Webinar interview with Siegfried Ruhl

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Transcript of webinar interview with ESM Head of Funding and Investor Relations Siegfried Ruhl
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Firstly, how does this crisis compare to the eurozone sovereign debt crisis or indeed any other crisis that Europe has faced?

The Covid-19 pandemic is a crisis like none other - not only for Europe - but for the whole world. It has caused huge economic damage. It was reported last month that UK GDP dropped by a record 20% in April. In Europe, also, economic growth will sharply decline in 2020. The IMF economic outlook for Europe suggests a 10.2% decline in euro area GDP this year.

But the economic decline is not the only aspect of this current crisis that is different to the past. The nature of the crisis is different too. Some people ask if there are parallels to the euro sovereign debt crisis we faced around 10 years ago, but there are no parallels.

The crisis in 2010 affected certain countries within the euro area - but not all of them – and it was often the result of economic imbalances and weaknesses stemming from unsustainable fiscal policies in that era.

Now, the current crisis is indiscriminate. It affects all countries of the euro and the wider European Union and beyond with the tragic loss of human life and economic costs. But none of our member states have lost market access so far.

The ESM's role is at the centre of helping Europe through this crisis. Could you outline the ESM's Pandemic Crisis Support?

The Pandemic Crisis Support is part of a wider package for Europe. In April, the euro area finance ministers decided on a package with three elements. First, there's the so-called SURE programme of the European Commission to support workers. Then we have the European Investment Bank supporting the SMEs [small and medium-size enterprises] and then finally the Pandemic Crisis Support provided by the ESM.

Altogether, this package amounts to €540 billion. What is the ESM's part? The Pandemic Crisis Support is a credit line based on an existing instrument which was created at the beginning of the ESM's existence – the so-called ECCL or Enhanced Conditions Credit Line.

In May, based on the ECCL, we launched the pandemic crisis support, which is available to all 19 euro area member states with only one condition - the money has to be used for direct and indirect healthcare costs to fight the Covid-19 crisis.

We can lend up to 2% of each member state's GDP to support member states dealing with the crisis. The loans we provide to the member states can have an average maximum maturity of 10 years. If we take the 2% for each member state's GDP, this would sum up to an amount of up to €240 billion if all 19 member states request the support.

How do member states go about applying for the pandemic crisis lines?

This Pandemic Crisis Support is based on the ECCL and so in general it follows the process of the ECCL. Nevertheless, the European Commission has already carried out a pre-selection exercise and determined that all 19 euro area member states are eligible for our assistance via the Pandemic Crisis Support on standardised terms.

If a member state wants to receive the Pandemic Crisis Support, it must provide its submission to the ESM Board of Governors, comprising the 19 euro area finance ministers. The Board of Governors then needs to unanimously endorse this application and this endorsement is based on the Board being satisfied that the proceeds will be used to fight the Covid-19 crisis by financing direct and indirect healthcare costs.

Once the Pandemic Crisis Support is approved, member states can decide if they want to draw the funds or not. There is no obligation to draw on the line. But if a member state decides to draw on the line then it can get 15% of the total amount per month, which means in around seven months, the full line can be disbursed.

Member states can also include any relevant backdated healthcare costs since February 2020. They can apply for the line until the end of 2022.

Roughly how many member states do these lines represent a cost saving for?

Under current market conditions, 12 of our 19 member states would benefit from the Pandemic Crisis Support. This means they would be able to fund themselves cheaper via these lines than they do in the markets.

For the 12 member states, the total amount of the lines would be in the area of €80-€90 billion. For them, it would be an incentive to draw on the credit line. For example, some of these member states pay 1%-1.5% for a 10-year issuance at the moment. But the rate of funding via the ESM Pandemic Crisis Support for 10 years would be around 0%. If we were to fund at seven to eight years, then the rate would be negative, which means that member states would be paid for taking money from the ESM.

So it’s a real incentive for them. It would mean saving taxpayers’ money. Some of them could save up to €6 billion over a period of 10 years. How did we lower the funding costs to these attractive levels? Well, on the one hand, we reduced the margin by more than two-thirds to 0.1%. We also reduced the one-off service fee from 0.5% to 0.25% and the annual service costs to just 0.005%.

On the other hand, we also created a funding silo to separate the costs for the Pandemic Crisis Support from our outstanding debt. This means the lines will not be impacted by what we have issued in the past and member states can fully benefit from the current low and negative interest rate environment.

The creation of the Pandemic Crisis Support with these attractive funding conditions is a real example of European solidarity. While the financial sector 10 years ago was the cause of the problem, now the financial sector with such attractive products can be part of the solution to the problem.

