

# Public Consultation on Tom/Next Transition

Date: 15 November 2021



### Responding to this paper

The Danish Financial Benchmark Facility (DFBF) invites comments on all matters in this paper and in particular on the specific questions summarised in Appendix 1. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives DFBF should consider.

DFBF will consider all comments received by Wednesday 15 December 2021.

All contributions should be submitted via email to [cpresponses@dfbf.dk](mailto:cpresponses@dfbf.dk) under the heading 'Your input - Consultations'.

#### Publication of responses

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All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed.

#### Data protection

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Information on data protection can be found at <https://dfbf.dk/privacy/> under the heading Privacy.

#### Who should read this consultation paper?

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This paper may be specifically of interest to users of Tom/Next, contributors of input data for the determination of Tom/Next, and to any investor dealing with financial instruments and financial contracts whose value is determined by Tom/Next.

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This public consultation is not intended to provide legal, regulatory, or other advice and should not be construed, or relied on in any manner, as such. The information (of a legal, factual or any other nature) included in the paper has not been independently verified. It is not comprehensive and may change.

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This paper discusses the proposed adjustment to the calculation methodology of Tom/Next and its proposed cessation in January 2026. Recipients of this public consultation are responsible for making their own assessments of the proposals.

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# 1 Introduction

The Danish Financial Benchmark Facility (DFBF) is the administrator of four Danish benchmarks: CIBOR®, Tom/Next, CITA and SWAP. Authorisation, under European Benchmark Regulation (BMR) was granted to the DFBF as of 1 January 2020 by the Danish financial regulator, Finanstilsynet, who acts as supervisor.

On 4 October 2021 the Danish Working Group on Short-Term Reference Rates (hereafter the Working Group), published a second report and public consultation<sup>1</sup> relating to the transition from the Danish benchmark reference rate Tom/Next to the Denmark Short Term Rate (DESTR). The report focused on developing an adoption plan for DESTR and outlined a proposal for the transition from Tom/Next to DESTR as well as the discontinuation of Tom/Next from 1 January 2026. Stakeholders reading this consultation paper are encouraged to access the Working Group's second report as it provides comprehensive supporting information. In the interests of efficiency, the DFBF has chosen not to repeat much of the useful information provided in the second report. On 9 November 2021, following the public consultation on the transition from Tom/Next to DESTR, the Working Group published its final recommendation<sup>2</sup> on the transition. Their public consultation did not give rise to any changes to the recommendation proposed in their consultation paper.

As administrator of Tom/Next the DFBF is conducting this consultation to seek feedback from stakeholders for the transition of the Tom/Next benchmark calculation methodology away from panel bank contributed input data to DESTR plus a fixed spread (revised calculation methodology). In addition, stakeholders are asked to respond on the proposed cessation of Tom/Next on 1 January 2026.

## 2 Consultation responsibility

The DFBF directors have authorised this consultation process to be undertaken as the proposed changes are considered material as defined by the [DFBF Consultation Policy](#).

As such the DFBF is conducting a public consultation to allow stakeholders and the broader community:

- a. the opportunity to provide feedback on such material change which the DFBF can take into consideration for its decision-making processes
- b. sufficient notice to apply the necessary actions to accommodate the changes

## 3 Rationale for change

The Working Group was established by Danmarks Nationalbank after it took over the ownership and administration of the DESTR. DFBF representatives have participated in the Working Group as observers.

The Working Group's first publication contained a recommendation for DESTR as the preferred short-term reference rate in Danish kroner. The recommendation concluded that DESTR is a better alternative as a more resilient and robust reference rate. In addition, DESTR appears to be more stable and predictable, which creates a stronger foundation for using the new reference rate directly or indirectly in the Danish loan, bond, and derivatives markets. Following the publication, the Danish Financial Supervisory Authority (FSA) stated their support of DESTR as the preferred short-term rate.

