



First public consultation by the working group on euro risk-free rates on the assessment of candidate euro risk-free rates

Summary of responses

August 2018

1 Executive summary

The first public consultation by the working group on euro risk-free rates on the assessment of candidate euro risk-free rates closed on Friday, 13 July 2018. The consultation drew considerable interest from the financial sector. 66 market participants – 41 of which are from the banking sector – submitted responses or comments in relation to the consultation document. The response sample ensures suitable geographic coverage and adequately reflects relevant (sub-)sector views. The main messages from the financial sector may be summarised as follows:

- 1. Respondents broadly agreed with the working group's analysis of unsecured candidates for the euro risk-free rate in terms of the analytical approach, selection criteria, results and conclusions.*
- 2. Respondents generally concurred with the working group's conclusion that the euro short-term rate (ESTER) is the most reliable and robust – and consequently the most appropriate – unsecured candidate for the euro risk-free rate.*
- 3. Respondents broadly agreed with the working group's analysis of secured candidate rates in terms of the analytical approach, selection criteria, results and conclusions, while highlighting additional aspects that could have merited assessment.*
- 4. Respondents largely shared the conclusion of the working group that the GC Pooling Deferred Funding Rate and the RepoFunds Rate are the most reliable and robust secured candidate rates, although some qualified their backing or expressed a preference for one of the two chosen candidates.*
- 5. 58 respondents or 88% of responses viewed ESTER as the most appropriate future euro risk-free rate, predominantly on the grounds of its unsecured nature, compilation methodology and low volatility, as well as the fact that the ECB – an EU institution – is the administrator. However, many respondents urged that both the start of the regular production and the daily publication time of ESTER be brought forward.*

6. Respondents widely saw a role for the working group in assessing potential fallback rates to the euro risk-free rate, given the benefits in terms of financial stability of having a fallback rate and the regulatory requirements mandating one.

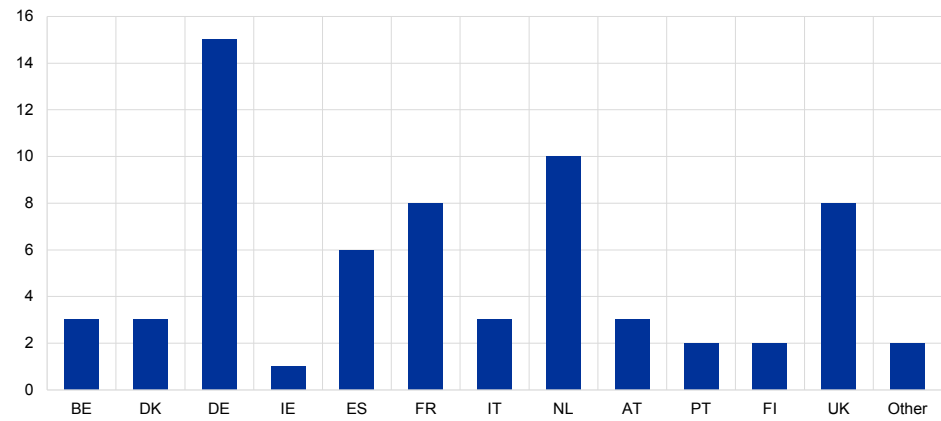
The working group on euro risk-free rates will keep market participants informed regarding the progress of its work and discussions, to support them in their own preparations for the introduction of the new benchmark. The working group may also seek further input from market participants through additional public consultations.

Chart 1

Geographic coverage of the response sample

July 2018

(number of respondents by geographic area)



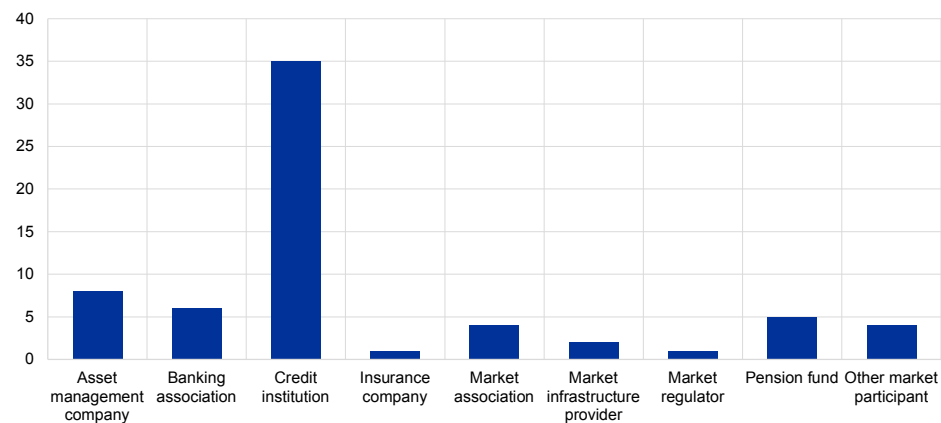
Source: ECB.

