

### Research Update:

## European Financial Stability Facility Rated 'AAA' On Sovereign Guarantees And Cash Buffer; Teleconf. Sept. 20 @ 2.30pm

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## Research Update:

# European Financial Stability Facility Rated 'AAA' On Sovereign Guarantees And Cash Buffer; Teleconf. Sept. 20 @ 2.30pm

## Overview

- Standard & Poor's is assigning its 'AAA' long-term issuer credit rating to the European Financial Stability Facility (EFSF) and expects to assign that rating to all of EFSF's upcoming individual debt issues, if any.
- The rating reflects our view that guarantees by 'AAA' rated sovereigns and freely available liquidity reserves invested in 'AAA' securities will, between them, cover all of EFSF's liabilities.
- Based on assurances from EFSF, we believe that the guarantees from member governments supporting the repayment of EFSF obligations will be unconditional, irrevocable, and timely, and thereby consistent with our criteria for sovereign guarantees.
- The outlook on EFSF's rating is stable and is linked to the outlook on the sovereign ratings of the 'AAA' guarantors.

## Rating Action

On Sept. 20, 2010, Standard & Poor's Ratings Services assigned its 'AAA' long-term issuer credit rating to the European Financial Stability Facility (EFSF), a supranational entity incorporated in Luxembourg, and to EFSF's upcoming individual debt issues, if any. The outlook is stable.

## Rationale

The rating on EFSF reflects our view that guarantees by 'AAA' rated sovereigns and freely available liquidity reserves invested in 'AAA' securities (subject to formal EFSF Board approval, which we expect to occur in due course) will, between them, cover all of EFSF's liabilities.

Standard & Poor's will hold a teleconference on Monday, Sept. 20, 2010, to discuss this rating action. The call will begin at 2.30 p.m. British Summer Time, 3.30 p.m. Central European Time, and 9.30 a.m. U.S. Eastern Time. Please see "Teleconference Information" below for access details.

EFSF is a limited liability joint stock company incorporated in Luxembourg. While the EFSF is not a licensed credit institution, its mandate is to lend to any of the 16 eurozone member state governments in the event of market disruption.

We consider EFSF to be the cornerstone of the EU's strategy to restore

financial stability to the eurozone sovereign debt market. It was established in mid-2010 by intergovernmental agreement, following the April 2010 emergency lending to Greece in which Greece received bilateral loans offered by fellow members of the eurozone. EFSF is expected to provide supplemental funding should other member states face funding difficulties in capital markets in future.

In our opinion, EFSF has been designed to bolster investor confidence and thus contain financing costs for eurozone member states. If its establishment achieves this aim, we would not expect EFSF to need to issue a bond itself, as under those circumstances member states would likely retain access to the capital markets.

It is our opinion that the eurozone governments are strongly and publicly committed to EFSF. At the time EFSF was established, its members assumed that it would have a limited life span and that it would not grant any new loans to member states after 2013. However, we consider it likely that its mandate would be extended if market conditions remained unsettled.

If a eurozone member receives approval for EFSF funding, EFSF would issue bonds in the capital markets and onlend the proceeds to the sovereign borrower. Under the agreement establishing EFSF, each nonborrowing member will unconditionally, irrevocably, timely, and severally guarantee up to 120% of its own share of the EFSF bonds issued. (Although Greece is a eurozone member, it will not participate in EFSF's lending programs as a provider of guarantees.) We have received assurances from EFSF that its members will issue such guarantees in a manner consistent with Standard & Poor's sovereign guarantee criteria. Each guarantor's share is based on that sovereign's subscribed capital to the European Central Bank.

Under EFSF's rules, any funds raised by EFSF will be onlent after the deduction from the loan disbursements of a 50 basis point service fee and a percentage equal to the net present value of EFSF's on-lending margin. In the pre-EFSF Greek financing package, this margin amounted to 300 basis points, which we calculate would lead to a net present value of just above 10%, assuming a five-year tenor. These two deductions serve as a fungible general cash reserve (the "reserve"), that could be deployed to support all EFSF bonds issued if needed. We anticipate the EFSF board to pass an operational policy, mandating that the reserve will remain invested in liquid and 'AAA' rated government, supranational, or agency securities.

In addition to the fungible reserve, we understand that EFSF will establish a loan-specific cash buffer (the "buffer"), which we would also expect to be invested in 'AAA' rated securities. The buffer will be funded by issuance receipts retained from the loan to the borrowing eurozone member state.

When issued, EFSF bonds will be serviced, in the first instance, by the proceeds from debt service from the borrowing members. In the event that one or more borrowers default, EFSF's policies provide that the shortfall would be covered first by making a demand on the sovereign guarantees. If that proves

insufficient, EFSF would follow by drawing down from the loan-specific buffer. Any shortfalls remaining after that would then be covered by the general cash reserve raised in conjunction with the EFSF bond that financed the loan to a eurozone member state in default.