An important part of the transition from Tom/Next to DESTR is to establish a clear plan for the cessation of Tom/Next. This is akin to the way the euro area transitioned from EONIA to €STR. Subject to comments received from the Working Group's second report and consultation, the second report contained clear recommendations

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<sup>1</sup> [Public consultation on the transition from Tom/Next to DESTR](#)

<sup>2</sup> [Final Recommendation](#)

to the DFBF as the administrator of Tom/Next on a suitable transition path. As no negative feedback was forthcoming from stakeholders in response to the second report and consultation the DFBF seeks feedback from its stakeholders on the transition path proposed.

This consultation paper also offers further clarity on the timetable for the pre-transition testing period and the determination and announcement of the new fixed DESTR to Tom/Next spread.

## 4 Timetable for change

Once DESTR is launched on 1 April 2022 at the latest, the Tom/Next will be recalibrated to DESTR plus a fixed untrimmed spread. The spread will be based on the historical daily differences between pre-DESTR and Tom/Next observed over a period from 19 March 2021 until 21 March 2022. This one-year period is to ensure a sufficiently robust spread determination and to avoid short-term volatility. A one-year period will cover the full annual economic and financial market cycle to encompass a range of influencing factors upon the value of both pre-DESTR and Tom/Next.

Once DESTR is launched and Tom/Next has been reformed, a transition period will follow in which market participants are expected to start trading DESTR related instruments instead of Tom/Next. The Working Group recommended that the transition period should end on 1 January 2026, where the reformed Tom/Next will cease to exist. The DFBF supports this timetable.

This public consultation is open for responses for 30 days from 15 November to 15 December 2021. At the end of the consultation period the DFBF will analyse the stakeholder feedback and present the feedback to the DFBF Oversight Committee for their further consideration and recommendation to the DFBF directors.

If the recommendation from the Oversight Committee and decision of the DFBF directors is to adopt the transition and cessation plan as proposed, then that position will be advised to all stakeholders within the Analysis of Stakeholder Feedback document to be made publicly available on the DFBF website in later December 2021 or early 2022.

It is expected that around 3 months' notice will be provided to stakeholders for the transition to DESTR plus a fixed spread and more than 3 years' notice for the cessation of Tom/Next.

## 5 DESTR to Tom/Next Spread

With the wide range of products referencing Tom/Next and CITA, the Working Group saw a need for a clear plan for the transition from Tom/Next to DESTR. The proposed transition plan is being communicated well ahead of the launch of DESTR, as uncertainty about the future of Tom/Next and products linked to Tom/Next could cause unwanted market disruption.

Choosing a transition format which is commonly known, and internationally accepted, was seen as an advantage by the Working Group, as a special Danish solution may have driven away international market participants due to the resources needed to understand and accommodate a unique Danish approach.

The Working Group used the following criteria to assess the best possible transition:

- The transition should be transparent and easy to understand for market participants
- The transition should minimize uncertainty across the financial markets
- The transition should require a minimal use of resources for market participants

The Working Group proposed the recalibration approach as preferred to a parallel run approach. The recalibration approach is perhaps the most well-known internationally and has proven to be effective and efficient in the EONIA to €STR transition. Under the recalibration approach, the Tom/Next methodology will be changed to become dependent on DESTR as of 4 April 2022. Tom/Next will from then be defined as DESTR plus a spread adjustment. Tom/Next will continue to exist until the cessation date on 1 January 2026. Existing contracts referencing Tom/Next that mature before the cessation date would be able to run until maturity, while DESTR-related products and instruments would have time to develop. By choosing a suitable transition period, the need to resort to fallback language or legacy clauses is negated.

Danmarks Nationalbank and the DFBF are currently analysing the spread difference between pre-DESTR and Tom/Next. After the conclusion of the one-year observation period (19 March 2021 to 21 March 2022) on the 25 March 2022, the DFBF, in concert with Danmarks Nationalbank, will announce the fixed spread to be applied to DESTR to determine Tom/Next from 4 April 2022.

#### Question 1:

Do you agree with the DFBF's recommendation, and the final recommendation of the Working Group, to follow a similar recalibration approach as used for the EONIA to €STR transition, whereby Tom/Next will be linked to DESTR at a fixed spread until cessation?

