CME Group | Advisory Notice

TO: Clearing Member Firms
Back Office Managers

DATE: October 4, 2021

FROM: CME Clearing

NOTICE #: 21-355

SUBJECT: **Modification of Cleared Euro Overnight Index Average ("EONIA") Overnight Index Swaps to Reference Euro Short Term Rate ("€STR") Ahead of Scheduled Discontinuation of EONIA**

**Background**

EONIA is scheduled to be discontinued on January 3, 2022 and therefore market participants must transition any remaining over the counter ("OTC") Euro ("EUR") swaps that reference EONIA to the successor €STR reference rate before this time.[1] CME currently supports EONIA overnight index swaps ("OIS") ("EONIA Swaps") and also supports €STR OIS and €STR /EURIBOR Basis Swaps in order to support firms seeking to transition to €STR.

In order to further assist market participants in the transition from EONIA to €STR, subject to regulatory review, CME shall effect a single step conversion of CME cleared trades in EONIA OIS from the EONIA Floating rate option to the €STR Floating rate option, with a cash adjustment mechanism to compensate for any resulting change in valuation (the "Conversion"), to take effect at close of business ("COB") on Friday, October 15, 2021 (the "Conversion Date"). The Conversion process and the Conversion Date have been determined by CME based on discussions with market participants and to ensure alignment with wider industry initiatives for transition of cleared EONIA interest rate swaps ("IRS") products.

Conversion of EONIA to €STR

In September 2018 the European Central Bank ("ECB") convened a private sector working group on Euro risk free rates (the "ECB Working Group"),[2] which determined that €STR should replace EONIA as the new EUR risk free rate for all cash and derivative market products and contracts, with EONIA due to be discontinued on January 3, 2022. €STR is calculated by the ECB and provides a broad measure of the cost of borrowing unsecured EUR cash on an overnight basis in wholesale markets based on a large number of banks contributing data and a significant transaction volume.[3]

On July 24, 2020, as part of an industry-wide transition for EUR IRS, CME completed the transition of the PA/Discounting protocol for CME cleared EUR interest rate swap products from EONIA to €STR (the "EUR

[1] In May 2019, EMMI announced that EONIA would be permanently discontinued from 3 January 2022, see https://www.emmi-benchmarks.eu/assets/files/D0194C-2019%20EONIA_consultation_feedback_press_release.pdf

[2] The ECB Working Group was also convened by the Financial Services and Markets Authority ("FSMA"), the European Securities and Markets Authority ("ESMA") and the European Commission.

[3] Further details on the administration of €STR are available on the ECB website at www.ecb.europa.eu.

IRS PA/Discounting Transition”). In order to complete the transition from EONIA to €STR before the scheduled discontinuation of EONIA on January 3, 2022, CME will implement a single step conversion of CME cleared trades in EONIA Swaps from the EONIA Floating rate option to the €STR Floating rate option, with a cash adjustment mechanism to compensate for any resulting change in valuation, to take effect on the Conversion Date.

**<u>Summary of Conversion Process</u>**

CME will transition all CME cleared EONIA Swaps to the €STR Floating rate option on the Conversion Date, utilizing a mandatory conversion process under which all continuing cleared trades in EONIA Swaps will be converted by CME in a single step, one time, conversion to €STR OIS, as summarized below:

