



**Summary of conclusions from the
public consultation on Recommendation
on the application of the WIRON index
in issues of floating-rate debt securities**

**Document of the National Working
Group for benchmark reform**

Summary of conclusions from the public consultation on *Recommendation on the application of the WIRON index in issues of floating-rate debt securities*

Introduction

The subject-matter of the public consultation was a proposal for a *Recommendation on the application of the WIRON index in issues of floating-rate debt securities*. The Recommendation was prepared by the National Working Group for benchmark reform (NWG) based on analyses and discussion of experts. Its purpose is to provide financial market entities with the best practices for applying the WIRON index to the calculation of interest payments in issues of floating-rate debt securities.

The Recommendation is one of the deliverables of the Preparatory Phase of the Roadmap for the replacement of WIBOR and WIBID benchmarks with WIRON index.

Conclusions from the consultation

In the opinion of the NWG experts, the comments on the draft Recommendation do not create the need for any modification of the document being consulted on.

In order to address all doubts and to consider the importance of all the issues and of raising awareness among market participants, the NWG experts provided detailed answers to the comments. Please see the answers in section 'Summary'.

Scope and period of the consultation

The consultation on the draft document was held by:

1. publishing the following communications on the KNF website in the section dedicated to the NWG's activities:
 - https://www.knf.gov.pl/dla_ryнку/Wskazniki_referencyjne/aktualnosci?articleId=80618&p_id=18 (Polish)
 - https://www.knf.gov.pl/en/news?articleId=80621&p_id=19 (English)
2. sending an invitation to the consultation and the document to professional associations of financial market entities

The consultation ran from 21 December 2022 to 4 January 2023.

All interested parties could send their comments to a dedicated e-mail address: konsultacjengr@knf.gov.pl.

Summary of the comments submitted during the public consultation and the NWG's answers

Until 4 January, one opinion was received from a professional association of financial market entities.

Association's comments:

1. The entity participating in the consultation pointed out that the current systems and processes of calculation agents and issuers were not prepared to apply the WIRON index in the issues of floating-rate debt securities using the recommended method.

In the opinion of the NWG experts, the need to replace spot interest rate benchmarks (e.g. WIBOR 3M and WIBOR 6M) with the WIRON index determined on the basis of overnight (O/N) transactions poses many new challenges, which require adaptation of systems and processes of entities in the floating-rate debt securities market. The recommendation on the application of the WIRON index aims to indicate best practices, thus the adaptation strategy.

The NWG's Expected Roadmap for the replacement of WIBOR and WIBID benchmarks with WIRON index provides that the issues of floating-rate debt securities based on WIRON will start appearing in 2024, and from 2025 the market will be ready to operate without the WIBOR index, so the period for the adaptation of market participants' systems and processes will be from 1 year to almost 2 years.

2. The entity participating in the consultation pointed to undesirable features of the recommended method using the 5-business-day lookback with observation period shift, such as: determining the final amount of interest only at the end of the interest period, the possibility of occurrence of negative interest with positive interest rates in specific situations, or difficulties in properly settling interest periods starting on non-business days.

In the opinion of the NWG experts each of the possible methods shows minor or major defects. Essentially, the more a method reflects economic reality, the more complicated it is and the more adaptation work it requires in terms of systems and processes. The NWG experts analysed the possible methods, their advantages and disadvantages and recommended a method that offers the best balance of desirable features, i.e. economical appropriateness, being understandable to the acquirer, and adaptation of the market infrastructure.

The disadvantages of the recommended method can be mitigated through systemic and/or contractual adaptations and proper communication between all parties. For example, an approximate value of interest may be estimated based on the WIRON family indices published: as the interest period runs, the estimated value of interest will be getting closer to the final amount of interest.

However, an event in which the amount of accrued interest decreases from day to day (negative interest per day) will be known a few business days earlier and be possible to consider in the 'pure' market price, which is allowed by the proposed observation period shift.

Finally, as regards interest periods starting on non-business days, traditionally occurring in the issues of securities denominated in PLN, this could be resolved by changing that convention or by adapting IT systems properly.

