

EFSF/ESM target broader investor base with new instruments, prepare US dollar issuances

Both entities will continue their N-bond programme in 2017 and will include the amounts raised in the overall long-term funding. The EFSF and ESM will continue to issue on all parts of the curve and identify pockets of investor demand. As part of the strategy to diversify its investor base and to respond to the maximum investor demand, the ESM will begin to issue in currencies other than the euro. The ESM is preparing a US dollar bond programme.

The introduction of the N-bond programme in 2016 and the scheduled launch of the US dollar bond programme in 2017 adhere to the ongoing strategy of increasing the spectrum of EFSF/ESM funding instruments to widen its potential investor base. It is part of the ESM's mandate to raise capital in the financial markets to support programme countries. The ESM must therefore always be able to raise large volumes at short notice. More funding instruments and more potential investors will assist the ESM in achieving this objective.

Emerging financial technology brings ESM challenges and opportunities

Financial technology (fintech) companies, or “companies that use technology to make financial systems more efficient”²⁴ may well revolutionise the way the financial industry operates. The ESM stands ready to ensure it avoids the threats and seizes the opportunities that this dynamic emerging field presents.

As an IFI that issues billions of euros to fund loans for its programme countries and invests its €80.4 billion in paid-in capital,²⁵ the ESM needs to stay abreast of new innovations in financial technology, which are intended to simplify operations and reduce costs. Additionally, electronic systems that connect issuers to investors directly could further simplify the bond transaction process. Fintech could thus have far-reaching consequences for many ESM departments, including Middle and Back Office, Funding and Investor Relations, Investment and Treasury, Finance and Control, and IT and Operations.

The ESM is actively pursuing the use of fintech in-house, focusing on data analytics. Concretely, the ESM is developing cutting-edge tools to analyse market data and investor patterns. With its unique mandate, the ESM has a particular need to identify and understand the fundamental changes, trends, and evolving mechanics that influence European capital markets. Hence, the ESM is building a sophisticated data warehouse and pioneering technically advanced data analysis methods to provide market intelligence for our funding operations.

One example is the ESM's use of financial networks to help visualise how political or economic events affect market sentiment. Figures 25 and 26 illustrate the relationships between different sovereign bond markets. They also forewarn about the impact of political or economic change on market stability.

Financial technology could revamp how the financial industry – and the ESM – do business.

Innovative technology could, for example, allow the ESM to better navigate markets, deliver better value for shareholders, and better meet investor needs.

ESM is already building its own fintech tools to analyse market data and investor patterns.

By studying financial networks, the ESM can see how events may affect market sentiment.

²⁴ Wharton School of the University of Pennsylvania, Wharton FinTech Club, February 2016.

²⁵ Note that the financial statements refer to the committed paid-in capital of €80.5 billion, the final amount that will be paid in once the two most recent ESM Members, Latvia and Lithuania, complete their contributions.

The deeper the blue, the stronger the dominating correlation between countries.

Bond yield correlation network figures 25 and 26 show the dominating positive correlations (blue) and negative correlations (red) between sovereigns on a given day. When viewed as time-lapse videos, they can also visually demonstrate the strong to weak correlation over a given period of time.

The week before the Brexit referendum

The uncertainty around the outcome of the UK referendum led to a dominant trend of negative correlation, with bond movements diverging, as investors sought safe haven Germany rather than peripheral countries.

Figure 25

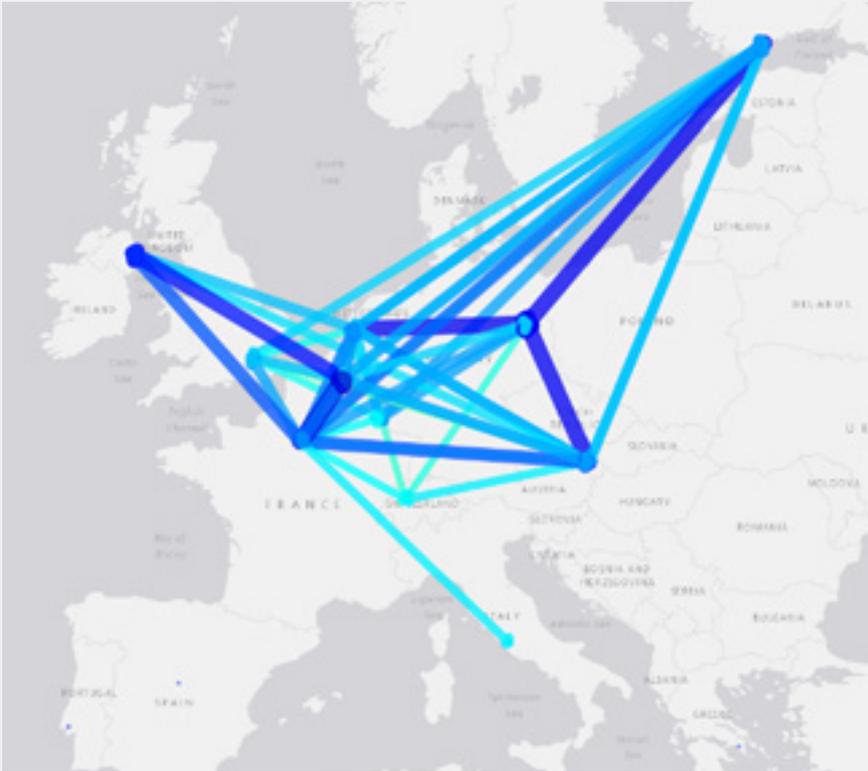


Note: For further information, please refer to ESM Working Paper No 8: European Government Bond Dynamics and Stability Policies Taming Contagion Risks.
Source: ESM, screenshots provided by Firamis (www.firamis.de)

The week after the Brexit referendum

Following the outcome of the UK referendum, market sentiment recovered and European sovereign bonds converged, moving more in tandem again.

Figure 26



Note: For further information, please refer to ESM Working Paper No 8: European Government Bond Dynamics and Stability Policies Taming Contagion Risks.

Source: ESM, screenshots provided by by Firamis (www.firamis.de)

To share the institution's experiences, ESM representatives have spoken at a number of forums, for example in London and Washington D.C., on 'How we can be leaders in fintech'. The ESM is also an active member of several fintech circles, which enables the institution to stay on top of new technological developments and any potential challenges.

The ESM also actively promotes fintech through collaboration and dialogue with other IFIs. As a relatively new institution, the ESM is largely unencumbered by historical systems and ways of working and can create and implement innovative ideas relatively easily. The ESM is looking for opportunities to improve efficiency and is thus monitoring the fintech community for any solutions that could enhance its work environment.

The ESM takes part in fintech forums, sharing its experiences, and learning from others.

The ESM is actively promoting and evaluating new fintech tools to improve its efficiency.