- With the exception of EONIA Swaps that mature on the Conversion Date, CME will convert each CME cleared trade in EONIA OIS that is open at COB on the Conversion Date by amending the terms of the swap, converting the cleared trade into a corresponding €STR OIS (a “Conversion €STR Swap”);
- In each case, the Conversion €STR Swap will be cleared as a CME cleared €STR OIS, with the same economic terms as the corresponding pre-Conversion EONIA Swap except that the Floating Rate Option of the converted cleared trade will be EUR-EuroSTR-OIS Compound, the €STR OIS reference rate;
- In order to neutralize the value transfer from the Conversion of the economic position of each EONIA Swap into each Conversion €STR Swap, CME will calculate a cash adjustment amount that will be applied by CME to each Conversion €STR Swap (the “Cash Adjustment”). In the case of each pre-Conversion EONIA Swap, the Cash Adjustment amount will be calculated by CME based on the difference between the net present value (“NPV”) of the pre-Conversion EONIA Swap and the NPV of the Conversion €STR Swap on the Conversion Date. The Cash Adjustment for each Conversion €STR Swap will be equal and opposite to the change in NPV calculated by CME, and therefore may be a positive or negative amount depending on the position;
- The Cash Adjustment amount will be applied by CME to each Conversion €STR Swap in a position account in the form of upfront “fees” on each trade. Cash flows relating to the Cash Adjustment will be applied in the next end of day clearing cycle following the Conversion Date on Monday, October 18, 2021, and will be settled the following morning. The Cash Adjustment will ensure that net cash flows for position holders impacted by the change of floating rate option from EONIA to €STR are zero;
- No spread or fixed rate adjustment will be applied to the Conversion €STR Swap; the Conversion will convert EONIA to €STR on a “flat” basis, with no spread component to account for the spread between EONIA and €STR);
- CME will report the close-out of each EONIA Swap and the establishment of each Conversion €STR Swap in the account of the relevant position holder to the CME Swap Data Repository (“SDR”) under Part 45 of the CFTC’s Regulations. The “Prior USI” field for each Conversion €STR Swap report will reference the Unique Swap Identifier (“USI”) of the relevant corresponding EONIA Swap, reflecting the nature of the Conversion process.

Each Conversion €STR Swap will be cleared by CME subject to the terms of the CME Rules. In legal terms, the Conversion will amend the terms of cleared trades in CME cleared EONIA Swaps which reference EONIA, converting each relevant cleared trade to reference the €STR Floating Rate Option, on the terms of a CME cleared €STR OIS. From an operational perspective within the CME clearing system, to aid operational processing by clearing firms, the Conversion will be processed by CME as a “termination” of each relevant EONIA Swap and the establishment of a “new” corresponding cleared trade in €STR OIS within the clearing system. This is reflected in operational terms by the reporting of each Conversion €STR Swap by CME to CME SDR with reference to the “Prior USI” of the relevant corresponding EONIA Swap.

The Conversion is a mandatory process and will apply to all cleared trades in EONIA Swaps on the Conversion Date with the exception of those EONIA Swaps that mature on the Conversion Date.

From COB on the Conversion Date, CME will cease to accept EONIA Swaps for clearing and CME will amend Chapter 901 of the CME Rules accordingly to remove the product rules for EONIA Swaps, as set out in ***CME Submission 21-413***.

Further details on the Conversion are provided below.

CME has consulted with a diverse cross-section of market participants to obtain feedback on the operational processes for the Conversion. In late 2020, CME first informed IRS Clearing Members of the intention to run an EONIA to €STR Conversion cycle and first presented the operational processing mechanics to IRS Clearing Members in March 2021. A summary of CME's Conversion plan was provided to market participants and made publicly available in May 2021 and further details were provided by CME to market participants in August 2021, followed by operational testing and additional support prior to the proposed date of implementation.[4]

Market participants expressed a clear preference for CME to transition to €STR a short period ahead of the last publication of EONIA on January 3, 2022, rather than rely on the contractual fallbacks that would otherwise apply under the CME Rules on the event of the scheduled permanent discontinuation of EONIA.[5] Furthermore, in CME's engagement with market participants, these stakeholders have expressed a clear preference that CME's approach to the EONIA to €STR transition should be aligned as closely as possible with the wider industry approach, and specifically that of the UK and EU CCPs responsible for clearing the overwhelming majority of EONIA Swaps, each of which have expressed their intention to effect a single

[4] The public overview is available on the CME Group website at: €STR OIS Clearing and EONIA OIS Conversion CME OTC Clearing (cmegroup.com). As part of the preparations for the Conversion, CME has provided market participants with:

- an "Indicative Analysis Report" in the CME Production Environment on a daily basis beginning on Monday, September 20, 2021 until Friday, October 15, 2021 to assist firms in understanding the impact of the Conversion ahead of the Conversion Date;
- an operational "Dress Rehearsal" for the Conversion process on September 10, 2021, to simulate the processes for the Conversion Date.

