

ESM Borrowing Guidelines

These guidelines outline the main elements of the ESM borrowing activity. The ESM mobilises funding and provides stability support under strict conditionality to the benefit of ESM Members. To this end, 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. More specifically, the ESM is empowered to borrow on the capital markets, from banks, financial institutions or other persons or institutions according to Article 21(1) of the ESM Treaty.

1. Funding objective and principles

The ESM borrowing strategy pursues several objectives and principles to comply with the purpose established in Article 3 of the ESM Treaty.

First, the market environment under which the ESM operates may be volatile during crisis episodes. The general borrowing strategy must therefore offer the possibility to react rapidly to unexpected market developments, including through the building up of liquidity buffers during episodes of systemic risk, and ensure market access even in a difficult market environment with a high degree of uncertainty.

Second, the demand for ESM financing over time is highly variable. The instruments available to the ESM may imply that large amounts of financing be required at relatively short notice. The addition of Direct Bank Recapitalisation to the list of financial assistance instruments amplifies this concern. By comparison, on-going standard macro-economic adjustment programmes more often entail a relatively steady flow of limited amounts, however, with uncertain disbursement profiles. The ESM borrowing strategy has therefore to offer the flexibility to raise predictable amounts over a longer period covering varying disbursement schedules as well as unexpected amounts at relative short notice, including prior to the entry into a financing programme.

Third, the ESM engages in efficient funding in order to offer financing at reasonable conditions to the beneficiary ESM Members, with a priority given to, first, mitigation of liquidity risk and, second, appropriate balance between costs and interest rate risk.

With a view to these objectives, the ESM fosters its role in the market as a reliable issuer of reference and maintains a regular presence. In a difficult market environment, investors prefer to buy liquid products with an easy, plain vanilla structure. The ESM's basic portfolio of

funding instruments fulfil these criteria. The basic portfolio may be broadened to tap other segments of the capital market when required due to specific financing needs and schedules.

Moreover, the ESM aims to access different parts of the money market to manage liquidity risk.

Finally, the ESM can use derivative instruments, whenever appropriate, to manage risks arising from its borrowing activities, and post its assets as collateral in the relevant derivatives transactions. Except where permitted under the ESM Treaty (namely, to avoid a capital call under Article 9(3) of the ESM Treaty), the investments of ESM capital (including cash) cannot be used as collateral in derivatives related to ESM borrowing activities.

Borrowing activities will be managed within an appropriate risk management framework, as specified in the High Level Principles for Risk Management and in the risk policies.

2. Funding tools

A broad portfolio of funding instruments is needed to ensure the necessary flexibility to issue large amounts at short notice. This portfolio of funding and pre-funding instruments should include capital market and money market instruments to deliver the required flexibility.

2.1 Capital market instruments

The ESM issues regularly in the capital markets. The maturities of the borrowing transactions shall not exceed the maximum maturity approved by a decision of the Board of Directors in view of the financial assistance commitments and revisited from time to time.

Debt Issuance Programme:

The main framework to issue medium and long-term bonds is the ESM debt issuance programme (DIP), under which the ESM carries out euro-denominated issues of notes.

The strategy of building a curve with the regular issuance of different benchmark lines offers access to different types of investors and allows raising large amounts of funding. Increasing the size of some outstanding lines in order to provide more liquidity to investors may be envisaged as an element to strengthen the funding efficiency.

The issuing processes are flexible and comprise syndicated transactions as well as auctions. In addition to the regular benchmark transactions and increases of outstanding lines, the ESM may issue bonds as private placements. This additional flexibility allows the ESM to improve its overall funding cost and take advantage of the specific demand which may arise from large investors.

The ESM retains the flexibility of holding own bonds for a limited amount. This offers the possibility to raise additional funding either by selling the bonds in the secondary market or by using them as collateral in the secured money market. It also helps testing real demand from market participants to secure the success of taps or auctions.

