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EUROPEAN CENTRAL BANK

EUROSYSTEM

Workshop on book building / allocation

outcome

6th Debt Issuance Market Contact Group meeting

15 April 2021

Introduction

- On 8 April 2021 a workshop was held with participants from volunteering DIMCG member organisations to discuss potential areas of harmonisation in book building and allocation

- The following slides aim to provide background and summarise the workshop discussion for the DIMCG plenary to validate the conclusions

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What is book building?

Preparation / announcement

- Pitching
  - RFPs / beauty parade
  - Market colour / Indicative terms / term sheet
- Mandate / formation of syndicate
- Mandating agents (PA, listing agent, auditor, etc.)
- Market sounding
- Announcement
- Marketing / roadshows

Book building / launch

- Initial price thoughts / IOIs / Initial price guidance
- Book opening announcement
- Order book management
  - Collection and validation of orders (confirming IOIs)
  - Processing, updating, cancelling and cleaning orders
  - Order book updates / reconciliation
- Closing of order book / launch

Allocation / pricing

- Allocation of issuance amount to investor orders
  - Prepare draft allocations
  - Discuss / comment on draft allocations
  - Finalise and share allocations
- Final pricing of the newly issued securities

Finalisation / closing

- Liquidity management and hedging / RMT
- Finalisation of documentation
- Final terms
- Listing / ECB eligibility
- Sharing deal stats / ex post order book info
- Preparation for settlement

Outcome of Pillar 1 survey

Book building

Risks

- ~50% of respondents consider the impact of operational and reputational risks to be medium or high, but likelihood of occurrence to be low
- Following risks were mentioned most:
  - Manual entry of orders
  - Manual communication and reconciliation
  - Ambiguity in investor identification

Costs

- The majority of respondents find costs in this step moderate/low
- For 5 respondents, at least one of the cost types (operational, fees, process duration and FTEs) is of medium of high relevance

Outcome of Pillar 1 survey

Book building

Inefficiencies

- Many respondents identified inefficiencies in the book building process, especially in the areas of systems & platforms, quality of service and process complexity

The following areas of inefficiency were mentioned the most:

- Inefficiencies in investor communication
- Ambiguity in investor identification
- Fragmentation in systems and platforms
- Duration of the book building process too long

- In addition, the **access to more timely and accurate data** would improve efficiency, enable faster decision making and accelerate the allocation process

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Outcome of Pillar 1 survey

Book building

Potential for improvement

- 11 respondents see medium or high potential of improvement by fostering harmonisation in the areas of terminology and document templates
- Also the level of media breaks (email, phone, manual entries) was considered high by about 25% of the cases

Following areas of improvement were mentioned explicitly by respondents to the Pillar 1 survey:

- Standardisation of order books
- Standardisation of investor identification and classification.
- More granular and faster access to data, as well as improved AI, would speed up the process and improve decision making

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Book building – data exchange

- Book building implies / requires fast exchange of structured data between investors, managers and issuers and is most commonly a target for digitalisation by third party platforms
- A significant evolution since the ’90s from paper – through Excel sheets – to proprietary apps / third party platforms
- Two layers of interaction in book building:
  - Between investor – sales desk of dealer / managers
  - Between syndication desks of managers and issuer (issuer receives / has visibility of book from / via LM)
- The key pain points here are manual data handling / cleaning and investor identification – also covered by existing DIMCG workstream

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Book building – investor to syndicate layer