All of the above-mentioned matters are discussed by professionals and experts gathering in the National Working Group. Some of them may be covered in further reports in this respect.

3. The entity participating in the consultation indicated preferred methods to be the methods based on historical, not current, values of the WIRON rate, as they require minor adaptations of systems and processes of entities in the floating-rate debt securities market.

In the opinion of the NWG experts according to the methods based on historical values of the WIRON index, the interest rate on debt securities will be disregarding the current economic situation and current market conditions. If issues involving such interest rate become more common, the difference between the current and historical interest rates available at the same time on various financial instruments will become part of the market play and will significantly increase price volatility in the secondary market, the volatility that results not from the issuer's credit quality or the market and economic situation but from the method of determining interest rate that fails to reflect economic reality.

It is possible to adapt the systems and processes of professional entities in the floating-rate debt securities market to the methods that better reflect economic reality. Therefore, the NWG must not recommend methods based on historical values of the WIRON rate as methods designed for general application.

4. When pointing to advantages of using historical values of the WIRON index, the entity participating in the consultation proposed a thesis that for long-term debt securities, the differences resulting from the application of historical, not current, values of the WIRON index would be naturally extended and reduced over the bond life.

Concrete methods of applying the WIRON index were also indicated, e.g. determining interest rate on a bond based on historical levels of WIRON at the beginning of the interest period (the quoted description corresponds to the Lockout Period method), and a name of another method was mentioned: the 'last recent' method (shorter reference period).

In the opinion of the NWG experts among the methods based on historical data, special attention should be paid to the 'last reset' method. It is assumed that with short interest-fixing periods, minor volatility of the volume, and for long-term contracts, the negative effects of application of historical interest rate values will be limited. This is why the method is recommended for mortgage loans with a restriction on the interest-fixing period to 1M.

At the same time, the NWG must not recommend this method for general application in issues of floating-rate debt securities. Such issues show diversification in terms of maturity and usually 6-month interest-fixing periods are applied; moreover, as opposed to loans, debt securities are traded in the secondary market, where the current and future interest rates are what matters, as they directly affect the current valuation.

It should also be noted that the NWG's recommendations are not obligatory and they may be applied freely in terms of freedom of choice, considering the specific aspects of each issue. Issuers and investors may shape the terms of issues freely, as permitted by applicable law.

5. The entity participating in the consultation points to the need to adapt the IT infrastructure of the capital market, in particular Warsaw Stock Exchange (GPW), to the operation of the secondary trade of WIRON-based debt securities. The final adaptation strategy must guarantee equivalent operation of IT systems of trading platforms and investment firms.

In the opinion of the NWG experts the schedule of the reform roadmap addresses the need to introduce these changes. The analysis of the impact of changes in the application of the WIRON index on secondary trading in debt securities has shown that the GPW trading system will not have to be modified. The changes will focus on the process of generating and processing interest tables and require cooperation with all market participants. In step one, the GPW is planning to adapt the current infrastructure used by issuers and calculation agents to automatically transmit interest tables to the notification system. The work is to be carried out in cooperation with stakeholders and in accordance with the NWG's Roadmap, and should be completed in 2023. In stage two, that is in 2024, the GPW is planning to prepare an IT tool ('interest generator') which, in the form of a service for issuers and calculation agents, will ensure the possibility of determining interest parameters on a one-off basis for the purpose of daily calculation of the value of interest due and feeding it into the trading system and distributing it by means of information channels currently used. At the design phase of the Roadmap, the timeline was adjusted to the plans for issues of WIRON-based floating-rate debt securities so that all market participants could choose the optimum solution and adapt their infrastructure to the solution of their choice.

6. The entity participating in the consultation pointed to the level of volatility of the WIRON index in relation to the WIBOR index.

For volatility of the WIRON index, the Index Administrator (GPW Benchmark) presented the results of comparative analyses of the course of the WIRON index in the [Consultation Paper](#) (of May 2022) and in the [Analytical supplement to Public Consultation Results with substantive conclusions on the method of developing RFR-benchmarks](#) (updated in January 2023). GPW Benchmark emphasised that according to information provided in the analytical documents the WIRON index measured based on deposit transactions for O/N maturity was an index with a relatively high volatility compared to foreign reference rates for the same maturity.

