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The LBBW public sector issuers' roundtable 2022

December 2022

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SSA issuers show strength and agility amid market turbulence

The emergence of several major macro risks across the year caused a paradigm shift in primary markets, increasing the complexity and challenge of funding to a level many sovereign, supranational and agency issuers have not endured in over a decade. Yet, many SSA issuers rose to the challenge, demonstrating a strength, agility and composure in successfully executing their funding plans, some even earlier than planned. As we move into 2023, the macro environment will remain challenging, but how challenging and what does this mean for the SSA market? *GlobalCapital* discusses this, together with analysing the impact of the market turbulence during the past year, with some leading funding and investor participants from across the SSA market.

Participants in the roundtable were:

Silke Weiss, head of funding and investor relations, European Stability Mechanism

Jörg Graupner, vice-president, treasury funding, KfW

Christian Engelen, head of unit, borrowing and lending, DG Budget, European Commission

Ralf Berninger, head of investor relations and sustainability, SFIL

Yiu Chung Cheung, group treasury investments, ING

Patrick Seifert, managing director, head of primary markets and global syndicate, LBBW

Richard Kemmish, moderator and *GlobalCapital* contributor

GlobalCapital: Clearly, it's been a volatile year. There have been long periods when the market has been closed, when spread movements and rate movements have been more than we expected. Looking back at the year how have you changed your funding plans as the year has gone on from what you expected on 1st January?

Silke Weiss, ESM: The EFSF (European Financial Stability Facility) and ESM (European Stability Mechanism) funding plans for 2022 did not change and were kept at €27.5bn — €19.5bn for the EFSF and €8bn for the ESM. We have been active via auctions as well as syndications. What was different compared with 2021 was the timing and currency composition of our syndications.

We finished our funding programme exceptionally early this year. The last EFSF transaction was on 4 October and the last ESM transaction was on 17 October. We did not issue a dollar-denominated bond for the ESM as in previous years. The rationale for focusing on euros came from the fact that with higher European rates the demand for short-dated euro bonds increased and we were able to tap into that demand several times at attractive rates for our beneficiary member states, i.e. on September 20 we tapped the ESM September 23, 2025 bond with a coupon of 1% for a size of €2bn and a yield at 2.32%. Books reached €26.9bn and the new issue premium was negative 1.5bp.

We adopted a new communication strategy in 2022 as we ended the announcement of planned issuance windows at the end of 2021. This has given us flexibility on the timing when we could come to the market, which has been beneficial this year from the perspective of an issuer as well as for our investors. We were able to react to market demand and avoid heavy supply or volatile trading sessions for our executions.

We changed our auction activity slightly in May when we ended the 12-month bill we introduced during the pandemic. Bills remain an important tool in our instrument box to address liquidity needs. The ESM's liquidity needs in 2022 were lower and the additional line therefore stopped.

Christian Engelen, EC: As the EU we had our first full funding calendar year after the launch of our revised debt management operations for the roll out of Next Generation EU, a very big funding programme, and it was a year with a lot of challenges. The market was not giving us an easy time, but I think we are all in the same boat. For us, the funding needs are determined by the underlying programmes and because of that we don't have the luxury of modulating the funding needs over the full calendar year. This is why we decided to communicate funding targets in shorter funding semesters. So we actually communicate and structure our funding plans in six month cycles, which gave us the possibility to adapt in the middle of the year to new information about the programme needs but then also to communicate to the market our new funding target.

We communicated €50bn for both funding semesters so it was an even €100bn over the full calendar year but communicated in two semesters. It brings for us, and also hopefully for investors, a bit more stability in terms of the likelihood that we can meet our funding targets.

GlobalCapital: Jörg and Ralf, do you also communicate on an annual basis or do you go to a shorter period.

Ralf Berninger, SFIL: We communicate on an annual basis the volumes that we are targeting. We are a bit of an exception as, on the one hand, we are active in the SSA market, via regular benchmark issuance via

SFIL, and then we have a second leg where we issue public sector covered bonds via our subsidiary CAFFIL. Looking back at the year, our experience was that sometimes issuers needed to scale back ambitions. The market was more volatile and getting a smooth execution was the big topic.

Jörg Graupner, KfW: The initial announcement about our funding needs at the end of last year showed a number of €80-€85bn but the loan performance went well, so we increased our funding needs in July up to €90bn. We always communicate our funding needs two times a year, so also this year there was a slight increase of our funding volume. We have already reached this €90bn mark now. It was indeed an extraordinary year in the history of our activities and the external factors are well known. Once again, with our flexible funding approach, very smooth execution is necessary. Usually we wanted to do more dollar bonds in 2022 but from an economic point of view the benefits were more on the euro. Other currencies were also less attractive over the course of the year. These are the reasons that we did more euro transactions in total.

