

Meeting of the ECB’s Bond Market Contact Group – 12 June 2019

Summary of the discussion

1) Bond market outlook

Fabio Noacco (Mediobanca) reviewed the main bond market developments over the last quarter and provided the outlook for the second half of the year. In particular he focused on the structural character of the recent trade tensions, what it implies for global interest rates, and how Italian sovereign bond trading is likely to be affected going forward.

In the subsequent discussion, several members were of the opinion that market participants had already priced in further ECB easing measures. Many members expressed the view that a deposit facility tiering system would send a strong easing signal. At the same time, several members cautioned that the positive impact on banks’ balance sheets from a tiering system was somewhat limited and it could ease pressure on banks located in excess-reserve rich jurisdictions to participate in cross-border money market operations. According to these members, the steepness of yield curves could be more relevant than the yield level for a proper functioning of the banking system, and therefore a proper transmission of ECB monetary policy.

Members were of the view that most market participants were well-prepared in the event of a “hard Brexit”. Some smaller banks were still in the process of preparing their legal documentation. In terms of financial market functioning, cliff-edge effects would likely be avoided, although some market turbulence was nevertheless likely. The mutual recognition by the Bank of England and ESMA of central counterparties (CCPs) and central securities depositories (CSDs) meant that stock, bond and derivatives transactions would not face immediate disruption in a no-deal scenario. In the near future, one important cliff-edge risk that remained was regarding the post-Brexit exchange of information under the General Data Protection Regulation (GDPR).

2) Update on sustainable and responsible investing (SRI)

Carsten Quitter (Allianz) and Tatjana Greil Castro (Muzinich) provided an update on SRI.

All members were of the view that SRI had crossed a tipping point and had become a mainstream topic among market participants. There had been a sharp increase in client demand

for financial products that adhere to SRI principles. Members also stressed that while “green” bonds often captured the headlines, to investors social and governance aspects were equally important in this context. Moreover, market participants were in the middle of a steep learning curve. Some scepticism still remained on data quality and greenwashing risk, as many important questions on how to implement SRI in investment processes remained unresolved, despite numerous private sector initiatives to bring greater transparency and clarity.

Members reported that many large investors increasingly engage with issuers/companies as part of their SRI process, rather than relying exclusively on environmental, social and governance (ESG) ratings or scores. Moreover, several members also reported that investors were trying to “look through” individual bond issuances that had a certain label. Instead, investors looked at the overall ESG credentials of a given issuer. One member also saw this increased need for engagement as an opportunity for active asset managers to differentiate themselves from passive ones.

Some members reported of “disclosure fatigue” due to a lack of standardisation. Investors that engaged with issuers/companies to obtain information about their ESG credentials did so in the form of non-standardised requests, which created substantial amounts of work for both sides. Such requests are particularly difficult for smaller investors and issuers, as they do not have the capacity to allocate resources to obtain or produce the required information. Members were of the view that disclosure fatigue could momentarily inhibit faster adoption of ESG standards, but it would not stop the global trend.

According to members, market participants look to the public sector to provide the financial sector with a concrete categorisation for sustainable activities, as well as harmonised transparency requirements. Market participants were closely watching ongoing work in the context of the commission’s action plan on financing sustainable growth and the Network for Greening the Financial System (NGFS).

3) The transition of risk-free rates and the reform of interbank offered rates (IBORs)

Stephanie Broks (ECB) provided a short update on the €STR. Jozef Prokes (Blackrock) and Christoph Rieger (Commerzbank) reviewed the overall progress of the transition to the risk-free rates and the reform of IBORs, with a focus on the potential impacts for bond market functioning.

Members observed that, in the USD and GBP markets, uptake of the new reference rates had been fast and smooth. As a consequence, members thought that, in the majority of cases, the transition to the hybrid EURIBOR methodology was also likely to work smoothly. Some members were of the view that there was a possibility that euro area market participants might refrain from issuing EURIBOR-based bonds, instead using an overnight index such as the €STR, as this is what happened in the GBP market space. As such, market participants moved away from term index rates (e.g. 12m LIBOR) to overnight index rates (SONIA).

At the same time, some members were concerned that, in a number of cases, the floating-rate bonds' documentation was not designed for the disappearance or reform of a reference rate.

This documentation was often designed to cater for eventualities when the underlying reference rate might be unavailable for a few days. In several cases, the documentation stipulates that, should the reference rate be unavailable, the last date that the reference rate was available should be used. The use of such language would effectively turn a floating-rate bond into a fixed-coupon bond. Other types of documentation give the issuer discretion over how to replace the reference rate and at which spread, thereby putting the investors at a disadvantage. Due to the very long lifetime of euro area residential mortgage-backed securities (RMBS) and their reliance on EURIBOR, some members viewed them as particularly challenging in the context of this transition..

ECB participants mentioned that the working group on euro risk-free rates was scheduled to release a legal action plan for the transition from EONIA to the new €STR risk-free rate.

Thereafter, the group would also work on recommendations concerning the fall-back rates for EURIBOR in financial contracts.

4) Closing remarks by Benoît Cœuré, Member of the Executive Board of the ECB

Mr Cœuré thanked the members for their regular participation in the BMCG. He then spoke about the effects of asset purchase programme (APP) reinvestments on euro area bond markets.¹

¹ See Cœuré, B. (2019), "[The effects of APP reinvestments on euro area bond markets](#)", closing remarks at the ECB's Bond Market Contact Group meeting, 12 June.