Chart 2

Representation of stakeholder groups in the response sample

July 2018

(number of respondents by sector)



Source: ECB.

Assessing unsecured candidates for the euro risk-free rate

Do you agree with the working group’s analysis of the ECB monetary policy candidate rates and the unsecured candidate rates?

Respondents broadly agreed with the working group’s analysis of unsecured candidates for the euro risk-free rate in terms of the analytical approach, selection criteria, results and conclusions.

Respondents felt that the working group applied a systematic, rigorous and data-driven process and comprehensively covered available unsecured candidate rates.

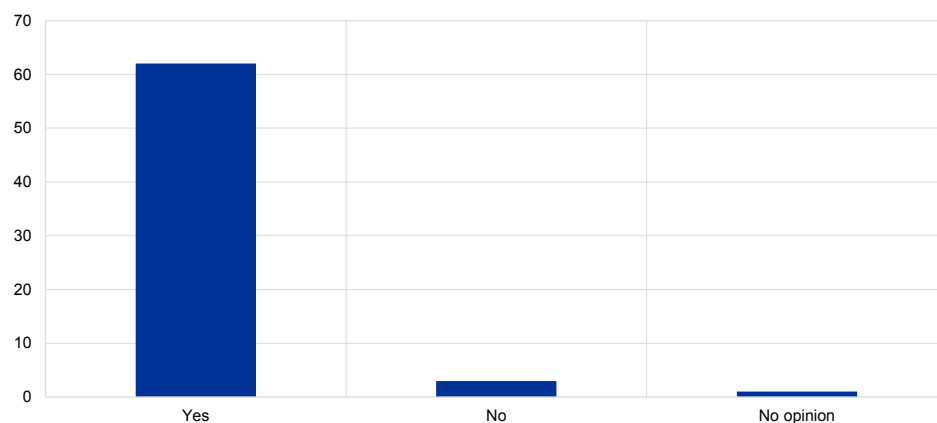
Respondents generally agreed that the monetary policy rates set by the ECB’s Governing Council to implement monetary policy are inappropriate to fully reflect reactions of market participants and are not underpinned by broad-based market data. A few respondents took a different view of the prospective reform of candidate rates and argued against excluding them from consideration.

Chart 3

Extent of agreement with the working group’s analysis of unsecured candidates for the euro risk-free rate

July 2018

(number of responses)



Source: ECB.

Do you support the working group’s conclusion that ESTER is the most reliable and robust unsecured candidate euro risk-free rate?

Respondents generally concurred with the working group’s conclusion that ESTER is the most reliable and robust – and consequently the most appropriate unsecured candidate for the euro risk-free rate.

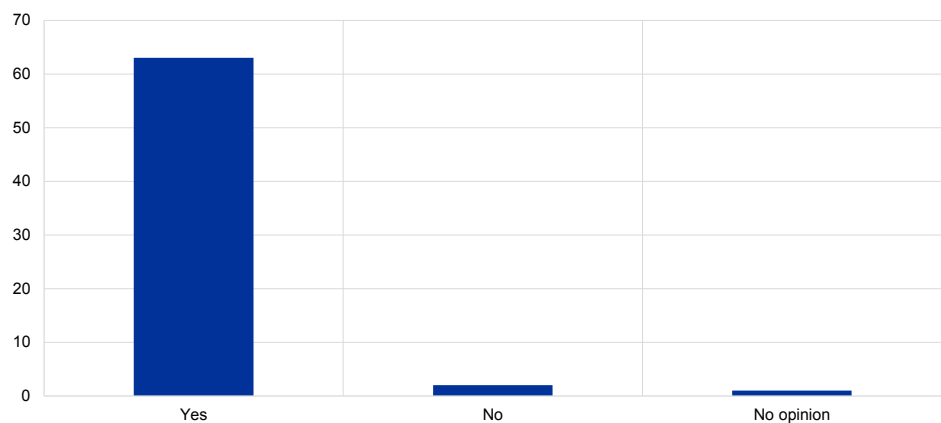
However, respondents also pointed to the short data history on which to assess ESTER, its “close to risk-free” nature and possible concerns regarding its geographic coverage in qualifying their views on ESTER.