Berninger, SFIL: That is in line with our experience. This year was the first in a long time that we didn't issue a dollar benchmark.

Yiu Chung Cheung, ING: On the back of the war in February, did that bring forward or delay any of your funding plan? Obviously, you could have delayed because market volatility at the beginning was tremendous but are there any structural changes for 2023 that we should take into consideration given that you might have been conservative in 2022?

Berninger, SFIL: From our side this is probably not going to be the case. When we look at next year, we do not know exactly what the market will bring. It is very difficult to see whether you should go for a large share of issuance early in the year, or whether it is better to wait. We will be looking at investor demand, at investor interest. But we don't have a strategy to front load issuance.

Ralf Berninger
SFIL

Engelen, EC: For the European Union of course the war has an impact on our funding needs next year, we have just proposed, and hopefully its near adoption, an additional support package that increases the funding needs. But from the funding execution side I must say that was one of the surprising elements this year. The market showed some reaction in February — but more in the equity market, not so much the rates market — and the rates market through the year was more driven by central bank policy expectations and less by news around the war. Also, the war has not yet impacted strongly into projections of global growth. So it was striking for me, I would have expected a stronger impact. There was a lot of volatility, but it was due to other factors.

Patrick Seifert, LBBW: I would confirm that view. In some way we have rediscovered that SSAs are a safe haven in being able to execute transactions when others have to step back. At the same time you probably needed to display flexibility around the shape of the individual transactions. That could be on the currency choice that Jörg spoke about, or designing the transaction differently to what was initially planned. I think that the ultimate proof in the impact of monetary policy is at the long end, which obviously has suffered much more when it came to being able to issue smoothly.

GlobalCapital: Silke, have you changed the way you approach deal execution?

Weiss, ESM: We have adjusted our trade execution to allow for market volatility slightly. Previously, we would always do a two-day execution, meaning announcing the mandate one day before pricing. This year we have executed more intraday transactions, meaning announcing and pricing on the same day. Intraday transactions have allowed us to be as little exposed as possible to market volatility and price moves. Given the high volatility at times as well as heavy supply, investors have told us that they appreciated the faster execution style the EFSF and ESM can use. However, we have also used the 'classic' two-day execution in 2022, e.g. when it was needed to help market participants discover the right prices, e.g. after unexpected changes to economic data and possible changes to the speed of ECB rate rises.

GlobalCapital: Yiu Chung, there is something that I'm always interested in for investors in this sector: SSA issuers try to be very transparent and predictable as much as they can at the beginning of the year. Does that actually matter to you as an investor?

Cheung, ING: It's good to have an idea about what the value of SSAs will be relative to, say, the government bond. For us as an investor it's more or less in the same portfolio. For KfW, EU or any SSA that has some explicit guarantee, we see it as a substitute for some of the government bond holdings that we have. In that sense, transparency is very important for us.

More important is if we know that SSA issuance will be sizeable — and for 2023 we do expect that to happen, given that there are some pretty large redemptions coming in the SSA space. What it means for me is a bit more negotiating power as a buyer. To give an example, EU as a very frequent issuer, we have very good contacts with the guys and I think some of the elements that we give as feedback we see that on the issuance side. For me, this is an indication of a buyer's market, more new issue premium than in the last couple of years and the larger the programme will be going forward, the more impact you will have as a large investor. So, it is important.

GlobalCapital: Issuers, is that need to create a plan on January 1 about the need to incorporate feedback from investors?

Engelen, EC: For us it's one of the key pillars that we think is important to be able to come to the market with the regularity and the volumes that we need. We need to give investors sufficient time to prepare. We want to be as predictable and as reliable as possible. That's not only a matter of fairness it is also a matter of consistency in the planning and to avoid being seen as opportunistic and trying to game the market.

What was just said is very clear, we come with very high volumes to the market, we have solid access to the market, and we are happy that we can place these volumes at reasonable pricing. Key for that is some kind of a mutual understanding between us and the market that we do that in a transparent way. That's one of the key elements that we take as a principle in our funding planning and in our communication with the market.

Graupner, KfW: I think the new issue concession, the premium is much more necessary in 2023, not only because supply is so huge, the ECB is probably less active, but also from a volatility perspective, investors need some buffer for the volatility.

