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ESM Pricing Policy

Objective

When granting stability support, the ESM shall aim to fully cover its financing and operating costs and shall include an appropriate margin (Art. 20 of the Treaty). The main objective of this guideline is to specify the pricing elements of the ESM financial assistance to beneficiary ESM Members.

Element of Pricing and Calculation of Interest Rate

1. Base Rate

The pricing of ESM is intended to cover the cost of funding and operations incurred by ESM. When possible, the ESM should seek to obtain funding in the capital markets on amounts and maturities matching the terms of the lending required. However, ESM may not able to obtain all financing at competitive rates for the long maturities of its lending operations, and may have to roll over short-term funding instruments. Generally, the funds raised by ESM will be assigned to a long-term pool comprising its capital market instruments (see Borrowing Guidelines Section 2.1) and a short-term pool comprising its money market instruments (see Borrowing Guidelines Section 2.2), from which disbursements are made and a certain liquidity buffer is maintained.

Exceptionally, certain drawdowns (in particular when the disbursement is made by ESM in the form of delivery of ESM Notes) will be sourced from individual funding operations that are not integrated into the short-term and long-term pools (back-to-back silos).

The ESM will "pass through" its cost of funding, along with any costs and commissions described below, to the beneficiary ESM Member. The pricing strategy adopted by the ESM is based on a daily computation of the actual interests accrued on all its funding instruments. In the general case of disbursements sourced from the pool, the accrued interests are allocated to each drawdown on the basis of the outstanding amounts. In the exceptional cases of disbursements sourced from back-to-back silos, the daily allocation of interests obviously only takes into consideration the funding instrument of the silo.

<u>Calculation of interest accrued amounts</u>

ESM will compute the daily amount of interests accrued in each of the pools of funding instruments. For the avoidance of doubt, such daily interest amounts will be equally applied to the disbursements or uses of all relevant ESM facilities that had the pools as their funding source (no discrimination amongst Beneficiaries).

First step: Calculation of the interest amounts accrued for, respectively, the short-term pool and the long-term pool.

- The calculation of the interest amount accrued for each of the pools is done on a daily basis. The interest is calculated as the daily equivalent of the actual (cash) interest payment for each of the funding operations. It is important to highlight that all computations are carried out on the basis of amounts, not interest rates. It is nevertheless possible to - for illustration and comparative purposes only - provide an indicative level of what would be the equivalent annualised interest rates in any particular date.

- The calculation is done daily, and the respective amount of daily accrued interest is expected to remain relatively constant as it would only change if the composition of the ESM funding operations in the short-term pool changes (e.g. when new short term funding is raised, when some instrument matures and must be rolled, or when investments mature or interest payments are received).

Second Step: Assignment of proceeds from the long-term pool to the outstanding facilities

- Also on a daily basis, ESM will calculate the aggregate of the outstanding amounts under, on the one hand, all ESM facilities that had the pools as their funding source ("lending") and, on the other hand, all the funding operations (nominal amounts) that were placed to feed the long and short term pools ("funding"). To complete this step, the ESM services will carry an allocation exercise between the funding and the lending, where the full amount available under the long term pool is allocated to the outstanding amounts made available in the ESM facilities, and any shortfall will be assigned to nominal amount from the short-term pool. Any excess of funds in the short term pool that cannot be assigned to facilities is considered as Liquidity Buffer.

Third step: Transfer of costs

- The daily accrued interest in the long and short term pools will be taken as the interest applied to all relevant facilities to beneficiary Members where the pools were used as their source. That means these disbursed amounts will also have a daily adjusted rate which is identical to the daily funding costs. All loans or disbursed amounts funded by ESM from the pools will have the same rate at the same day, independent from the beneficiary Member and independent from when they have been disbursed.