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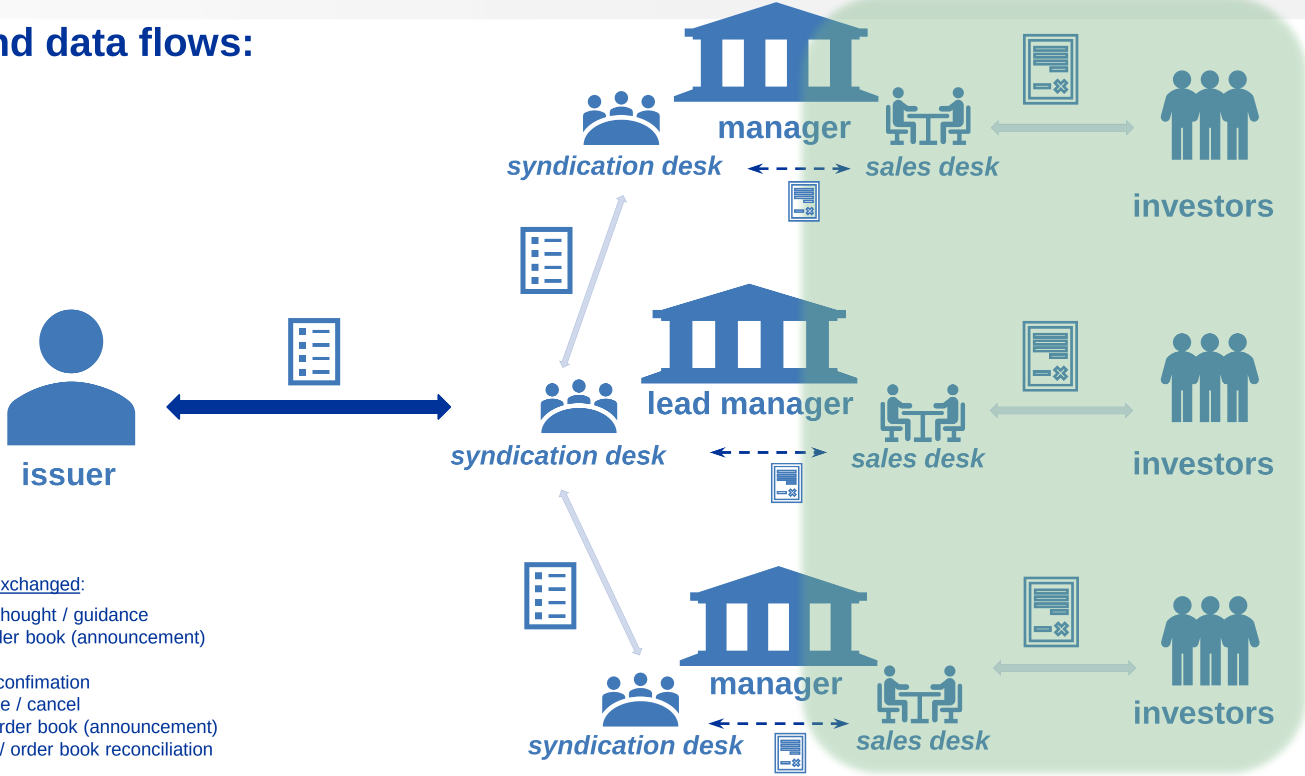
Stakeholders and data flows:

