European Stability Mechanism
esm

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# Short-term debt relief measures for Greece
# Frequently Asked Questions

### 1. When was it decided that Greece would receive short-term debt relief measures?

In its statement of 25 May 2016, the Eurogroup mandated the ESM to work on a first set of debt relief measures, referred to as short-term measures.

The ministers said that these measures would be implemented after the closure of the first review and before the end of the current ESM programme (the third programme). The first review has since been concluded. On 5 December 2016, the ESM presented detailed plans for the short-term measures to the Eurogroup, which agreed to adopt them.

On January 23, the governing bodies of the ESM and of the EFSF formally completed the approval process of the measures, and implementation will now start.

### 2. Will there be further measures in the future?

In its statement of 25 May 2016, the Eurogroup also mentioned a possible second set of measures, if needed, following the successful implementation of the ESM programme by Greece. These are called medium-term measures.

For the long term, the Eurogroup has agreed to a contingency mechanism to ensure long-run debt sustainability in case a more adverse economic scenario materialises in the country.

### 3. What are the guiding principles for additional debt relief?

The Eurogroup has excluded any nominal haircuts. It has further decided that the measures must: facilitate market access for Greece, in order to replace publicly financed debt by privately financed debt; smooth the repayment profile; incentivise the country's adjustment process (even after the ESM programme ends); and ensure flexibility to accommodate uncertain economic growth and interest rate developments in the future.

### 4. Which short-term measures will be implemented?

There are three sets of short-term measures:

- smoothing Greece's repayment profile;
- reducing interest rate risk;
- waiving the step-up interest rate margin for 2017.

### 5. How does the smoothing of the repayment profile work?

The smoothing of the repayment profile refers to Greece's second programme, with the EFSF. The weighted average maturity of the loans in this programme was initially agreed to be 32.5 years. Due

to a number of factors, this has since dropped to approximately 28 years. The maturity will now be brought back up to 32.5 years, so that a number of repayment humps in the 2030s and 2040s can be spread out over several years.

**6. What about the second measure, the reduction of interest rate risk?**

There are three different schemes for the second measure.

The first is a *bond exchange*. To recapitalise banks, the EFSF/ESM provided loans to Greece worth a total of €42.7 billion. These loans were not disbursed in cash, but in the form of floating-rate notes. Greece used the notes to recapitalise banks.

The notes will now be exchanged for fixed-rate bonds with a longer maturity, or for cash. Because the new bonds are fixed-rate, Greece no longer bears the risk that interest rates will go up.

The banks are prohibited from selling the floating-rate notes and the fixed-rate notes to the market, but they can sell them to the ECB. Notes that the banks have sold are excluded from the exchange.

After a certain amount of time, the EFSF/ESM will buy back the fixed-rate notes the Greek banks still hold to avoid them having to bear the interest rate risk. This will be done with funds raised on the market. To ensure a smooth execution, this process will take place in several phases over a longer period of time.

The second scheme foresees the ESM entering into *swap arrangements*. This scheme would stabilise the ESM's overall cost of funding and reduce the risk that Greece would have to pay a higher interest rate on its loans when rates in financial markets start rising in the future.

A swap is a financial contract that enables two counterparties to exchange, for instance, fixed-rate payments for floating-rate payments.

The third scheme, known as *matched funding*, foresees the ESM charging a fixed rate on part of future disbursements to Greece. This would entail issuing long-term bonds that closely match the maturity of the Greek loans.

Market conditions may influence the degree to which any of these three schemes can be applied.

**7. And the third measure, the waiver of the step-up interest margin?**

The *waiver of the step-up interest rate margin* applies to the €11.3 billion tranche of the EFSF programme (second programme) used to finance a debt buy-back. No margin is currently charged on this loan, but a margin of 2% had originally been foreseen from next year. This will now be waived for 2017.

**8. When will you start implementing the measures?**

The smoothing of the repayment profile is expected to be implemented at the beginning of 2017. The three schemes to reduce the interest rate risk will be pursued to the extent possible given market conditions and implementation feasibility. The formal decision to waive the step-up margin for 2017 was taken on 23 January 2017.

**9. Why was there a delay at the end of last year?**

The approval of the measures was delayed in December, when the Greek government decided on a number of budget expenditures without previous discussion with the institutions. The approval process resumed after the Eurogroup received a letter from Greek Finance Minister Euclid Tsakalotos, which made clear that Greece remained fully committed to programme conditionality.

**10. What savings will the measures bring for Greece?**

When implemented in full, these measures should lead to a cumulative reduction of Greece's debt-to-GDP ratio of around 20 percentage points until 2060, according to ESM estimates in a baseline scenario. It is also expected that Greece's gross financing needs (see question 16) will fall by almost five percentage points over the same time horizon. The bond exchange and the interest rate swaps make up the largest part of this reduction. Second-round effects on Greece's refinancing rates would be an additional benefit. The short-term measures will improve Greece's debt sustainability.

However, caution is warranted. The impact of some of the measures hinges on several factors beyond the ESM's control. These include the interest rate environment and the availability of other market participants to conclude some transactions.

**11. Are there any costs to the measures, and who will pay them?**

The adjusted repayment profile is expected to bear no cost. The cost of the waiver of the step-up margin will consist of the foregone profit for the EFSF and its shareholders.

Any costs from the three schemes to reduce the interest rate risk will be borne by Greece. This is particularly the case for the bond exchange and the interest rate swaps. Such short-term costs are more than compensated by the long-term benefits of the operation for Greece.

**12. Are there any costs for other euro area Member States, and particularly the four former programme countries?**

No. The Eurogroup set as a condition that the transactions would not have any direct cost for other countries.

**13. Are there any costs for Greek banks from the bond exchange?**

The scheme is expected to be neutral for Greek banks and needs their consent for implementation.

**14. What is the impact on the EFSF/ESM funding strategy?**

The funding strategy remains unchanged. To cover liquidity needs stemming from the measures – particularly the bond exchange and the swap arrangements – the overall long-term funding volume of the two institutions for 2017 was raised to €57 billion, from €50 billion announced earlier

**15. Will you stop issuing shorter maturities and focus on the long end?**

No, we will remain present as an issuer in benchmark sizes along the entire yield curve.

**16. Why did the Eurogroup decide to look into debt relief measures for Greece?**

The measures seek to address a general concern that future debt payments will pose an undue burden on budget spending and thus stifle the economy. Gross Financing Needs (GFN), the total amount of money a country spends in one year on interest rates payments and repaying maturing debt, is the benchmark used to measure this burden.

The Eurogroup has agreed that, under a baseline economic scenario, Greece's GFN should remain below 15% of GDP during the post-programme period for the medium term, and below 20% of GDP after that.