European Fund and Asset Management Association

EFAMA response to the second public consultation by the working group on euro risk-free rates on determining an ESTER-based term structure methodology as a fallback in Euribor-linked contracts

A. Preliminary comments

The European Fund and Asset Management Association, EFAMA[1], welcomes the decision of the working group on euro risk-free rates (hereafter EUR RFR WG) to incorporate fallbacks in Euribor linked contracts and the opportunity to provide its views on that.

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)[2].

As supervised entities under the Benchmark Regulation[3], alternative investment fund managers (AIFMs) and UCITS management companies that use a benchmark are required to produce and maintain robust written plans setting out the actions that they would take in the event that a benchmark materially changes or ceases to be provided. Where feasible and appropriate, such plans shall nominate one or several alternative benchmarks that could be referenced to substitute the benchmarks no longer provided, indicating why such benchmarks would be suitable alternatives. The

[1]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

[2] http://www.esma.europa.eu/system/files/2012-832en_guidelines_on_etfs_and_other_ucits_issues.pdf

[3] Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (Text with EEA relevance)

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supervised entities shall, upon request, provide the relevant competent authority with those plans and any updates and shall reflect them in the contractual relationship with clients[4].

The ongoing effort to identify fallback rates for those contracts linked to Euribor and in the future to hybrid Euribor is useful in terms of asset managers complying with the Benchmark Regulation. Currently fallback rates of Euribor vary across financial instruments and are temporary. A stable and permanent approach would make the fallback clauses more robust. Important to note though that even if the presence of a fallback rate is important, it isn't necessary to make reference to the specific fallback chosen in the contract with the clients, whereas it is sufficient to make reference to existing robust contingency plans.

EFAMA agrees with the views in the consultation paper in favour of forward-looking fall-back rate, given that Euribor is also forward looking. It would allow for a smoother transition to the fall-back rate, if it is triggered. Moreover, it is important that the fall-back rate is easy to implement and to understand, broadly recognised by market participants and freely accessible or accessible at a reasonable cost.

B. EFAMA response to the consultation's questions

Q1. For your current and future business, for which asset class would a forward-looking term rate methodology as a fallback to EURIBOR be required? (essential/desirable/dispensable/not business-relevant)
Please elaborate on the reasons underlying your answer, also taking into account possible interactions among asset classes and related instruments

For asset managers it would be essential to have a forward-looking term rate as a fall-back to Euribor for the following asset classes: financial leasing, OTC derivatives – both cleared and uncleared, exchange-traded derivatives, money market or securities lending, floating rate notes, securitisation structures, corporate lending.
EFAMA agrees with the views of the EUR RFR WG in favour of a forward-looking fall-back rate, given that Euribor is also forward looking,

Q2. Do you agree with the working group's analysis of the OIS transactions-based methodology? (yes/no/no opinion)
Please provide your assessment of the OIS transactions-based methodology in terms of (i) data sufficiency (high/medium/low), (ii) transparency (high/medium/low), as well as (iii) overall feasibility (feasible/challenging/unviable)
Please elaborate.

Yes, we agree. EFAMA's assessment of the OIS transaction-based methodology (i) in terms of data sufficiency is low, (ii) concerning transparency is medium (iii) on the overall feasibility is feasible.

[4] Requirements foreseen in article 28 para 2 of the Benchmark Regulation

Based on the information provided in the consultation paper, a minimum number of transactions isn't available, which means low data sufficiency.

Q3. Do you agree with the working group's analysis of the OIS quotes-based methodology? (yes/no/no opinion)
Please provide your assessment of the OIS quotes-based methodology in terms of (i) data sufficiency (high/medium/low), (ii) transparency (high/medium/low), as well as (iii) overall feasibility (feasible/challenging/unviable)
Please elaborate.

EFAMA agrees with the EUR RFR WG analysis. Our assessment of the OIS quotes-based methodology:

(i) Medium
(ii) High
(iii) Feasible

Q4. Do you agree with the working groups conclusions regarding a point-in-time fixing? (yes/no/no opinion) Please elaborate.

EFAMA agrees with the conclusions regarding a point-in-time fixing and with the view that the shorter time window would be the best solution limiting the risks in periods of low volumes.

Q5. Do you agree with the working group's analysis of the OIS composite methodology? (yes/no/no opinion)
Please provide your assessment of the OIS composite methodology in terms of (i) data sufficiency (high/medium/low), (ii) transparency (high/medium/low), as well as (iii) overall feasibility (feasible/challenging/unviable).
Please elaborate.

We agree with the analysis of the OIS composite methodology and have the following comments on it: (i) medium, (ii) medium, (iii) challenging.

Q6. Do you agree with the working group's analysis of the futures-based methodology? (yes/no/no opinion)
Assuming sufficient liquidity, what would be your view of the futures-based methodology?
Please provide your assessment of the futures-based methodology in terms of (i) data sufficiency (high/medium/low), (ii) transparency (high/medium/low), as well as (iii) overall feasibility (feasible/challenging/unviable).
Please elaborate.

EFAMA agrees with the analysis on the futures-based methodology. Our assessment:

(i) Medium
(ii) Medium
(iii) Feasible

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? (yes/no/no opinion)
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.

Yes, we agree. See also our preliminary remarks as to what our preference is for the fall-back rate.

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