

European Stability Mechanism



ESM Social Bond Framework

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CONTENTS

2	1. BACKGROUND FOR ISSUING ESM SOCIAL BONDS
2	1.1 The European Stability Mechanism
2	1.2 ESM Pandemic Crisis Support
3	1.3 ESG commitment of the ESM
3	2. ESM SOCIAL BOND FRAMEWORK
3	2.1 Use of Proceeds
4	2.2 Process for project evaluation and selection
5	2.3 Management of proceeds
5	2.4 Reporting
6	3. EXTERNAL REVIEW
6	4. LEGAL DOCUMENTATION
6	5. DISCLAIMER

1. BACKGROUND FOR ISSUING ESM SOCIAL BONDS

1.1 The European Stability Mechanism

The European Stability Mechanism (“ESM”) is a Luxembourg-based inter-governmental financial institution established in October 2012 by the euro area member states (“ESM Members” or “Members”). The ESM provides financial assistance to ESM Members experiencing or threatened by severe financing problems to safeguard the financial stability of the euro area as a whole and of its Members.

With €704.8 billion of subscribed capital, split between €80.5 billion of paid-in capital and €624.25 billion of committed callable capital, the ESM is one of the largest international financial institutions in the world. Since 1 July 2013, the ESM is the sole mechanism for responding to new requests for financial assistance by euro area member states.

The ESM provides its Members with different types of financial assistance. To finance this assistance, the ESM issues debt instruments, purchased by a global investor base.

1.2 ESM Pandemic Crisis Support

The Covid-19 pandemic constitutes an unprecedented challenge with severe socio-economic consequences. Against this backdrop, the euro area finance ministers (“Eurogroup”) on 9 April 2020 decided on a comprehensive economic policy response to the Covid-19 crisis. This was endorsed by the EU Heads of State or Government (European

Council) on 23 April 2020, agreeing inter alia for the ESM to establish the Pandemic Crisis Support. On 8 May 2020, the Eurogroup subsequently endorsed the features and standardised terms of the Pandemic Crisis Support.

These political endorsements as well as the approval by the ESM Board of Governors enable the ESM to make available to all euro area countries the Pandemic Crisis Support based on the existing Enhanced Conditions Credit Line (“ECCL”) instrument, in accordance with the ESM Treaty.¹

The Eurogroup has instructed the ESM to prepare a Pandemic Crisis Support credit line amounting to 2% of the respective Members’ GDP as of end-2019, as a benchmark. Should all 19 euro area countries draw from the credit line, this would amount to a combined volume of around €240 billion.

Although support will be available for all euro area member states, it is up to each member state to decide whether it wants to draw on it or not. Even if a country applies for the credit line, it may not be drawn down by the country. Therefore, less than the available funds of €240 billion are expected to be requested.

The credit line is tailored to the Covid-19 crisis and will be activated, upon request, under standardised terms defined in advance. The financing of these measures follows the ESM lending process for ECCL² and will be available until the Covid-19 crisis ends.

Once Members draw from the credit line, the only requirement will be the commitment to use the funds received to support domestic financing of direct and indirect healthcare, cure, and prevention-related costs due to the Covid-19 crisis. This is detailed later under section 2.1.

[1] ESM Treaty: https://www.esm.europa.eu/sites/default/files/20150203_-_esm_treaty_-_en.pdf.

[2] ESM governance and approval process, starting from request by ESM Member, is detailed at: https://www.esm.europa.eu/assistance/lending-toolkit#lending_toolkit.

The credit line will be available until the end of 2022. This period could be adjusted if there is a need, given the evolution of the crisis.

The ESM intends to fund the Pandemic Crisis Support with all debt instruments available. Social bonds should provide the significant part of such funding.³

1.3 ESG commitment of the ESM

As an international financial institution with a public mandate, the ESM strives to implement environmental, social, and governance (“ESG”) best practices within its operations. The ESM believes that embedding ESG best practices will contribute towards better, more sustainable outcomes within ESM internal operations, as well as its funding and investment activities.

During the past years, the ESM has therefore undertaken significant efforts to reduce the institution’s environmental impact, to ensure that internal policies and practices are in line with the respective best practice standards, and that its governance practices are based on transparency and accountability. In this context, the ESM has signed up to a range of ESG initiatives. The ESM has recently become a signatory of United Nations Principles for Responsible Investment. In addition, the ESM is engaged in the market ecosystem establishing guidelines for the Social Bond markets. The ESM supports the Green Bonds Principles and Social Bonds Principles (“SBP”), published by the International Capital Market Association (ICMA),⁴ as an Observer in the Social Bond Working Group and a Member of the Advisory Council.

