed" rates**, reflecting the reality of the Market. Each of the target rates will be calculated ex post, based on a panel with an enlarged scope of operations to better reflect the real situation.
- The EONIA calculation is based on a **weighted average of all the overnight operations**, executed on the Eurozone interbank market, by around **20 banks** which **declare their operations** on a day to day basis. This calculation methodology, based on report, does not match anymore the Benchmark regulation requirements. The €STR, its successor, will be directly calculated by the ECB from a **statistical data collection of 52 banks** on their interbank lendings over 1 million euros*.
- Below are the main milestones of the replacement/evolution of the benchmark rates.



* Contact us for more details on the €STR exact calculation

EONIA → €STR Transition: 3 mistakes to avoid

- Within the scope of its assignments, SAGALINK Consulting had discussions about this transition period with the main market stakeholders. The vast majority of them have indicated not being contacted by their "Buy-side" clients (asset managers, insurers, asset owners, ...) about the transition impacts.
- The latter have probably fallen in one or several of the below pitfalls:



« I do not manage money market funds: I am not involved »



« A new benchmark rate, with only financial consequences on markets and for my funds »



« 2021: I 've got plenty of time! »

Regardless of your range of fund or your management style, you are involved: see next page!

Your Needs.



All management styles are involved

Beyond the interest rate instruments, the EONIA is largely used for OTC, collateral payment...

- The money market funds remain mainly concerned. However, it is critical to realise a quick analysis of the different asset types and of the cashflows using the EONIA in order to check that all impacts are under control.

Securities

- Instruments** : Listed or non listed monetary bills, floating rate bonds indexed on EONIA
- Process** : Accrued interest calculation / security valuation, income payment amount and ex-date calculation

Contracts

- Instruments** : OIS swap and other OTC (for the collateral payment), REPO and reverse REPO, Securities lending and borrowing
- Process** : Valuation and (as fallout) collateral calculation, interest calculation (accrued and payment), remuneration of cash collateral, contracts / CSA with counterparts

Funds and mandates

- Managing structures**: Funds / Mandates / Dedicated Funds whose composite or single benchmark include the EONIA or which include assets linked to the EONIA
- Process** : Performance measurement, performance attribution, risk calculation, performance fees calculation, Investment Management Agreement, prospectus and commercial documentation ...

Others

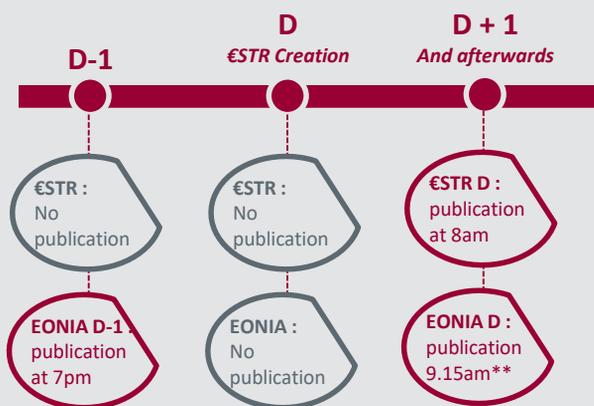
- Interest-bearing accounts
- Cash management of the asset manager
- Contracts evolution and/or set up evolution for data providers



Operational impacts to anticipate

The €STR creation goes along with EONIA time publication changes

- The €STR creation goes along with an EONIA recalibration which will now be calculated as an **€STR "tracker"**. This calculation methodology* change **does not represent a significant benchmark change** but has impacts on the EONIA publication.
- Indeed, the D €STR being published at 8am on D+1 by the ECB **with exceptional adjustments in case of errors by 9am**, the EMMI (EONIA administrator) will not be able to provide the **recalibrated D EONIA before 9.15am on D+1** while the latter is currently published at 7pm on D.
- This period has significant impacts on the whole calculation process, especially on the **NAV calculation** and **NAV validation** for all the funds with securities or contracts (collateral...) using EONIA, in addition to the **planned overnight operations** in order to have your daily holdings valued on the morning.
- Besides, the preceding and following days of the €STR creation will experience specific publication methods for the 2 indices – see opposite drawing.



* Contact us for more details on the exact calculation (8,5 bps spread, spread calculation methodology with historical data, ...)

** Or shortly after the 1st day



Actions to
implement from
Q2 2019

The most significant operational impacts are expected for October 2019

- The **operational impacts** of the EONIA publication postponement to D+1 (*see previous page*) will occur **on October 1st 2019** and should be anticipated now. The **transition duties towards the €STR** (modification of prospectus, contracts, transition towards a €STR liquidity...) can be undertaken over a **longer period**.
- Below **the main tasks**; a **detailed action plan** must be built in light of each asset management company's context.

01/10/2019

03/01/2022

Legal

- Ensure that the EONIA calculation change does not impact the funds and mandates documentation

- Modify the prospectus, contracts, funds and mandates documentation to implement the transition towards the €STR

Marketing /
Communication

- Communicate (website & direct communication for mandates and dedicated funds) on the absence of significant impacts on funds and mandates (no significant EONIA change)
- Prepare the migration plan towards the €STR (directly with some clients)

- Define the policy regarding the performance fees (gap of 8,5 bps between the 2 rates)
- Implement the communication to clients / distributors on the funds / mandates transition

Operational
& IT

- Identify all the involved overnight tasks
- Analyse the impacts on the funds' valuation timing
- Discuss with the counterparts and providers about the impacts on the interest calculation timing, the security valuation delivery...
- Create the new €STR in the system

- Modify the parameters during the fund transition from the EONIA to the €STR (as an index)

What should I do now?

- The first step relies on designing a **quick mapping** of the impacts in order to identify the actions to undertake till the end of September. This mapping must make an inventory of:

Open funds, mandates,
dedicated funds

Funds / Mandates directly impacted

- EONIA index or composite index with EONIA
- EONIA in the asset managing objectives
- EONIA in the performance fees calculation

Funds / Mandates indirectly impacted

- Funds including impacted assets (instruments / contracts) (see above)

Assets
incl. maturity date &
related documentation
(contracts / termsheets)

Assets directly impacted

- Bills and floating rate bonds indexed on EONIA
- OTC indexed on EONIA (e.g. SWAP OIS)
- Sec. Lending or REPO

Assets indirectly impacted

- OTC, Sec. Lending , REPO (remuneration of cash collateral)

Process &
Tools

Process

- Process using EONIA in calculation
- Process allowing to retrieve the rate/ calculate the indicators based on the rate (eg : capitalized EONIA)

Tools

- Batch / IT tasks integrating: frequency and related operations time + ability or not to postpone operations
- Tools and flows upstream and downstream from each batch / IT operation

Your Needs.

*Contact us for a first discussion regarding
your impacts during a meeting !*

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Who are we?

SAGALINK Consulting is a management consulting firm, specialized in asset management, private banking, insurance, and investor services business.

Our expertise in these four interrelated business areas allows us to understand the key challenges across the whole value chain, to identify the best growth drivers, and to make our recommendations with conviction.

Convinced that mastering consulting techniques is not sufficient anymore to meet the challenges of the financial industry, and that the business expertise is becoming an outstanding advantage in the conduct of cross-functional projects, the company's ambition is to leverage its consulting techniques and financial markets expertise to create the link between the clients' business and their projects.

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