

**The ECB's Corporate Sector Purchase Programme
Meeting with the ICMA Secondary Market Practices Committee
November 2016**

On 3 November 2016, The ECB attended a meeting of ICMA's Investment Grade Corporate Bond Secondary Market Practices Committee (SMPC) to discuss the progress of its Corporate Sector Purchase Programme (CSPP) with ICMA members.

The ECB began the discussion with a brief progress report on the implementation of the CSPP to date:

- As of end-October, there had been €38 billion of purchases made, covering around 680 bonds, 180 issuer groups, and 18 issuer countries (measured by country of risk).
- The share of primary market purchases increased in September, to 19.7% of total monthly purchases, from 3.7% in June.
- Trade tickets are primarily smaller sizes (around 60% of tickets less than €10 million). Around 10% of trades are in clips above €50 million.
- More than one third of counterparty offers received are in bonds issued in the past year.
- Secondary market yield spreads initially declined and later stabilized, with non-eligible bond spreads also tightening.
- ECB staff analysis suggests that the CSPP has been the main driver of the decline in corporate bond yields in the two-week period after the announcement of the Programme in March 2016.
- As of end-October, around 15% of eligible bonds traded at negative yields (compared with practically none at the beginning of the year).
- Overall issuance has increased since the CSPP announcement, while the share of euro-denominated issuance has remained stable, and there has been no notable increase in euro-denominated issuance of corporates outside of the euro area.
- Borrowing costs for non-financial corporates (NFCs) have been declining and converging across countries.

The key points arising from the discussion with SMPC members are summarized below:

Major impacts of the CSPP: The forum noted that the corporate bond market had become more expensive as the CSPP introduced a large, structural buyer to the market. From the fund manager perspective this was changing the way that funds were being managed, particularly in terms of selecting between eligible and non-eligible bonds. For example, there was now a preference for lower-rated, subordinated debt, since these assets afforded more protection against interest rate volatility. This was also changing behaviour in the primary market, where fund managers were becoming more selective in terms of target levels, and not participating where issues came below those levels. In general, it was felt that the CSPP has been relatively successful to date, and the level of purchases was above expectations without having too much impact on market liquidity. However, ultimately corporate bonds remain an illiquid asset class and so there are some concerns about how much the National Central Banks (NCBs) can buy, particularly given an individual ISIN limit of 70% of issuance.

Private placements: The ECB clarified that it does not rule out using private placements, which is a normal market practice, however its maximum 70% issue limit would still apply. This would therefore require other participants to purchase at least 30% of any issue.

Liquidity impacts: The forum suggested that since the announcement of the CSPP, the Programme had helped support the bid-side of the market, and, while this was likely to be a short-term effect, at the margin it could be argued that this has improved liquidity. However, the longer-term impact may not be so positive, particularly where the ECB does buy 70% of any issue, which will naturally erode liquidity in those lines. It was suggested that the ECB consider not only publishing the ISINs of bonds purchased under the CSPP, but also the quantity of bonds purchased, which would help the market to assess better the potential liquidity of different issues. It was also noted that many buy-side firms who purchase bonds in the primary market can be tempted to sell their bonds back into the secondary market shortly after in the event that the bonds tighten through target spreads, and which helps add to secondary market liquidity.

On the 70% ISIN limit, the ECB commented that this was consistent with the other private sector purchase programmes.

The sell-side perspective put forward largely corroborated the experiences relayed by the buy-side members. It was noted that there had been a squeeze on spreads and liquidity post-announcement, but it was felt that this was unsustainable and it was expected that conditions would correct. Since the start of the Programme, volumes had held steady, and liquidity had not noticeably reduced. What did seem to be happening, however, was that there was now more focus on client and dealer axes. One concern, however, was going into year-end, with the seasonal thinning of liquidity, and the potential impact should the ECB continue at its current rate of purchases.

The ECB commented that the overall Asset Purchase Programme (APP) target of €80 billion per month was embedded with some flexibility to reduce or increase monthly purchases taking into account market conditions at specific points in time.

Reverse auctions: A further suggestion was that the ECB consider using a reverse auction mechanism similar to the Bank of England's Corporate Bond Purchase Scheme (CBPS), which would not only provide an advantage to the buy side who would be able to tender blocks of specific holdings, but would also potentially allow the ECB to purchase more bonds.

