ICMA
International Capital Market Association

The European Central Bank
Sonnemannstrasse 20
60314 Frankfurt am Main
Germany

(submitted by email to EDDI.Initiative@ecb.europa.eu)

9 July 2019

Dear Sirs,

EDDI – Market consultation on a potential Eurosystem initiative regarding a European mechanism for the issuance and initial distribution of debt securities in the European Union

The International Capital Market Association (ICMA)[1] is submitting its response to certain aspects of the above consultation.

ICMA is a membership association, headquartered in Switzerland, committed to serving the needs of its wide range of members. These include private and public sector issuers, financial intermediaries, asset managers and other investors, capital market infrastructure providers, central banks, law firms and others worldwide. ICMA currently has 571 members located in 62 countries. See: www.icmagroup.org.

This response has been prepared with comments requested from ICMA's market wide stakeholders, including public sector issuers, primary market underwriters and secondary market banks, asset managers, post-trade market participants and infrastructure providers. We have received a range of different views from our members and different constituencies and have sought in our response to be balanced and constructive while also conveying market concerns.

ICMA agrees with the publication of any related personal data included in the comments on the internet. ICMA declares that it has obtained consent for the publication of such personal data from the involved persons.

We set out our response in the Annexes to this letter and would be pleased to discuss it at your convenience.

Yours faithfully,

Martin Scheck
Chief Executive

[1] European Transparency Register #0223480577-59

Annex 1 – General points

ICMA has identified the following issues that should be addressed for the successful implementation of EDDI:

1 Governance framework: The involvement of market users in the detailed design – through a user requirements document – and future governance of the project will be critically important to the success of EDDI, if a decision is taken to go ahead.

2 Cost and liability: As users will pay for EDDI through cost recovery, market involvement will help to keep costs acceptable for users and under control. Users will also want to understand the allocation of liability between the ECB/Eurosystem and private sector actors.

3 Optionality: It will be important to ensure that use of EDDI is open, optional, and neither mandatory nor a monopoly. Users of EDDI can then determine whether there are incentives and commercial or other advantages to use it, rather than being required to use it whether it provides value for money or not. Incentives to use EDDI need to be sufficiently clear for the activity to flow naturally through, and consolidate on, the platform.

4 Data: the use, privacy, and regulation aspects of, and rights to the data generated by EDDI will need to be clearly understood and acceptable to users. There are market concerns about the ECB having access in particular to confidential data regarding investors and their relevant trading activity.

5 Neutrality: It will be important either to demonstrate to the market that EDDI is neutral, as intended, as well as on the overall expected net benefits. This is because there will be concerns in the market that EDDI will not be neutral in the medium term, for example in relation to the competitive landscape for intermediation and syndication fees.

6 Capital market integration: EDDI could play a significant role in promoting Capital Market Union and the international use of the euro. But there are significant constraints within which EDDI as a pan-European project will need to work: national legal systems including differing insolvency regimes; national tax systems; and different national government auction mechanisms. Even so, there are still potential opportunities relating to greater transparency and standardisation of euro area sovereign bond terms and conditions.

7 Auction vs. syndicated issuance: Some market participants believe that there is more scope for harmonisation and rationalisation in the auction process whereby different processes and systems are used by various issuing entities or issuers and that market participants would benefit from harmonised processes and a system for EU sovereign and SSA auctions. The US auction platform run by the FRBNY is seen as a success in this regard, for example.

8 Non-euro issuance: EDDI is designed as a pan-European issuance platform for euro area issuers accessing the euro capital markets, as currently there are only national or international platforms. But many issuers in euro also issue in US dollars and other currencies. This means that they will continue to need to use more than one platform, which will involve using different models. Over time the platform should develop multi-currency functionality allowing it to become a one stop shop for frequent borrowers.

9 Systemic risks: It will need to be clear to the market how EDDI will provide a buffer against systemic shocks. Does this amount to the use of central bank money and trust in the ECB rather than private sector alternatives?

10 Perceived conflicts of interest: The ECB is globally the largest holder of euro area bonds as well as a major investor in sovereign, supranational, agency, covered corporate and asset backed securities. If it also provides a platform for such issuers, this information advantage could constitute a significant conflict of interest. How should this be addressed? It will also be important for the ECB to explain to the market why EDDI is within the ECB's mandate.

11 Pre-issuance: Market participants, including some public sector issuers, will need to be convinced that the pre-issuance role of EDDI is not a solution looking for a problem and many believe that the current market works well for them with low execution risks. What is the evidence that issuers are paying too much and that investors consider that conventional pre-issuance processes, which are often iterative, complex and difficult to replicate substantially through available technology, are sub-optimal? More empirical evidence would be useful to help convince the market.