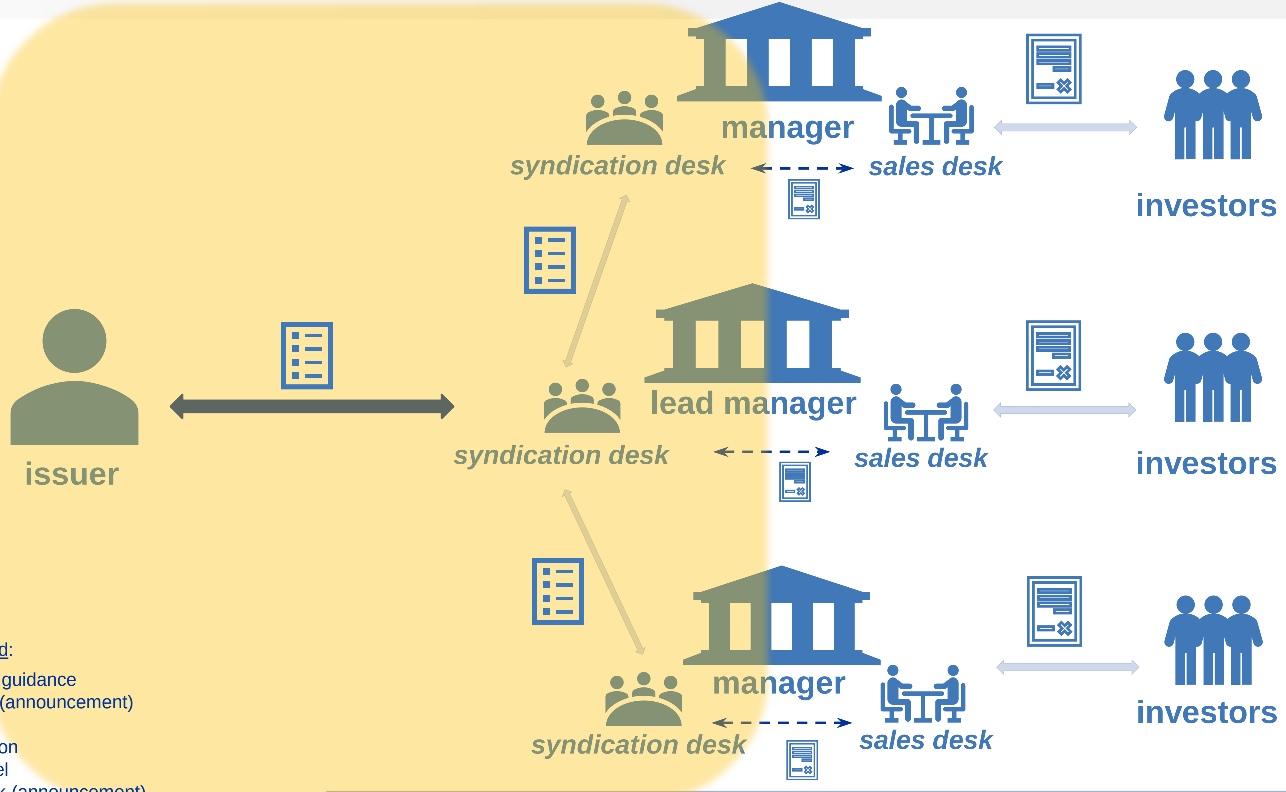


Data elements exchanged:

- Initial price thought / guidance
- Opening order book (announcement)
- IOI
- Order / IOI confimation
- Order update / cancel
- Closing of order book (announcement)
- Order book / order book reconciliation
- …

Book building – syndicate to issuer layer

Stakeholders and data flows:



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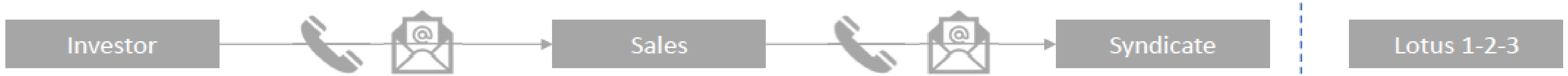
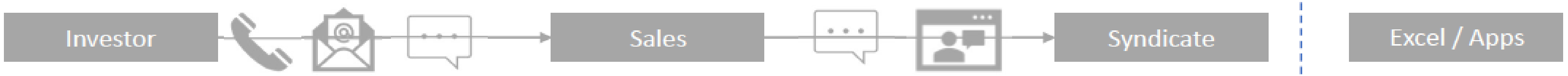
Book building – communication channels

Historical evolution of communication for book building *(borrowed from ICMA)*

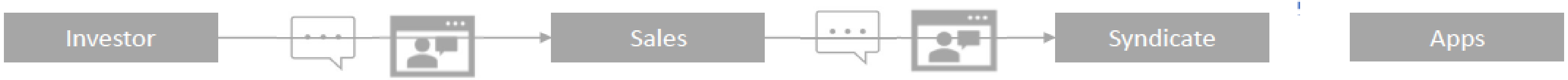
- In the mid to late 90s email became part of the communication process:



- In the early 2000s “chat” became a more established communication method between investors and sales.



- Over the last 5 years almost all communications have shifted to chat or dedicated platforms.



Ways to (further) digitise

There are two primary ways (not exclusive) to achieve digitalisation

Use of common (third party) platforms / utilities

e.g.

