Turnover in the European government bond markets continues to decline

- Germany has seen turnover decline from 3.4% in 2005 to a mere 1.4% in 2006
- Non-euro countries have also seen the turnover continue to decline, with both UK and Sweden at roughly half of the level in 2005
Primary Dealers Numbers

- Number of primary dealers has seen changes since 2012
  - Seven euro-area countries have seen the primary dealers (PD) community decrease over the period
  - Some countries have seen notable variability in the number of PD, e.g. Belgium
  - While the UK has seen a reduction, the US has seen an increase in the number of primary dealers

Source: HSBC, AFME, National DMOs
Data from the French market suggests increasing PD concentration

Cumulatively the Top 5 and Top 10 in bonds and also in inflation have increased their share of market turnover

<table>
<thead>
<tr>
<th>Year</th>
<th>Top 5</th>
<th>Top 10</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>46.6%</td>
<td>50.6%</td>
</tr>
<tr>
<td>2013</td>
<td>48.5%</td>
<td></td>
</tr>
<tr>
<td>2016</td>
<td>50.6%</td>
<td></td>
</tr>
</tbody>
</table>

Source: HSBC, AFT

Herfindahl index for Primary Dealer in the French government bond, inflation and BTF market – rising since 2010

- Evidence of increasing concentration among Primary Dealers in French market
  - The Top 5 Primary Dealers in French market have increased their share of market turnover since 2010…in 2016 was above 50%
  - The Top 10 PDs account for over 82% of turnover
  - Using the Herfindahl index (measure of concentration), both bonds and inflation have see increases since 2016…
  - …the only sector that is lower than 2010 is BTFs

Source: HSBC, AFT
Lack of Primary Market Harmonisation

Method for standard primary auctions in each country

<table>
<thead>
<tr>
<th>Country</th>
<th>Type of Primary Auction Used</th>
<th>Auction Procedure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>Multi-price</td>
<td>Austrian direct auction system</td>
</tr>
<tr>
<td>Belgium</td>
<td>Multi-price</td>
<td>Bloomberg auction system</td>
</tr>
<tr>
<td>Finland</td>
<td>Single price auction</td>
<td>Bloomberg auction system</td>
</tr>
<tr>
<td>France</td>
<td>Multi-price</td>
<td>Banque de France</td>
</tr>
<tr>
<td>Germany</td>
<td>Multi-price and Average possibility</td>
<td>Bund bidding system</td>
</tr>
<tr>
<td>Ireland</td>
<td>Single price auction</td>
<td>Bloomberg auction system</td>
</tr>
<tr>
<td>Italy</td>
<td>Single price auction</td>
<td>Todeal Bank of Italy</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Single price auction</td>
<td>MTS</td>
</tr>
<tr>
<td>Portugal</td>
<td>Single price auction</td>
<td>Bloomberg auction system</td>
</tr>
<tr>
<td>Slovakia</td>
<td>Multi-price/Single price auction</td>
<td>Bloomberg auction system</td>
</tr>
<tr>
<td>Slovenia</td>
<td>Multi-price</td>
<td>Bloomberg auction system</td>
</tr>
<tr>
<td>Spain</td>
<td>Modified Dutch</td>
<td>Servicio de Liquidación del Banco de España (SLBE)</td>
</tr>
</tbody>
</table>

Note: The list covers only the major methods of primary auction bond issuance. Does not include process for T-Bills or some inflation-linked issuance (such as BTP Italia)

Source: HSBC, National DMOs

US has seen increasing direct and indirect bidding at auctions

Aspiration of harmonisation across all markets

- However, there remains significant differences across all the Euro-area markets that primary dealers need to contend with
- This includes the methodology for auction processes, including whether single, multi price or combination of both
- Additionally, although the Bloomberg auction system is prevalent, there are other systems used elsewhere

Clients participation into auctions has remained low in the Euro-area

- Different in the US

Source: HSBC, US Treasury, Bloomberg
Auction Workload

In 2016 a total of 452 lines were auctioned

Number of Euro-area auctions (incl. ESM), monthly in 2016

Source: HSBC, National Debt Agencies and DMOs

- **Number of auctions and lines is large in Euro-area**
  - For Euro-area, including ESM, there was a total of 452 lines auctioned through the course of the auctions in 2016…
  - …Italy saw a total of 99 lines issued, whereas France (86), Spain (79) and Germany (53) were also notable
  - In terms of auction times, this averaged 19 per month in 2016…
  - …however, the first five months of the year saw 21-22 auctions per month – just over one auction per working day
The Regulatory Framework

- **Capital** - Stress VaR, IRC, CVA VaR, Leverage Ratio
- **Liquidity** – LCR, NSFR
- **Derivatives** – IM and VM
- **Clearing** – Trading Obligation
- **MIFIR** - Transparency, SI regime, Algo
- **Volcker** – FBL, …

Access to Liquidity
Size/Balance Sheet
Innovation
Electronification
Performance monitoring

Consistent and Growth Oriented Regulations
Supervisors’ Cooperation

Source: HSBC
Several domestic markets with:
- Their own cut-off settlement cycles
- Their settlement costs
- Their set of matching standards

Source: HSBC
Post-Trade European Landscape (Post T2S) – Primary Dealership

Source: HSBC
Expected European Post-Trade market – Primary Dealership

Central Securities Depositary

No more national restrictions on the activity of primary dealers and market makers

One Security Account held by one custodian or CSD whatever the country

Cash account

One Dedicated Cash Account

Target 2 account

One RTGS Account

Target 2

T2S

Source: HSBC

HSBC
Global Banking and Markets

PUBLIC
Primary Dealership: Barriers to Complete Harmonisation

- **T2S main goal was to harmonise the post-trade market in the Euro-System**
  - At the beginning of the T2S project, the ‘Giovanni Barriers’ were identified by a group of financial market experts to describe the main obstacles for efficient cross-border clearing and settlement in Europe
  - After T2S implementation, barrier number 10 “National restriction on the activity of primary dealers and market makers” still remains an issue for an efficient cross-CSD settlement environment
  - However ongoing discussions between T2S participants are removing some barriers

- **As of today**
  - A security account held by the CSD is still required on the French and Italian market for Primary Dealership
  - Germany is a specific market with most of the activity performed on International Central Security Depositary
  - Due to recent migration of the Spanish market, ongoing discussions and technical issues still prevent cross-CSD Issuances on the Spanish Market
A huge transformation has taken place

- **Primary dealers have undertaken significant change, adapting to the shifting landscape**
  - Regulatory transformation
  - Capital charge
  - Mean of trading

- **...however specific issues remain**
  - No new comers have been forthcoming given the constraints (e.g. Capital Charge)
  - Fragmentation continues to prevail (Clearing, Auction system)
  - Low level of clients participation at auctions remains an issue
  - Coordination on issuance program can still be improved
Items for Discussion

• Simplifying the current set-up for Primary Dealers
  – Are there any initiatives that could be taken in order to try and simplify the Primary Dealer model?

• Elevated sovereign issuance in a declining ECB PSPP purchasing future
  – The ECB is likely to reduce their bond purchases through PSPP over the coming year or so
  – Euro-area governments will continue to issue sizeable amounts of bonds going forward
  – How will the market and Primary Dealers absorb this projected increase in ex-PSPP issuance?