The ESM can further diversify its funding strategy by issuing in other currencies, either under the DIP or otherwise. Such foreign currency issues shall be hedged.

Other capital market instruments:

As a complement to the DIP, the ESM can issue promissory/registered notes. This instrument allows the ESM to benefit from substantial additional demand in this kind of specific products, and may be valuable when large or unexpected financing needs arise.

2.2 Money market instruments

The ESM operates a bill programme through regular auctions. Such a programme allows the ESM to raise large amounts even in a volatile environment. It provides flexibility and efficiency to borrowing operations, as bond issues can be launched when market conditions are adequate.

The ESM can engage in unsecured money market transactions. Transactions can be done on the same day, on a rolling basis or for tenors up to one year. This flexible instrument can be used to finance temporary liquidity gaps.

The ESM maintains uncommitted liquidity lines with the debt management offices (DMOs) of ESM Members. Any amounts available from individual DMOs to lend to the ESM have to be in accordance with national budget law rules and the cash position of the respective office. Therefore, these lines should be used in exceptional circumstances only, when other ways of funding are not available.

The ESM maintains uncommitted credit lines with banks of appropriate credit standing. These credit lines will be used to bridge temporary short-term liquidity gaps.

The ESM may enter into committed credit lines with the counterparties mentioned above in the context of uncommitted lines, and may use other money market instruments, such as commercial paper denominated in euro or, if needed in other currencies, money market promissory notes, and engage in repo transactions.

The ESM may carry out borrowing activities in line with the limits set out on the liquidity buffer and the overall borrowing amounts determined pursuant to these guidelines.

3. Transfers of the raised funding amounts into financial assistance

Under a matched funding approach, funding instruments and financial assistance have mostly the same financial profile as regards the amount, time of issue, currency, repayment profile, final maturity and interest index.

Under a diversified funding strategy, the characteristics of the funding instruments are extended to a wide range of techniques and can deviate from the parameters of the financial assistance. A variety of instruments, maturities and currencies can be used to ensure the efficiency of funding and continuous market access. Consequently, liquidity, interest rate or currency exposure may arise and management of those risks to minimise the exposure of ESM will be necessary. The ESM operates a diversified funding strategy to be able to fulfil its purpose as stated in Article 3 of the ESM Treaty in the most efficient and flexible way. The diversified funding strategy is based on a short-term and a long-term funding pool.

The aggregate size of the short-term funding pool, long-term funding pool and all issuance on a silo basis will be limited by an overall maximum borrowing amount approved by the Board of Directors and revisited from time to time, which takes into account the lending portfolio.

The size of the liquidity buffer is also approved by the Board of Directors.

4. Governing law and clearing systems

The documentation of the ESM DIP is governed by Luxembourg law or by any other major governing law if required for specific instruments or investors. DIP issuances in currencies other than euro shall be approved by the Board of Directors.

Clearing and settlement shall be performed by the major platforms.

For an interim period, the ESM DIP may be carried out based on a similar legal structure as the EFSF DIP whose operating model requires a clearing settlement in Frankfurt.

5. Reporting and procedures

The borrowing strategy is implemented in accordance with the provisions of the ESM Treaty and the By-Laws.

In addition, these guidelines are implemented through a set of internal procedures specifying the authorisations, delegations and controls for the steps to be taken ahead of and after a transaction. In particular, they detail the involvement of the Chief Risk Officer in controlling

risks in line with the ESM risk management framework and the involvement of other relevant ESM functions, such as ALM and Middle Office.

The Managing Director reports regularly, at least every three months when financial assistance is provided and otherwise at least annually, on funding activities to the Board of Directors.

Whenever necessary in view of pending lending requirements and market conditions approach, the Managing Director requests the Board of Directors to authorise the size of the Overall Borrowing Amount, the Short-Term Pool, the Long-Term Pool and the Liquidity Buffer. This authorisation shall be reviewed and renewed at least annually.