

**EFAMA response to the questions of the Report  
by the working group on euro risk-free rates  
on the transition from EONIA to ESTER**

## **A. Preliminary comments**

The European Fund and Asset Management Association, EFAMA<sup>1</sup>, welcomes the opportunity to provide its feedback on the report of the working group of risk-free rates (hereafter the EUR RFR WG) on the transition from EONIA to ESTER and its concrete recommendations for the recalibration of EONIA's methodology and for a gradual replacement of EONIA with ESTER as a reference rate for all products and contracts. In particular, with respect to the replacement process, we consider that the perspective of the end-user is crucial to ensure a gradual and as smooth as possible transition to ESTER.

Asset managers represent an important group of benchmarks' users, either in the case of passive managed funds and exchange traded funds (ETFs) - where benchmarks are used as a target for index linked funds - or in the case of the evaluation of an active manager's performance - where the fund performance is measured against a selected index or a set of indices. Asset managers as benchmarks users are generally not involved in the production, calculation, and contribution to data on which benchmarks are based. Therefore, their role is limited to the use of a benchmark, for which they are called to pay high and multiple fees and are subject to extensive regulatory requirements (in particular in the case of the use of financial indices by UCITS - see ESMA Guidelines on ETFs and other UCITS issues ESMA/2012/832/EN)<sup>2</sup>.

EFAMA participates in the EUR RFR WG as a non-voting member and was asked to give its input as to EONIA's footprint, in particular concerning its use in investment funds. In the absence of official data on EONIA's usage in the European funds industry, EFAMA relied upon empirical analysis and data gathered via an internal survey with its membership in order to contribute to EUR RFR WG mapping of EONIA's usage across different investment products and contracts<sup>3</sup>. Apart from the identification of the main types of funds that use EONIA and would therefore be impacted by the transition to ESTER, one other important outcome of this survey was the identification of the main challenges in respect to the transition from EONIA to ESTER. Such challenges include the need to adapt the systems to T+1

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<sup>1</sup>EFAMA is the voice of the European investment management industry. EFAMA represents through its 28 member associations, 62 corporate members and 25 associate members more than EUR 25 trillion in assets under management of which EUR 15.6 trillion managed by 60,174 investment funds at end 2017. Close to 32,000 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds, with the remaining 28,300 funds composed of AIFs (Alternative Investment Funds). [www.efama.org](http://www.efama.org)

<sup>2</sup> [https://www.esma.europa.eu/system/files\\_force/library/2015/11/esma-2014-0011-01-00\\_en\\_0.pdf](https://www.esma.europa.eu/system/files_force/library/2015/11/esma-2014-0011-01-00_en_0.pdf)

<sup>3</sup> The feedback provided by EFAMA on EONIA's usage by asset management companies and investment funds is presented in page 14 of the EUR RFR WG's report.

publication and the impact this would have for the calculation of the net asset value of funds, but also for the redemption/subscription process. Another key challenge is related to the necessary changes in respect to the communication to the clients, for instance changes in the contractual agreements and the Prospectus will be necessary, even if only one of them, to reflect this transition from EONIA to ESTER. Furthermore, in the context of the EMIR regulation, the usage of derivative contracts (e.g. overnight index swaps) within the investment fund and a transition of such derivatives to ESTER could generally have an impact on the investment fund management company in respect to the regulatory obligations for the valuation, portfolio compression and reconciliation with the other counterparty. On the other hand, it seems that in the majority of the cases this transition will not have an impact on the investment strategy.

To be able to efficiently address these challenges and allow for a smooth transition it is crucial for asset managers to have clear guidance and information as regards the key features of the rate. Moreover, ensuring such transparency, along with timely information is equally crucial.

In our view, this report is already providing useful insights to EONIA users on the transition process and the changes to the methodology. In general, we agree that due to time constraints the only workable solution for the transition is a recalibration of EONIA's methodology on the basis of a spread added to the new RFR, ESTER.

