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EFSF Guideline on Precautionary Programmes

1. Introduction

At the Euro Area Summit on 21 July 2011, the Heads of State or Government of the Euro Area and EU institutions agreed to increase the flexibility of the EFSF in order to address contagion by allowing them to (i) act on the basis of a precautionary programme; (ii) finance recapitalisation of financial institutions through loans to governments including in non-programme countries; (iii) intervene in the secondary markets on the basis of an ECB analysis that financial stability is at risk.

2. Objective

The objective of a precautionary programme is to support sound policies and prevent crisis situations by encouraging countries to secure the possibility to access EFSF assistance before they face difficulties raising funds in the capital markets. In this way, precautionary programmes should help Member States whose economic conditions are still sound to continue refinancing via the market , while at the same time avoiding the possible negative connotations of being a 'programme country', i.e. actually in receipt of external financial assistance. Beyond helping to reinforce the credibility of the country's macroeconomic performance, an important contribution of a precautionary programme may be the positive signal that it sends to markets. This means a precautionary programme should be designed in a way that reduces the stigma effect of a regular programme, while ensuring an appropriate strict conditionality.

By its nature as a crisis prevention tool, the precautionary programme should have lighter procedures and be more swiftly implementable than the regular crisis resolution programmes supported by the EFSF. The less cumbersome procedures should allow countries to react in a timelier manner in order to prevent a crisis and reduce exposure to contagion, as well as to send a positive signal and comfort financial markets that this is only a short-term arrangement.

More flexibility means that a precautionary programme could be seen as a 'reserve type' instrument, i.e. a credit line to overcome external temporary shocks to prevent a crisis from occurring. As a corollary, it is important that the resources available are sizable enough to counter doubts that the country has sufficient funds to meet its financing needs and to give market confidence. However, the tool should not merely be seen as a liquidity facility but as an effective and comprehensive crisis prevention tool.

3. Type of credit lines

Types of credit line

	Precautionary conditioned credit line (PCCL)	Enhanced conditions credit line (ECCL)
Access	Countries with robust policy frameworks and very strong track records in economic performance	Countries with sound policies and fundamentals, but with some vulnerabilities that preclude using the PCCL
Benchmark	IMFs FCL	IMF's PCL
Ex-ante conditions	Yes	Yes
Ex-post conditions	No	Yes
Cap	No upfront cap	No upfront cap
Typical size	2-10% of GDP	2-10% of GDP
Information exchange	Yes	Yes
Duration	1 year, renewable for 6 months twice	1 year, renewable for 6 months twice

Two types of credit lines are foreseen: a precautionary conditioned credit line (PCCL) and an enhanced conditions credit line (ECCL). There is no explicit upfront cap, but the size of the credit lines is expected to vary between 2 and 10% GDP of the Member State concerned.

3.1 A precautionary conditioned credit line

Access to a PCCL is based exclusively on pre-established conditions and is limited to euro area Member States where the economic and financial situation are still fundamentally sound and which remain evidently committed to maintaining sound and credible policies in the future.

A *global assessment* shall be made on whether a Member State qualifies for PCCL, using as a basis the following criteria:

- The respect of the SGP commitments. Countries under excessive deficit procedure could still access PCCL, provided they fully abide by the various Council decisions and recommendations aiming at ensuring a smooth and accelerated correction of their excessive deficit.
- A sustainable public debt.
- The respect of their EIP commitments. Countries under an excessive imbalance procedure could still access PCCL, provided that they can demonstrate that they are committed to addressing the imbalances identified by the Council.
- A track record of access to international capital markets on reasonable terms.
- A sustainable external position.
- The absence of bank solvency problems that would pose systemic threats to the euro area banking system stability.

The beneficiary Member State shall ensure a continuous respect of the eligibility criteria after the PCCL is granted, to be monitored by the Commission. The PCCL has an initial duration of one year and is renewable twice, for six months each time. The availability fees charged shall aim at covering fully the costs occurred by the EFSF.

