European Financial Stability Facility

European Financial Stability Facility

December 2011

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Determined and coordinated action to safeguard financial stability

2010

12 April	€110 billion for Greece (€ 80 billion EAMS, € 30 billion IMF)
10 May	€750 billion for European support package to secure stability within the Euro Area
7 June	As part of this package, ***The European Financial Stability Facility ("EFSF")*** was created
28 November	Agreement of financial assistance programme for Ireland (€85 billion)

2011

25 January	**EFSF inaugural issue as part of programme for Ireland**
17 May	Agreement of financial assistance programme for Portugal (€78 billion)
15 June	**EFSF's first issue in support of programme for Portugal**
20 June	Agreement by euro zone and EU finance ministers to increase EFSF effective capacity, widen scope of mandate and finalise terms of permanent stability mechanism, European Stability Mechanism (ESM)
22 June	**EFSF's second issue for Portugal**
21 July	Euro zone summit, second support package for Greece and increased scope for EFSF/ESM
18 October	Amended EFSF enters into force
7 November	**EFSF's second issue for Ireland**
29 November	Maximising EFSF's "firepower" approved
9 December	EU summit – ESM brought forward to July 2012, EFSF will continue as scheduled until end June 2013
13 December	**EFSF's holds first bill auction**

European Financial Stability Facility

EFSF

A robust framework for crisis management …

€750bn Financial Stability Package

European Financial Stabilisation Mechanism "EFSM"

€60 bn

Available to all 27 EU member states

European Financial Stability Facility "EFSF"

€440 bn (lending capacity)

For euro area Member States

International Monetary Fund

€250 bn max

Up to half the amount drawn from EFSF and EFSM

A comprehensive strategy at European level

- Reinforcing the **Stability and Growth Pact**
  - Automatic consequences if 3% deficit ceiling is breached
  - Possible sanctions in corrective **and** preventive arm
- New **“Fiscal Compact”**
  - Annual structural public deficit shall not exceed 0.5% of nominal GDP
  - Rule introduced in national legal systems at constitutional (or equivalent level)
- New **”Excessive Imbalances Procedure”**
  - Multilateral surveillance to tackle imbalances early, sanctions possible
- **“European Semester”** to avoid negative spill-over effects
- **“Euro-Plus-Pact”**
  - National measures to foster competitiveness
- Comprehensive **regulatory reform agenda** for financial markets
  - Implementation of Basel III
  - Regulation of Rating Agencies
- New European Institutions
  - Three new supervisory authorities – **EBA**, **EIOPA**, **ESMA** – oversee banking, insurance & securities markets
  - A “European Systemic Risk Board” (**ESRB**) to monitor macro-economic risks
- More efficient **decision-making process**
  - Reinforcing the Eurogroup
  - Creation of Euro Area Summit
- **Permanent crisis mechanism** – European Stability Mechanism (ESM)

European Financial Stability Facility

EFSF: mission and scope of activity

Mission : to safeguard financial stability in Europe by providing financial assistance to euro area Member States

Scope of activity, linked to appropriate conditionality

- Provide loans to euro area Member States in financial difficulties
- Intervene in the debt primary market
- Intervene in the secondary bond markets
- Act on the basis of a precautionary programme
- Finance recapitalisation of financial institutions through loans to governments including in non programme countries

To fulfil its mission, EFSF issues bonds or other debt instruments on the capital markets

Primary market purchases (PMP)

Objective: maintain or restore a Member State's relationship with the dealer/investment community and reduce the risk of a failed auction

Circumstances

- Countries under a macro-economic adjustment programme or to drawdown of funds under a precautionary programme.
- Primarily used towards the end of an adjustment programme to facilitate a country's return to the markets

Conditions: Those of macro-economic adjustment programme or the precautionary programme as stated in relevant MoU

Limit: No more than 50% of the final issued amount

Once purchased: EFSF could

- Resell to private investors once market conditions have improved
- Hold until maturity
- Sell back to country
- Use for repos with commercial banks to support EFSF's liquidity management

Secondary Market Purchases (SMP)

Objective: support the functioning of the debt markets and appropriate price formation in government bonds

- market making to ensure some liquidity in debt markets
- give incentives to investors to further participate in the financing of countries

Conditions:

- Programme countries: conditionality of the programme applies as in MoU
- Non-programme countries: conditionality refers to
  - ex-ante eligibility criteria as defined in the context of the European fiscal and macro-economic surveillance framework
  - appropriate policy reforms as in MoU

Procedure:

- Initiated by a request from a Member State to Eurogroup
- Exceptionally, ECB could issue an early warning.
- In all cases, subject to an ECB report identifying risk to euro area and assessing need for intervention.