EFSF have advised us that all loans to borrowing states will be made in a manner that ensures that, initially, they will be exactly 100% covered by either guarantees from 'AAA' rated sovereigns or 'AAA' rated liquid assets, comprising:

- Guarantees from 'AAA' rated sovereigns (currently Germany, France, The Netherlands, Austria, Finland, and Luxembourg) backing an EFSF bond raised to lend to a specific state,
- The loan-specific buffer raised by that EFSF bond, and
- The portion of the reserve constituted by that specific borrowing.

EFSF's policies provide that the reserve is in principle fungible and can be used to support debt-service on any EFSF bond, irrespective of which borrower the funds were originally raised to support. We also understand that the reserve may be drawn on to absorb any losses that EFSF incurs in the conduct of its business. However, if only the 'AAA' guarantees are paid on time and in full and the buffer is fully used, only the reserves that were raised in conjunction with the EFSF bond that had financed the defaulted loan to a eurozone member state will be needed to support debt service on that bond.

In May 2010, the governments involved committed up to €440 billion of guarantees. This commitment has been codified in the framework agreement approved by member states on June 7, 2010. Adjusting for the guarantee overcollateralization and the exclusion of Greece from EFSF's program, we calculate that EFSF can raise up to €350 billion. In practice, we believe the amount would be lower under EFSF's policies, as borrowing governments cannot guarantee EFSF bonds. The potential volume of EFSF lending would be reduced further because EFSF will deduct the buffer and the reserve from the amounts it raises.

## Outlook

The stable outlook reflects the outlook on the 'AAA' sovereign guarantors and EFSF's policy of investing both the reserve and the buffer in 'AAA' securities at all times. The buffer will be sized to ensure that all cash available (i.e., the buffer and reserve), plus all guarantees issued by 'AAA' rated sovereigns, at least match the amount of EFSF's outstanding bonds.

EFSF's rating and rating outlook depend on the ratings and outlooks on the 'AAA' guarantors. EFSF's outlook or its rating could be revised if we revised the rating outlook or the rating on one or more of the 'AAA' guarantors, unless EFSF introduced additional credit enhancements to offset the potential reduction in 'AAA' guarantees supporting EFSF's bonds. If EFSF had no bonds outstanding and the rating on a 'AAA' sovereign guarantor was lowered, EFSF's rating would not automatically be lowered, but under its current policies

EFSSF's potential lending capacity would be reduced.

## Related Criteria And Research

- Rating Sovereign-Guaranteed Debt, April 6, 2009
- Criteria For Multilateral Lending Institutions, Oct. 19, 2007
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Sovereign Credit Ratings: A Primer, May 29, 2008

## Ratings List

New Rating; CreditWatch/Outlook Action

European Financial Stability Facility

Sovereign Credit Rating

Foreign Currency

AAA/Stable/--

## Teleconference Information

Standard & Poor's will hold a teleconference on Monday, Sept. 20, 2010, to discuss the rating announced above. The call will begin at:

- 2.30 p.m. British Summer Time,
- 3.30 p.m. Central European Time, and
- 9.30 a.m. U.S. Eastern Time.

Please join Moritz Kraemer, Head of the Sovereigns Ratings Group for EMEA as he discusses this rating action. A Q&A session open to all callers will follow the presentation.

To participate in the call, please dial one of the following numbers:

- International: +44 (0) 1452 555 566
- U.K. local call: 0844 493 3800
- U.S. free call: 866 966 9439
- France local call: 0176 742 428
- Germany local call: 0692 222 4918
- Italy local call: 0236 008 146
- Spain local call: 9141 436 69
- Sweden local call 0850 336 434
- Ireland local call 0150 601 53

CONFERENCE ID NUMBER: 12180732

The title of the teleconference is "European Financial Stability Facility Rated 'AAA' Based On Sovereign Guarantees And Cash Buffer; Outlook Stable." The teleconference will begin promptly at the time indicated. Please dial in at least 15 minutes before the scheduled start to complete the pre-call

registration process. If the number you dial is busy, please call one of the other numbers. There is no charge to participate other than long-distance telephone charges, if applicable. Participants will be asked to provide their name, company affiliation, and e-mail address. The entire call will last approximately one hour.

Recorded replays of the call will also be made available about one hour after the call concludes and are available up until midnight on Oct. 3, 2010. To listen to a replay, please dial:

- International: +44 (0) 1452 55 00 00
- U.K. + 44 (0) 845 245 5205
- U.S.: +1 866 247 4222

Replay Access Number: 12180732#

If you have any questions about the teleconference, please contact Lucy Huggett at +44 (0) 207-176-7237 or via e-mail: [lucy\\_huggett@standardandpoors.com](mailto:lucy_huggett@standardandpoors.com).

**Additional Contact:**

Sovereign Ratings; [SovereignLondon@standardandpoors.com](mailto:SovereignLondon@standardandpoors.com)

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