[5] Contractual "fallbacks" within the CME Rules provide a mechanism that would provide for CME cleared EONIA Swaps to "fall back" to the €STR rate on the permanent discontinuation of EONIA, on the relevant "Index Cessation Effective Date" for the purposes of the relevant ISDA fallback documentation set out in the ISDA IBOR Fallbacks Supplement and the "Permanent Cessation Fallbacks" incorporated into the CME Rules set out in CME Submission No. 21-431, in force from October 4, 2021. However, as permitted by CME Rule 90102.H (Application of Permanent Cessation Fallbacks) within those same rules in force from October 4, 2021, CME is able to exercise its discretion not to apply the "Permanent Cessation Fallbacks" from the ISDA 2021 Definitions incorporated into the CME Rules. In the case of the permanent discontinuation of EONIA, in response to market participant feedback, CME does not propose to apply the "Permanent Cessation Fallbacks" within the ISDA 2021 Definitions and CME Rule 90102.H to EONIA Swaps cleared by CME. In CME's engagement with market participants in relation to the specific question of EONIA transition during the first half of 2021, market participants expressed a clear preference for CME to convert EONIA Swaps to standardized €STR OIS a short period ahead of the last publication of EONIA on January 3, 2022, rather than rely on the contractual fallbacks that would otherwise apply under the CME Rules to transition EONIA Swaps to €STR on the event of the scheduled permanent discontinuation of EONIA. The industry consensus communicated to CME by market participants indicates that the significant majority of cleared market participants prefer such an "early" transition of cleared EONIA Swaps to €STR on the basis that a CCP-led conversion could effect the transition into standardized €STR Swaps, which would not be the case with a "fallback" approach where the resulting positions referencing €STR would not be on the same terms as, and therefore not directly fungible with, standardized €STR Swaps. As a result, based on consultations with market participants and consistent with broader cleared industry initiatives, CME proposes to effect the Conversion in relation to the conversion of EONIA Swaps into €STR OIS on the Conversion Date, over two months prior to the relevant scheduled Index Cessation Effective Date in respect of EONIA. As a result, the amendments to the terms of the CME Rules set out in this Clearing Advisory in respect of the Conversion effectively disapply the Permanent Cessation Fallbacks set out in CME Rule 90102.H. for the purposes of the Conversion in relation to EONIA.

step conversion of EONIA Swaps to reference €STR on October 15, 2021.[6] Given the feedback from market participants, CME has determined to convert EONIA Swaps to €STR ahead of the last publication of EONIA, and to align its approach and proposed timing for the Conversion as closely as possible with that of the other major UK/EU CCPs clearing EONIA IRS.

**Exchange Fees for Conversion Process**

In supporting transition to RFRs, CME will apply a transaction fee per line item for conversion of any CME cleared interest rate swaps that reference EUR, GBP, CHF or JPY where such swaps are converted by the Clearing House into equivalent overnight index swaps referencing the relevant nominated successor RFR rate to EONIA, GBP LIBOR, CHF LIBOR or JPY LIBOR respectively (a "Conversion Fee"). In each case the Conversion Fee shall be a fee of $10 which shall be applied by the Clearing House per line item subject to the conversion and shall apply on the resulting RFR-referencing replacement swap transactions.[7]

| Fee Type | Trade Types | Products | Source, Terminate Reason (TR), Create Reason (CR) | HOUSE FM / NONFM | CUSTOMER Standard Client Schedule | High Turnover (HTS) |
|---|---|---|---|---|---|---|
| RFR Conversion Fee | All | All | CR = Index Conversion | $10 per line item* | $10 per line item* | $10 per line item* |

*This fee will be charged on the resulting RFR trades with the exception of single unit trades booked for the specific purposes of preserving additional payments, which will not be charged. [8]

Note: for bilateral swaption exercise that result in a cleared swap under the legacy index reference rate (e.g. GBP LIBOR, etc), CME will conduct a daily conversion of these trades to the respective RFR rate. A charge of $10 per converted trade will be applied to the position in addition to new trade clearing fees. [9]

As a result, CME will apply an Exchange Fee of $10 for each €STR Swap that is established as a result of the Conversion.

This Advisory Notice sets out the binding rules and operational processes under which CME Clearing will implement the Conversion, including the operational termination of EONIA Swaps, the establishment of post-conversion €STR Swaps, and the Cash Adjustment process which will be implemented by CME with respect to open cleared trades in affected CME cleared products at the Conversion Date.