Exceptional cases: back-to-back silos – example of disbursements in specie

There may be situations where particular drawings under specific facilities require ad-hoc terms. Such drawings cannot be sourced from the pools. An example is situations where ESM disbursements are made through the delivery of ESM notes, and not cash (in this case, the source cannot be the pools as the pools only contain cash). A further explanation of this example is as follows:

ESM Members could receive ESM notes instead of cash. The application of interest accrued daily from a pool of funding instruments would not be correct in this case, as these countries are likely to receive a limited or unique set of maturities, and applying the weighted interest cost of several funding sources could distort the costs for other countries receiving ESM assistance. Therefore, these beneficiary ESM Members shall pay the interest rate of the notes received, and in addition all negative carry if applicable, the service fees and other fees described.

2. Commitment Fee - Coverage of the Negative Cost of Carry and Issuance Costs

The liquidity buffer entails the possibility of Negative Carry for the period from the raising of the funds until their disbursement to the beneficiary ESM Member or for the period from the refinancing of the relevant funding instrument until its maturity. Negative Carry is determined by the fact that the interest rate at which ESM raises funds would most likely be higher than the return obtained for shorter-term investments in high quality assets. The Commitment Fee will be applied to beneficiary ESM Members for the purpose of recovering the Negative Carry. The Commitment Fee will also include a "pass through" of commitment commissions under committed credit lines from banks or DMOs and any Issuance Costs of instruments issued as part of the prefunding activity.

The Commitment Fee will be applied ex-post on the basis of the Negative Carry actually incurred.

The procedure proposed for the calculation and allocation of Negative Carry is as follows:

1. The Negative Carry for all ESM operations actually incurred for any given year (“n”) is accrued throughout the year (from 1 January until 31 December) and deliver a “Total Negative Carry for year “n” (in EUR) accumulated by 31 December.

2. The Total Negative Carry in any given year (“n”) is recovered in the following year (“n+1”) by allocating such amount amongst all of the Beneficiary Members.

3. The allocation by ESM Member is done on the basis of the proportion (the “Allocation Share of the ESM Negative Carry”) that represents the Programme Amount[1] for that beneficiary ESM Member, as related to the aggregate of all the Programme Amounts for all the Beneficiary ESM Members. The Programme Amount is the maximum amount of the facility, from which any amount explicitly cancelled is deducted. The calculation of the Allocation Share of the ESM Negative Carry for each country is made on 31 December for any given year, and the sum of all the Allocation Shares of the ESM Negative Carry is 100%.

4. The amount to be recovered from any given beneficiary ESM Member in year “n+1” shall be the product of: i) the Total Negative Carry for year “n” and ii) the Allocation Share of the ESM Negative Carry of that beneficiary ESM Member in year “n”. Such amount will be paid to ESM via the Commitment Fee.

5. ESM will present to the beneficiary ESM Members and to the Board of Directors as soon as feasible the results of the calculation (if possible, during the month of January), that -in the absence of manifest error- shall be considered as final by all parties.

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[1] For precautionary credit lines, programme amount is defined for this purpose as the total disbursed amount plus the maximum agreed amount of a single disbursement.

6. The payment by each beneficiary ESM Member of the Commitment Fee will be done within 5 days of receipt of the corresponding invoice, unless the beneficiary ESM Member indicates that, for reasons of e.g. national accounting, it prefers that the payment is made via the introduction of a % Commitment Fee as part of the ESM Cost of Funding. For the avoidance of doubt, the amount to be recovered when the Negative Carry is paid via a % Commitment Fee shall be the exact amount that would be otherwise paid upon receipt of an invoice. In this event, the allocated Commitment Fee will be payable on the first Interest Payment Date following the calculation (and issuance of the invoice to other beneficiary ESM Member).

For precautionary credit lines the commitment fee applies to the maximum agreed amount of a single disbursement to be made available for a drawdown at short notice, as liquidity provisions have to be made for these amounts. In case of draw-downs, the commitment fee for precautionary credit lines applies to the maximum agreed amount of a single disbursement plus the amount outstanding under the credit lines.

For secondary market purchases, the commitment fee is charged on an amount to be set by the ESM Board of Directors.

