

Executive Summary: Consultation Paper on Money Market Benchmarks

1. General

a) Continuous use of WIBID and WIBOR in financial contracts and financial instruments

The Fixing Participants agree that the transactional aspect should be taken into account in order to harmonise WIBOR with BMR. In their response to the questions asked in the consultation paper, they committed themselves to supporting GPW Benchmark in the modification of the WIBID and WIBOR provision methodology in a way ensuring compliance with the Regulation. What is of key importance for the sector is to ensure continued validity of existing financial contracts which refer to WIBOR. The WIBID and WIBOR definitions, including their underlying markets, are essential to the Fixing Participants. Any modification or extension of the scope of the deposit market segments necessary to enhance the transactional aspect in the input data waterfall methodology would be a material change of the methodology; from the perspective of the continuity of the benchmarks, it could require decisions at the central level (a dedicated legislation) to ensure continued use of WIBID and WIBOR in existing financial contracts and financial instruments. An impact assessment of the “enhanced” transactional aspect is reflected in the banks’ responses summarised in Section 2. The foregoing conclusions follow from replies to the following questions asked in the consultation paper.

Question 1.1. (...) Please select one statement which best matches your preferences or describe your proposed solution.

No.	Response	# responses
1	I am in favour of including the transactional aspect in WIBID/WIBOR in order to make it BMR compliant so it can be published after 31 December 2019.	11*
2	I am in favour of creating a new BMR-compliant benchmark to replace WIBID/WIBOR in new contracts as of 1 January 2020.	0
3	None of the above. Describe the proposed solution.	0
	No answer given.	1

• One of the Participants marked no response in the survey but its comments and subsequent responses clearly suggested inclusion of the transactional aspect in WIBID/WIBOR (to a limited extent only). The bank’s response was considered positive.

Question 1.7. From the perspective of WIBID and WIBOR risks and processes, in the opinion of your institution:

No.	Response	# responses
1	Maintain the current definition of the underlying market (unsecured inter-bank deposit market) when introducing the transactional aspect, for instance by adding transaction data from related markets within the meaning of Annex I to BMR.	11
2	Introduce a new benchmark.	1*
3	I do not know.	0

• The bank which marked this response also marked response 1.

b) Basis risk and interest rate risk management on the banks' balance sheets

According to the banks basis risk management on the balance sheet in the presence of more than one benchmark would be difficult in the absence of a liquid and accessible derivative market. This provides an additional incentive for financial institutions to equip the Administrator with tools necessary to develop a WIBOR definition and methodology ensuring effective basis risk management, similar to the status quo. The balance sheets of Polish banks are particularly sensitive to the management of that kind of risk from the perspective of the banks' exposure to floating interest rates with different repricing dates. The basis risk of money market curves (WIBOR rates with different maturity dates) is frequently left open on the balance sheets of the banks but the risk of WIBOR vs. other benchmarks requires a more active management approach.

The Fixing Participants commonly believe that term money market curve (which factors in expectations of future interest rates) would be necessary even if it would be not complete. Smooth management of liquidity risk and interest rate risk in banks requires the use of O/N rates (short end of the yield curve) as well as term rates: 1M, 3M and 6M.

Any alternative benchmarks, including GPW Benchmark's propriety concept WRR, would require a period of parallel use in order to develop market instruments necessary to track and compare the benchmarks and to construct derivatives.

2. Transactional aspect

a) General

As indicated in Section 1, it seems essential to develop a method which takes into account the transactional aspect and complies with the approach defined in Annex I to BMR, which defines the waterfall of input data starting with transactions on the defined underlying market.

In addition to transactions among them, all Fixing Participants suggest that the provision methodology should include transactions between Fixing Participants and non-panel banks in view of the similar subjective and objective scope of the market (the difference being that non-panel banks have less market-making ability; hence, the suggestion to include their transactions with Fixing Participants but not their mutual transactions).

Concerning deposit transactions with non-bank entities, two Fixing Participants covered by the survey mentioned transactions with financial institutions as the most similar related market which could support the transactional aspect in the new methodology. Less than one half of the Participants endorsed the addition of conditional transactions to the waterfall methodology, mainly GC (REPO and BSB) transactions, which are transactions made by the same entities on the wholesale money market. Caution is recommended when it comes SC transactions involving a specific security as collateral because the interest rates are different from the prevailing rates.

b) Input data waterfall – objective scope: transactions other than unsecured deposits

The Fixing Participants emphasise that the rates used in secured transactions are significantly different from the rates of deposit transactions (the former are potentially lower; the longer the tenor, the bigger the differential). This could largely affect WIBOR if there are sufficient number of secured transactions to activate their presence in the calculation methodology.

Concerning the potential inclusion of conditional transactions in the waterfall of input data used to develop a WIBID and WIBOR hybrid methodology, the Administrator advises that any change of taxation on conditional transactions would affect the economic attractiveness of repos vs. unsecured deposits. This could upset the stability of the difference between the rates on secured and unsecured deposits based on the magnitude of the "bank tax"

factored into the price. The volatility of the difference could be mitigated by offsetting the impact of the “bank tax” on the rates of unsecured inter-bank deposits with maturities longer than one month.

