EUROPEAN DEBT DISTRIBUTION – SCOPE FOR IMPROVEMENTS?

Presentation to ECB DIMCG

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A PUBLIC ISSUER’S FOCUS

Final objective is to minimize execution risk:

- Operational risk
- Maximum investor outreach
- Transparency of processes
- Efficient and fast processes
- Reliability and continuity
- Cost and resources of processes, fees
- Data protection

...and to further develop a European ‘domestic’ market
CURRENT ISSUES – A PUBLIC ISSUER’S PERSPECTIVE (1)

Main issues for debt distribution today:

- **Lack of Digitisation**: Outdated communication and market place: compare with distribution for goods and services, e.g. Amazon
- **Too slow**: Long settlement periods: t+1 or instant is missing
- **Fees**: High fees, no fee competition
- **Bank-to-issuer**: Banks focus on bank-to-investor efficiency; bank-to-issuer seems out of scope [example: Direct Books initiative]
- **Bias in services**: Guiding principles for providing an efficient market infrastructure are neutrality and harmonisation
  - Private and national service providers are biased, can’t be neutral.
  - Harmonisation is in the interest of issuers and investors; no incentive for service providers to push for harmonisation
<table>
<thead>
<tr>
<th>Topic</th>
<th>Description</th>
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<tbody>
<tr>
<td>Banks’ role</td>
<td>Acting as intermediary. Providing tech not necessarily a bank role, rather creates dependencies for issuers and investors</td>
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<td>Private initiatives</td>
<td>No private initiative came up with a market standard, pan European platform where issuers and investors efficiently meet and are not subject to dependency risks (commercial, monopolistic, continuity, geopolitical)</td>
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<td>Fragmentation</td>
<td>Pre-issuance and post-trade services for debt distribution are splintered with a multitude of proprietary systems acting according to their own rules, legal statutes, and links between them</td>
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<td>Fragmentation data</td>
<td>Importance of data collection, analytics, ownership for overall market efficiency not addressed so far</td>
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<td>One-stop platform</td>
<td>A front-to-end digital debt distribution infrastructure for all debt distribution techniques (syndication, private placements and auctions) is missing. European financial markets lag years behind digital distribution for goods and services: eBay, Amazon, AirBnB</td>
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<tr>
<td>Collateralisation</td>
<td>Access to high quality collateral fragmented</td>
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ISSUES AT STAKE – DIMCG ACTION POINTS BY AREA

- Pre-trade processes
- Post-trade processes
- Governance risks
- European ‘domestic’ capital market
PRE-TRADE PROCESSES

- Manual work, several media-breaks and a lack of standardisation
- Use of different communication channels, lack of coordination in the communication regularly leads to misunderstandings and multiple investor outreach
- Issuers receive order books in different formats which makes automated processing difficult to impossible and creates technical issues
- Investor identification remains an issue. Content of order books often unclear. Consolidation time consuming
- Outdated tech complexity: log-ins, data imports, browsers, fire-walls,...
PRE-TRADE: AS IS SITUATION

Before opening the books

- Prepare invitation letters (senior, junior)
- Finalize IIIA announcement (and twitter...)
- Check & agree on Bloomberg screen announcement
- Send & receive complete working party list plus send the Transaction Check List for Lead Managers
- Send announcement to WM Data
- Send drafts of invitation letters to communication manager & receive updated
- Send joint term sheet to docs & settlement manager
- Prepare with docs manager a DD call
- Send senior co-leads/co-leads invitation letters (parallel to the book opening)
- GO/NO GO call
- Book monitoring and updating
- Send senior co-leads/co-leads invitation letters (parallel to the book opening)
- DD call
- Agreeing on book updates
- Book cleaning
- Agreeing allocation
- Pricing call
- Prepare & agree final statistics
PRE-TRADE – DIMCG TO LOOK AT....

