

## Euro SSA Strategy

### ESM Bond Supply Is Nearly Here

- **A new species of bond – ESM supply:** In a widely anticipated SSA transaction, the ESM has indicated it is to issue €9bn in 2H 2013. We update and summarise the key points regarding this SSA issuer, full details of which can be found in our note [Euro SSA Strategy - The EFSF and ESM in 2013](#).
- **ESM “supply” has already occurred in other guises:** The ESM is involved in the Spanish bank recapitalization package (up to €100bn) and the bailout of Cyprus (€9bn). It has already supplied €41bn in securities that were handed over to Spain (the FROB) and has been issuing bills since it took over this responsibility from the EFSF.
- **ESM is now the permanent euro area stability facility:** The ESM is now the sole and permanent euro area stability mechanism for new programme countries. The EFSF will continue to fulfill commitments for its own programmes involving Greece, Portugal and Ireland. The EFSF will also refinance debt until all loans have been repaid.
- **Peer comparisons and relative value considerations:** Relative value considerations are likely to involve other core supranationals within the European SSA market, including the EFSF, the EIB and the EU. The ESM benefits from paid-in capital (ultimately €80bn), permanence and its complete lending capacity of €500bn. Such features should ensure it becomes a core market issuer within the wider SSA universe.

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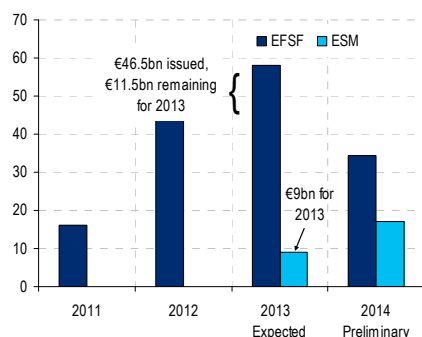
## ESM bonds to trade are nearly here

In this one page overview, we update and summarise the key points regarding the funding programme of the European Stability Mechanism (ESM). For full details on the issuer's structure, comparisons with the EFSF and views regarding the market impact, please see our primer [Euro SSA Strategy - The EFSF and ESM in 2013](#).

### A new entrant to the SSA universe

**European Stability Mechanism:** The ESM is now the permanent stability mechanism for the euro area. The EFSF is no longer active in new programmes but will continue to fund its existing commitments to Greece, Portugal and Ireland and to refi and manage existing debt until all loans have been repaid ([EFSF in June 2013: Au revoir, not adieu](#)). The ESM has commitments to Spain (up to €100bn) and Cyprus (€9bn) as detailed below.

Figure 1. EFSF and ESM Supply (€bn)



Source: Citi Research, EFSF, ESM

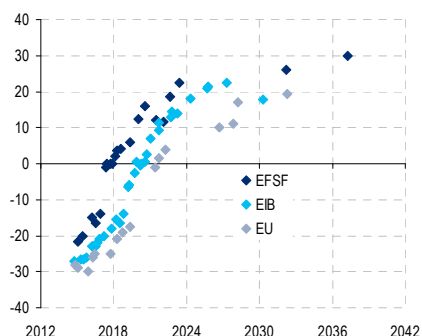
Figure 2. EFSF and ESM Commitment History

Date	Sovereign	EFSF/ESM Commitments	EFSF/ESM	Details
Nov-10	Ireland	17.7	EFSF	EFSF commitments to the total €85bn Troika programme
May-11	Portugal	26	EFSF	EFSF commitments to the total €78bn Troika programme
Mar-12	Greece PSI	35.5		PSI bonds
	2nd Greek Bailout	48		Bank recap
		24.4		Funds carried over from 1st Greek bailout
		36.7		2nd Greek bailout funds
		144.6	EFSF	
Dec-12	Spain	100	Now ESM	Up to €100bn available for Spanish bank recap package Originally EFSF but later transferred to ESM
Mar-13	Cyprus	9	ESM	ESM commitments of €9bn, IMF contributions of €1bn
Total Agreed Commitments EFSF		192		Portugal, Ireland, Greece, Includes €3.7bn cash buffer
Total Agreed Commitments ESM		109		Spain and Cyprus, remaining lending capacity €391bn

Source: Citi Research, EFSF, ESM

**Supply outlook:** The ESM has indicated (August Investor Presentation) a preliminary supply pipeline for its long-term funding programme of €9bn for 2013 (and €17bn for 2014, Figure 1). Bonds may range in 1yr-30yr maturities, are likely to come in benchmark size and will be traded on the secondary market. However, note that ESM "issuance" has already occurred. The ESM has issued and provided €41.3bn of its capacity to the FROB in cashless securities to be used for the Spanish bank recapitalization package. It has also been issuing bills for much of the year (having taken over this responsibility from the EFSF) and such funds have already been used to provide Cyprus with €3bn in bailout resources.

