SBBS Panel Discussion
01-03-2018
## Objectives of Sovereign Debt Management

- **Minimise the cost of debt**
  - Within the boundaries of sound risk management
  - In line with monetary and budgetary constraints
    -> **TAX PAYER**

- **Achieve appropriate level of transparency in terms of**
  - Market presence – curve - consistency
  - Pricing and conditions – continuous availability of prices

- **Level playing field**
  
  Same conditions for all potential investors

### IN PRACTICE

*In order to achieve these objectives:*

Sovereigns issue: **SIMPLE – STANDARDISED – LIQUID BONDS**
Sovereign Debt Markets in the Eurozone

Holdings of government bonds

- Size sovereign debt markets: € 9 trillion
- Investor base outside Euro zone: 26%
- In € zone holdings almost equally divided between 4 large “investor” types
- Banks represent only +/- 1/6 of interested investors in sovereign debt
• Strategic objective: increase financial stability of banking sector by reducing BANK- SOVEREIGN NEXUS

• SBBS will be demand-led product

• No mutualisation of RISK for SBBS issuer or Member States

• No increase in Issuance cost for Member States
Reducing bank-sovereign Nexus: absolute priority

Is SBBS the right instrument?

*Nature of the instrument: SYNTHETIC*

- Very complex instrument backed by highly correlated cover pool.
  - How will bonds behave in an adverse environment?
  - Risk creation versus risk reduction

- 3 tranches are meant to be issued and sold simultaneously: investor base for 3 tranches
- Questions wrt rating of senior tranche
What is the demand for a synthetic product and will it fulfil the objective?

IF size is SMALL

- Strategic objective requires issuance huge size of SBBS
  - Given the size of the bank investor base → 1.5 trillion
  - Given relative size of the bank investor base in the global investor base → 17%
  - Given the tranching with 70% being senior

- Huge size is required in order to have a liquid and attractive product with full price transparency and a near-cash instrument

IF size is HUGE

- What will be the effect on the liquidity of the underlying and how will this affect the pricing of the underlying and hence the cost for the TAX PAYER
Product set-up

Cover pool:

• Construction of a COVER POOL by PUBLIC or PRIVATE entity
  Acquisition of the sovereign bonds cover pool and structuring and simultaneous
  selling of the various tranches is COSTLY

• COST =

  → MUTUALISATION of RISK in case of a PUBLIC structurer

  → Impacting the attractiveness of SBBS in case of PRIVATE issuer:
    Cost absorption in the price of the tranches
Costs of SBBS

What are the COSTS?

1. Costs related to the funding/warehousing and market risk management of the cover pool
2. Cost related to the structuring of the SBBS and selling of the SBBS in the market

Why? Construction of Cover Pool

• Through Primary market participation as an investor → equal treatment of investors

• Through secondary market buying → importance of gradual buying
  • In order not to affect the liquidity and pricing in national sovereign debt markets
  • And ultimately pricing of SBBS
CONCLUSION

Challenging product

- Can only fly if some regulations wrt securitized nature are changed

- Concerns
  - Complexity of product
  - Be aware of costs related to the product creation
  - Be aware of the effect on liquidity and pricing of real sovereign debt financing product