With respect to reverse auctions, the ECB's experience with bilateral purchases from the other purchase programmes had been positive and offered a high degree of flexibility. Three of the NCBs did use reverse auctions for some segments in the Public Sector Purchase Programme (PSPP), and it was something that the ECB could potentially consider in the future for the CSPP.

Spread compression: One member raised the point about the impact of the CSPP on spreads on eligible bonds, and asked whether the ECB had considered the outcome for buy-side firms that are required to match liabilities and generate guaranteed returns, such as insurance funds, who had little flexibility in terms of the assets they can buy.

Credit protection features, downgrades, and eligibility: The ECB was asked about the non-eligibility of bonds with certain credit protection features, such as step-up coupons, which had widened with respect to vanilla, eligible issues by the same issuer, and whether they could consider buying these issues.

The ECB noted that such features could be viewed as a positive from an investor perspective, however they were bound by their collateral rules which excluded such bonds, and that issuers would need to consider this if looking to issue eligible bonds. Furthermore, while it was possible that the collateral eligibility criteria could be reviewed in the future, particularly if it was felt it was

necessary, there was no indication on whether this could happen within the current projected timeframe of the CSPP.

On a related theme, the ECB was asked what happened in the event of bonds becoming “junked”, and whether they would continue to hold them, or would have to sell the position.

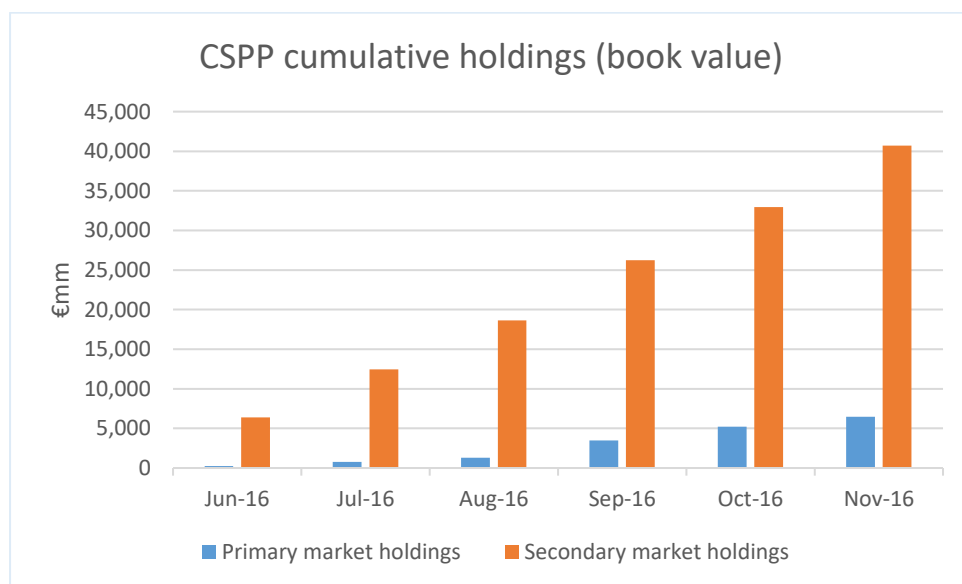
The ECB responded that in the event of a holding being downgraded to sub-investment grade they would assess the appropriate response on a case-by-case basis as also explained on their website.

Changes in participant behavior: The ECB asked the Committee whether the CSPP had changed the way different firms operate in the market, whether in terms of transaction sizes, approach, or other behavioral aspects, including issuance.

One buy-side member responded that as a “bottom-up” investor, who is focused on primary market IPTs (initial price talks), they have had to pull-out of several deals where the ECB is thought to be a buyer, and where the IPTs became squeezed.

An SMPC member suggested that there had been no discernable change in issuer behaviour, and that corporates were very much still driven by their business or refinancing needs.

Other: At the 3 November SMPC meeting with the ECB, SMPC members also commented on the question of a December pause and on the question of extending the CSPP.



Source: ECB

Modifications to the Asset Purchase Programme: Following its meeting on 8 December 2016, the Governing Council announced that it was extending the APP, due to finish in March 2017, to December 2017. The pace of targeted monthly purchases is to decrease from €80 billion to €60 billion from April 2017. However, it is expected that the size of purchases under the CSPP are likely to remain relatively constant at around €5 to €10 billion per month.

Prepared by Andy Hill, December 2016