Jörg Graupner
KfW

The second point is the liquidity. In the last couple of days and weeks there have been a few comments about liquidity, and in particular that at the moment there is a concentration when we talk about which bonds are liquid and which ones are less liquid. The size of the transaction is important for investors; that they are always able to buy and sell a bond. This is one side of a definition of what liquidity is. The other side is a tight bid/offer spread. It's also important for having a liquid curve, when we are talking about coming out with a new issue, relevant for determining the fair value.

Seifert, LBBW: It is a buyer's market, let's accept that as reality for now. What has made trades successful is addressing the right pocket of demand in given circumstances. That's why at one point the shorter trades work better, at times the trades limited in size work better, at times the ESG transactions really made a difference. Depending on what value investors find in the individual SSAs, there will be a new issue premium, but it won't be the same for every issuer. So, from that point of view it's about differentiation and the names we have here today benefit from that as seen in 2022.

Cheung, ING: A question to Christian if I may, the only unfortunate thing about NGEU is: every time some politician is asking about mutual debt to finance energy or gas or whatever, people always look at NGEU and say, maybe there will be €25bn more, this is more for a name like EU. That's the unfortunate thing that we have about NGEU, you are a function of a lot of plans that are coming, especially this year with the volatility in the market and the gas prices, and as a consequence if there is one issuer where you see the new issue premium moving higher it is the EU. Is this something that you hear from other investors?

Engelen, EC: We experience that, indeed, the reactiveness of the market to political noise is higher for us. And that has to do with the volumes we are talking about and with the novelty of NGEU and our presence. Maybe that's a process of maturing into an issuer where not every political noise is perceived by the market as an immediate threat of new funding volumes.

We are a political institution and like any member state or any of our peers, there are political ideas being discussed about what could be done or should be done, but that does not mean that it will immediately translate into a concrete initiative.

What we can guarantee to the market is that we communicate as transparently as we can existing confirmed funding needs and that for us it is absolutely vital to make sure that, whatever will be decided in the future, this will not erode our financial capacity and our ability to provide value.

If anything, additional funding volumes should actually give the market an optimistic perspective as this will improve the liquidity of our bonds without undermining our credit quality. Whenever we are asked what could be done in terms of policy design, we insist that this is the overarching principle because it is the foundation to provide value both to the market and to the policies that we support. If we cannot provide reasonably priced funding the implementation of policies will become very difficult.

GlobalCapital: Jörg and Ralf, the amount you have to issue is not as sensitive to political news but are you also getting questions about funding needs as politics dictates?

Berninger, SFIL: In our case, the underlying lending business is quite stable. We are a local government and export financing agency, and recent years did not really bring any large ups and downs in our funding needs.

One of the reasons is that local authorities rely on taxes on property which are quite stable over the years. We see a steady increase in lending activity, but it is not going up and down dramatically.

Graupner, KfW: KfW, as you know, is a promotional bank here in Germany. And in this role we also have been assigned tasks from the German government. KfW is conducting mandated transactions on behalf of the Federal Government, the credit risk in this case is borne by the Federal Republic of Germany.

As a consequence of the war in Ukraine, energy utility companies in Germany are suffering from supply reductions and significantly higher prices. The mandated transactions serve to secure the energy supply and resilience of the economy.

Importantly, since the end of October, we are able to draw on loans from the Economic Stabilisation Fund to refinance the mandated transactions. This is important for the energy companies and means that the mandated transactions are ringfenced by the Economic Stabilisation Fund.

GlobalCapital: Silke, what can you share about ESM's funding plans for 2023?

Weiss, ESM: The funding programme will be a similar amount, between €20bn-€30bn. We will announce the exact amount in our year end newsletter. The funding programme may change, should we be involved in any new programme, which means net supply from EFSF and ESM is stable.

We will issue benchmark bonds on different parts of the curve identifying the best opportunities in accordance with investor demand. We will continue to tap outstanding bonds, issue new bonds in euros and dollars, and will maintain our bill programme with three-and six-month maturities.

Our core objective will be, as usual, to raise potential additional liquidity needs smoothly in the market, using a wide range of maturities and products to avoid disruptions on specific parts of the curve or in specific products. We will continue our transparent communication of our funding plans and update the market about any change.

In 2023, we will be happy to introduce Pierre Gramegna, our new ESM managing director, to our investors and peers. Pierre was appointed in November by the ESM Board of Governors and took office on December 1.

GlobalCapital: Patrick mentioned the safe haven status of the issuers we have here, which is clear from a credit point of view, but the biggest risk this year has been duration. The EU in particular, but quite a lot of other issuers, have been issuing some high duration bonds. Whereas the covered bond market, for example, has been focussing on three to five year. What is the rationale or the justification for the longer bonds?

