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Answers of the European Financial Congress[1] in relation to the European Central Bank's consultation paper on Fallback in EURIBOR-linked contracts[2]

Methodology for preparing the answers

The answers were prepared in the following stages:

Stage 1

A group of experts from the Polish financial sector were invited to participate in the survey. They received the ECB's consultation document and a form with consultation questions. The experts were guaranteed anonymity.

Stage 2

Responses were obtained from experts representing major commercial banks operating on the Polish market.

Stage 3

The survey project coordinators from the European Financial Congress prepared a draft synthesis of opinions submitted by the experts in writing as well as those presented at the meeting. The draft synthesis was sent to the experts participating in the survey with the request to mark the passages that should be modified in the final position and to propose modifications and additions as well as marking the passages they did not agree with.

Stage 4

On the basis of the responses received, the final version of the European Financial Congress' answers was prepared.

[1] European Financial Congress (EFC – www.efcongress.com). The purpose of the EFC is to promote debate on how to ensure the financial security and sustainable development of the European Union and Poland.
[2] https://www.ecb.europa.eu/paym/pdf/cons/euro_risk-free_rates/ecb.consultation_details_201812.en.pdf

Answers of the European Financial Congress to the consultation questions

Q1 For which asset class would a forward-looking term rate methodology as a fallback to EURIBOR be required?

A forward-looking fallback rate would be desirable or essential for the majority of client contracts. Customers expect to know their interest costs for the coming months in advance and want to smooth out possible changes in the market rate over time.

The product mix which is offered by banks creates an interest rate risk profile mismatch. It is managed with derivatives to keep the exposure within risk limits.

This means that not all products could be migrated from EURIBOR to a backwards-looking ESTER fallback term rate because the backwards-looking rate is just an O/N rate with deferred payment, which is not in line with the customers' needs.

Q2 Do you agree with the working group's analysis of the OIS transactions-based methodology?

No opinion

Please provide your assessment of the OIS transactions-based methodology in terms of (i) data sufficiency, (ii) transparency, as well as (iii) overall feasibility.

The analysis presents quite a fair overview of the possibilities and the market description. The low count of daily OIS transactions and their volumes cast problems for the development of a transaction-based methodology. However, it should be noted that it is superior to the methodology based on interbank deposits longer than O/N. The methodology based on the clearing house & MMSR data ensures improved robustness, reliability and transparency of the rate.

The presented turnover on OIS market is low and created by few market players. It is noted that such a turnover is lower than in the period of higher rates and higher uncertainty. Therefore, it could be perceived as a bottom. As a consequence, it will hopefully grow with time and along with the transition from EONIA to ESTER as a more reliable benchmark.

Gradually ESTER entrenches itself in the market and then an increase in funding based on the new rate and hence more hedging transactions will follow, resulting in a higher turnover in the OIS market.

Q3 Do you agree with the working group's analysis of the OIS quotes-based methodology?

Yes

Please provide your assessment of the OIS quotes-based methodology in terms of (i) data sufficiency (ii) transparency, as well as (iii) overall feasibility.

A benchmark derived from quotes is not as robust, reliable and transparent as the one based on transactions (which is BMR's most important objective). Therefore, a quotes-based methodology could be a good supplement for the transaction-based approaches (as depicted in chapter 5.4). The "tradable quotes" captured as snapshots throughout the day would need to be published on MTFs and would fall under the regulation of MiFID2

and MAR, thus making them "equivalent" to real transactions. However, they'd still be theoretical transactions, which makes them a weaker source of information within the meaning of BMR.

Q 4 Do you agree with the working groups conclusions regarding a point-in-time fixing?

Yes

The point-in-time fixing (a one-hour window) should be beneficial for the benchmark. It could evoke increased trading activity around the time window. However, it should be noted that there could be attempts at the markets to shift the "real" transactions outside of that window. It could be of particular concern if the window was set early in the working day. Therefore, if there must be a time window, it should be set close to the end of the working day so as to include all the important events that happened that day and to reflect the end-of-day valuations.

Q5 Do you agree with the working group's analysis of the OIS composite methodology?

No opinion

Please provide your assessment of the OIS composite methodology in terms of (i) data sufficiency, (ii) transparency, as well as (iii) overall feasibility.

The composite methodology wouldn't be as transparent as the transaction- or quote-based ones separately.

There is a need for an additional mechanism to prioritize, or weigh, the data from different sources. But once the methodology has been developed, tested and agreed upon, it will become available for inspections and checks over its lifetime. And the market should accept it as aligned with the market reality and formal requirements.

The composite methodology gives an advantage of having much more data to work with and resilience to short-lived market liquidity hiccups. It clearly outweighs any additional methodological complications.

Q6 Do you agree with the working group's analysis of the futures-based methodology? Assuming sufficient liquidity, what would be your view of the futures-based methodology?

No opinion

Please provide your assessment of the futures-based methodology in terms of (i) data sufficiency , (ii) transparency , as well as (iii) overall feasibility.

The futures-based methodology could be a supplement to the transaction- or quote-derived fixing. But it should be noted that the market is too shallow and also modelling is more complex than for the other methods discussed. Moreover, the futures-based methodology has to rely on some assumptions which could be perceived as a weakness. However, we believe that such an approach should be included in the methodology waterfall to ensure the largest possible pool of available data sources. If necessary, futures-based methodology might come in with a relatively lower weight or with an appropriate volume floor.

Q7 Do you agree with the working group's assessment that the OIS quotes-based methodology offers the best prospect for producing a viable fallback rate within a reasonable time period following the launch of the daily ESTER publication?

No

Please elaborate on the reasons for your most preferred forward-looking methodology, taking into account that your preferred methodology could serve as the basis for determining a fallback rate for EURIBOR.

The composite methodology, including a waterfall-based structure based on OIS deals, tradable quotations on MTFs and the futures-based one will be the most resilient to temporary market liquidity hiccups and will be in line with BMR.