3. Service Fee – coverage of ESM overheads

The Service Fee is applied to beneficiary ESM Member and represents the source of general revenues and resources to cover ESM's operational costs. The Service Fee has two components:

- Up-front Service Fee component: Up-front payment applied at the time of a disbursement and paid generally via a deduction on the drawn amount. Alternatively, should ESM be required to disburse by delivery of ESM securities, the Up-front Service Fee will be deducted from the next cash disbursement made under any facility ESM may have with that beneficiary ESM Member or may be invoiced separately to the beneficiary ESM Member.

- Annual Service Fee component: Annual payment applied over the outstanding principal amounts. It is paid on the interest payment date or invoiced separately.

At the time of each disbursement an up-front payment of 50 bps over the disbursed amount is charged as, and an Annual Service Fee of 0.5 bps per annum payable in arrears from the 1st anniversary of the signature of the facility. A lower level of Up-front Service Fee may be applied to facilities provided for a short-term loan.

Under precautionary credit lines (PCCL, ECCL) the up-front service fee will be invoiced at the inception of the programme based on the maximum agreed amount under a single disbursement. This up-front fee, already paid, will be deducted from any new up-front service fee obligations which become due as a result of an actual draw-down under the PCCL or ECCL. The annual service fee will be calculated based on the amounts actually drawn under the credit lines.

For secondary market purchases, an upfront service fee of up to 50 million will be invoiced initially. The precise amount will be determined by the Board of Directors. Upon any actual use of the facility, the fee will be invoiced in line with the amounts spent taking into account the upfront payment.

A first review of the Service Fee will take place, when the build-up of the ESM will have been completed. Afterwards, the pricing policy will be regularly reviewed every 3 years to reflect ESM's actual cost and revenues' position.

4. *Other Costs and fees of ESM*

The other costs and fees that are part of the ESM:

Margin - The ESM Treaty envisages the application of certain levels of margin to the ESM lending. The margin is paid at the same time of interest payments. The margin paid by the ESM Members shall differ across the financial support instruments to reflect varying risk profiles of each instrument.

- For loans, the margin will be 10 bps, which corresponds to the guarantee commitment fee applied under the EFSF and is not expected to impact the sustainability of the public finances of a beneficiary ESM Member.
- A higher margin of 30 bps will be applied to facilities for the recapitalisation of financial institutions reflecting, among others, the substantive rates charged under state aid rules.
- For primary market purchases (PMPs), a margin of 35 bps will be applied under a precautionary credit line and a margin of 10bps under facility accompanying a macro-economic adjustment programme. For secondary market purposes, a margin of 5bp will be applied, as the ESM may participate in capital gains and receives market rates.

Issuance costs, and other costs and expenses - Issuance costs are related to back-to-back silos and they are paid directly by the beneficiary ESM Member. They are either deducted by the disbursed amount or invoiced separately. Issuance costs that are incorporated in the pools are aggregated and treated in the same manner as the negative carry (cf. Section 3 above). The Issuance Costs and all other commissions, fees and costs incurred by ESM in respect of the ESM Debt Securities shall be promptly paid by the beneficiary ESM Member within five Business Days following the receipt of invoices which ESM will periodically provide on a quarterly or annual basis.

Penalty Interest: A penalty interest may be applied on overdue amounts (a charge of 200 bps over the higher of (a) the EURIBOR rate applicable to the relevant period selected by ESM and (b) the interest rate which would have been payable).

5. *The Treatment of Profit and Interest Rates under PMSF and SMSF*

Any capital gains (profit) which is realised under the Primary Market Support Facility (PMSF) and the Secondary Market Support Facility (SMSF) will be retained by ESM.

When the beneficiary ESM Member enters into the PMSF, ESM will pay the excess into the reserve buffer attributable to the respective ESM Member when the interest received on the purchased bonds exceeds the ESM funding costs, other costs and the margin of the facility. At the end of the Facility, 75% of the accumulated reserve buffer will be retroceded to the beneficiary ESM Member. In case of the SMSF, the ESM will maintain any interest surplus.