The Fixing Participants agree in their comments that the inclusion of transactions other than unsecured deposits relates to the impact of regulations governing the banks’ liquidity and exposures. The most commonly raised issues are the LCR weights attributed to different types of secured and unsecured transactions with specific types of counterparties.

Considering that WIBOR input data under the methodology whose objective scope would be extended in the repo context would be sourced from the trading system organised by BondSpot, it would seem reasonable to use those transaction data whose volume exceeds the adequate threshold set in the methodology. In addition, the input data waterfall and the methodology should include a “buffer” protecting them against the impact that single secured and unsecured transactions could have on the benchmark where the waterfall is used beyond the first step assuming a very active underlying market.

c) Input data waterfall – subjective scope: deposit transactions of non-participants

Inclusion of data of deposit transactions between Fixing Participants and public entities or large enterprises to the methodology was largely rejected by the respondents in view of the risk that it could be considered a material change of the methodology. Furthermore, the volatility of prices of transactions with that sector could overly increase the volatility of the benchmark, disrupting a smooth transition from the “old” to the “new” methodology. In view of their positive impact on the liquidity measures, such transactions are allocated different transfer prices, impacting the rates offered to end customers.

The Fixing Participants also largely opposed to the inclusion of deposit transactions with non-bank financial entities. The opinions were based on similar arguments as in the case of deposits of the public sector and large enterprises. Some positive arguments were raised, as well (e.g., regulatory issues, lesser potential legal risk). However, in spite of the foregoing and despite less prevalent cross-selling of the deposit offer for such entities, the Fixing Participants believe that the rates offered to the sector could be much different from the rates on the inter-bank market, thus limiting their potential use in the new methodology.

The majority of the banks are ready to provide additional data in order to support benchmark provision; however, they stress limited resources and the need to clearly define the scope and nature of the data. The key issues include IT limitations and necessary additional IT resources.

The preferences of the WIBID/WIBOR Fixing Participants concerning the extension of the subjective and objective scope of input data waterfall in the calculation methodology are summarised in the following question asked in the consultation paper.

Question 2.1. In your opinion, assuming that the transactional aspect is included in the calculation methodology or the subjective and objective scope of the definition of underlying market is extended, which transactions should be included in the determination methodology?

No.	Response	# responses
1	Deposit transactions between WIBID/WIBOR Fixing Participants.	11
2	Deposit transactions between WIBID/WIBOR Fixing Participants and other entities, including:	10
3	transactions with other banks (non-participants of WIBID/WIBOR)	10
4	transactions with non-bank financial institutions	2
5	transactions with large non-financial institutions	1
6	transactions with public institutions and local governments	1
7	retail transactions (consumers, SMEs)	1
8	Other	1
1	Conditional transactions	4
2	REPO	4
3	BSB GC	3
4	BSB SC	1
5	FX Swap/ CIRS	3
6	Transactions in derivative markets	2
7	Other	1

3. Alternative concept of the term rate

a) Potential use of the compound WIBON rate in financial contracts and financial instruments

The message that comes from the responses of the banks participating in the survey is clear: the proposed WIBON rate would not be used in financial contracts and financial instruments. One half of respondent banks did not take a stance on the issue; the majority of the other participants see no reason to use the rate in the banks' balance-sheet and off-balance-sheet positions listed in the table. However, the proportions of responses were different on the question of the potential use of WIBON as an alternative benchmark within the meaning of Article 28 of BMR. On this point, most of the institutions which replied agreed that the benchmark could be used in this aspect of the Regulation. This suggests that financial institutions do need a market benchmark to be used in contingency plans. The question on this issue is summarised below.

Question 3.1. In view of the methodological concept of WIBON, in which financial contracts could a compound term rate be used? In which financial instruments and financial contracts could WIBON be used?

No.	Contract	Yes	No	N/A	No response
1	Consumer loans	1	4	1	5
2	Corporate loans	1	5	0	5
3	Mortgage loans	1	4	1	5
4	Corporate deposits	0	4	1	6
5	Deposits of public institutions	1	4	0	6
6	Deposits of financial institutions	0	4	1	6
7	Fund transfer price curve	2	4	0	5
8	Derivatives and their valuation	2	4	0	5
9	Floating-rate bonds – own issues	2	4	0	5
10	Floating-rate bonds – bonds in assets	2	4	0	5
11	Money market instruments	1	4	1	5
12	In all of the above as an alternative benchmark (Article 28 of BMR)	4	3	0	3

b) Calculation method

In the opinion of the Fixing Participants believe, a compound term rate determined at the end of the period is the preferred approach to compound rates based on O/N rates, mainly because this methodology is consistent with the practice of the financial market. A compound rate determined at the beginning of the period would not take into account current rates as it would be based on the preceding interest period. However, the banks suggest that a broad “market approach” would not be practicable as the banks need to fix interest payments due to customers’ at the beginning of each period.

c) Development of a risk-free term rate structure

The banks participating in the consultations pointed to the need to develop a risk-free term rate as this would enable them to use risk-free term rates incorporating the liquidity premium as well as expectations of future rates in financial contracts and financial instruments combined with effective risk management.