Chart 4

Extent of agreement with the working group’s conclusion that ESTER is the most reliable and robust unsecured candidate for the euro risk-free rate

July 2018

(number of responses)



Source: ECB.

3 Assessing secured candidates for the euro risk-free rate

Do you agree with the working group’s analysis of the secured candidate rates?

Respondents broadly agreed with the working group’s analysis of secured candidate rates in terms of the analytical approach, selection criteria, results and conclusions, while highlighting additional aspects that could have merited assessment.

Respondents noted that the working group’s analysis focused on the compilation methodology and volumes. Some respondents considered that the following issues and concerns warranted deeper analysis:

- The quarter-end and year-end effects common to the secured indices – mainly linked to the regulatory framework or balance sheet constraints – leading to reduced volumes and increased volatility;
- The relevance of collateral requirements, rather than funding requirements, in determining the pricing of secured transactions;
- The potential reduced responsiveness of secured rates that are a blend of overnight, tomorrow/next day and spot/next day transactions in periods of

changing market conditions (in particular due to monetary policy rate changes), as this may result in less transparent rate fixings and consequently increased risk management challenges;

- Potential conflict of interest related to secured rates based on trading platform data or transactions cleared by a central counterparty.

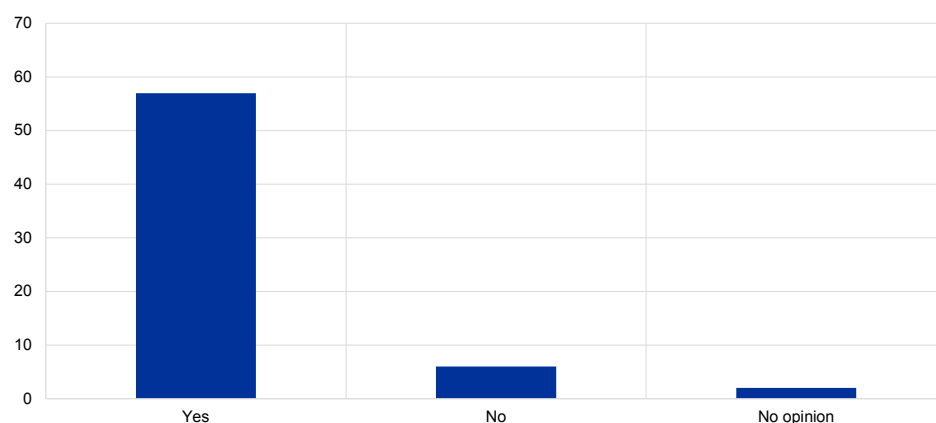
Finally, a number of respondents expressed regret about the current unfeasibility of producing – and hence considering – the Pan-European Repo index or an index based on money market statistical reporting (MMSR) data.

Chart 5

Extent of agreement with the working group’s analysis of secured candidate rates

July 2018

(number of responses)



Source: ECB.

Do you support the working group’s conclusion that GC Pooling Deferred and RepoFunds Rate are the most reliable and robust secured rate candidates for the euro risk-free rate?

Respondents largely shared the conclusion of the working group that the GC Pooling Deferred Funding Rate and the RepoFunds Rate are the most reliable and robust secured candidate rates, although some qualified their backing or expressed a preference for one of the two chosen candidates.

Those respondents who disagreed with the working group’s conclusion mainly questioned the appropriateness of a secured rate being a euro risk-free rate on the grounds of sustainability concerns and the fact that secured transactions are sometimes used for funding and sometimes used for collateral purposes.