ESM Social Bonds will be new elements building on the ESM’s ESG efforts over the last years.

2. ESM SOCIAL BOND FRAMEWORK

The ESM Pandemic Crisis Support is set up to finance exclusively direct and indirect healthcare, cure, and prevention related costs due to the Covid-19 crisis thus addressing a social issue which is severely threatening public health.

The ESM Social Bond Framework (the “Framework”) is structured around the SBP’s four core components and is considered to be compliant with the 2020 edition of the SBP. With this approach, the ESM strives to make full 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 hit by the pandemic crisis.

Payment of the principal and of interest on ESM Social Bonds is exclusively based on the credit standing of the ESM. Consequently, ESM Social Bonds will benefit from the same credit ratings as all its other outstanding bonds.⁵

2.1 Use of Proceeds

The ESM will use an amount equal of the net proceeds from the Social Bonds to finance or re-finance the Pandemic Crisis Support (the “*Eligible Social Loans*”). The measures financed or re-financed under this Pandemic Crisis Support relate exclusively to direct and indirect health, healthcare, cure, and prevention costs (the “*Eligible Social Expenditures*”). These are grouped under the following *Eligible Social Expenditures* categories:

- (i) Healthcare, cure, and prevention costs directly related to the Covid-19 pandemic, thus providing universal access to healthcare services, for which the target population is the general population affected by the crisis in the euro area member states.

^[3] More details can be found here: <https://www.esm.europa.eu/content/europe-response-corona-crisis>.

^[4] <https://www.icmagroup.org/green-social-and-sustainability-bonds/social-bond-principles-sbp/>.

^[5] ESM credit ratings: <https://www.esm.europa.eu/investors/esm/esm-ratings>.

- (ii) The part of overall public healthcare spending estimated to be directly or indirectly attributed to addressing the impact of Covid-19 on the healthcare system to ensure the continued supply of basic goods and services to the population, and for which the target population is the general population affected by the crisis in the member states. These measures can include, inter alia, spending on hospitals, cure and rehabilitative care, ambulatory cure and rehabilitative care, diagnostics, pharmaceuticals, preventive care, health administrations, and health-related long-term care.
- (iii) Other indirect costs related to healthcare, cure, and prevention due to the Covid-19 crisis.

2.2 Process for project evaluation and selection

The collective, political endorsement by all ESM Members described under section 1.2, as well as the approval of the ESM Board of Governors, enables the ESM to make the Pandemic Crisis Support based on the ECCL available to all its Members in accordance with the ESM Treaty. The Pandemic Crisis Support is available to all ESM Members with terms agreed in advance by the ESM

Board of Governors, based on upfront assessments performed by the European Commission, in liaison with the ECB, and in collaboration with the ESM.

When an ESM Member requests access to the ESM's Pandemic Crisis Support, such request has to be⁶ assessed as required under Article 13(1) of the ESM Treaty and Articles 3(1) and 3(2) of the Guideline on Precautionary Financial Assistance (the "Guideline"),⁷ in respect of:

- The existence of a risk to the financial stability of the euro area as a whole or of its member states;
- Whether government debt of the beneficiary Member State is sustainable;
- The actual or potential financing needs of the beneficiary Member State.

The European Commission, in liaison with the European Central Bank (ECB), and in collaboration with the ESM, performed these assessments upfront at the moment of the agreement on the Pandemic Crisis Support. At the same time, the European Commission, in liaison with the ECB, and in collaboration with the ESM, have assessed whether the ESM Member concerned meets the conditions for accessing an ECCL as set out in Article 2(4) of the Guideline.

PROCEDURE FOR REQUESTING AND GRANTING PANDEMIC CRISIS SUPPORT



⁽⁶⁾ The ESM's full governance structure can be found here: <https://www.esm.europa.eu/esm-governance>.

⁽⁷⁾ The ESM Guideline on Precautionary Financial Assistance: https://www.esm.europa.eu/sites/default/files/esm_guideline_on_precautionary_financial_assistance.pdf.

On this basis, and pursuant to Articles 13 and 14 of the ESM Treaty, the ESM Board of Governors⁸ may grant precautionary financial assistance to the ESM Member concerned in the form of an ECCL; approve the Pandemic Response Plan, which will serve as the MoU for the purposes of the ESM Treaty; and adopt the Managing Director's proposal ("MD proposal") for an FFA, detailing the financial terms and conditions of the precautionary financial assistance.