Capitalized terms used but not defined in this Advisory Notice shall have the meaning set out in the CME Rules.

---

[6] On March 5th, 2021, the FCA made an announcement regarding the future cessation or loss of representativeness of all LIBOR benchmarks. As a result, CHF, GBP, JPY and EUR LIBOR rates will cease permanently on December 31, 2021. CCPs and market participants are expected to seek to transition away from these rates during December 2021. See FCA announcement at https://www.fca.org.uk/news/press-releases/announcements-end-libor. Market participants have indicated that an "early" transition of EONIA Swaps to €STR could be scheduled outside the end-December 2021 / early January 2022 time period which is anticipated to be subject to significant operational congestion for cash and derivatives market participants and CCPs due to the scheduled cessation of certain LIBOR benchmarks on December 31, 2021.

[7] The Conversion Fee shall not apply to single unit trades booked for the specific purposes of preserving additional payments.

[8] Note that CME does not create single unit trades as part of the Conversion of EONIA swaps and therefore this is not applicable to the Conversion.

[9] Note that CME will not accept swaps referencing EONIA after the Conversion Date and therefore will not accept cleared swaps referencing EONIA arising from bilateral swaptions arising after the Conversion Date.

**CME Cleared Contracts Subject to the Conversion and this Advisory Notice**

The Conversion will apply to all cleared trades in CME cleared EONIA Swaps that reference EONIA[10] as the interest rate swap rate option (the "Floating Rate Option") and that are open at COB on the Conversion Date and that do not mature on the Conversion Date (the "Affected Contracts").

**Terms and Operation of Conversion Process**

1. At or shortly after COB on the Conversion Date, CME Clearing will:

   (a) amend the terms of each cleared trade in the Affected Contracts that is open at COB on the Conversion Date in the account of the relevant position holder (each cleared trade, a "Pre-Conversion EONIA Swap") such that the cleared trade shall be converted into a corresponding €STR OIS (a "Conversion €STR Swap") in the position account of the relevant position holder. The economic terms of the Conversion €STR Swap will be the same as the corresponding Pre-Conversion EONIA Swap except that the Floating Rate Option of the converted cleared trade will be EUR-EuroSTR-OIS Compound, the €STR OIS reference rate; and

   (b) for each position account, calculate the difference in net present value ("NPV") at COB on the Conversion Date (at closing curve levels on the Conversion Date) between:

      a. each Pre-Conversion EONIA Swap; and
      b. the corresponding Conversion €STR Swap,

   (the "Conversion Calculation").

2. CME Clearing will determine settlement variation for each Conversion €STR Swap on the Conversion Date (at closing curve levels on the Conversion Date) for valuation for the end of day clearing cycle on the Conversion Date.

3. At the next end of day clearing cycle following the Conversion Date, for each Conversion €STR Swap, CME Clearing will:

   (a) apply as an upfront fee to each Conversion €STR Swap an offsetting cash compensation amount that is equal and opposite to the difference in NPV between the Conversion €STR Swap and the corresponding Pre-Conversion EONIA Swap, as determined by CME Clearing during the Conversion Calculation (the "Cash Adjustment"):

      i. where the Conversion Calculation determines that the NPV of a Conversion €STR Swap is greater than the NPV of the corresponding Pre-Conversion EONIA Swap, the Cash Adjustment applied to the Conversion €STR Swap will be negative;
      ii. where the Conversion Calculation determines that the NPV of a Conversion €STR Swap is less than the NPV of the corresponding Pre-Conversion EONIA Swap, the Cash Adjustment applied to the Conversion €STR Swap will be positive; and

   (b) settle outstanding exposures and payments from the end of day clearing cycle (including for the avoidance of doubt, settlement variation and the Cash Adjustment) in accordance with CME Rule 814. The relevant Cash Adjustment will offset the change in NPV for each

[10] EONIA Swaps include any CME cleared EUR IRS referencing "EUR-EONIA-OIS-COMPOUND" or "EUR-EONIA-OIS Compound" as the Floating Rate Option.

Conversion €STR Swap such that the net cash flow in respect of the Conversion will be zero for each cleared trade in such Affected Contract per account.

4. Following the Conversion Date, each Conversion €STR Swap will be cleared by CME subject to the terms of the Rules applicable to €STR OIS.