... the pre-trade processes and assess potential for harmonization, standardization and digital automation. It should evaluate scope and magnitude of cost savings and risk reduction compared to the legacy infrastructure

• Standardized order book including direct investor access
• investor identification and on-boarding
• Automation of announcements, final term sheets, legal docs
• Reduce e-mails, as they are inefficient and a security risk
• Ownership and usage of data
• Acceleration of processes (allocation, distribution of information)
• ISIN usage and centralized ISIN administration
• Digitization and streamlining of processes
• Blockchain to be considered for technical solutions?
POST-TRADE PROCESSES – THE ISSUER’S PERSPECTIVE (1)

DIMCG should assess risks and costs of current splintered post-trade processes

DIMCG should consider digital issuance techniques as potential drivers for leaner processes and structural improvements

• Issuer’s objective
  o Reach all potential investors, no access burdens depending on their location
  o Smooth and safe settlement process, no liquidity risk on the settlement day

• Issuer’s ideal
  o STP from pre-issuance to post trade and settlement
POST-TRADE PROCESSES – THE ISSUER’S PERSPECTIVE (2)

• Issuer’s current
  o Efficiency of issuer-to-investor and investor-to-issuer depends on respective locations
  o Post-trade processes are complex
  o Multiple settlement chains create settlement and liquidity risk
  o Transaction cost depending on the location of actors

• Evolution to dematerialized issuances, modern management of data and docs, may allow for leaner set-up
DIMCG should take stock of divergent conventions and assess scope for harmonisation. DIMCG should analyse the impact of multiplicity of national issuance processes on financial integration

- European financial markets are still fragmented and not sufficiently harmonized in their infrastructure and conventions.
- Lack of harmonisation makes euro denominated debt less attractive to international investors.
- Country specific infrastructures lead debt issuers to prefer their domestic dealers and agents and complicates settlement processes.
- This cements the fragmentation of the EA capital market for debt instruments.
- It prevents the national eco-systems to converge to a European “domestic” market and to become deeper, more liquid, and more resilient.
- Finally it prevents the euro from taking a stronger role in the international monetary system.
GOVERNANCE RISKS

DIMCG should evaluate critical dependency risks and propose risk mitigation measures

- Globalisation requires harmonisation and standardisation
- Digitisation allows for standardisation
- Both come along with increased commercial and geopolitical dependency risks
  - Change of ownership, business model
  - Data protection and usage/analytics
  - State interventions
GOVERNANCE RISKS – THE ISSUES IN DETAIL (1)

Proliferation of platforms leads to risks of discontinuity and prevent harmonisation or risk of monopolisation

• Platforms evolving in the private sector will not be aligned, forcing participants to deal with different standards and systems.
• In case one provider will become the major one, it will create a de-facto monopoly. This provider will set the standards and fees, which might not be in the best interest of issuers (booking.com).

Data ownership, intelligence and control is of high importance.

• Digital financial systems are collecting large amount of confidential private data.
• This data and the control of it will gain strategic importance for general market intelligence, best access to investors and debt distribution capacities.
• This data have the potential to become a key capacity for public debt distribution.
• This data and the ownership needs to be protected.
GOVERNANCE RISKS – THE ISSUES IN DETAIL (2)

Political dependency can expose European issuers and investors to high operational risk and cost.

• Critical debt infrastructure provided by non-European banks implies exposure to geopolitical decisions (such as embargos) beyond control of European financial actors. Particular relevance in times of crisis.
DIMCG ACTION POINTS – THE ISSUER’S PERSPECTIVE

Pre-trade
• DIMCG should look at the pre-trade processes and assess potential for harmonization, standardization and digital automation
• DIMCG should evaluate scope and magnitude of cost savings and risk reduction compared to the legacy infrastructure

Post-trade
• DIMCG should assess risks and costs of current splintered processes
• DIMCG should consider digital issuance techniques as drivers for leaner post-trade processes and structural improvements

European ‘domestic’ market
• DIMCG should tack stock of divergent conventions and assess scope for harmonisation
• DIMCG should analyse the impact of multiplicity of national issuance processes on financial integration

Governance risks
• DIMCG should evaluate critical dependency risks and propose risk mitigation measures
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