The secondary market for Italian government securities

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Outline of the presentation

- The structure of the secondary market
- A bit of story on the founding and developments of MTS
- MTS today
- MTS Repo segment
- Other ETPs where the Italian government securities are traded
The main characteristics of the Italian public debt market

- A very large size because of the huge outstanding amount of Italian government securities
- A widespread distribution among retail investors
- A large presence of foreign dealers and investors
- The key role of electronic trading for price formation
- An increasingly important tool for bank funding
- Instrumental to monetary policy and financial stability
- A complex structure where several distinctions can be made (wholesale vs. retail, interdealer vs. dealer-to-customer, multilateral vs. bilateral, electronic vs. voice, cash vs. repo, regulated vs. unregulated)
The structure of the secondary market (I)

- **Electronic**
  - Wholesale
    - Interdealer
      - MTS Cash
    - MTS Repo
  - Customer
    - BondVision
  - Retail
    - MOT
  - Non-electronic

- **Regulated Markets**
  - MTS Cash
  - MTS Repo

- **Multilateral Trading Facilities**
  - EuroMTS BrokerTec
  - Bloomberg
  - Reuters
  - BGC Brokers - eSpeed
  - MarketAxess
  - Tradeweb
  - EuroTLX
  - HiMTF

- **Over-the-counter**
The structure of the secondary market (2)

Primary Market

Electronic Platforms

Wholesale
- Interdealer (quote driven)
- Dealer to client (RFQ)

Retail
- Order driven for small size minimum lots

Key segment of the market decisive for the liquidity of all the other segments

OTC Space
- Voice brokers
- Systematic internalisers (sometimes electronic)
A bit of story (1)

- MTS S.p.A. was the **first electronic market for government bonds** in Europe and probably in the world.

- In 1988 the market started but without an electronic autonomous central system. It was relying on a private server managed by Italian banks.

- In 1992 new central autonomous system owned by the Treasury and managed jointly by the Treasury and the Bank of Italy (Italian Central Banks, henceforth B.o.I.). The system was operationally managed by a specialised IT company that currently is still keeping this role (after 29 years).

- In 1997 the company created by the Treasury and the B.o.I. is privatized to 55 banks (half domestic and half foreign).

- The main reason for the launch of MTS was to **create a supportive environment for the big changes that were ongoing in the primary market**, namely the evolution in the placement technique of government bonds.
  - From a system of **firm sale** to a predetermined group of banks to an **auction based system**, where all market players can participate and bid competitively for the amount of bonds announced by the issuer.
A bit of story (2)

- In 1998 with the new law “on markets and financial intermediation” MTS becomes a Regulated market owned by the private sector

- According to several 2n tier regulations (Ministry decrees), also issued to transpose in the Italian regulatory framework several EU directives, the set of rules according to which the market for \textit{wholesale} trading in government bonds works is laid down by the Treasury, while the supervision is under the control of B.o.I. and marginally of Consob (the Italian S.E.C.)

- The Treasury issued two main regulations in 1999 and 2009 that reaffirmed MTS as a pure interdealer platform with market making obligations, high levels of transparency both pre trade and post trade, even before MIFID 2 (2014 EU directive) requirements. The 2 decrees also set down the rules for PDs

- Starting from 1998 MTS became more international with the creation of Euro MTS and several domestic MTS throughout the EU and outside
The measures to create an efficient secondary market, were adopted within the general framework of public debt management policy, aimed at achieving a **structural minimization of funding cost**.

The goals to accomplish with the new trading system were:

- greater **liquidity for Government bonds**, through an enhanced network which makes transactions very easy to be executed.

- **clear picture of market conditions** for the market participants, by means of a continuous “on screen” availability of **bid-offer prices**.

- better forecast of the market conditions, to **help the issuer in the placement of specific bonds** offered at auctions.
A bit of story (4)

MTS was created to provide a **network for electronic trading** of Italian government securities

In order to participate to the system, financial institutions had to adhere to the market signing an agreement

The main feature of the new system consisted in the possibility for operators to unload even large positions:

- in **any market condition**
- at **clear and reliable prices**
- at the least possible cost (through **reduced bid/offer spreads**)

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A bit of story (5)

- In 2001 the same company founded Bondvision, a web based market relying on the same infrastructure as MTS, dedicated to B2C transactions with which MTS dealers can interact with final investors.

- In 2002 a Central Counterparty service is introduced with the presence of CCG (Cassa Compensazione e Garanzia, the Italian CCP) and LCH Clearnet, two interoperable CCPs.

- In 2006 the majority of shares was then sold to an holding (a joint venture between Euronext N.V. and Borsa Italiana S.p.A.). Major international financial institutions hold the remaining shares.

- Currently MTS, after a short period under the ownership of Borsa Italiana SpA, is now part of the LSE group after the latter took over the Borsa Italiana group in 2007.
MTS today

• **MTS is a wholesale market**, where cash and repo are traded: membership is limited to institutional intermediaries (essentially banks) participating on their own account (or on behalf of institutional investors but as a direct counterpart), with minimum amount requirements for trading

• **Anonymity**: the counterpart is disclosed only after trade is executed

• **Liquidity of bonds traded and depth of the market**: market makers are subject to quoting obligations and should trade large volumes in all circumstances

• **Transparency**: MTS provides clear information about best prices and latest trades, also through real-time market statistics

• **Efficiency**: auto-matching of proposals is provided and pending orders are aggregated

• **Quickness**: around 3 seconds are required to enter an order manually and less than 1 second for the effectiveness of a quotation change (parallel transactions enable all quotes to be changed at the same time)
The wholesale Repo market

- A **Repo trading facility** is also available on the MTS platform called MMF-Repo (Money Market Facility - Repo)

- It allows buy and sell back on Italian government bonds, classic repos and buy and sell back on non-Italian Government bonds and non-Government bonds

- Provides users with the functionality to trade repos electronically, thus enabling the **simultaneous management of both repo and cash** securities trading

- All securities traded can be object of repurchase agreements; two types of contracts can be negotiated: **Special repos** and **General collateral repos**

- There is **no role distinction among the participants** and there are **no quoting obligations** on the regulated wholesale Repo market

- Participants can also be non-banking entities such as funds or insurance companies
Other ETPs where Italian Public Debt is traded

- In Italy, beyond MTS and Bondvision, there is also a **retail regulated secondary market** for Government bonds and other securities, called MOT (managed by Borsa Italiana S.p.A.)

- After mid-2000s Italian debt has been increasingly traded on foreign platforms based in Europe:
  - Based in UK there are **Euro-MTS, BrokerTec/ICAP, BGC e-speed** while in Germany there is **Eurex-bond**. These are all **interdealer markets** with rules similar but not the same as MTS. The volumes there are still pretty small if compared to MTS ones.
  - There are also **dealer-to-client** electronic markets such as **Tradeweb, Bloomberg, Reuters and Market Axess**. Tradeweb shows volumes in line with Bondvision.
  - All these markets are **Multilateral Trading Facilities** according to MIFID: therefore the level of regulation and supervision is slightly lighter than those of a regulated markets