5. CME will apply a fixed conversion surcharge of $10 (the Conversion Fee) for each Conversion €STR Swap that is established as a result of the Conversion process.

6. CME will not apply the Permanent Cessation Fallbacks in CME Rule 90102.H (Application of Permanent Cessation Fallbacks) in respect of any IRS Contract referencing EONIA.

7. The terms of this Advisory Notice and the Conversion process are binding on Clearing Members and position holders in all Affected Contracts, effective October 15, 2021. To the extent that there is any conflict between the Rules and the terms of this Advisory Notice with respect to the Conversion process, this Advisory Notice shall prevail. For the purposes of this Advisory Notice, Rule 90103.A (Contract Modifications; CME Rules) shall not apply to the extent it purports to restrict modification to the terms of IRS Contracts that are the subject of this Advisory Notice.

The Conversion process is a mandatory process. The Conversion and the relevant Cash Adjustment will therefore apply to all positions in cleared trades in Affected Contracts on the Conversion Date. Market participants should consider the terms and impact of the Conversion as set out in this Advisory Notice and take appropriate action prior to the Conversion Date. Position holders that do not wish to participate in the Conversion must close out any positions in Affected Contracts prior to the Conversion Date.

**Delisting of Affected Contracts Following Conversion**

From COB on the Conversion Date, CME Clearing will cease to accept for clearing trades in the Affected Contracts. The product rules for EONIA Swaps will be removed from Chapter 901 of the CME Rules. The removal of the product rules and attendant non-substantive conforming revisions to Chapter 901 to remove "EUR-EONIA-OIS-COMPOUND" and "EUR-EONIA-OIS Compound" from the list of interest rate swaps rate options accepted for clearing by CME is reflected in amendments to Rule 90102.E.1. ("Interest Rate Swaps Rate Options") set out in ***CME Submission 21-413***.

**Operational Information**

CME Clearing will provide the following information in relation to Affected Contracts:

- End of Day Trade Register report made available by the Clearing House only to IRS Clearing Members and clients via an sFTP site;
- CME OTC IRS Bookkeeping document, made available to IRS Clearing Members and their customers on request;
- FpML Confirmations for Pre-Conversion EONIA Swaps and Conversion €STR Swaps; and
- EONIA to €STR Cash Compensation Report made available by the Clearing House only to IRS Clearing Members and clients via an sFTP site, illustrating the NPV for each EONIA Swap and the revised NPV for each Conversion €STR Swap and the Cash Adjustment at the trade level for each position account. This report will be available as an "Indicative Analysis Report" in the CME Production Environment on a daily basis beginning on Monday, September 20, 2021 until Friday, October 15, 2021. The actual Cash Adjustment amounts will be indicated in the IRS Trade Register at COB on the Conversion Date.

To reflect the operational processes within the clearing system, CME will send:

- a termination message to relevant CME clearing firms in respect of the termination of each relevant EONIA Swap; and
- a clearing confirmation message to relevant CME clearing firms in respect of the establishment of each new relevant Conversion €STR Swap.

As part of the Conversion process, all relevant Trade IDs on each EONIA Swap will be carried over to the relevant Conversion €STR Swap. In order to identify the link between each EONIA Swap and the relevant Conversion €STR Swap, CME will add a replacement Trade ID and Original Trade ID respectively in the History section of the clearing confirmation messages.

CME will report the result of the Conversion to CME SDR in accordance with the requirements of the CFTC's Part 45 Regulations, to reflect the conversion of each EONIA Swap into each Conversion €STR Swap. With regard to reporting data submitted to SDR in respect of each Conversion €STR Swap, CME will populate the "Prior USI" field with the USI of the relevant EONIA Swap to reflect the nature of the Conversion process. For SDR reporting purposes, reporting rows will be generated and submitted to CME SDR terminating the USI of each EONIA Swap and CME will ensure that each Conversion €STR Swap will be reported as a "New Trade".

Additional details regarding the Conversion may be viewed in ***CME Submission No. 413***.

Inquiries regarding the aforementioned may be directed to:

| | | |
|---|---|---|
| Jim Roper - Clearing | jim.roper@cmegroup.com | 312.338.7137 |
| Steve Dayon - OTC Products | steven.dayon@cmegroup.com | 312.466.4447 |