Further thoughts on the ECB's Corporate Sector Purchase Programme
A briefing note by the ICMA IG Corporate Bond Secondary Market Practices Committee
April 27 2016

Technical parameters of the CSPP

On April 21, ICMA published a briefing note discussing a number of considerations related to the potential implications of the ECB's Corporate Sector Purchase Programme (CSPP) for European corporate bond market liquidity and investor and issuer behaviour. The note also identified the key components of the Programme that would ultimately determine its market impact, including bond eligibility for purchases, the allocation of purchases across countries and issuers, the split between primary market and secondary market purchases, and, most importantly of all, the intended size of CSPP purchases.

On the same day, following the meeting of the Governing Council, the ECB published further details of the CSPP, answering some of these questions. The technical parameters of the CSPP outlined by the ECB are:

- The CSPP will be conducted by six Eurosystem central banks: Belgium, Germany, Spain, France, Italy, and Finland.
- Purchases will be made in the primary and secondary markets.
- Eligible bonds will have a minimum IG credit rating from at least one of the four main rating agents.[1]
- Eligible bonds will have a remaining maturity of greater than six months and shorter than 30 years.
- Eligible issuers will be incorporated in the euro area. Issuers incorporated in the euro area whose ultimate parent is not based in the euro zone will also be eligible, so long as the issuer is not a credit institution or an asset management vehicle.
- Purchases of individual ISINs will be limited to 70% of the outstanding issue size.
- A 'benchmark' will be determined based on the market capitalization weighting of issuance across jurisdictions to help ensure proportionality and a diverse portfolio of purchases.
- CSPP holdings will be made available for repo and securities lending by the relevant NCBs.

Universe of eligible bonds

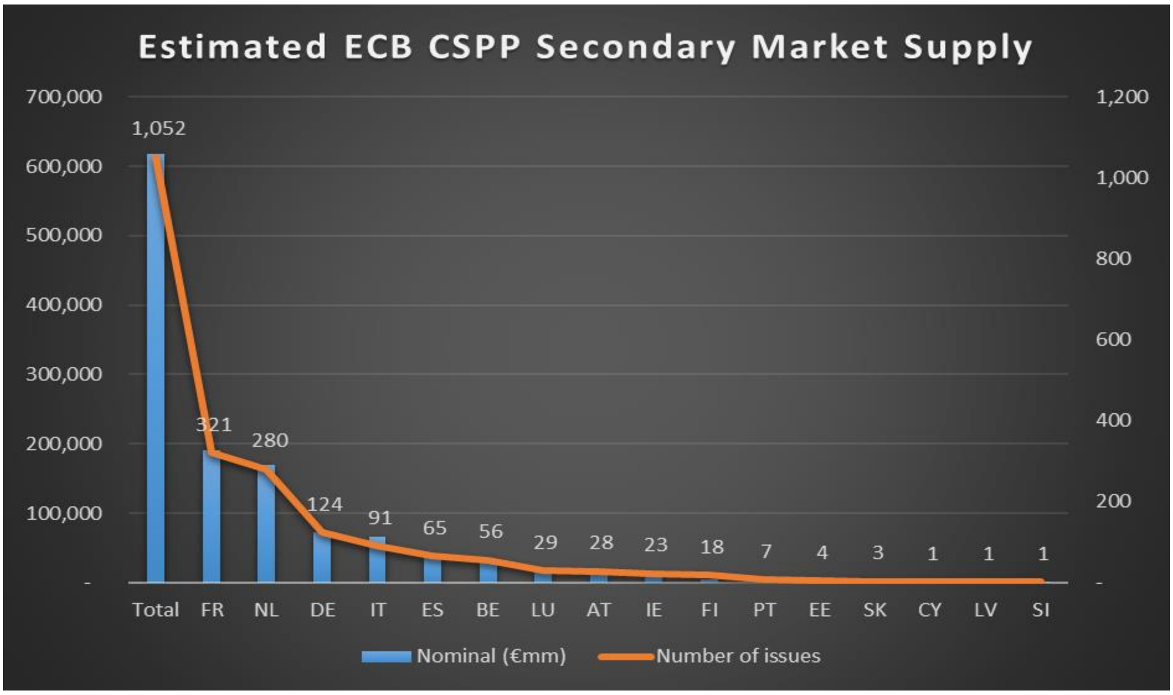
As discussed in our earlier note, the key determinant in estimating market impact will be the size of purchases relative to the universe of eligible bonds. The details provided by the ECB help in estimating the latter. It would appear that the ECB is trying to keep the pool of potential purchases as deep as possible (including all remaining maturities from six months to thirty years, as well as issuers parented outside of the euro area). According to metrics available on Bloomberg, this would bring into scope 1,052 outstanding secondary market issues with a total nominal value of €617 billion.

[1] Moody's, Standard and Poors, Fitch, and DBRS

Given relatively poor liquidity conditions in the European corporate bond secondary market, we would stick to our view that secondary market purchases will be relatively limited and opportunistic, with a skew towards purchases in the primary market.

