BRIEFING

European Parliament

The ESM Pandemic Crisis Support

This paper provides a summary analysis of the European Stability Mechanism Pandemic Crisis Support instrument agreed by the Eurogroup. This instrument allows the ESM to provide financial assistance (either as loans or by purchasing sovereign bonds) to euro area Member States, to be used for recovering costs related to direct and indirect healthcare, cure and prevention due to the COVID- 19 crisis. The paper focuses on the main feature of the instrument, including its eligibility, the financial and the surveillance aspects.

I. Background

The European Stability Mechanism (ESM) is an international financial institution, set up in October 2012, aimed to provide financial assistance to euro area Member States under strict conditionality. ESM financial assistance is granted through a number of financial instruments: loans, purchase of Member States' sovereign issuances in primary and secondary markets, as well as precautionary credit lines. Each instrument has attached different pricing and conditionality. The main decision body in the ESM - the Board of Governors - is composed of the Ministers of Finance of euro area Member States, and therefore coincides with the Eurogroup (EG). For an overview of ESM, its instruments and accountability, please see a specific EGOV briefing.

Following its 16 March meeting and in the context of discussions aiming at defining the EU emergency response to the COVID-19 crisis, the EG asked institutions - including the ESM - to "*explore ways, within their mandates, to address the challenges posed by the coronavirus.*". At that time, the ESM Managing Director suggested to make use of existing facilities: "*We have an unused lending capacity of €410 billion (...) We have a number of facilities and several of them have never been used (...)*".

There is no public information pointing to discussions on using the ESM as part of the crisis response before the 4 and 16 March EG teleconference meetings; in January and February, 2020 the EG was still following its agenda and work programme (euro area recommendations were approved in February, with no references to the brewing corona crisis).The EG (in inclusive format) was also discussing a reform of the ESM which has been suspended for the time being (see specific EGOV briefing).

Following Heads of State's endorsement, on 17 March, of the 16 March EG meeting results, the EG reported on 25 March to the European Council President the Ministers' "*readiness to use the ESM, as needed, in a manner consistent with the external, symmetric nature of the COVID-19 shock" (...) broad support to make a Pandemic Crisis Support safeguard available, within the provisions of the ESM Treaty, building on the framework of the existing Enhanced Conditions Credit Line (ECCL).*".

On 9 April 2020, the EG agreed a new and temporary Pandemic Crisis Support (PCS) instrument. On 8 May, the Eurogroup agreed on the features and standardised terms of the instrument and on 15 May, EG and the ESM Board of Governors finalised the PCS.

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PE 651.350v2- August 2020

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II. Features of the Pandemic Crisis Support

The EG established that assistance under PCS is available to any Euro Area Member State and is to be used for covering costs related to direct and indirect healthcare, cure and prevention due to the COVID 19 crisis (non-euro area Member States can access the BoP facility). It also established that the PCS is to be offered with similar conditions to all Member States, including the same current eligibility requirements for acceding ESM's precautionary assistance (the section below presents some details).

The PCS is based on the current ESM Enhanced Conditions Credit Line (ECCL) and will allow granting precautionary financial assistance of up to 2% of 2019 GDP to requesting Member State, as a benchmark. The Annex provides some relevant figures, including the 2% of 2019 GDP, for each euro area Member State; it also presents estimated possible interests costs and benefits of using the PCS.

On 9 April, the Eurogroup decided that a Member State requiring access to the PCS would remain committed, after the covid-19 crisis is over, "*to strengthen economic and financial fundamentals, consistent with the EU economic and fiscal coordination and surveillance frameworks, including any flexibility applied by the competent EU institutions*". No further conditionality is attached to the PCS.

On 8 May the Commission proposed a common template for the Response Plan that Member States will use to detail the costs incurred or planned to implement the policy measures to be associated with financing under the PCS. Such template will correspond to the Memorandum of Understanding as per Articles 13(3) and 14(2) of the ESM Treaty and Article 7 of Regulation 2013/472[1]. The ESM Board of Governors approved the establishment of the PCS (and of the template) on 15 May.