d) Potential replacement of the WIBOR curve by a compound term rate

The majority of the banks believe that a compound rate could not fully replace a term WIBID/WIBOR rates. The main reasons mentioned include the fact that the former does not factor in liquidity preferences or expectations of future rates. One of the banks which believes it to be possible stressed that the rate would not be adequate anyway as it would not factor in liquidity risk or credit risk adequate to the tenor of the loan and the term rate repricing dates. Another bank suggested that all efforts should be made to maintain WIBOR while WIBON could be used as an alternative benchmark.

e) Calculating a compound forward rate

The vast majority of the Fixing Participants said that the compound term rate should be calculated by the ON rate Administrator or another administrator rather than being determined by banks using that rate. Thus, the Participants clearly indicated that the responsibility for the calculation and publication of the benchmark should be with a regulated and specialised benchmark provider. One of the banks made a reference to POLONIA and its potential use as an RFR.

4. Benchmark for secured transactions REPO on regulated market

a) Options and conditions of secured transactions REPO market stimulation

One half of all Fixing Participants are ready to move a part of their transactions and to provide bids and asks to BondSpot in order to stimulate the REPO market. One of the survey participants made a comment to the effect that it is ready for market-making subject to setting a new index based on prices provided. Two banks suggested that conditions should be put in place similar to those applied to the spot market operated by BondSpot, including the maximum time window of maintaining quotations and the maximum spread of the quotes, which suggests that they are unwilling to commit to how they want to participate in market-making.

b) Potential importance of WRR for the Polish financial market

Most of the banks believe that the calculation and implementation of a Warsaw Repo Rate (WRR) as a part of the local benchmark system would be beneficial for the Polish market as a source of information about the cost of financing of positions in securities. In addition, in the opinion of the Fixing Participants, an O/N WRR may, in the long term, become an alternative to POLONIA. Furthermore, the Fixing Participants believe that the benchmark may be useful provided that the volume of relevant transactions is significant.

c) Use of WRR in financial contracts and financial instruments

The response of the banks concerning the use of WRR in financial contracts and financial instruments suggests that one half of the Fixing Participants are not interested in using the benchmark in financial contracts. However, the majority of the banks which took a position on this point believe that they could use that index on their balance sheets. In addition, the vast majority of all respondents underscored the potential importance of WRR as an alternative benchmark in contingency procedures within the meaning of Article 28 of BMR. The question concerning the use of WRR is summarised in the table below.

Question 4.5. In which financial contracts and financial instruments could the Warsaw Repo Rate be used?

No.	Contract / instrument	Yes	No	N/A	No response
1	Consumer loans	4	1	1	5
2	Corporate loans	5	1	0	5
3	Mortgage loans	4	1	1	5
4	Corporate deposits	4	1	0	6
5	Deposits of public institutions	4	1	0	6
6	Deposits of financial institutions	4	1	0	6
7	Fund transfer price curve	5	1	0	5
8	Derivatives and their valuation	5	1	0	5
9	Floating-rate bonds – own issues	5	1	0	5
10	Floating-rate bonds – bonds in assets	5	1	0	5
11	Money market instruments	4	1	0	6
12	In all of the above as an alternative benchmark (Article 28 of BMR)	9	0	0	2

5. Improvement factors of transactionality on the money market

The consultation paper includes a number of questions concerning factors that could improve transactionality in the money market's unsecured and secured segments (including repo transactions in the trading system). The table

below summarises the factors listed by the WIBID/WIBOR Fixing Participants in the survey.

Relevance	Factor
Critical	• Bank tax
Significant	• Open market operations • Regulatory factors • Documentation (REPO)
Other	• Central clearing (REPO and deposits) • Number of trading participants (REPO and deposits) • Competition incentive scheme (Primary Dealer, Money Market Dealer) • Trading system optimisation

All of the WIBID/WIBOR Fixing Participants believe that the critical factor improving transactionality is a modification or amendment of the bank tax. As the factor was named by all respondents, it is considered the key factor. The significant factors are those named by several respondents; other factors were named once each.

6. Methodology drafting plans

Regarding the directions of development of WIBID/WIBOR outlined by the Fixing Participants in the consultations, GPW Benchmark will test a methodology which covers the underlying market as well as potential related markets.

We will shortly expand the debate on the optimum definition of the benchmark. GPW Benchmark will draft amendments of the Data Delivery Procedure, which is a part of the Code of Conduct, in order to extend the scope of data provided by the Fixing Participants.

In H1 2019, we will be focusing on the development of the optimum methodology comprising the input data waterfall and on calibrating the methodology following tests run on data provided by the Fixing Participants, to be summarised at meetings of the working groups with the stakeholders. We will amend the benchmark documentation accordingly in order to align the input data delivery process with the new methodology.

The final step before filing the application will be to conduct public consultations of the final version of the methodology combined with an analysis of its economic continuity in the context of the use of the benchmarks in financial contracts. We will review the methodology and improve it as required if any new circumstances are identified at this stage. Finally, using the outcome of all previous work, we will draft the complete benchmark documentation, including the benchmark statement to be published once the Administrator is licensed.