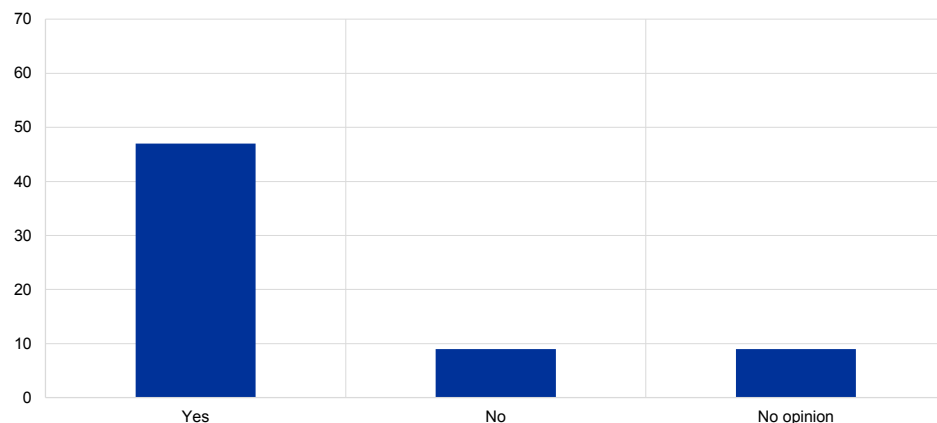
Moreover, both supporters and critics of the two secured candidate rates expressed concerns about the provider of a critical benchmark being a commercial entity and about a potential licence fee, which were deemed detrimental to the wide adoption of such a rate as a euro risk-free rate.

Chart 6

Extent of agreement with the conclusion that the GC Pooling Deferred Funding Rate and the RepoFunds Rate are the most reliable and robust secured candidate rates

July 2018

(number of responses)



Source: ECB.

4

Assessing the final candidates for the euro risk-free rate

Which of the final three candidate rates do you think would be the most appropriate future euro risk-free rate?

58 respondents or 88% of responses viewed ESTER as the most appropriate future euro risk-free rate, predominantly on the grounds of its unsecured nature, compilation methodology and low volatility, as well as the fact that the ECB – an EU institution – is the administrator. However, several respondents urged that both the start of the regular production and the daily publication time of ESTER be brought forward.

Respondents generally deem ESTER to be reliable – as it is based on MMSR data and administered by the ECB – and robust – in view of the number of reporting agents, average and lowest daily volumes, average and lowest number of transactions, and low volatility. Given that ESTER is an unsecured rate, respondents regarded it as being much closer to the currently used EONIA rate than other candidate rates, as well as being easier to understand and to communicate to clients.

To further enhance markets' understanding of ESTER's behaviour under different market conditions (particularly at quarter-ends and year-ends and in periods of market stress), respondents called upon the ECB to commit to an earlier start to the daily publication of ESTER. This would also support the transition from the EONIA, as well as the development of a term curve.

Moreover, respondents asked that the envisaged daily publication time be brought forward in order to reduce operational challenges (in particular, valuation issues).

Respondents also pointed to the need to increase the coverage of the underlying MMSR data to ensure continued representativeness and to enhance the robustness of ESTER.

Finally, respondents viewed the absence of licence fees as another argument in favour of ESTER.

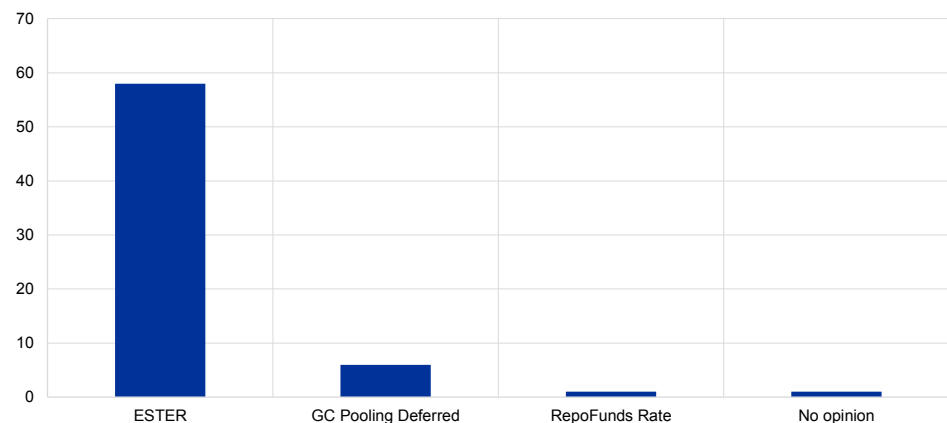
Those respondents who expressed a preference for one of the two secured candidate rates viewed these rates as better reflecting funding costs in the euro area, while having significant trading volumes. Furthermore, they regarded secured rates as more robust, especially under conditions of market stress. These responses also reflected some sector-specific preferences for secured rates.

