“Embracing Opportunity From Disruptive Technology” - speech by Siegfried Ruhl

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14/11/2019
Speeches
ESM
London, UK

Siegfried Ruhl, ESM Head of Funding and Investor Relations

“Embracing Opportunity From Disruptive Technology”

ICMA Primary Market Forum
London, 14 November 2019

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Ladies and Gentlemen,

It gives me great pleasure to be among you here today and share with you our experiences of using technology as a public issuer.

In a world facing many disruptive factors such as technological change we often focus on risks and so miss the opportunities.

The European Stability Mechanism was created at the height of risks for the European economy, the euro and the people in the euro area. With the benefit of hindsight, we can say that it was also a time of opportunity even if it didn’t feel that way in the midst of the crisis.

But in the present day we also face risks. What I am about to tell you is that, technological change should be viewed as an opportunity, rather than a risk.

Allow me to offer you one personal experience of this.

A month ago, on a flight back to Europe from the Annual Meeting of the International Monetary Fund in Washington I reflected on meetings I had with bankers.

Only about a quarter of them had spoken about opportunities, the others about risks. I noted that those who were upbeat also reported strong corporate earnings recently.

It vividly reminded me of the impact that searching for opportunities can have on business success.

Technology's progress is unavoidable

We cannot hold back technological advances. The most we can do is delay them.

Perhaps we might find a more productive use of time to identify technological advances, observe how they evolve, and then adapt them to our needs. That way we turn a risk to our advantage.

The Needs of a Public Issuer

If we want to identify opportunities for issuers and especially in the public sector, we have to look first at their needs. The ESM and its predecessor the European Financial Stability Facility have provided a combined €295 billion of financial assistance to five Member States.

Following the successful completion of those five country programmes, our work now continues as an issuer of bonds and bills as we refinance the ultra-long loans that were provided to distressed nations.

We have to be able to raise money not only in normalised times but also in times of crisis with difficult market situations prevailing - when some market participants might be facing challenges of their own.

This is the same scenario for other public issuers such as governments and their debt managers. They have to fund the budget of the state whatever the situation. If they are not able to do this in times of crisis, the crisis gets worse.

For us this could be even more important if we become the backstop for the Single Resolution Fund. We then might be in a situation that we have to raise money when the banking sector is in difficulties.

So given our mandate as a borrower, what attributes does the infrastructure of public sector issuers need? In four words:

- Reliability
- Trustworthiness
- Safety
- Efficiency

Secondary markets went through a deep transformation process over the last two decades in which technology changed massively the means of communication and trading between market participants.

But this didn‘t happen in the primary market where issuance originates. Here we still work like in the 1990s and we lack a front-to-back Straight-Through-Processing solution.

Here, I would say, issuers, investors and bankers are missing an opportunity.

What is more, the needs of issuers are often shared with other stakeholders in bond instrument distribution.

Issuers and investors want a seamless transaction process that identifies bond buying and selling opportunities and then carries them out with the least risk of delay or danger of failure.

Ask yourselves this. Which is the bigger problem? The risk of new technology over which we have some degree of control? Or the risk of new technology which was established by others and at one point we have no other choice than to use it?

Why we see EDDI as an opportunity

The European Distribution of Debt Instruments service, or EDDI, is one primary market opportunity, which the ESM supports.

EDDI is a front-to-end Straight-Through-Processing system, which we believe would be efficient, reduce operational risks, and allow for settlement in Central Bank money.

EDDI would be provided by the European Central Bank, a trusted institution which has already proven itself capable of running complex IT systems reliably.

The ECB, as a central bank, would also ensure that the EDDI service is available even if a crisis comes to financial markets.

So already, it satisfies the key public issuer needs: Reliability, Trustworthiness, Safety and Efficiency.

But it goes on to present other advantages to all stakeholders, investors and banks alike.

EDDI would not cause the disintermediation of the transaction. The roles and responsibilities of banks and investors remain unchanged. Issuers continue to rely on banks, their salesforces and their contacts.

EDDI also improves communication with investors, and increases transparency.

Public Governance would be enhanced because EDDI would be neutral of commercial owners.