Engelen, EC: The maturity structure of our bonds reflects several factors, it's not only about market environment but also about arriving at a maturity structure which fulfils several requirements: that we stay within limits of our financial and budgetary capacity, that we create a maturity profile that facilitates a gradual repayment of debt that is required under NGEU and some other considerations.

So, we have a requirement to target a longer duration at the moment but will reduce that over time. It's not something that is absolutely mechanical but to some degree pre-determined and it will change over time. If we speak in a few years you will see a different maturity structure.

It is also for historic reasons, in the old world where we were funding our programmes 'back-to-back', so we were extending the same funding to the loan beneficiaries, we issued almost exclusively with very long durations This is something that we have changed now, and it will also go down over time.

Graupner, KfW: In general, we have to act as a bank and the duration of our funding activities is determined by our loan business, that's very clear. On the asset side, its rather short so that means that our funding activity is an average between five and six years. So we can't say that we have a need for much longer transactions, our funding need at the longer end, above 10 years and up to 20 years, is very limited.

What I see from the sidelines is that the very long end was less requested by the investor base and the reasons were interest rates combined with the inflation outlook and the expected supply.

Berninger, SFIL: When we lend to a municipality in France the typical loan format is 25 years amortising. In terms of issuance strategy, we do a lot of the long dated issuance under covered bond format. When we issue in the agency market, we have a bit more flexibility. The trend we saw this year was that issuing long dated has been more complicated. A lot of the investors looking for 10 years at the beginning of the year are rather looking at three to five years now. So things have become more complicated at the long end.

Seifert, LBBW: You know better in the UK! The very long end and the volatility hurt very, very hard. Those were extraordinary circumstances. There are issuers with structural needs at the long end and others that have been using the long end to escape negative yields. The long end has traditionally never been something that you would tap every single day but has always been a little bit more challenging.

Patrick Seifert
LBBW

When we leave 2022 behind, we are looking at fairly attractive fixed income markets. Going forward we see yields that are attractive in historic terms and backed by the underlying quality, which is addressing recession fears, we are moderately optimistic for the long end next year but it's not for everyone, let's be honest.

Graupner, KfW: I think it's worth striking a more positive tone. It is quite remarkable that there was this continuity in the market and stability in the market that gave us the possibility to basically access the market with these longer durations and still at reasonable prices. It has become more expensive, but it could have been much worse given what we have seen. So overall, I'd suggest a rather positive note in 2022, and hopefully, if the volatility recedes a bit going into 2023, we'll see greater stability and we can build on that. At least from our perspective, we never had the feeling that we were facing a situation where the longer dated executions were really at risk, and that's a remarkable finding for a year like 2022.

GlobalCapital: Yiu Chung, duration has obviously been problematic this year. Given that SSA issuers are so much constrained by having to issue longer duration, while the covered bond market isn't, do you feel a temptation to put on more covered bonds and less SSA?

Cheung, ING: For most bank treasury investors, the HQLA investors, it is not the duration that's an issue simply because we swap the duration away. What is left is just credit spread and from that perspective it becomes a pure relative value position relative to swap or — if there is an explicit guarantee involved — a government bond. If you look at, say, where an EU is trading relative to where France is trading, for us it's a very logical choice to say let's put some money into AAA EU. The volatility, sure we have to endure that but as a banking book you have a little more leeway.

At the very long end, if you have to buy it for ALM reasons and you have outright duration positioning it is rather painful but from a credit spread perspective it has been very well behaved. Obviously, there were times when it has gone bad — QT is one important risk factor — but generally it has been very good for us given the flexibility of our long bonds mandate and that is the reason why, as Christian was saying, it has been very good for the EU, it's exactly for this reason that this is happening.

For the covered bonds it might be a different story.

What we have seen is that demand for covered bonds in the past couple of months has been at the front end as longer dated paper saw less interest. This in contrast to e.g. SSA where especially green long bonds saw healthy appetite.

GlobalCapital: Jörg, we have been speaking about the euro market but you are also active in other markets, particularly dollars. Patrick mentioned sterling, have you relied more or less on foreign currency this year than you would have expected and how does it compare?

Graupner, KfW: We have our natural funding needs in euros, but, of course, we also execute in foreign currencies if and when there is an arbitrage possible and/or there is an opportunity to show our flexibility and broaden our investor base.