The main differences between a "standard" ECCL and the PCS can be summarised as follows (the next section presents some details):

- **ECCL**: a detailed and country specific MoU; **PCS**: uniform policy conditions for all Member States, as in the "template Pandemic Response Plan";
- **ECCL**: enhanced surveillance in accordance to Regulation 2013/472; **PCS**: light version of enhanced surveillance (as detailed in Commission's letter of 7 May);
- Pricing conditions (see Table 1 below).

III. Eligibility, pricing and financial conditions and surveillance of the Pandemic Crisis Support

III.1 Eligibility criteria

Two different precautionary credit lines are available in the current ESM toolbox: the Precautionary Conditioned Credit Line (PCCL) and the ECCL. Access to the PCCL is available to a Member State whose financial condition is still fundamentally sound and that fulfills specific "eligibility criteria", whilst access to an ECCL can be granted to a Member State that does not fulfill all these criteria, but whose general economic and financial situation remains sound.

The current ESM guideline lists such criteria:

- Respect of the commitments under the Stability and Growth Pact;
- A sustainable general government debt;

[1] Regulation (EU) No 472/2013 of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability.

- Respect of the commitments under the excessive macroeconomic imbalance procedure;
- A track record of access to international capital markets on reasonable terms;
- A sustainable external position; and
- The absence of bank solvency problems that would pose systemic threats to the stability of the euro area banking system.

The Member State that does comply with these criteria will have access to the PCCL, whilst the Member State that does not comply with some of these criteria would have access to the less favourable ECCL.

The assessment of the conditions is to be made by the Commission, in liasion with the ECB and involvement of the ESM.

On 9 May 2020, the Commission published a preliminary assessement of the eligibility criteria for all euro area Member States, in cooperation with the ECB and the ESM. It took into consideration the EG agreement on PCS, that will be offered with similar conditions to all Member States, and the current eligibility requirements for acceding ESM precautionary assistance. It concluded that "*the economic situation in euro area Member States is considered to be fundamentally sound*" and that all the eligibility criteria are met. The assessment was separately done for each of the relevant eligibility criteria, as follows:

(a) Euro Area Member States government debts are expected to remain sustainable and all Member States are expected to retain market access at reasonable terms (see here). In particular, the Commission considered that, based on Commission forecast, additional costs due to the impact of the Corona virus outbreak would amount to more than €830 bln in 2020 and €280 bln in 2021 (including health related costs), for the euro area as a whole;

(b) no euro area Member State is in an excessive deficit procedure pursuant to Article 126 TFEU, nor is in an excessive macroeconomic imbalance procedure pursuant to Article 7 of Regulation (EU) 1176/2011 (see here);

(c) external positions of euro area Member States are sustainable (see here); and

(d) the ECB has concluded that there is no evidence of systemic solvency problems in the euro area banking systems.

The Commission also assessed that "*Financial assistance by the ESM to the benefit of its members, in particular under precautionary arrangements, would contribute to instilling confidence, would help to stabilise financial markets and would reduce risks to the financial stability of the euro area as a whole and of the euro area Member States.*".

III.2 Financial/pricing conditions

On the basis of a proposal by the ESM Managing Director, the ESM Board of Governors approved on 15 May the financial and pricing conditions of the PCS:

- The amount available for support is of 2% of Member States GDP as of 2019, as a benchmark. It takes into account the ESM financial situation and the assessment made by the Commission of Member States possible financing needs;
- Requests may be made until 31 December 2022;
- The initial availability period for each PCS will be 12 months, which could be extended twice for 6 months, in line with the standard framework for ESM precautionary instruments;
- Disbursements (15% per month) can be made in cash or in kind, with detailed rules dealing namely with the periodicity and amount available for each disbursement request;
- The envisaged maturity of the financial assistance is of 10 years;

