SBBS Panel Discussion

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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

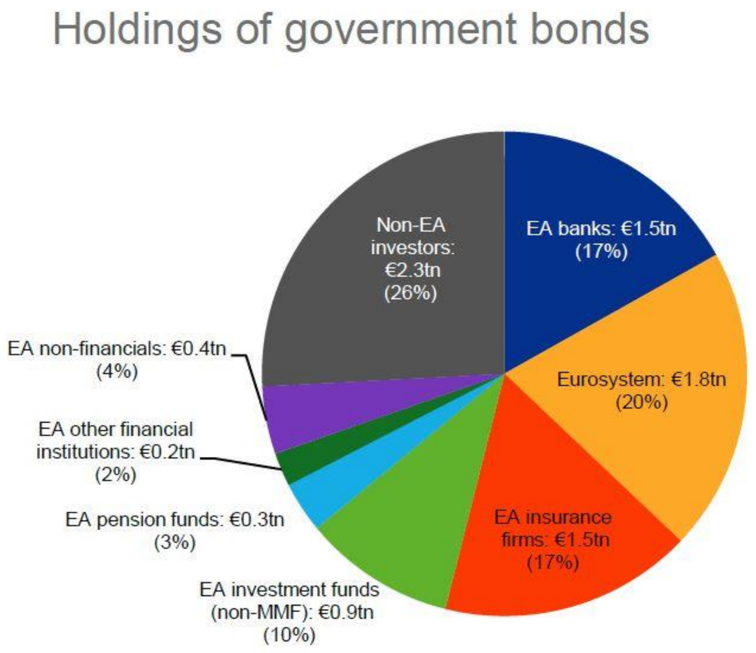
  Same conditions for all potential investors

IN PRACTICE

In order to achieve these objectives :

Sovereigns issue: **SIMPLE – STANDARDISED – LIQUID BONDS**

Sovereign Debt Markets in the Eurozone



- 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

SBBS

- 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

Demand-led Product

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