Moreover, GPW Benchmark pointed out that volatility levels similar to WIRON could be seen in WIRF and WRR indices, which were being considered during the consultation as alternatives to WIRON, and – what is equally important – in the POLONIA index. A similar level of volatility of

POLONIA, which is set as an average (weighted by the volume of particular transactions) of interest rate on unsecured inter-bank deposits concluded for an overnight (O/N) maturity on a given business day until 16:30, allows for an explicit conclusion that high volatility of transaction-based O/N indices is a feature following from the overall characteristics of the Polish market.

The WIRON index, being the base index for setting indices from the WIRON Compound Indices Family, loses the feature of high volatility as a result of the conversion into WIRON 1M Compound Rate, WIRON 3M Compound Rate, WIRON 6M Compound Rate and WIRON Compound Index through the use of the compounded interest method based on the principle of accumulation of overnight indices, considering their daily capitalisation.

7. The entity participating in the consultation pointed to concerns about the possible application of WIRON in connection with the recalculation of the historical course of the index performed by the Administrator. The entity also referred to the need for observation of the WIRON index and for an appropriate length of time series that allowed for the observation of the behaviour of the index.

As regards the comments and questions concerning the recalculation of historical values of the WIRON index, information on the completed recalculation of the WIRON index has been provided in a report made available by the Administrator on the website: [Information about the impact of Data Transmission Audit on WIRON](#). The statement of reasons to the Administrator's decision was provided in the document and it mainly says that the recalculation (1) was performed prior to the introduction of the index into financial agreements and financial instruments, and (2) was a result of verification of tasks related with identification and qualification of transaction data and their submission to the Administrator, carried out by all data contributors. GPW Benchmark performed the recalculation of the index for the entire pre-production period, which reflects the historical base of values of the WIRON index, i.e. from the beginning of 2019. The Administrator also recalculated the indices from the WIRON Compound Indices Family. If any error in transaction data or any related correction is recorded in the future, GPW Benchmark will be presenting disclosure materials showing the impact of any such correction of the errors on the course of the index in the past, in a way similar to how some Administrators proceed. The observation of other Administrators' practices confirms that in terms of operations of providing indices, operations on big transaction data may lead to errors that are not due to intentional action but, for example, operational reasons. Operations related to Data Transmission Audit and any non-compliance identified by means of this process improve the processes and identification of corrective and remedy actions among data contributors.

The observation of a time series for the WIRON index can be done for 4 years. WIRON is available for the entire 2019, 2020, 2021 and 2022 and shows the behaviour of the index at various stages of the economic cycle. With the period corresponding in the Roadmap to the phase of introducing the WIRON index for application and phasing out the WIBOR index, when the WIRON index and indices from the WIRON Compound Indices Family will be being provided in accordance with the Rules, the published history of indices allows for a comparative analysis and preparation for a safe conversion of the current benchmarks in Poland. The consultation papers and recommendations of the National Working Group and the analytical documents/materials provided by participants in the NWG's activities will be supporting the process.

8. The entity participating in the consultation addresses issues related to the determination of spread adjustment and conversion of the portfolio of floating-rate debt securities that are currently based on WIBOR.

These issues go beyond the scope of the recommendation in question. The NWG is now engaging in analytical work on a recommendation on the conversion of the portfolio of floating-rate debt securities that are currently based on WIBOR, a topic which will probably be discussed during a separate consultation.

9. The entity participating in the consultation claims that the lack of an explicit start date for application of the WIRON index in issues will decrease competitiveness of such issues as WIRON is lower than WIBOR.

The roadmap envisages preliminary dates for carrying out first issues based on WIRON and the target date for ceasing to provide and make available WIBOR. The analysis of those data shows that new issues based on WIBOR or WIRON can be carried out in the market only for a short period of time. No explicit date can be set, as issuers may use any available interest rate index of their choice, to the extent permitted by applicable law.

A chosen reference rate, even though it is not the only parameter of an issue, affects the set of its price parameters. It is the whole set of parameters that determines the competitiveness of a given issue, not only a chosen reference rate.