

**EFAMA RESPONSE to the  
EMMI 2<sup>nd</sup> CONSULTATION PAPER  
on  
AN HYBRID METHODOLOGY FOR EURIBOR**

**Introductory remarks**

EFAMA<sup>1</sup> is supportive of EMMI's commitment to deliver a reformed and robust methodology for Euribor and welcomes its decision to hold an additional round of consultation with market participants on the development of a hybrid methodology. Seeking feedback from a wide range of market participants on different methodological parameters is pivotal for meeting stakeholders' needs and for the overall success of the project.

Asset managers are users of benchmarks and market indices when managing portfolios on behalf of their clients. Indices are either used as a target for index linked funds, such as passive investment funds and exchange traded funds (ETFs), or as an evaluation tool of an active manager's performance (i.e. to measure fund performance against a set index or a combination of indices).

EFAMA closely follows the transition to new risk free rate benchmarks and in particular the transition to the new Euribor, as well as the discussions in relation to a possible discontinuation of EONIA. We are aware of the difficulties experienced by EMMI in its efforts to develop a transaction-based methodology as an alternative to the existing one. In that respect, we consider the new proposal for a hybrid methodology a balanced one taking into account the previously encountered limitations.

For any new rate to be relevant from the asset managers' perspective, it needs to be as representative as possible of the activity and the market-based funding costs in the market segment it covers. For that, ensuring clarity and concrete information as regards the key features of the rate is of paramount importance for users. In this regard, transparency as to the underlying methodology used in each step of the calculation of the benchmark, including in the fall back cases where there aren't sufficient real transactions in place, is key. Moreover, ensuring such transparency is there on a timely basis is equally

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<sup>1</sup> EFAMA is the representative association for the European investment management industry. EFAMA represents through its 28 member associations and 62 corporate members close to EUR 23 trillion in assets under management of which EUR 15.6 trillion managed by more than 60,000 investment funds at end 2017. Just over 32,000 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds, with the remaining 28,100 funds composed of AIFs (Alternative Investment Funds). Please see [www.efama.org](http://www.efama.org)

critical. Sufficient time and a standardised process in terms of the continuity of contracts are required for a transition from Euribor to the new risk free rate to be done on an efficient manner.

### **Responses to the Questions of the Consultation**

***Q1. Do you agree with the set of anonymized indicators proposed by EMMI? Would you consider helpful to have any other indicator published on a regular basis? Do you think that the frequency is adequate, and will allow you to fully understand the benchmark determination? Could you provide an example of the use you will make of these indicators?***

***Please, provide rationales for your answers***

EFAMA agrees with replacing the individual panel bank submissions with the set of anonymized indicators proposed by EMMI. We would also consider very relevant to add an indicator on the geographical breakdown of the volumes per jurisdiction, as well as the percentage of counterparties in level 2.1.

In terms of the frequency of publishing such indicators we agree with the proposal for a publication on a monthly basis. We also understand the reasons for the delay for the publication, but we consider that this delay could be shortened, i.e. from a month to two weeks after the end of each month. Moreover, we consider important to include the possibility for exceptional frequency of the publication in case of a crisis, which would help users better understand how Euribor is reflecting stressed market conditions.

These aggregated anonymised indicators on liquidity on each tenor, the type of participants, their geographical dispersion etc. can help users better assess the quality of the benchmark itself and how it reflects the market reality it intends to represent, as well as the depth of the underlying market and relevant trends.

In the case of investment funds being able to assess the accuracy of the benchmark used in terms of reflecting the underlying market is a key part of the asset managers' due diligence. In particular, in the case of UCITS, asset managers are already subject to extensive requirements and conditions under which UCITS may use financial indices as benchmarks. The ESMA Guidelines on ETFs and other UCITS issues (ESMA/2014/937/EN)<sup>2</sup> foresee that only transparent indices are permitted for UCITS to use as a benchmark. These transparency requirements are very extensive covering calculation, re-balancing methodologies, as well as constituents and their respective weightings. For that reason, the aggregation of this data via the anonymised indicators will be important in helping asset managers comply with the requirements of their own sectoral legislation.