12 A project in two stages? We are finding that there is more of a consensus in favour of the post-trade potential of EDDI, on grounds of rationalisation of the existing fragmented structure and attendant cost efficiency, than on the pre-issuance platform, at least at this point in time. Market participants also will need to be convinced why the two parts of the EDDI initiative (which are stated to be both voluntary and modular) must be implemented together rather than in two stages, with the post-trade platform being introduced first, and the pre-issuance platform being implemented later.

Annex 2 – Specific questions

1. *Question 1: Please provide your views on the description of the European ecosystem for the issuance of debt instruments, in particular as regards whether you deem other actors, elements or processes relevant to complete the picture.*

   The consultation paper's description captures the main actors, elements and processes appropriate at least at this early stage of the initiative to allow it to progress. The proposal today is naturally going to be higher in concept, without having all the technical details worked out. All the better to keep it less complicated to enable wider understanding and early buy-in from market participants. Moreover, as EDDI is developed over time, additional relevant actors, elements and processes may be identified and included. One area that could be explored, for example, is whether later EDDI might serve as a basis for improving sovereign issuer prospectus disclosure and standardising sovereign bond terms and conditions, the modalities for which vary considerably among Euro area sovereign borrowers.

2. *Question 2a: Do you think that there is a structural issue in the current debt issuance and distribution in the EU, seen from the perspective of a single capital market? If so, what is your view regarding the underlying causes of this structural issue?*

   Regarding post-trade processes, we generally agree with the statement that the existing multiple channels "are neither neutral, nor pan-European by construction" and that this fragmented, siloed structure results in a non-level playing field with respect to location as well as unnecessary costs.

3. *Question 2b: Do you face problems or see problems for issuers when reaching out to a pan-European or international investor base? If so, please specify.*

   With regard to post-trade processes, while some supranational issuers do not see a particular problem reaching relevant investors, we understand from other relevant issuers that they would welcome and benefit from the ability to distribute and settle debt issues with EU based investors on a more consistent, efficient and centralised basis.

4. *Question 2c: What are the main considerations for issuers and/or their agents/dealers when choosing a place of issuance and a service provider?*

   This of course can vary both from issuer to issuer as well from one issue to the next for the same borrower. Obviously cost of funding is likely to be paramount, however, an important element and consideration of this are the related execution, distribution and post-trade fees and administrative costs and associated time involved. Other factors would include diversification of an issuer's investor base geographically and in certain other qualitative respects.

5. *Question 2d: What is your view on the statement that there is a need to improve competition and level playing field conditions regarding the access of banks, investors and CSDs to debt securities?*

   As mentioned above, the existing multiple channel, siloed structure is an impediment to a more neutral, efficient and competitively fair market.

6. Question 2e: Would the improvement in the neutrality, harmonisation and pan-European reach support and develop further the issuance of debt in euro?

It should in our view, regarding post-trade processes, though that depends of course on the final realisation and efficacy of EDDI. As with other changes to the status quo in markets where adoption is voluntary, a key factor will be the existence of sufficient economic and other incentives for its acceptance and use by issuers, investors and other market participants.

7. *Question 3a: Do you think that there is a need for further harmonisation and standardisation in the area of debt securities issuance?*

Yes. There appears a consensus, with certain caveats (e.g., data use; conflict of interest), among ICMA members with the paper's analysis in this regard with respect to post-trade processes.

8. *Question 3b: Should the work on harmonisation/standardisation cover the full transaction chain, i.e. from pre-issuance to post-trade?*

On balance our members are of the view that there are potentially materially greater benefits for more different types of market participants from harmonisation of the post-trade environment offered by EDDI. Modernisation of certain – not all - pre-issuance processes is already a possibility via private sector agents, for example, direct access to issuer by some investors, however, direct access raises concerns with some of our public sector issuer stakeholders specifically regarding fulfilling know-your-customer ("KYC") and client onboarding responsibilities. While offering an official sector provided pre-trade technical facility might have some benefits, we have found that a number of market participants do not see a compelling need for harmonisation in this regard. It should remain freely the choice of issuers and investors to alternatively use private sector solutions, for example direct electronic access, or use no such facilities.

9. *Question 3c: What are your views regarding the pre-issuance harmonisation items/topics? Which processes should be looked at?*

See our answer to question 3b.

