

Euroclear response to the Commission's consultation on the Green Paper on the Feasibility of introducing Stability Bonds

This response is provided on behalf of the Euroclear group of companies ("Euroclear"). Euroclear comprises the International Central Securities Depository ("ICSD") Euroclear Bank ("EB"), based in Brussels, as well as the national central securities depositories ("CSDs") Euroclear Belgium, Euroclear France, Euroclear Nederland, Euroclear UK & Ireland Limited, Euroclear Finland, and Euroclear Sweden. It also includes Xtrakter, a provider of trade matching and transaction reporting services based in the UK.

Euroclear is registered on the European Commission's register of interest representatives (ID number 88290282308-75).

Euroclear group welcomes the opportunity to contribute its views on this topic. As market infrastructures actively involved in significant portion of the issuance and safekeeping of Euro-zone government debt, we support all initiatives that will make the functioning of financial markets more efficient and that leverage the specific role of these infrastructures.

We believe that the effectiveness and success of this policy initiative can only be fully achieved if all aspects – as it affects to primary and secondary markets - of the issuance of securities are carefully taken into consideration in the design of the options best suited to meet the specific goals of the proposed common issuance.

KEY POINTS

- Euroclear does not wish to express a specific preference for any of the options for structuring Stability Bonds (or to opine on the fiscal framework for such instruments).
- The determination of the right approach for the issuance of Stability Bonds cannot be made solely on the basis of fiscal or monetary policy considerations.
- The success of the issuance of the Stability Bonds will also be determined by the appropriate primary market issuance and distribution process allowing it to be smoothly and efficiently placed with the widest possible group of investors in the EU and globally.
- The choice of settlement venue and the access it offers to the broadest possible investor base is a key driver of a successful issuance and placement of international issues.

SPECIFIC COMMENTS

The Euroclear group CSDs and the ICSD Euroclear Bank play a crucial role in the international distribution of Euro-zone government debt, including debt issued by the European Financial Stability Fund, and by the European Investment Bank.

Euroclear acknowledges and agrees with the rationale and pre-conditions for the issuance of Stability Bonds which are outlined in the Green Paper. We do take note that the underlying rationale includes elements of reinforcing financial stability, improving market efficiency and enhancing the role of the euro in the global financial system.

As market infrastructures at the service of domestic and global debt and equity markets¹ we are of the view that decisions on the options for structuring any type of financial instruments are the exclusive remit of the issuers (in casu, the EU member states).

We therefore do not wish to express any specific preference for any of the options for issuance of Stability Bonds (as described in Section 2) nor to opine on the fiscal framework for such instruments (Section 3).

Given our specific expertise in the post-trade segment and taking into account the recent developments in the sovereign government debt markets of the EURO-zone, we believe it is of paramount importance that the determination of the right approach for the issuance of Stability Bonds is not made solely on the basis of fiscal or monetary policy considerations. This choice should equally take into account

- the nature and structure of the proposed Stability Bonds and the appropriate issuance and distribution process as this will determine the attractiveness of the instrument chosen and the ease with which it can be targeted at the broadest possible group of investors in the EU and globally;
- the technical and operational aspects that are key to an efficient and successful implementation of the issuance and distribution of the proposed Stability Bonds.

Our focus is therefore on Section 4 "Implementation Issues".

The Green Paper focuses mainly on the institutional and organisational set up of issuance - through a centralised EU Debt Management Office (DMO)² or alternatively in a decentralised fashion through national Treasuries or DMOs - and how the designated institution(s) will on-lend the funds and organise repayment of the funds. We would like to complement this analysis with some market-facing considerations of how the designated issuance body will operationally interface with primary markets and the drivers for successful and smooth issuance. For ease of reference this response will further refer to DMO as the issuance body.

A DMO has 2 options for distributing securities in the primary market:

- Option 1 – the DMO builds an *auction platform* (as is a common practice in the Euro-zone states) and holds auctions to sell the Stability Bonds. All the pan-

¹ The Euroclear group CSDs support domestic debt and equity markets in 7 EU countries. Euroclear Bank is a gateway for foreign domestic investment in Europe. It plays a crucial role in the issuance and distribution of international debt with a value of €9trillion. It also holds over €3.5 trillion EU sovereign debt (including EFSF) mainly for international (non-EU) investors.

² either the Commission, an entity resulting from the transformation of EFSF/ESM into a full-scale DMO or a completely newly created DMO

European and even international Primary Dealers should be participants of the auction platform.

- Option 2 – the DMO uses an *international syndicate of banks with underwriter(s)* to sell the securities in the primary market.

Under Option 1, Primary Dealers will join the auction platform, if the distribution can be done efficiently, i.e. if they can resell most of their purchased bonds in a very short time-frame and minimise their related funding needs. As the nature of Stability Bonds clearly is international (i.e. they are pan-European as opposed to domestic instruments), the counterparts to whom the Primary Dealers will resell the Stability Bonds will de facto also be international as well. In light of this it is important that the distribution occurs in a settlement venue which offers access to a maximum number of international investors.

Syndicate banks, who take part in the distribution under Option 2 have similar concerns regarding their capacity to resell the Stability Bonds to investors without incurring undue funding costs and will also prefer that the distribution is done through a settlement venue where they can transact against as many international investors as possible.

The distribution can occur either in a domestic CSD or in an International CSD (ICSD). The choice for a domestic CSD could be based on specific criteria such as the country which is to benefit from the proceeds of the Stability Bond issuance. If such criterion does not come into play, but instead the capacity to reach foreign investors in the EU or outside the EU is the main driver, issuance could be through an ICSD, which is independent of the country benefitting from the proceeds of the Stability Bonds. ICSDs offer direct access to a wide array of global investors.

Both scenarios have operational consequences, which can best summarised as follows:

Case 1 – Distribution in a domestic CSD

- Since the bulk of final investors in Stability Bonds are likely to be international investors who hold their assets in the books of the ICSDs, the primary dealers/syndicate banks will need to transfer positions from their accounts in the issuer CSD to their accounts in the ICSDs (cross-border transactions) followed by a book-entry transfer of positions to the international investors in the ICSD. Cross-border transactions take time and hence the primary dealers/ syndicate banks will have to fund these transactions for this entire period (often overnight). In the present conditions of strained liquidity, primary dealers/ syndicate banks will only participate in the auction process if they don't face liquidity problems.
- Since the Stability Bonds are common bonds, the investors will expect to receive the same level of service for each bond irrespective of which country benefits and which CSD holds the securities. Note that service levels are not equal across all CSDs in the EU-zone.

Case 2 – Distribution in an ICSD

- All the international primary dealers and syndicate banks have accounts in one or both of the ICSDs. They will onward sell their bonds via internal transfer in the books of the ICSDs to international investors also in the books of the ICSDs.
- ICSDs provide a comprehensive level of service across the international securities they handle which is widely recognised by a global participant base.

The above illustrates how the choice of settlement venue and the access it offers to the broadest possible investor base is a key driver of a successful issuance and placement of international issues. This has been recognised by international issuers like the European Investment Bank which accesses international debt markets through the issuance of Euro Medium Term Notes issued through the ICSD.

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