



EUROPEAN CENTRAL BANK

EUROSYSTEM

A common model for pan-European EUR denominated debt

DIMCG workshop
discussion - outcome

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Introduction

- In the DIMCG meeting held on 15 April the topic of ISIN allocation was discussed
- Triggered by the perceived ‘branding’ effect of ISIN pre-fixes the discussion evolved into a broader conversation on whether and how a common template / model for pan-European high-quality EUR-denominated debt should be created
- A workshop held with volunteering DIMCG members on 6 May discussed the idea and its pros / cons further

A common template / model for pan-European EUR denominated debt – what is the issue?

- The market for high-quality EUR-denominated debt issued by European issuers is currently fragmented with a clear segmentation between national sovereign (and other high credit quality national) issuers and the so-called ‘international market’
- These market segments work well within their own ecosystems (*Eurobonds/ICSDs/CoBM* and *National CSDs/securities/CeBM*) with the stakeholders well used to / familiar with their idiosyncratic / legacy practices
- Most importantly issuers and investors adjust their behaviour, their agents according to the segment they wish to operate in with many operating in national markets and the international market at the same time

A common template for pan-European EUR denominated debt – what is the issue?

- Issuers navigate these ecosystems based on their own legal status, location and preferred targeted set of investors
 - Issuers in large / central eurozone economies primarily rely on their domestic market and can expect that also international investors will enter their market (but with the trend that more and more large national issuers use the international segment as well)
 - Smaller and periphery eurozone and non-euro area issuers rely more often on the international market segment to attract (a wider range of) international investors
 - EU institutions primarily rely on the international market (with no domestic jurisdiction to rely on)
 - There are other factors (beyond geography / issuer residence) that also play into the decision by the issuer on which segments to use (e.g. choice of issuer agents, preferred law of issuance, etc.)
 - The choice of segments seems to strongly correlate with the other key features of the issuance transactions i.e. choice between syndication vs auction, choice of day-count / business day conventions, choice of location (for the issuer)

A common template / model for pan-European EUR denominated debt – what is the issue?

- European investors navigate these ecosystems by relying on
 - i. their domestic procedures for buying their own domestic debt (e.g. PT pension fund buying PT government bonds)
 - ii. access the few central / large European national markets directly and
 - iii. rely on the international market to access the debt issued by the other issuers
- In all three scenarios investors face different practices, different standards and as they go from i) via ii) to iii) they are less familiar with the idiosyncratic nature of the issuers (potential legal complexities, market conventions)
- Therefore the current ecosystem helps investors by presenting them a finite set of practices / quasi-standards to limit the set of information they need to manage so that they can focus on the risk / return characteristics of the debt instrument and not e.g. specific legal risks, etc.
- This caters for the challenges within these market segments but still leaves Europe with a fragmentation within and between the segments

A common template / model for pan-European EUR denominated debt – how could it help?

- Beyond general harmonisation that has been taking place an additional element that can help issuers and investors to achieve better transparency, a more efficient a more integrated market for high-quality EUR denominated debt instruments is a common template / model
- Such common template / model could be an optional model for issuers wishing to target pan-European investor base and designate issuance in EU in EUR in CeBM to investors
- It could easily co-exist with / build on the existing ecosystems, i.e. no forced ‘overwriting’ of existing practices in the national or international segment but creating an additional option to which interested issuers (primarily IFIs or other issuers targeting a pan-European investor base) could consider over time. Other issuers could also make use of certain relevant elements of such model (e.g. single investor id scheme)
- It can be built from the elements discussed by the DIMCG and where already some level of de facto convergence to standards has been achieved by the industry in order not to represent something radically new
- It can and should be agnostic to platforms or infrastructures (incl. book building platform, place of listing or issuer (I)CSD)!

A common template / model for pan-European EUR denominated debt – potential elements

- Such a common (optional!) template could target plain vanilla high quality EUR denominated debt issued by interested issuers and could be built on e.g.:

In the economic / legal terms domain:

- Common term sheet template (representation, field names, allowed values)
- Single calendar, business day, day-count, rounding convention
- Single reference rate / rate calculation (for floating rate instruments)
- Common document templates (to the extent allowed by legal / regulatory differences between jurisdictions)

In the issuance process domain:

- Single investor identification scheme and KYC procedures (principles)
- Single data model / data library for term sheet and / or book building data and messaging
- Common principles / rules for book building and allocation process (e.g. transparency of ex post deal data, etc.)

In the post-trade domain:

- Common settlement cycle (already standard)
- Application of SRD2 industry investor identification standards
- Use of European CA rulebook (issuers' and intermediaries' adherence to SCoRE, CAJWG and T2S CA standards)
- Common rules / arrangements to prevent / resolve conflict of law issues
-?

A common template / model for pan-European EUR denominated debt – benefits

- By providing a standard ‘package’ of key features with a common label investors would know what they get without the need to
 - Read / browse / do due diligence on prospectuses and final terms, legal documents when investing in primary or even more importantly in secondary markets
 - Try to infer key characteristics based on poor proxies such as the country code in the ISIN pre-fix
- By creating an organic convergence to standard elements such a label could promote / catalyse standardisation in general (i.e. even for securities not issued under the label)
- Would clearly contribute to the EC’s Capital Markets Union initiative and to promoting the international role of the euro
- A coherent label would also help accelerate the ECB eligibility request and assessment process (see living example of the STEP label)
- As for branding / labelling a common ISIN pre-fix could be considered (but this is only the branding and not the substance of the harmonisation!)

A common template / model for pan-European EUR denominated debt – challenges / barriers

- A common template would not solve the issue of existing legal and fiscal differences between jurisdictions (e.g. place of issuance, potential conflict of laws, etc.) that is a key concern for issuers and investors today (for which they use, inter alia, the ISIN pre-fix as a poor proxy)
- In some of the example elements mentioned above the industry cannot create harmonisation on its own and depend on external actors (e.g. adoption of LEI for investor identification, regulatory actions on KYC, differing national implementation of European legal acts, WHT procedures etc.)
- A common template / model has to take into account different product characteristics or be created only for a narrow product set (e.g. plain vanilla EUR MTNs)
- A common template could create a European market / pool for European benchmark but will not eliminate fragmentation between national markets

A common template for pan-European EUR denominated debt – summary outcome of WS discussion

- Some of the WS participants believe that there is a good potential in such a label to contribute to a more harmonised and integrated debt issuance landscape while others were sceptical with regards to its added value
- The elements listed on slide 7 as examples were considered a good starting point by the majority of the participants, at least on discussing such a potential label further and to clarify its scope
- These elements are already part of the DIMCG Pillar 2 analysis and the main different with this label is the potential bundling of them (as an option)
- It was emphasized that the feasibility of the individual elements of such a label should also be carefully analysed and discussed,
- Some members noted that – especially in the short term – such a label may add to the fragmentation rather than reducing it by creating yet another segment of European debt markets.
- Others commented that this standardised label would add another, truly European, choice to the market and add to competition not to fragmentation

A common template for pan-European EUR denominated debt – summary outcome of WS discussion - *continued*

- Some members stressed that without additional harmonisation in fiscal rules (WHT) and national legal requirements / regimes the label may not add value and not achieve much.
- Others mentioned that even in the absence of fiscal and legal harmonisation across Member States, such initiative could act as catalyst for change in the EU
- Broad consensus on such a potential label remaining optional and on preserving the free choice for stakeholders to use segments / procedures they wish (should not impede competition)
- In further work on such a concept the scope should be made clearer (e.g. which issuers, CeBM ?)