10. *Question 3d: What would you consider the best way forward, for example in terms of methodology and governance, for fostering harmonisation in this area?*

Pre-issuance includes certain hi touch human interactions - negotiation, consultation and considered judgements and accompanying advice - features that are not as readily automated. Prescription by rule and standardisation in this respect may be impractical and have certain disadvantages. Some issuers indeed might prefer to preserve the flexibility of these aspects of the pre-issuance stage in order to achieve the most optimal execution outcomes. There is therefore a challenge with harmonising pre-issuance further without at the same time imposing a mandatory and rigid governance or monopolistic regime. While EDDI is intended to be voluntary, there are concerns that it may in any event come to dominate (and participants may feel pressure to favour its use) over other alternatives, as it is an official sector facility. On the other hand, there are specific pre-issuance areas that more readily lend themselves to standardisation, for example, regarding data and communication. A free and competitive market approach would favour encouraging development and implementation of alternative market sourced technological solutions without preferring any one system or offering. To the extent that one or more of these solutions proves decidedly useful and appealing, market forces should work to result in better standardisation of previously more ad hoc and inconsistent processes. As mentioned, private sector digitalisation solutions for the primary market already exist and may over time transform how primary markets operate today, irrespective of EDDI.

11. *Question 3e: Is there a need to reinforce and/or support with EU regulation any harmonisation efforts in the area of pre-issuance?*

    Based on our response to question 3d we do not believe regulation is the appropriate means of encouraging harmonisation in the area of pre-issuance.

12. *Question 3f: Do you see any other efforts that could help resolve the current market fragmentation?*

    Please see our response to question 3d.

13. *Question 4a: Do you think that the establishment of a European market infrastructure service could potentially address the lack of neutrality and pan-European reach in the current debt securities market? If not, what other solution would you propose?*

    Based on the description set out in section 4.2 of the paper, this could improve neutrality and extend reach for borrowers and investors. EDDI should be available to all borrowers in recognition of there being a global market.

14. *Question 4b: Do you think that this service, as described above, exists today in the EU? If not, should it be offered by a private entity or a public entity, and why?*

    While several market participants are of the view that the service should be a commercially run operation, it may be that initially some combination of public/private cooperation, with the public sector providing the basic framework and sponsorship, but later contracting out the operation of the services to the private sector should be considered.

15. *Question 4c: Is there a need to combine both approaches, i.e. a Europe-wide harmonisation initiative and the provision of a European market infrastructure service, and why?*

    Our view is that the infrastructure service, if successful, will facilitate further harmonisation.

16. *Question 4d: Do you see a need for the Eurosystem to support those actions? If so, how?*

    No response.

17. *Question 5a: What is your view regarding the inclusion of the pre-issuance and post-trade functions in a potential EDDI initiative?*

    We noted above in our answer to question 3d that there are certain features of pre-issuance that might not easily or should not necessarily be harmonised. At the same time other aspects, particularly processes including communication, data, indications of interest, book building and order transmission may be practically and beneficially standardised. Linking or integrating these pre-trade processes with the post-trade settlement and clearing functions is an important goal of EDDI and offers the potential for efficient straight through processing.

18. *Question 5b: What is your view regarding the concept of the optional and voluntary usage of the two EDDI components for all relevant EDDI stakeholders/users?*

    Use of any part of EDDI should be fully optional and voluntary.

19. *Question 5c: What do you think are the relevant debt issuers that could benefit from, or would be interested in, issuing via EDDI and why?*

Euro area sovereign issuers chiefly. We understand that supra-national and agency borrowers in the EU (with some exceptions, including the EFSF and ESM) settle in similar fashion to corporate issuers - through the ISCD's, Euroclear and Clearstream, i.e, where settlement is not as fragmented.

20. *Question 5d: Should access to EDDI be restricted to certain classes of issuers? If so, why?*

There would seem to be no reason to restrict access to certain borrowers.

21. *Question 5e: How would the benefits of EDDI change if access to EDDI were restricted to certain classes of issuers, e.g. public or supranational, sub-sovereign and agency (SSA) issuers?*

See our answer to question 5d.

22. *Question 5f: Should access to EDDI be restricted to certain CSDs?*

It is not obvious as to why EDDI should be restricted to certain CSD's.

23. *Question 5g: In your view, which criteria should an EDDI service meet in order to be attractive for your institution?*

No response.

24. *Question 6a: What are your views on the expected impact of EDDI on the market in general and on your institution in particular?*

No response.

25. *Question 6b: Which other elements do you consider relevant regarding the potential impact of EDDI, beyond what is described above?*

No response.