Figure 3. EFSF, EU and EIB ASW curves (bp)



Source: Citi Research, Bloomberg

**Peer comparisons:** The ESM is a supranational, being an intergovernmental organization incorporated by Treaty under international law. Within the core European market, we have detailed that peers are likely to include the EFSF, EIB and EU and their ASW curves are shown in Figure 3. The ESM benefits from paid-in capital (ultimately €80bn), permanence and a complete lending capacity of €500bn. Further details on peer comparisons and how the structure differs from the EFSF is provided in our [Euro SSA Strategy - The EFSF and ESM in 2013](#).

### Conclusions – enhanced credit features likely to ensure core status

In short, we see the establishment of the ESM as an important step in the evolution of the euro area debt crisis management framework. The EFSF has seen considerable investor support, being able to syndicate in large size and across several maturities. 10yr EFSF spreads at 22bp also signify healthy performance. The ESM benefits from various credit enhancements which will likely to ensure it becomes a core market issuer within the European SSA universe.

## Appendix on the ESM Treaty

### The ESM Treaty – a quick guide for SSA markets

We highlight further key features of the ESM below in a quick “ESM Treaty guide” for SSA markets. This is an abbreviated version of the original ESM Treaty (from our [Euro SSA Strategy - An Introduction to Core European SSA Issues](#)) which forms the legal basis for ESM operations as ratified by the euro area member states<sup>1</sup>:

**To safeguard financial stability by raising funds and entering into financial arrangements**

**Article 3 – Purpose:** *“The purpose of the ESM shall be to mobilise funding and provide stability support under strict conditionality, appropriate to the financial assistance instrument chosen, to the benefit of ESM Members which are experiencing, or are threatened by, severe financing problems, if indispensable to safeguard the financial stability of the euro area as a whole and of its Member States. For this purpose, the ESM shall be entitled to raise funds by issuing financial instruments or by entering into financial or other agreements or arrangements with ESM Members, financial institutions or other third parties”.*

**Guarantees are irrevocable and unconditional**

**Article 8(4) – Explicit Guarantee:** *“ESM Members hereby irrevocably and unconditionally undertake to provide their contribution to the authorised capital stock, in accordance with their contribution key in Annex I. They shall meet all capital calls on a timely basis in accordance with the terms set out in this Treaty.”*

**Article 9(1) – Capital Calls:** *“The Board of Governors may call in authorised unpaid capital at any time and set an appropriate period of time for its payment by the ESM Members.”*

**ESM aid is conditional**

**Article 12(1) – Conditionality:** *“If indispensable to safeguard the financial stability of the euro area as a whole and of its Member States, the ESM may provide stability support to an ESM Member subject to strict conditionality, appropriate to the financial assistance instrument chosen. Such conditionality may range from a macro-economic adjustment programme to continuous respect of pre-established eligibility conditions”.*

**Article 14(1) – Precautionary Programmes:** *“The Board of Governors may decide to grant precautionary financial assistance in the form of a precautionary conditioned credit line or in the form of an enhanced conditions credit line in accordance with Article 12(1).”*

**ESM can buy bonds in the primary and secondary markets**

**Article 17(1) – Primary Market Purchases:** *“The Board of Governors may decide to arrange for the purchase of bonds of an ESM Member on the primary market, in accordance with Article 12 and with the objective of maximising the cost efficiency of the financial assistance.”*

**Article 18(1) – Secondary Market Purchases:** *“The Board of Governors may decide to arrange for operations on the secondary market in relation to the bonds of an ESM Member in accordance with Article 12(1).”*

**Article 21(1) – Borrowing:** *“The ESM shall be empowered to borrow on the capital markets from banks, financial institutions or other persons or institutions for the performance of its purpose.”*

**Article 25(1) – Loss Charges:** *“Losses arising in the ESM operations shall be charged: (a) firstly, against the reserve fund; (b) secondly, against the paid-in capital; and (c) lastly, against an appropriate amount of the authorised unpaid capital, which shall be called in accordance with Article 9”*

<sup>1</sup> Details and quotes are directly from the ESM Treaty text. Recent details of the ESM's involvement in the banking resolution regime are detailed in the [Euro Economics Weekly](#), 28<sup>th</sup> June 2013

## Appendix A-1

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