Under PMSF and SMSF, in case of a shortfall between interest received on bonds purchased and ESM's funding and related costs of financing its PMP or SMP position (such as hedging costs and transaction costs including back office, custodian costs, agent fees and service fees), the beneficiary ESM Member will reimburse the shortfall to the ESM. Under PMSF, any such shortfall shall be firstly paid out of the above mentioned reserve buffer of the respective ESM Member

6. ***Early repayment arrangement for ESM Members receiving funds under the recapitalisation of financial institutions***

An early repayment event of the funds to recapitalize financial institutions has occurred and the ESM Member is required to repay part of its loan to the ESM in case the beneficiary ESM Members receives funds from its equity or other investments in one or more financial institution(s) (such as common shares, contingent convertibles or such other instruments which qualify as bank regulatory capital) and/or its participation (s) in an asset purchase programme ("bad bank programme"). Funds comprise cash payments by the financial institution(s) in relation to the securities (such as dividend, interest) and proceeds generated by the sale of ESM securities or other investment or by the sale of bank assets (which have been isolated as part of an asset purchase programme). Under an early repayment event, the beneficiary ESM Member has to repay part of the loan up to the full outstanding amounts under all ESM facilities. ESM's Board of Directors may agree not to request an early repayment, if the European Commission in liaison with ECB and EBA confirms to ESM that the funds received by the beneficiary Member State are still required for (a) additional unforeseen capital injections (for countries under financial assistance for the recapitalisation of financial institutions) or (b) ensuring the respect of the adjustment path where there is an unexpected significant deterioration of the fiscal situation (for countries under financial assistance under a macroeconomic adjustment programme).

ESM claims may be reduced if and to the extent the early repayment of the ESM loan triggers a proportionate prepayment of any other official sector financing or the initial financing needs have been identified and reduced by taking into account these returns.

ESM will issue requests for early repayment on a quarterly basis in line with the review cycle under a programme.

Contractual arrangements in the financial facility agreements with individual Member States can deviate from the provisions in this section, if they would lead to undesirable, unintended consequences, are inconsistent with national laws and/or international commitments or preclude necessary policy measures.

Table: Pricing structure – an overview

Financial Support Instrument	Base Rate 1)	Commitment Fee 2)	Service Fee: 50 bps upfront, 0.5 bps p.a.	Margin (bps)	Penalty interest: 200 bps 10)
1. ESM loans	X	X	X 3)	10	X
2. ESM precautionary financial assistance	X	X 4)	X 5)	35	X
3. Financial assistance for the re-capitalisation of financial institutions of an ESM Member	X	X	X	30	X
4. Primary market support facility	X 6)	X	X	10/35 7)	X
5. Secondary market support facility	X 8)	set by BoD	Up to EUR 50 mn 9)	5	X

1) Base Rate = Cost of funding and operations incurred by ESM, derived by a daily computation of the actual interests accrued on all of ESM's funding instruments.
2) Committment Fee = Negative Cost of Carry and Issuance Costs, charged for the period from raising funds by the ESM until disbursement to the Beneficiary Member State or for the period from the refinancing of relevant funding instrument until its maturity.
3) Lower upfront fee for short-term loans.
4) If undrawn, fee reflects the max. agreed amount of single disbursement; if drawn, fee reflects the max. agreed amount of single disbursement and in addition the outstanding amount under the precautionary credit line.
5) Up-front fee calculated on max. agreed amount of single disbursement.
6) Surplus (interest on bonds purchased exceeds base rate+other costs+margin) put in a reserve buffer, shortfall (interest on bonds purchased below base rate+other costs +margin) covered by ESM Member. At the end of the Facility, 75% of the reserve buffer will be repaid to the beneficiary ESM Member.
7) 10 bps are applicable to disbursement via Primary Market Purchases (PMP) under a loan facility; 35bps for using PMPs for draw-downs under a precautionary credit line.
8) Surplus (interest on bonds purchased exceeds base rate+other costs+ margin) retained by ESM, shortfall (interest on bonds purchased below base rate + other costs+margin) covered by ESM Member.
9) To be determined by BoD, upfront and on actual purchases.
10) Penalty rate has to be paid on overdue amounts.