Ultimately, EDDI offers the opportunity for a higher degree of standardisation and the strengthening of the euro area capital market, an objective of Capital Markets Union (CMU).

That’s our view of EDDI. But now let me turn to some of the initiatives which the ESM is working on in-house.

How AI can be used to manage investor relations

Investor Relations is another area where we see new technology, big data and Artificial Intelligence as an opportunity. The better we know and understand the needs of our investors, the better we can offer the right product at the right time.

We are currently working on methodologies to assess market conditions based on more criteria than yields and spreads alone. We use a wider range of market data, like exchange rates and commodity prices and combine them with macroeconomic data.

Using machine learning, we want to understand how they impacted investor decisions in the past. When did Central Banks consider the market as attractive, when did it influence the investment decisions of fund managers or insurance companies? Under which conditions did investors from Asia participate and what was attractive for investors from the Middle East?

Based on this we want to draw conclusions for future transactions. Is it better to issue in the 5-year or in the 10-year bond maturities? Is the market ready to absorb a new big benchmark or is it better to go for a more limited size?

While this project is still at an early stage, initial results look promising. Should it be successful ultimately it will be for the benefit of all involved parties of the primary market. There will be lower execution risks and better performance of issuance.

Another area where technology can improve the current situation is the allocation of a transaction. Currently this is a manual and - depending on the orderbook - also time-consuming process.

With an algorithm, which takes more criteria than simply the investor type into account, we want to improve quality and speed of the allocation of our transactions. We want to avoid surprises for investors based on human error. We want to reduce the time and risks of uncertainty between books closing and allocation announcements.

This of course requires a clear and correct identification of the investor, which is currently deficient as we assess different orderbooks from different banks. I highlighted earlier the benefits of EDDI. Here too it can bring a lot of advantages.

One tool, which we have developed, is with the use of Deep Data Analytics. It starts with data from the primary market and also comprises data on trades in the secondary market. The database contains more than one million data points.

This data analysis tool allows us to understand how our bonds are traded in the market. We can see which investor groups from what regions are buying or selling our bonds.

From this information, we draw knowledge that traders typically refer to as “market sentiment”. But what is significant about our tool is that we can now reinforce this market feeling for our bonds with hard data. For us, this information about the market is very important as it gives us unique insights for our issuance strategy. We are already using these findings as guidance for allocation of newly issued bonds.

These are some of the examples where we see opportunities in the use of technology.

Of course, we also have to consider the risks. Data security will be a key challenge in the future. That‘s why we want to have the data held by the ECB.

The structure of the primary market is working well at the moment, that‘s why we want to keep it. What we want to change is the ”how“. This is outdated and needs to change. We want to shape this change in order to manage the risks of the change.

The overriding objective is to create a more stable and resilient capital market, especially for the euro area. Therefore it fits with the political objectives of creating a capital markets union and to strengthen the international role of the Euro.

There are other areas where the ESM is also innovating and changing. One example is in ESG, a theme for the next item on the itinerary at this event. I should just like to add that the ESM is proud to be part of this year’s ICMA Green Bond and Social Principles Advisory Council and to making a contribution to the evolution of sustainable debt markets.

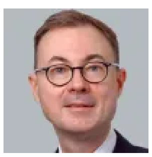
Finally, other discussions to which we contribute include the creation of a liquid European safe asset. All innovations have risks – and they offer big opportunities.

What is certain is that maintaining the status quo is not managing risks. It just feels comfortable. However, that strategy may bear even higher risks than the change it tried to hold back.

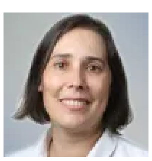
Author

Siegfried Ruhl
Head of Funding and Investor Relations, Funding and Investor Relations

Contacts



Cédric Crelo
Head of Communications and Chief Spokesperson
+352 260 962 205
c.crelo@esm.europa.eu



Anabela Reis
Deputy Head of Communications and Deputy Chief Spokesperson
+352 260 962 551
a.reis@esm.europa.eu

Juliana Dahl
Principal Speechwriter and Principal Spokesperson
+352 260 962 654
j.dahl@esm.europa.eu