On the dollar side there is one thing I want to highlight — we want to be a permanent issuer from a diversification perspective, and it is absolutely helpful that we can refinance some of our fundings needs in dollars. As a permanent issuer I can say that we also have a liquid curve in dollars. We have done four benchmarks in 2022 in dollars. We usually wanted to do more but the economics were against this. I'm very positive that we are continuing our dollar refinancing activities within the next years, which will strengthen the liquidity in our outstanding dollar bonds.

Weiss, ESM: Since 2017 we have a strategic presence in the dollar market. The dollar market gives access to dollar funding in up to five year tenors normally. With higher interest rates in euros and greater interest in the short end of the euro curve we saw great interest from investors in euros and therefore this year, we have not issued in US dollars. The dollar market for the ESM has been a great addition to its funding strategy and remains an important strategic tool for the future.

GlobalCapital: We haven't spoken much about central bank policies. How is the normalisation of QE changing relative value and liquidity in the SSA market? Is it a game changer?

Seifert, LBBW: 2022 was a year when you could spend a lot of time blaming central banks for getting it terribly wrong. But let's face it: a couple of things were really unprecedented and unexpected so let's give them credit that they managed to get back on course.

Getting back to the 'buyer's market' notion — a lot of them have come back with nominal yields going up. They are again finding value in SSAs, it's not chasing return at any cost but it's much more risk aware. And with a recession waiting for us, it's not difficult to find value in SSAs. We still have a bit of market distortion. But at the end of the day it is much more of a market rather than investors trying to buy the ECB leftovers and moving into more risky asset classes. Overall, some seem to have been underestimating the aspect of liquidity which is why the issuers that we are discussing here add so much value.

Engelen, EC: For us, the impact of the withdrawal of liquidity support from central banks is noticeable throughout the market. The question is if there are more impacts on SSA than EGB? We do not see that there is a single driver from the central bank driving SSA disproportionately compared to EGB, we all feel the same pain. For the SSA and all swap products, the swap spread development was really painful, but I didn't see that as mainly driven by central bank policy, there were other structural factors.

We heard that from Yiu Chung, he is looking at us — and this is music to my ears — in comparison to France, there is no distinction between SSA and EBG, there is a distinction in terms of certain rating classes. I think that's a positive development that shows also why there is no disproportionate impact on the SSA market, compared to the EGB market.

Graupner, KfW: Talking about TLTRO, QT, my view is that repayments of TLTRO puts more repo bonds back into the market and this could be one of the reasons why, in the next weeks or so, we do not see such a wide bund swap spread. On the QT side of course Christian is right when he said that the ECB put more liquidity in the market. My expectation on the QT side is that ECB will be not an active seller. The redemptions will no longer be fully reinvested, so maybe we will get more information about this out of the ECB during the December meeting. In addition to that, one huge buyer, the ECB, will be less active in secondary and primary. Bonds have to find new investors and we will see more liquidity in the outstandings.

Yiu Chung Cheung
ING

Cheung, ING: You asked if this is a fundamental game changer? Of course, it's not. We've been in this situation before 2012. The strategy that a lot of investors, liquidity providers, market makers had in the past 10 years is to follow the biggest elephant in the room — the ECB. Now that the ECB is stepping out we are back to old skills: relative value is important, inventory control is important, basis risk hedging is important because you need to know how your position is moving relative to your hedge. These are very fundamental skills that liquidity providers need to find again, and they will. So, in that sense it is not a fundamental game changer.

In the SSA market you have to think about efficient inventory control because supply or taps tends to be less frequent and more difficult to predict. This means that a market maker short in bond A either needs to buy that bond back, or hedge it with a second best bond, use repo for delivery and wait till I get hit in my bid.

If you ask me will liquidity improve? Yes, the structural question about liquidity is about the free float of bonds. If the biggest elephant in the room is buying less then there are more bonds available, then you come back to elementary questions like how much is EU going to issue? How much is KfW going to issue? What part of the curve? How should I position? It's a blessing to finally move back to a situation when the fundamental valuation of a bonds is becoming key again.

GlobalCapital: Patrick, I'm sure you agree about a return to normality. Does it feel like a return to normal for your trading, syndicate, relative value…?

Seifert, LBBW: The fascinating thing is we are getting back to normal after so many years of zero interest rates, We have been in negative territory, some even lost the belief that we would one day get back. So, it is really good to see those readjustments, normality coming back, price is now driven by investors, not just one investor, but by investors looking at opportunities and making economic decisions. That's the best we can expect: A functioning market. I absolutely share the comments on liquidity being very important going forward. When looking into real transactions, you see those names — real buyers who have been sidelined for many years and that is the difference to buyers who have been there to piggyback the ECB in one way or another. So, optimistic. Absolutely.