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

**Q2. Do you consider that the proposed maturity windows allow EMMI to capture a more representative sample of transactions in the underlying interest? Please, provide a rationale for your answer.**

We agree with EMMI's proposal on a broad definition of maturity date windows in respect to the 1 week tenor, given the significant increase of the available data (as per the result of EMMI's analysis) and the fact that the dates remain consistent with the tenor they contribute to.

However, for the other tenors and given that EMMI's analysis results in less increased volumes captured by a broad bucket of eligible transactions, you would question the usefulness of a broad definition for them. We would also suggest to stay cautious as to the cliff-edge effects that can appear at the end of the year or the quarter.

**Q3. On the basis of the evidence provided by EMMI, do you agree that transactions with NFCs should be excluded from the set of eligible L1 transactions? Please, provide a rationale for your answer.**

EFAMA agrees with the exclusion of transactions with NFCs as these don't necessarily reflect the market reality (possibilities for an NFC to benefit from special deals). It would be also appropriate to add MMFs and other investment funds to the list of counterparties for eligible transactions foreseen in point 7.1.4<sup>3</sup>.

**Q4. On the basis of EMMI's analysis, do you agree with EMMI's proposal to include floating rate transactions referencing the unsecured euro overnight interest rate as eligible under Level 1? Please, provide a rationale for your answer.**

EFAMA agrees with the proposal to include floating rate transactions against the unsecured euro overnight interest rate as eligible under Level 1, as the results from contributing banks from the testing phase confirmed that such transactions reflect market rates and wouldn't impact in a negative way Level 1 submissions. At the same time given the reliance of the contributing banks on the corresponding IOS market curve to help them derive the converted fixed rate and the relevant EMMI guidance during the testing phase, we would consider important for EMMI to further guide towards building a common reference for the OIS quotes. Further work on such standardised reference could play an important role also in the more general context of the transition of the OIS based on EONIA to ESTER.

**Q5. On the basis of EMMI's analysis, do you agree with EMMI's proposal of a EUR 20 million minimum size threshold for a transaction to be considered eligible under Level 1? Please, provide a rationale for your answer.**

Given EMMI's analysis that the introduction of the minimum size threshold of EUR 20 million for a transaction doesn't significantly reduce the average volume captured in the respective tenors, we agree with this introduction that can help limit the price volatility.

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<sup>3</sup> There is a reference in footnote 7, but we consider it better to have an explicit reference in the text.

**Q6. Do you agree with EMMI's proposal of not introducing a threshold on the number of eligible transactions? Please, provide a rationale for your answer.**

EFAMA wouldn't agree with any minimum threshold that would tend to decrease reliance on real transactions at Level 1 and increase the use of level 3 data. Therefore, we agree with EMMI's proposal to not introduce a threshold on the number of eligible transactions.

**Q7. On the basis of the analysis performed by EMMI, do you agree with the proposal to determine the Spread Adjustment Factor from the previous 5 days' Euribor fixings? Please, provide a rationale for your answer.**

The proposed method to determine the Spread Adjustment Factor from the previous days' Euribor fixings seems appropriate as the submissions at both adjacent tenors should be based on Level 1 methodology and calculated not only at the linearly interpolated rate, but also taking into account the curvature of the money market yield curve.

However, it is difficult to assess the concrete suggestion for a 5 days' Euribor fixings for the Spread Adjustment Factor in the absence of further analysis on the selected timeframe or comparison in respect to other timeframes.

**Q8. Do you have any comments you would like to share with regards to Level 2.2 in the hybrid Euribor methodology?**

As mentioned in our response to Q2, we would see reasons to be cautious as regards the cliff-edge effects that can appear at the end of the year or the quarter.

**Q9. On the basis of the analysis performed by EMMI, do you agree with the proposal for the lookback period for Level 2.3, as described in the table above? Please, provide a rationale for your answer.**

We understand the need for a lookback period to take into account past transactions in cases when there is a lack of transaction data on a given day. As long as the transactions used at Level 2.3 remain on a most recent basis and given the proposal for a market adjustment factor seeking to correct the overall movement in interest rates between the submission date and the current date, the suggestion for a lookback period doesn't seem to generate important risks of divergence with the reality.

However, as per our response in Q7, it is difficult to assess the concrete suggestion for a 4 days' lookback period in the absence of further analysis on this particular timeframe or comparison in respect to other timeframes.

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Brussels, 30 November 2018

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