3.2 An enhanced conditions credit line

Access to an ECCL is open to euro area Member States whose general economic and financial situation remains sound, but which do not comply with some of the eligibility criteria required for accessing a PCCL. Accordingly, the Member State concerned shall, after consultation of the Commission and of the ECB, adopt corrective measures aimed at addressing the above mentioned weaknesses and avoiding any future problems with access to market financing, while ensuring a continuous respect of the eligibility criteria which were considered met when the credit line was granted.

The ECCL has an initial duration of one year and is renewable twice, for six months each time. The availability fees charged shall aim at covering fully the costs occurred for the EFSF.

4. Accompanying enhanced surveillance

A Member State receiving an ECCL or drawing a PCCL is placed under enhanced surveillance by the Commission for its availability period. The content of the enhanced surveillance will vary according to the nature of the risks to financial stability or imbalances to address.

On a request from the Commission, it shall notably:

(a) Communicate any information needed for the monitoring of public expenditures and tax revenues;

(b) Carry out an Audit of its public finances (covering both revenue and spending sources);

(c) Carry out, under the supervision of Eurostat, an audit of the quality of the statistics used for establishing the public accounts;

(d) Communicate to the Commission and the ECB on a weekly basis disaggregated information on developments in its financial system;

(e) Carry out, under the supervision of the European Banking Authority, stress test exercises or sensitivity analysis necessary to assess the resilience of the banking sector to various macroeconomic and financial shocks, as indicated by the Commission and the ECB, and share the detailed results with them;

(f) Provide the EFSF with all necessary information required for the execution of its lending activity and related risk management (such as monthly information regarding its financial condition, cash balance and other key information that would usually be provided for facilities of this type and any of the information mentioned above if deemed useful).

5. Procedure and activation

The involvement of the IMF in the design and implementation of precautionary programmes will be actively sought in all cases. To benefit from an EFSF credit line, the request by the Member States concerned shall follow the following steps:

(a) A euro area Member State makes a request for a credit line to the members of the Eurogroup.

(b) The members of the Eurogroup task the Commission, in liaison with the ECB, to assess the risk of future problems in maintaining access to market financing on reasonable terms, the respect of the eligibility conditions and the possible need for corrective measures of the Member State making the request.

(c) On the basis of this analysis, the members of the Eurogroup decide by unanimity on a proposal from the EFSF whether to grant such a credit line, its type (PCCL or ECCL), amount, and duration. In order to allow for rapid disbursement if needed, there will be only a MoU and a Financial Assistance Agreement (FAA), specifying the modalities of possible disbursement if the precautionary programme were to be activated. The FAA will be signed along with the MoU.

(d) The Commission, in liaison with the ECB, will carry out an enhanced surveillance of the Member State concerned (where a ECCL is granted or a PCCL drawn) and report every three months to the members of the Eurogroup Working Group on the persistence of the risk of future problems in maintaining access to market financing on reasonable terms and on the continuous respect of the policy conditions (including the implementation of the corrective measures announced by the beneficiary Member State in case of ECCL).

(e) In case the Member State deviates from its policy conditions or if those commitments have become clearly inadequate to resolve the threat of financial disturbance, the members of the Eurogroup, after having received an analysis from the Commission prepared in liaison with the ECB, may decide on a proposal from the EFSF to close the credit line. The beneficiary Member State will then be expected to request a regular stability support, with a full macroeconomic adjustment programme, following the procedure applicable to it.

(f) The activation of the credit line is at the initiative of the beneficiary Member State. The Member State has the flexibility to request the draw-down of funds or a primary market intervention at any time during the availability period of the credit line according to the agreed terms. It shall inform the EFSF at least a week in advance of its intention to draw funds, depending on the intended size. The maximum size of a tranche or primary market purchase shall be set in the initial decision to grant a credit line. The lending conditions will be the same as for regular EFSF loans.

(g) The fulfilment of the conditionality of the MoU shall be reassessed and the adequacy of a precautionary programme re-evaluated by the members of the Eurogroup Working Group, on the basis of an EFSF proposal that incorporates the analysis from the Commission, in liaison with the ECB, when funds are drawn by the beneficiary Member State. A decision shall be taken on a case by case basis by the Eurogroup Working Group on whether the beneficiary Member State steps out from its guarantee to the EFSF.