However, for asset managers to start implementing their projects for the transition from EONIA to ESTER important parameters are still missing, such as the publication of ESTER, which is only expected during the second semester of 2019. In addition, after ESTER's publication, EFAMA members expect to need more than 12 months to be ready for transactions in ESTER-based instruments. We, therefore, fully support the recommendation for the evolved EONIA to be authorized for a specific time period (until end-2021) as this will certainly facilitate a smoother transition for users.

## **B. EFAMA response to the report's questions**

### **Q1. Do you agree with the working group's recommendation that the preferred transition path is the time-limited recalibration approach with spread and clean discounting?**

EFAMA agrees with the time-limited calibration approach with spread and discounting as the preferred transition path. From a user's perspective this transition will allow additional time for the transition (as the evolved EONIA will aim at getting a time-limited authorisation until 2021) and further clarity as to the methodology (evolved EONIA would be ESTER plus a fixed spread). Moreover, the fixed EONIA ESTER relationship allows EONIA to continue representing the euro overnight unsecured market, which is very useful for a smooth transition. Finally, we believe that this stable framework can mitigate legal risks regarding the continuity of legacy contracts.

We also agree with the proposed EONIA-ESTER spread methodology as this is based on a simple formula that is straightforward to implement and will minimise valuation transfers and balance sheet impact. Further on, we consider that announcing the recalibration methodology and the determination of the spread before ESTER's first day of publication and setting the recalibration date on the first day of ESTER's publication is a good approach to avoid market disruptions and the possibility of arbitration. The reliance on public data from ECB that are published prior to any decision on spread methodology can ensure the transparency and robustness of the rate's underlying data. Finally, the clean discounting proposed by the EUR RFR WG is the preferred approach also for us, given that it allows for a simpler transition process, avoids fragmentation and contributes to a faster transition, therefore developing faster liquidity on ESTER.

EFAMA urges the administrator of EONIA and EMMI, as well as public authorities to communicate thoroughly on the evolved EONIA and the transition path in order to reduce litigation risks.

### **Q2. If not, what would be your preferred option and why?**

Apart from the time-limited recalibration approach EFAMA doesn't consider any other of the transition paths referenced in this report as appropriate.

### **Q3. Do you agree that a publication deadline for the recalibrated EONIA of end-2021 is sufficient for a smooth transition under the recalibration approach with spread and clean discounting path?**

We understand that a deadline for the publication of the recalibrated EONIA can be an incentive for market participants to conclude the transition faster. However, in practical terms dealing with the challenges of this transition may require more time. We would therefore suggest that public authorities and the EUR RFR WG re-assess the progress of the transition from EONIA to ESTER one year after the first publication of the later and consider based on the outcome of this assessment the need for additional time prior to the ceasing of EONIA.

**Q4. Do you have any other ideas to accelerate the transition of the derivatives market to ESTER?**

As mentioned in our response to Q1, EFAMA urges the administrator of EONIA and EMMI, as well as public authorities to communicate thoroughly on the evolved EONIA and the transition path in order to reduce litigation risks.

**Q5. Do you see any benefit in the new recalibrated EONIA to be authorised and supervised until its publication deadline?**

Please see our response to Q1.

**Q6. Do you agree with a spread methodology based on a 1-year pre-ESTER historical data period, calculated as an average with a 15% trimming?**

EFAMA agrees with the 1-year pre-ESTER historical data period as it can be sufficient to capture the real economic value of the rate.

As regards the trimming mechanism, we consider a 15% trimming is important to exclude outliers, is consistent with Euribor's hybrid methodology as presented so far and allows for sufficient data depth by ensuring the majority of observations during the historical data period are kept in.

**Q7. If not, what would be your preferred option and why?**

EFAMA doesn't support other options.

**Q8. How much time do you think would be the minimum to make your systems ready for ESTER T+1 publication and why?**

As mentioned in our preliminary remarks, making the systems ready for ESTER T+1 publication is an important challenge for asset managers because of the impact this would have for the calculation of the net asset value of funds and the redemption/ subscription process, in particular for funds offering same day settlement. Given that apart from the valuation process, the risk management process, and legal documentation will also be impacted and new IT developments should be set up, a 20-month adaptation period has to be envisaged.

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