- ESM will finance itself in the markets to provide financial assistance and create a "common funding silo" for possible drawdown requests; to that end, "social bonds" may be offered;
- Member States requesting the opening of the PCS credit line will be charged at inception an Upfront Service Fee of 25bp, based on 15% of the amount allotted to that Member State, and an annual Commitment Fee as part of ESM funding costs. For Member States drawing funds on their PCS, additional fees will apply, as follows: a margin of 10bp accruing on outstanding amounts; an upfront Service Fee of 25pb on each disbursement (to be discounted in any Upfront Service Fee paid); and an Annual Service Fee of 0,5% accruing day to day on any outstanding financial assistance amounts. Fees are in addition to the interest rates accruing on financial assistance given by the ESM.

Table 1 compares the pricing conditions applied to the standard precautionary credit lines and those applicable to the PCS. It can be noted that the conditions for the PCS are more favourable than those in the standard instrument: in addition to the price paid by the ESM on its borrowing, Member States benefitting of PCS pay an additional rate of around 35.5 basis points (compared to 85.5 basis points under the standard precautionary instruments).

Table 1: Pricing conditions - A comparison between "standard precautionary credit line and PCS"

	Precautionary Credit Line	Pandemic Crisis Support	Comment/Explanation
Upfront Service Fee	50 bps	25 bps	A first Upfront Service Fee on 15% Member States allocated amount will be invoiced at the inception. This fee will be deducted from subsequent fees, when actual money is drawn.
Annual Service Fee	0.5 bps	0.5 bps	
Margin	35 bps	10 bps	
Commitment Fee	TBD	TBD	Depending on ESM's financial losses
Penalty fee	200 bps over Euribor (or interest payable)	Not specified	
Primary market purchases	Additional margin of 35 bps	Not specified*	

Source: ESM pricing policy (2014); ESM Managing Director draft proposal
TBD: to be determined (it is applicable, but is currently unknown)
* in its blog of July 2020, the ESM does not include this item in the calculation; it can therefore be assumed that it won't apply for the PCS.
bps: basis points

In June 2020, the ESM published a blog "Out of the Box: A new ESM for a new crisis" with details and simulations related to the pricing and costs of the PCS. In July, the ESM published another blog "Why the Covid-19 credit line still makes sense", with updated figures. Simulations refer to yields on national sovereigns of 7 and 10 years maturities. The ESM concludes that (based on the 24 July ESM cost of funding, 10 years), the total ESM lending rate for PCS would be -0.12%; and hence for ten euro area Member States the PCS would be more attractive than borrowing on financial markets, namely Estonia, Ireland, Greece, Spain, Italy, Cyprus, Lithuania, Malta, Portugal and Slovenia. Such gains would be in terms of saving on interests paid on the portion of public debt financed through the PCS; other advantages should be considered: less pressure on the financial markets, reduced need of PEPP from the ECB, possible future flexibility on the financial conditions (maturity extensions, grace periods...).

III.3 Surveillance

In accordance with ESMT and Regulation 472/2013, the Member State that received financial assistance is subject to surveillance until 75% of the amount lent is paid. The Commission has clarified in a letter (dated 7 May) that a Member State benefitting of the PCS will be subject to a light enhanced surveillance, once the credit line is drawn[2]. In the letter addressed to the Eurogroup President, the Commission stated that as "*Member States do not experience, nor are threathened, with serious difficulties* ***of an internal origin*** [our emphasis] *with respect to their financial stability (…) a streamlined reporting and monitoring framework is warranted",* in line with Eurogroup decisions endorsed by the European Council. Therefore, the Commission will "*focus its monitoring and reporting requirements on the actual use of the PCS funds to cover direct and indirect healthcare costs, reflecting the only conditionality attached to the credit line.*".

Assessment of compliance will be made on the basis of the commitments detailed in the template, in accordance with Eurogroup statement of 8 May. The PCS support will activate ESM "Early Warning System" to allow the ESM to assess assisted Member States ability to replay the loan.