DirectBooks

IHS Markit

Ipreo IssueNet Fixed Income

Bloomberg

Use of open data exchange standards

FIX PROTOCOL INDUSTRY-DRIVEN MESSAGING STANDARD

FpML Financial products Markup Language

ISITC

SIIA/FISD

SWIFT

XBRL eXtensible Business Reporting Language

Book building – landscape / road to digitalisation

- Significant convergence over recent years in syndication onto third party platforms – also bringing about some convergence / harmonisation along proprietary standards (e.g. Issuenet codes)
- Convergence is more advanced in syndicate to issuer layer but strong impetus present also in the investor to syndicate layer
- External (third party) platforms serve as ‘pipes’ to which dealer banks also link their own in-house systems – such interfacing is on-going work at many stakeholders in the industry
- Recent third party offerings to cover investor-to-dealer space including also initiatives for data exchange harmonisation / common data library
- Issuers rely on lead managers to access electronic orderbook, can also be granted direct access to common book building platform

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Book building – landscape / road to digitalisation

continued

- If the leading initiatives are successful at consolidating data exchanges on one or a few platforms that will further benefit the industry in terms of efficiency but might also create risks of monopolistic behavior and single point of failure
- Certain mitigating factors exist: a book building platform is more easily replaceable than a trading venue or a clearing / settlement system, i.e. more difficult to apply monopoly pricing. Mutualisation and open governance can also alleviate such concerns.
- The new landscape may also facilitate better access to historical deal data by issuers and managers but may also give rise to new questions on governance and data ownership
- The key challenge that is remaining is investor identification and classification which the usage of a common platform in itself does not solve

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Book building – summary of WS discussion

- Significant consolidation under way in using common book building platforms in the industry paving the way for much more efficient way of managing data in the book building process
- Consolidation is more advanced in the syndicate to issuer layer than in the investors to syndicate layer due to the need to onboard a high number of investors in the latter
- No major harmonisation gaps / opportunities are identified in the area of book building apart from investor identification / classification (already covered by a dedicated DIMCG workstream / discussion)
- With many stakeholders having to adapt internal systems / interlinking to third party platforms a discussion on the use of open data exchange standard (which could decrease adaptation costs) may benefit the industry – recent initiatives also point in this direction
- The ongoing digitalisation creates opportunities to have better access to historical deal data but might create also new questions related to data ownership

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What is allocation?

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Outcome of Pillar 1 survey

Allocation and pricing

Risks

- The risk of misallocation is considered substantial and more likely to occur than risks in the previous steps
- In this process step, respondents also identified considerable financial risks, e.g. if the allocation takes too long and in the meantime market conditions worsen

Costs

- Lengthy duration of the allocation step causes significant costs, also in terms of FTEs

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Outcome of Pillar 1 survey

Allocation and pricing

Inefficiencies

- Many respondents identified inefficiencies in the allocation process, especially due to a lengthy process duration, but also in the areas of systems & platforms and quality of service
- Regarding the pricing of the debt instruments, most respondents considered this step efficient

Potential for improvement

- Standardisation of investor identification and classification was mentioned most often, both as a root cause for the duration of the allocation process and as a potential improvement
- More granular and faster access to data, as well as improved AI, would speed up the process and improve decision making

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Allocation

- Allocation is an interactive discussion and process between the issuer and the managers with the final order book as the input and the final allocations as the output
- Based on issuer guidelines / priorities managers lead by the LM compile draft allocations based on allocation policy for the issuer to review
- If there are many bookrunners the process can be challenging with different views on how allocations should be made
- The allocation process is also subject to regulatory requirements (incl. documenting the process, retention of records, etc.)
- Final allocation decision is with the issuer
- In syndication the allocation decision itself cannot be fully automated as it is a delicate decision subject to broad range of hard and soft considerations (‘rather art than science’). AI could help but the datasets may not be big enough for ‘big data’ type of solutions
- Nevertheless, better access to historical deal data can also further help analysis of investor behavior. However, Chinese walls within banks between data on primary market transactions and secondary market behavior of investors have to be respected
- Biggest challenge is common and robust investor identification

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Allocation – summary of WS discussion

- The allocation process is a very complex exercise with a high number of (soft and hard) factors playing in the ultimate allocation decision
- Investor identification and classification remains the key challenge, this will not be solved by the use of common platforms alone – highlights the importance of DIMCG discussion on this topic
- Recent regulatory requirements (MiFID, MAR, etc.) helped increasing transparency between stakeholders on the allocation process and principles
- More efficient data management / access in book building and in relation to historical data can help in investor classification

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