## 6 Spread calculation methodology

The Working Group's second report and consultation described how the spread methodology arose from three parameters:

- a) DESTR is a borrowing rate, where Tom/Next is a lending rate. As with EONIA and €STR, one would expect this to yield a positive spread between the two, with Tom/ Next expected to be the higher of the two.
- b) DESTR is based on O/N deposits and thus includes transactions with value date equal to trade date that mature the following business day. Tom/Next, on the other hand, is based on transactions with value date tomorrow and maturity the following business day (two trade days from the trade date). Thus, for the same trade date, DESTR and Tom/Next have different value dates. Therefore, when calculating the historical spread adjustment, the value dates should be aligned to ensure that transactions with the same value date are used.
- c) DESTR is based on wholesale borrowing transactions with banks and other financial institutions, whereas Tom/Next is an interbank rate. DESTR is, however, predominately based on interbank transactions.

Based on publicly available time series for pre-DESTR and Tom/Next, the Working Group considered the various trimming levels to potentially exclude outlier days. For this purpose, spread differences were calculated by using pre-DESTR and Tom/Next for the same value date. The daily calculated spread was then ranked from lowest to highest, and the respective trimming levels were applied to remove days with the smallest and the largest observed spreads.

The results showed that there was a significant difference in spreads when no trimming was applied compared to all other trimming levels. This derives from the familiar pattern for Tom/Next around month-ends and, in particular, quarter-ends. The usual justification for applying trimming is to remove anomalies that are not representative of the underlying trend. This was the reason why the European Central Bank working group recommended a 15 per cent trimming to be applied when calculating the spread between EONIA and €STR. However, trimming also removes systematic, but rare patterns that are in fact representative of an underlying time series. The Working Group believed that 'turn effects' are a fundamental property of Tom/Next that are naturally in market expectations and therefore impact, e.g., CITA. The application of trimming unavoidably removes those 'turn effects' as they appear only around month-ends, and it would lead to undesirable value transfers if trimming was applied. In the Working Group's view, the concern of avoiding value transfers and the

desire to base the spread on data that is representative of Tom/Next outweighs any concerns around including potential outlier observations.

Thus, the Working Group recommended that no trimming be applied when determining the spread between Tom/Next and DESTR.

The Working Group therefore recommended that:

- The DESTR to Tom/Next spread methodology be a simple average based on calendar days
- No trimming should be applied when calculating the spread between Tom/Next and pre-DESTR
- The spread determination should be performed in coordination and made public by Danmarks Nationalbank.

Question 2:

Do you have any objection to the DESTR to Tom/Next fixed spread being announced 6 business days prior to the launch of reformed Tom/Next?

## 7 Timing of implementing the revised Tom/Next calculation methodology

To align the value dates between DESTR (O/N) and Tom/Next the Working Group recommended that at transition neither DESTR nor Tom/Next be published. Therefore, on Friday 1 April 2022 neither DESTR nor Tom/Next will be published. The following Monday 4 April 2022 DESTR will be published and Tom/Next will be published for the first time calculated as DESTR plus the fixed spread.

The rationale for not publishing either DESTR or Tom/Next on 1 April arises from the different referenced value dates of the benchmarks. DESTR, being an overnight rate, is calculated from overnight transactions from the day before publication i.e., yesterday/today on the day of publication. Tom/Next is calculated from Tom/Next transactions from the day before publication i.e., today/tomorrow on the day of publication. If reformed Tom/Next was published on 1 April 2022, then the Tom/Next would be published twice with the same referenced value dates i.e., on Thursday 31 March the Tom/Next published would be for referenced value dates 31 March/1 April. On the 1 April DESTR would also be for the referenced value dates 31 March/1 April. Therefore, to avoid Tom/Next being published twice for the same referenced values dates neither DESTR nor Tom/Next will be published on 1 April 2022.

Question 3:

Do you foresee any challenges to not having Tom/Next published on 1 April 2022?