Chart 7

Extent of support for the three final candidate rates

July 2018

(number of responses)



Source: ECB.

5 Assessing potential fallback rates to the euro risk-free rate

Do you think the working group should consider assessing potential fallback rates to the euro risk-free rate?

Respondents widely saw a role for the working group in assessing potential fallback rates to the euro risk-free rate, given the benefits in terms of financial stability of having a fallback rate and the regulatory requirements mandating one.

Respondents cited the following reasons when arguing in favour of the working group assessing potential fallback rates:

- The benefits of a fallback rate in providing robustness to the financial system by reducing financial, operational and legal risks;
- The requirement under the EU Benchmarks Regulation¹ in general and Article 28.2 thereof in particular;
- The role, composition and representativeness of the working group, as well as the expertise gained since its establishment.

Notably, a number of respondents either implicitly or explicitly assumed that ESTER would be the future euro risk-free rate.

Those respondents who opposed the working group's involvement in the assessment of fallback rates predominantly argued on the grounds that the ECB is the administrator of ESTER and that the ESTER compilation methodology provides for contingency arrangements.

Finally, a number of respondents – irrespective of their stance on the working group's involvement in the assessment of potential fallback rates – saw merits in focusing on defining and agreeing market guidance for the process of choosing a fallback rate, rather than defining specific fallback rates. A few respondents in this context also referred to the need for international coordination in these efforts.

Respondents highlighted that, in an ideal scenario, the switch from a new euro risk-free rate to its fallback rate should be as smooth as possible and avoid value transfers. Regarding the critical issues that the working group should consider with respect to nominating fallback rates, responses primarily focused on:

- Consistency with the criteria applied to the new euro risk-free rate to ensure the quality of the methodology used to compile the fallback rate, particularly with respect to robustness and transparency.
- Correlation with market developments to determine scenarios under which a fallback rate would be used (e.g. a scenario of market stress and a scenario of normal market conditions), together with an assessment of resulting spreads between the euro risk-free rate and the chosen fallback rate.

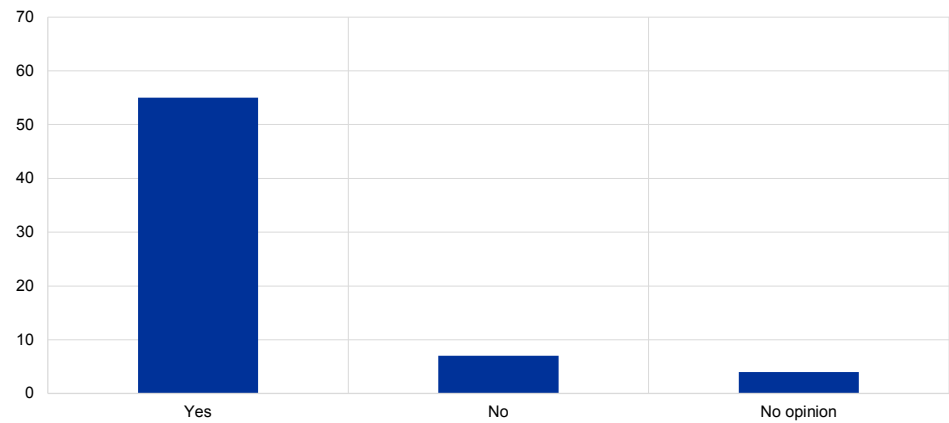
¹ [Regulation \(EU\) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation \(EU\) No 596/2014 \(OJ L 171, 29.6.2016, p. 1\).](#)

Chart 8

Extent of agreement with the working group having a role in assessing potential fallback rates

July 2018

(number of responses)



Source: ECB.

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For specific terminology please refer to the [ECB glossary](#).