The European Commission signs the Pandemic Response Plan on behalf of the ESM, subject to compliance with the conditions and approval by the Board of Governors. The Managing Director signs the FFA, subject to approval by the Board of Directors.

The Member may request a drawdown of funds during the availability period of the credit line according to the agreed terms; specific notification periods apply.

Once the Member requests the drawdown of funds, the ESM, for funding purposes, will identify the expenditures which qualify as *Eligible Social Expenditures*, and, therefore, may be financed by the proceeds from the Social Bonds.

2.3 Management of proceeds

The ESM is a public financial institution, which covers overall cash outflows for financial assistance through cash inflows from debt issuance. In particular for the tracking of proceeds, therefore, the ESM is akin to sovereign issuers in the Green, Social and Sustainability Bond markets: the net proceeds from the Social Bond are credited to the income side of the general budget of the beneficiary Member State. On the expenditure side of this budget there must be an amount of *Eligible Social Expenditures* equal to or higher than the corresponding credit.

An amount at least equivalent to the net proceeds of the ESM Social Bonds issued under this Framework may be used to finance or refinance disbursements

under the ESM Pandemic Crisis Support in relation to which the relevant beneficiary Member State has undertaken to use the funds received from the ESM to finance or refinance *Eligible Social Expenditures*. The ESM expects that this allocation will be done in the 12 months following the bond issuance.

The use of all financial assistance provided to a beneficiary Member State will be monitored and confirmed by the European Commission, in collaboration with the ESM, based on regular reporting by the beneficiary Member States.

Pending their use as described above, the net proceeds of the Social Bonds issued will remain in the ESM's treasury accounts and be invested according to the ESM investment guidelines.

2.4 Reporting

The ESM will collaborate with the European Commission (in liaison with the ECB) on the monitoring of the use of funds, based on regular reporting by the beneficiary Member States.

Based on this monitoring the ESM will report on the *allocation* and *impact* of the net proceeds raised by the Social Bonds, i.e. on *Eligible Social Expenditures* made by the beneficiary Member States.

The ESM will publish a report up to one year following the issuance of the first ESM Social Bond, and then every year thereafter until allocation is complete. As recommended in the SBP reporting guidance,⁹ this report will describe all Social Bonds issued and *Eligible Social Loans* outstanding. The report will also include the total amount of *Eligible Social Expenditures* funded through Social Bonds, a breakdown of such *Eligible Social Expenditure* by country and by category (as described under 2.1), and publicly available information about the beneficiary Member State's *Eligible Social Expenditures*.

ESM Social Bond reporting will be available on the ESM website.

^[8] The Board of Governors is composed of government representatives of each of the 19 ESM shareholders with the responsibility for finance (generally, the Ministers of Finance). Representatives of the European Commission and the ECB may participate in its meetings as observers. The Board of Governors is chaired by the President of the Eurogroup and meets at least once a year and whenever the affairs of the ESM so require.

^[9] <https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/June-2019/Framework-for-Social-Bond-Reporting-Final-06-2019-100619.pdf>.

3. EXTERNAL REVIEW

The ESM will engage with an external party to provide an independent assessment (the "Second Party Opinion") on the alignment of the Framework

with ICMA's Social Bond Principles. The Second Party Opinion document will be made available on the ESM's website.

4. LEGAL DOCUMENTATION

The *Use of Proceeds* section of the ESM Social Bond transaction documents will specify that the ESM intends to allocate an amount equal to the net proceeds of the Social Bonds to *Eligible Social Expenditures*, as defined in this Framework.

The documentation will refer also to the reporting on the allocation of funds and the impact of related *Eligible Social Expenditures*, which will be provided as described in this Framework.

5. DISCLAIMER

This Framework has been prepared by the ESM for information purposes only. This Framework should not be taken as investment advice and it is not intended to serve as a basis for any kind of obligation, contractual or otherwise. In particular, it does not constitute an offer to sell or the solicitation of an offer to buy any securities, nor will there be any sale of securities in any state or jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such state or jurisdiction. No communication and no information in respect of the offering of securities may be distributed to the public in any jurisdiction where a prior registration or approval is required. The offering or subscription of securities may be subject to specific legal or regulatory restrictions in certain jurisdictions. The ESM takes no responsibility for any violation of any such restrictions by any person. If any offer

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