## 8 Proposal to move Tom/Next publication time to 11:15am

Tom/Next is currently published at 12:00pm midday each good business day. DESTR will be published at 10:00am each good business. The DFBF understands that Danmarks Nationalbank will have a post publication re-determination policy that will allow for the republication of DESTR arising from any errors detected post publication. That policy will allow for DESTR to be republished no later than 11:00am on the day of publication. To cater for the potential for a republication of DESTR to occur the DFBF proposes that the reformed Tom/Next be published at 11:15am each day. This will provide the DFBF with a 15-minute window to utilise a republished DESTR should that occur, with sufficient time for appropriate validation controls to be applied.

With a buffer of 15 minutes following any possible republication of DESTR at 11:00am, and the simplicity of the revised calculation methodology (DESTR plus a fixed spread) the DFBF proposes not to apply a post publication re-determination policy to Tom/Next.

**Question 4:**

Do you support the proposed new publication time of 11:15am for Tom/Next?

## 9 Proposed cessation of Tom/Next on 1 January 2026

The DFBF supports the recommendations of the Working Group that Tom/Next will cease to be provided on 1 January 2026. The last day of publication for Tom/Next would therefore be Tuesday 30 December 2025. The introduction of the reformed Tom/Next in April 2022 will provide close to four years for users of Tom/Next to migrate away from Tom/Next to DESTR as the preferred short-term reference rate for transactions.

**Question 5:**

- a) Do you support the proposed cessation date for Tom/Next of 1 January 2026?
- b) Do you currently have, or expect to take on, exposures that run beyond the suggested cessation date, which you deem to be problematic?

## 10 Proposed amendment of related Tom/Next documentation

A number of DFBF Tom/Next public documents will require amendment to reflect the adjustment to the Tom/Next calculation methodology. These documents include:

- Tom/Next Calculation Methodology (June 2020)
- CIBOR and Tom/Next Panel Bank Code of Conduct (August 2021)
- DFBF Post Publication Re-determination policy (September 2020)
- CIBOR Tom/Next Benchmark Statement (June 2020)

## 11 Consultation timeframes

The standard timeframe for DFBF consultations is 30 days.

The timetable for this consultation is as follows:

- Consultation Paper publication 15 November 2021
- Closing date for respondents' comments 15 December 2021
- Collation and consideration of responses On or around 23 December 2021
- Publication of Analysis of Stakeholder Feedback On or around 30 December 2021

## 12 Respondent's confidentiality

In the case that some respondents indicate that they would like their responses kept confidential, the DFBF will ensure that the respondent's individual response is not published. The DFBF however, will be able to include their response in any aggregated summary of responses from all respondents – as long as the aggregate summary would not identify the respondent who require confidentiality.

All responses, whether requiring confidentiality or not, will be processed and reviewed by the DFBF and may also be shared with the DFBF secretariat, governance, and potentially regulatory bodies.

## 13 Post consultation summary to stakeholders

The DFBF will respond to comments by stakeholders, provided as part of the consultation process, after collation and approval by both the Oversight Committee and the DFBF directors. The DFBF will provide a summary of responses and will declare its position regarding the aggregated feedback on each issue contained in the consultation paper. The outcome of the consultation process will be posted according to the timeframes detailed above to the DFBF website.

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## Appendix 1 – Summary of questions

Question 1:

Do you agree with the DFBF's recommendation to follow a similar recalibration approach as used for the EONIA to €STR transition, whereby Tom/Next will be linked to DESTR at a fixed spread until cessation?

Question 2:

Do you have any objection to the DESTR to Tom/Next fixed spread being announced 6 business days prior to the launch of reformed Tom/Next?

Question 3:

Do you foresee any challenges to not having Tom/Next published on 1 April 2022?

Question 4:

Do you support the proposed new publication time of 11:15am for Tom/Next?

Question 5:

- a) Do you support the proposed cessation date for Tom/Next of 1 January 2026?
- b) Do you currently have, or expect to take on, exposures that run beyond the suggested cessation date, which you deem to be problematic?

Other:

If you have any comments or remarks on any of the aspects regarding the proposed changes described within this Consultation Paper, please include them in your response under 'Other comments'.