[2] The ESM PCS explainer states that "*According to EU framework, the Member States that benefit from precautionary financial assistance from the ESM are subject to Enhanced Surveillance.*". The ESM guideline on precautionary financial assistance points to a Member State being subject to enhanced surveillance "*Where an ECCL is granted or a PCCL drawn*" (article 5(1)).

ANNEX

This Annex presents some figures related to public finances in euro area Member States, including the 2% of 2019 GDP that is used as a benchmark in the context of PCS. See also ESM blog of June "Out of the Box: A new ESM for a new crisis" and of July "Why the Covid-19 credit line still makes sense" for estimations on the costs and explanation of benefits of using the PCS.

	Assessment of the potential use of the PCS						Some other public finance indicators				
Member State	GDP at Market prices (Billion €)	2% of 2019 GDP (Billion €)	Yield on sovereign bonds (10 years)	Difference respect to ESM -0.26% interest rate (%)	Difference respect to PCS annual cost (-0.12%) (**)	Annual gain or loss Million €, per year	Government Debt % GDP		Government Expenditure for Interests on public debt % GDP		Gross Financing Need % GDP
	2019	2019	July 2020	July 2020	July 2020		2019	2020	2019	2020	2020
BE	473	9.47	-0.17	0.09	-0.05	-4,7	98.6	113.8	2.0	2.0	21.1
DE	3.435	68.72	-0.52	-0.26	-0.40	-274,9	59.8	75.6	0.8	0.7	11.0
EE*	28	0.56	0.05	0.31	0.17	1,0	8.4	20.7	0.0	0.0	1.5
IE*	347	6.94	-0.05	0.21	0.07	4,9	58.8	66.4	1.3	1.2	13.1
EL*	187	3.75	1.14	1.40	1.26	47,3	176.6	196.4	2.9	3.0	5.8
ES*	1.245	24.91	0.37	0.63	0.90	122,1	95.5	115.6	2.3	2.4	23.0
FR	2.419	48.38	-0.15	0.11	-0.03	-14,5	98.1	116.5	1.4	1.4	19.7
IT*	1.788	35.75	1.20	1.46	1.32	471,9	134.8	158.9	3.4	3.7	28.3
CY*	22	0.44	0.95	1.21	1.07	4,7	95.5	115.7	2.5	2.4	8.1
LV	30	0.61	-0.17	0.09	-0.05	-0,3	36.9	43.1	0.7	0.8	4.2
LT*	48	0.97	0.16	0.42	0.28	2,7	36.3	48.5	0.9	0.6	12.7
LU	64	1.27	-0.43	-0.17	-0.31	-3,9	22.1	26.4	0.3	0.3	5.5
MT*	13	0.26	0.64	0.90	0.76	2,0	43.1	50.7	1.4	1.5	13.3
NL	812	16.24	-0.39	-0.13	-0.27	-43,8	48.6	62.1	0.8	0.8	12.3
AT	398	7.97	-0.25	0.01	-0.13	-10,4	70.4	78.8	1.4	1.5	13.8
PT*	212	4.25	0.40	0.66	0.52	22,1	117.7	131.6	3.0	3.4	18.6
SI*	48	0.96	0.09	0.35	0.21	2,0	66.1	83.7	1.7	1.8	11.0
SK	94	1.88	-0.16	0.10	-0.04	-0,8	48.0	59.5	1.2	1.3	9.2
FI	240	4.80	-0.21	0.05	-0.09	-4,3	59.4	69.4	0.9	0.8	15.9
EA	11.907	238.10	-	-	-	-	-	-	1.6	1.7	-

Sources: Eurostat (2019 GDP, retrieved in May 2020), Commission Forecasts Spring 2020, ECB (yields on sovereigns), ESM, own calculations (see also Public finance in EA MSs: selected indicators).

* Member States for which the PCS would be convenient in terms of costs.

** The figure -0.12% indicated as the "PCS annual cost" is provided by ESM in its blogs, obtained as the sum of ESM borrowing cost in financial markets (reference date of 24 July 2020) and the ESM pricing details (see Table 1)

Note: a previous version of this table included a mistake, that has been corrected.

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