OIS Curve

Overnight index swaps (OIS) curves became the market standard for discounting collateralized cashflows. The reason often given for using the OIS rate as the discount rate is that it is derived from the fed funds rate and the fed funds rate is the interest rate usually paid on collateral. As such the fed funds rate and OIS rate are the relevant funding rates for collateralized transactions.

Many banks now consider that overnight indexed swap (OIS) rates should be used for discounting when collateralized portfolios are valued and that LIBOR should be used for discounting when portfolios are not collateralized.

In the past, a classic yield curve, such as 3 month LIBOR was used for both discounting cashflows and projecting forward rates. However, this classic viewpoint is too simplistic. It does not take into account the relative credit risk between lending money forward over a short period of time at interbank rates, versus the risk involved in short-term funding of those loans.

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During the financial crisis, the spread between three month US LIBOR and three month US treasury rate—increased dramatically. As a result, the LIBOR curve can not be regarded as risk free anymore.

Market practitioners started to use a new valuation methodology referred to as dual curve discounting, overnight index swaps (OIS) discounting or CSA discounting.

OIS curves became the market standard for discounting collateralized cashflows. This curve represents the market expectations of the Federal Reserve daily target for the overnight lending rate.

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Reference:

https://finpricing.com/lib/EqConvertible.html