GlobalCapital: Ralf, as someone active in both the SSA and the covered bond sectors, how does this 'paradigm shift' — the brand new market, central banks fundamentally changing. Similar in the SSA and covered bond sectors or are they different?

Berninger, SFIL: Overall, it's the same story. What we expect to see next year is going to be a big shift in the investor base. When we look back six years, when looking at our order books, we had well over 30% bought by investment managers and insurance companies. This year it was significantly below 20%. We expect this trend to reverse.

When we look at investor meetings this year, we had a lot with investors we had not seen for the past three or four years. These investors are coming back, or will be coming back, next year. One question will be whether this is going to be a quick process.

GlobalCapital: There are a couple of big trends in ESG markets. One is a lot of new investor reporting, disclosure, green asset ratios, etc. A second is pressure for more holistic reporting — about an overall organisation. What is the net effect? Are ESG bonds, relative to other bonds changing? Is the greenium increasing?

Graupner, KfW: We haven't seen many changes in 2022, but the recent questions that we have received from investors are more and more related to rising regulatory requirements. This, of course, brings some challenges for us as an issuer. What the investors have to adopt is very strict, not just on the ESG bonds but also on the conventional bonds. What we at KfW are aiming to do is bring our green bonds closer to the EU Taxonomy, but this is a long way. We have included statements on the current status of the implementation of the EU Taxonomy in our green bond framework — the underlying assets meet the majority of the substantial contribution requirements. We will continue in 2023 with our current framework. On the holistic side, we have top ratings from the relevant agencies – special green agencies and the bigger well known agencies. We are constantly improving in this area.

GlobalCapital: Christian, is the EU the world's biggest green bond issuer yet?

Engelen, EC: I wouldn't say 'yet'. There are bigger outstanding volumes but, given the magnitudes that we could take it, could become the biggest green bond programme in the world. We have said that we want to issue up to 30% of the Next Generation EU in the form of green bonds which will be around €250bn, and that is quite a sizeable compared to other programmes out there. We have issued so far around €36bn in green bonds, we also need to do that in line with the green expenditure reporting that we get from our member states on what the money is used for. We can't just issue that in a front-loaded manner and hope that we can confirm that this has been used for the right purposes.

In our green bond framework, we need to keep a close link with what we have reported and that is why we have issued so far €36bn, which is a good amount compared with the implementation of NGEU.

We had quite a good experience with that, our framework — even though it is relatively young has established itself quite well and we see that in the transactions it is a factor that is helping us in terms of demand. Investors appreciate that. I wouldn't like to go into detail about whether that yields a greenium or not, that is dependent on the specific moment, transaction, maturity, environment. As we always said it was never our main objective to get a sizeable greenium. For us it's more important to build up a loyal and broad investor base that is supporting us in the issue of green bonds. So overall quite a good experience so far, we will continue with that, when we meet in a year's time maybe I can report whether we are on track with reaching the biggest programme out there.

GlobalCapital: Yiu Chung, are you seeing a lot of new reporting disclosure and reporting requirements?

Cheung, ING: Absolutely. What we do right now is really dig quite deeply into what is a green asset. The EU taxonomy gives a bit of a guideline, as does the delegated act. We have seen a number of newspapers reporting about investors being accused of greenwashing, so we are extremely careful about the green asset side of our balance sheet. I think we will move into a situation, maybe in the coming 18 months when people will be more careful about anything that seems green.

The same things will hold for us, we will scrutinise the issuer, asking for additional information about why something is being categorised as green. What is also very important, when we have the asset side well defined in terms of green, we can move to what we call green ALM. So, we have to match it with green liabilities. If a lot of financial institutions are doing it this way then probably issuance in green is going to increase which is a very good thing.

So, all of these things for me would imply that the greenium that we see now, which is not that big by the way, is going to move towards flat. I think that's good. At the end you want, that the question is not 'what the standard curve is?' and 'what green is pricing relative to the standard curve?'. But in the future the standard curve is green and anything else will be at a discount. Hopefully we will move to that situation because that is the only way to create a future asset out of current liabilities.

GlobalCapital: Patrick, do you agree that the greenium is diminishing and we should look at green as the default setting?

Seifert, LBBW: We are moving in that direction absolutely. One or two years ago, a large asset manager from France said 'green is mainstream' and I agree with that.