You recently published your social bond framework, which will be used to fund your Pandemic Crisis Support. Why have you decided to issue social bonds?

Well, the ESM was always an advocate of the environmental, social and governance principles, known as ‘ESG’, as an institution and as an investor. In February this year, we signed the United Nations-backed Principles for Responsible Investment.

So with the investment of our paid-in capital, we follow the six ESG principles and are part of a network of more than 2,900 investors who have signed up to the UN’s PRI from over 50 countries representing more than $90 trillion in assets under management.

On the funding side, we have been also been looking at ESG topics for a while. Since last October, we have been a member of the International Capital Market Association’s Green and Social Bond Principles Advisory Council.

We already looked at the possibility to issue social bonds and now, with the Pandemic Crisis Support, we are able to do so because we have a clear definition of the use of proceeds.

Over the last weeks, we worked on our social bond framework and published it at the end of June. It’s compliant with the latest version of ICMA’s social bond principles, which were also published in June. Our social bond framework describes all four principles: the use of proceeds, the process of project evaluation and selection, the management of proceeds and the reporting.

Should countries now apply for the Pandemic Crisis Support, we will be able to issue social bonds under the social bond framework. This will also further underline the social character of the Pandemic Crisis Support.

When countries apply for the credit line, they have to agree on a pandemic response plan. There are three categories for the eligible social expenditures. The first is healthcare, cure and prevention costs directly related to the Covid-19 pandemic. Then there is the part of the overall healthcare spending to be directly or indirectly attributed to addressing the impact of Covid-19 and lastly, other indirect costs related to healthcare, cure and prevention from the Covid-19 crisis.

The ESM will work closely with the European Commission to monitor the use of proceeds and based on that, we will report to our investors on the use of proceeds and the impact. This will be published on our website.

We will report up to one year following the issuance of the first social bond and then every year until the proceeds are fully allocated. With this approach, we can make use of social bonds as an innovative debt instrument, allowing the investor community to allocate their funds to the social needs of euro area member states. It’s also our objective to support the development of this young market.

Do you expect the ESM’s social bonds to be priced tighter than its conventional bonds?

Well, from a credit perspective, the social bonds are not different from our conventional bonds that we are already issuing. So, the secondary market curve of our outstanding debt should be the first pricing reference for ESMs social bonds. Like our conventional bonds, the social bonds will benefit from our triple-A rating from Fitch and the Aa1 rating from Moody’s.

Nevertheless, the social bonds may be more attractive for some of our investors or they may even bring new investors to our books. So there is a possibility that ESM social bonds will offer a cost advantage but it’s a bit too early to say. This needs to be seen once we are issuing social bonds to the market and once they are traded in the market.

Will the ESM continue to issue social bonds after the pandemic is over?

Well, it depends very much on how the Covid-19 crisis develops and first, we need member states to request the Pandemic Crisis Support.

But the fact that we have published a social bond framework indicates that this is not a one-off exercise and the maximum average maturity of the loans of 10 years gives us the possibility to issue social bonds over a longer period of time.

We have chosen a portfolio approach, which means as long as we have social loans outstanding and the Pandemic Crisis Support outstanding, we can fund this by issuing social bonds. This shows that we will not be active only for one or two years, but that we will be active in the social bond market for a longer period of time.

Will the ESM continue to make use of its existing funding instruments including the bill and dollar programmes?

We will of course continue issuing under our existing products. We will continue with our bill auctions. We just added the 12-month bill line in April this year, which we are issuing on a monthly basis via auction to the market.

We also have to roll over our existing debt. So we will continue to issue the conventional products; our benchmark bonds either as new bonds or taps of existing ones and we will continue our presence in the dollar market.

Do you expect the ESM's funding programme to increase in size?

What we have currently announced for the ESM this year is €11 billion. The €11 billion is needed to roll over our existing debt which matures during the course of the year. Should we receive a request for our Pandemic Crisis Support, this will impact our funding plan and we will have to increase our funding depending on the size of the request.

As in the past, transparency is crucial for us. We always communicate very transparently about our funding plans and funding needs. So if we receive a request for our Pandemic Crisis Support and we have to amend the funding plan, we will communicate this transparently to the market so that everybody has a clear view of what is expected from the ESM.

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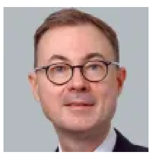

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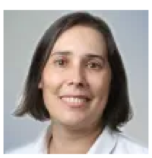

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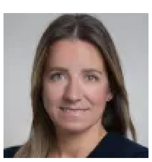

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