The charts below show the estimated distribution of eligible secondary market issuance across the various member states. Interestingly, and quite importantly, the ECB intends to weight its purchases based on such a distribution, rather than applying the capital key used for sovereign purchases, or based on where it feels it is likely to have the most impact in terms of supporting local credit markets.

Estimated secondary market universe of eligible bonds for CSPP purchases



Country	Total	FR	NL	DE	IT	ES	BE	LU	AT	IE	FI	PT	EE	SK	CY	LV	SI
Issues	1,052	321	280	124	91	65	56	29	28	23	18	7	4	3	1	1	1
Nominal (€mm)	617,531	190,224	170,036	72,851	65,702	40,028	33,025	15,695	10,433	9,653	5,203	2,027	983	1,130	200	75	265
Average issue size (€mm)	587	593	607	588	722	616	590	541	373	420	289	290	246	377	200	75	265

Data source: Bloomberg

Lending facilities

Another important determinant for market impact is the availability of purchases into the repo and securities lending markets. As with purchases made under other components of the Asset Purchase Programme (APP), purchased securities will be made available, on a cash neutral basis, via the holding National Central Banks. This could lead to potential dislocations in the repo market since each NCB has its own unique lending facility or mechanism, with different terms and arrangements.

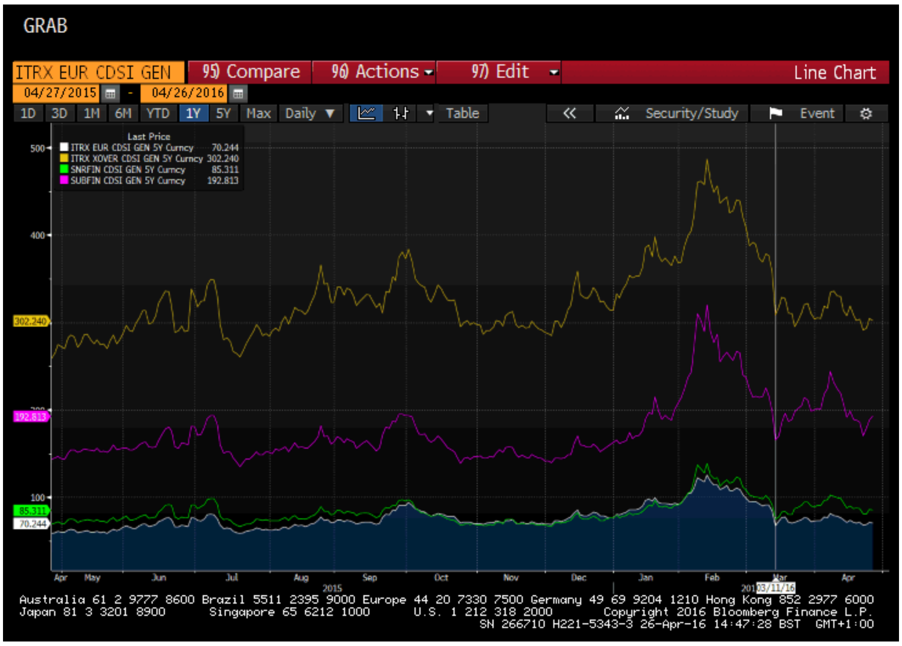
For instance, to borrow bonds from the National Bank of Belgium, counterparties will need to have in place a repo contract with the NBB. Meanwhile, the Bundesbank makes APP purchases available through Clearstream's Automated Securities Lending service, while the Bank of Spain utilizes both bilateral repo agreements and Euroclear's automated lending programme. Furthermore, all of these different mechanisms have varying terms, costs, haircut criteria, and collateral eligibility.

There have been growing calls for the ECB to create a centralized and harmonized lending facility for its sovereign purchases; but the argument for a central and easily accessible facility for corporate bond purchases could be even more compelling, particularly given an upper limit on individual purchases of 70% of outstanding issue size. Without the comfort of a liquid and accessible repo market, dealers are unlikely to risk taking a short position in any eligible bond, which, in turn, has important implications for secondary market liquidity.

Spreads appear to have stabilized…for now

The immediate market reaction to the announcement of the CSPP on March 10 was a sharp tightening of credit spreads; not just for the likely in-scope investment grade segment, but also across financials and high yield. Since then, however, spreads seem to have normalized, with a fairly muted reaction to the details of the Programme published on April 21. It does not seem unreasonable that following an initial re-pricing the most likely impact should be a drop in volatility as the CSPP establishes a potential 'support bid' for the market. Further tightening, or widening, is likely to follow the launch of the CSPP when the market can better assess the size of secondary market purchases the ECB intends to conduct. The general market consensus is for monthly purchases in the region of €3 to €5 billion, split between the primary and secondary markets. As previously discussed, it would seem likely that the purchases will be toward the lower end of this range, and more skewed toward new issuance. This would also be the least damaging outcome for secondary market liquidity.

iTraxx European CDS indices (the white line marks the announcement of the CSPP)



Source: Bloomberg

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