What exactly is green? In the context of the energy crisis, we need to redefine some of our thoughts on nuclear energy, carbon capture and storage, etc, but that's a definition thing. It's about providing as much transparency as possible. You also have to look at what you do not issue in green, the conventional business. The more transparency is coming across the entire value chain, the more credible investors can find issuers or not. In the long term you cannot get away with issuing in green and everything else stays as is. I don't think that is credible.

This year the green feature sometimes made the difference between a deal and no deal meaning we are not simply talking about some basis points greenium. Those transactions helped attract and develop a much broader investor base.

Berninger, SFIL: I totally agree. The greenium has been much less of a topic. But there have been big advantages by widening the investor base. New investors are coming aboard because you have more differentiation to other issuers via your green and social issuance. And then obviously smooth execution has been a big topic. When you issue under green format you are sure of getting more investors on board.

For us this year a big topic has been setting up of a new 'Green, Social and Sustainability Framework'. On top of what we were doing already, we are now providing social loans to local authorities, for example for public education. And we are going to issue social bonds with a focus on local social investments.

With respect to the holistic approach — yes, absolutely. We see more questions from investors on the overall approach on sustainability. That is something that we know already from issuing social bonds. When we met investors for a social bond project, they were looking much more on the overall approach, than what they did on the green bond side. So, we are now going in the same direction for green bonds as well.

GlobalCapital: The taxonomy has its debates and uncertainties for green assets. Does it matter that we don't have a definition of social assets at an EU level?

Berninger, SFIL: We are active in green and social bonds. It is clearly a good thing to have a Green Taxonomy. We always had discussions in the past, for example on whether hybrid buses are a green investment or not. So, it is a good thing to have clear standards. On the social side, I think it will not be possible to replicate what we see on the green side. There are so many other factors to consider which make it more difficult to have clear criteria. But it will be useful to have a more common language on the social side.

Engelen, EC: We are issuing social bonds. The SURE programme was where we issued with a social bond label. We need to be a bit careful as issuers because bifurcation is an issue. It is already challenging with the dichotomy between green and conventional bonds, if you add a third category you end up undermining the fungibility of your bonds and that will come with a price.

As much as we from the Union like the idea of social bonds I do not see that we will easily jump into a new social bond issuance, precisely for that reason. Any sizeable issuer will need to think about the same issues. Because also for the green, it only makes sense if you are able to put out a sizeable volume of green bonds and to maintain that. It is our intention to build a green curve across all benchmark maturities precisely for that reason, because we want to keep it liquid, we want to issue the full spectrum of maturities so that investors can properly hold and trade that, otherwise it will die out over time.

GlobalCapital: We have already spoken about future funding plans and the drivers of future funding. In general, though is there anything you can say about total supply in the SSA market because of what Patrick likes to call this paradigm shift?

Seifert, LBBW: What we heard from the issuers is that they are mindful of expectation management. There is political noise. If you ask politicians, they probably want to double funding plans. But that is not on the agenda for now. It's a fine balance between expectation management and reliability. Being sufficiently big but not oversupplying.

There is some management issuers can do around that — foreign currencies, for example. In Germany, the TLTRO was something that KfW used. We also heard of the bill programmes. That is showing the way that the benchmark supply is being managed.

Going forward, there remains a very strong role for Europe and for governments, let's not ignore that. That has a lot to do with the geopolitical context. Therefore, issuance volumes will remain elevated but by no means out of control. There always must be a strong link to the use of proceeds and why we do certain things. It's good that Germany, or strong members of the Union, are willing to make those investments. Let's take a second to think how Ukraine, without that support, would be a totally different scenario. We are very happy that this is not the case, that we can be united and support those political decisions with competitive funding. Again, elevated but manageable levels.

Christian Engelen
European Commission

GlobalCapital: Do you agree, 'continued elevated but not excessive issuance for the sector as a whole'?

Engelen, EC: We are very mindful that we bring quite big volumes to the market and that is what we have communicated from the beginning. Next Generation EU is a sizeable programme and needs to be implemented within a certain timeframe which leads us to our funding needs for that programme alone of between €100bn–€150bn per year. As we have communicated, we are just about to agree on an additional support programme for Ukraine, so this gives some guidance as to where the funding needs could lie. With these funding needs, we would be one of the prime suppliers, if not the biggest supplier of net new issuance.

Being in that position is already challenging, I have no ambition to stretch it out to the level where the market goes on strike. So, it will be already quite difficult for us to implement prudently set funding targets and we will communicate that quite soon, as I said, with no intention from our side to be experimental in terms of what the market can absorb.

Berninger, SFIL: Our public sector clients obviously have a big role to play. It's a big role mainly linked to green transitions. We see a lot of investment needs for green public transport, energy efficient buildings or waste recycling. Looking ahead, we expect to have strong lending activity.

Graupner, KfW: On our side, I want to repeat that we are in this good situation where we can refinance our activities, specifically what we do on behalf of the Federal Republic of Germany, via the Economic and Stabilisation Fund.

So, no additional funding needs on this side. On the traditional side, our funding needs are driven always by developments on the loan business and redemptions. The Commission or the EU don't have a huge number of redemptions. We do, also in 2023. At the moment, I can say there is no huge change to expect when we're talking about our funding needs for 2023. We want to publish our funding needs in December.

GlobalCapital: There is one very specific change for the ESM: your membership is going to grow. How are the plans progressing?

Silke Weiss, European Stability Mechanism

Weiss, ESM: We are excited that as of January 1, 2023, Croatia will join the euro area. Consequently, Croatia will shortly afterwards become the 20th member of the ESM. The technical preparations for Croatia to join the ESM are ongoing.
Just like all other ESM members, Croatia will contribute to the ESM authorised capital based on its respective share of the EU total population and gross domestic product (GDP).

Croatia is the third country to join the ESM since its creation in 2012, following Latvia in 2014, and Lithuania in 2015. The fourth, if you chart back to the creation of the temporary European Financial Stability Facility, with Estonia joining the euro in 2011.
The minister of finance of Croatia will become a member of the ESM board of governors that take all the important decisions regarding the ESM.

Croatia will benefit from the solidarity that comes with ESM membership, with access to financial assistance tools with a total available firepower of over €413bn. This is a signal of protection for investors

GlobalCapital: What do you think is going to be the main talking point at this session this time next year?

Engelen: I find it difficult to pick just one big story. There are so many themes I expect to continue, such as geopolitical risks, inflation and economic growth.

Top of my mind as an issuer are, however, the issuance dynamics and ECB balance sheet adjustments. I expect that primary markets will be more challenging on increased net supply and a less active ECB.

Cheung, ING: If you look at this year, there was nowhere to hide. There was no diversification whatsoever. Risky assets underperformed, bonds underperformed simply because we were all driven by the same common factors: central bank balance sheets and inflation. Next year, the big story will be what retail investors will do?

If you look at how much money is sidelined at the moment in the US, look at just the size of the reverse repo at the Fed balance sheet. This is all fund money that is ready to be invested and if you think about what levels we see in government bonds or SSAs compared with bank deposits, I think people will start to wake up and say 'risky assets? Maybe not yet.

But bunds and two year Schatz at levels way more than attractive than bank deposits?' That will create demand for fixed income. What will happen is that Central bank QT will be replaced by investor QE. That will be a very important trend. You see it already in the US as direct participants in auctions is increasing. In Europe we will see the same type of trends.

Engelen, EC: We hope that next year we will discuss how the dichotomy, the boundaries between the SSA and the EGB markets, have come down further. In a world where the SSAs are outgrowing the SSA niche, I think it comes back to fundamental value analysis of the individual securities, relative value and to think in that manner, not about the classification which, for us, is not the best way to look, given the transition we are undergoing.

Berninger, SFIL: What we expect is a shift in the investor base. We've got all of these real money investors that started buying corporate bonds or senior non-preferred bonds to get sufficient yield. They will be coming back, and they will replace some of the activity from the ECB and some of the activity from bank treasuries. The big question will be: will this go smoothly or is this going to create volatility?

Graupner, KfW: Let me first answer the question more politically. The common understanding within the participants here is that we hope that we can see the end of the war in Ukraine and once again face the challenges we usually have to face — climate change, for instance — more fully.

The question of energy supply is also closely linked with this. On the market side, key issues will be being flexible and bringing liquid bonds, as well as finding the right balance between what the issuer and what the investor needs are.

Seifert, LBBW: The good thing about the paradigm shift is that it will be one year old, we will have learnt some way to deal with it.

The energy crisis is hitting the north harder than the south, for Europe that is interesting, it forces us to really appreciate the value of a unified Europe in the geopolitical context.

Some of the risk is still out there and hasn't full translated into real economies. Bottom line at LBBW, we remain optimistic for fixed income — 60% of the investors that we recently did a survey with do not expect SSA spreads to widen. It won't always be a one way street but the quality of SSAs will add value going forward and give room for secondary performance. That's why we stay optimistic that fixed income is back. GC

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If cutting down on CO_2 so that we're not up to our necks in H_2O is your business, then cutting down on CO_2 so that we're not up to our necks in H_2O is our business.