Precautionary programme

Objective: prevent crisis situations by assistance before Member States face difficulties raising funds in the capital markets and avoid negative connotation of being a programme country

- **Precautionary conditioned credit line (PCCL)**
  - access limited to countries with sound economic and financial situation,
  - Clear track record of access to capital markets, respect of SGP* and EIP* commitments
- **Enhanced conditions credit line (ECCL)**
  - access open to countries with moderate vulnerabilities that preclude access to PCCL
- **Enhanced conditions credit line with sovereign partial risk protection (ECCL+)**
  - An ECCL provided in the form of sovereign partial risk protection (Partial Protection Certificate)

Conditions:

- Beneficiary placed under enhanced surveillance during its availability period
- All conditions stated in MoU

Size: Typical size 2-10% of GDP of beneficiary country.

Duration: 1 year renewable for 6 months twice

Procedure: lighter request procedure for swift implementation

*SGP: Stability and Growth Pact, EIP: Excessive Imbalances Procedure

Finance recapitalisation of financial institutions

Objective: limit contagion of financial stress by assisting a country to finance recapitalisation of financial institution(s) at sustainable borrowing costs (particularly to countries where the financial sector is disproportionally large).

Circumstances: Countries that are not under a macro-economic adjustment programme*. Any loans must be requested and disbursed to Member States. EFSF will not loan directly to financial institutions

In order to determine eligibility for an EFSF loan, a three step approach is applied:

1. **Private sector (shareholders)**
2. **National level (government)**
3. **European level (EFSF)**

Conditions:

- Restructuring/resolution of financial institutions
- Compliance with European state aid rules
- Additional conditionality on financial supervision, corporate governance and domestic laws on restructuring/resolution.
- All conditions stated in MoU

* Those countries under a programme, an amount has already been designated within the programme for the recapitalisation of the financial sector (ie €12 billion for Portugal, €35 billion for Ireland)

EFSF shareholder contribution

Member States	Credit rating (S&P/Moodys/Fitch)	New EFSF maximum guarantee Commitments (€m)	New EFSF contribution key (%)	New EFSF maximum guarantee commitments (PT, GR, IE stepped out)	New EFSF contribution key in % (PT, GR, IE stepped out)
Austria	**(AAA/Aaa/AAA)**	**21,639.19**	**2.78**	**21,639.19**	**2.99**
Belgium	(AA+/Aa1/AA+)	27,031.99	3.47	27,031.99	3.72
Cyprus	(BBB/Baa1/BBB)	1,525.68	0.20	1,525.68	0.21
Estonia	(AA-/A1/A+)	1,994.86	0.26	1,994.86	0.27
Finland	**(AAA/Aaa/AAA)**	**13,974.03**	**1.79**	**13,974.03**	**1.92**
France	**(AAA/Aaa/AAA)**	**158,487.53**	**20.31**	**158,487.53**	**21.83**
Germany	**(AAA/Aaa/AAA**	**211,045.90**	**27.06**	**211,045.90**	**29.07**
Greece	(CC/Ca/CCC)	21,897.74	2.81	0.00	0.00
Ireland	(BBB+/Ba1/BBB+)	12,378.15	1.59	0.00	0.00
Italy	(A/A2/A+)	139,267.81	17.86	139,267.81	19.18
Luxembourg	**(AAA/Aaa/AAA)**	**1,946.94**	**0.25**	**1,946.94**	**0.27**
Malta	(A/A2/A+)	704.33	0.09	704.33	0.10
Netherlands	**(AAA/Aaa/AAA)**	**44,446.32**	**5.70**	**44,446.32**	**6.12**
Portugal	(BBB-/Ba2/BB+)	19,507.26	2.50	0.00	0.00
Slovakia	(A+/A1/A+)	7,727.57	0.99	7,727.57	1.06
Slovenia	(AA/Aa3/AA-)	3,664.30	0.47	3,664.30	0.51
Spain	(AA-/A1/AA-)	92,543.56	11.87	92,543.56	12.75
Total		**779,783.14**	**100**	**726,000.01**	**100**

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In case a country steps out, contribution keys would be readjusted among remaining guarantors and the guarantee committee amount would decrease accordingly.

EFSF: a lean organisation

Founded 7 June 2010 with Tenure of 3 years - up to June 2013

Shareholders
Euro Area Member States

Based in Luxembourg ("société anonyme" under Luxembourgish law)

Board of Directors*

European Financial Stability Facility

CEO Klaus Regling + about 20 staff covering:

Operations:
- Funding strategy
- Lending
- Risk management

Research
Legal
Communication
Corporate governance,
Audit, accounting & admin

Federal Republic of Germany
Finance Agency GmbH

Finanzagentur (German DMO)

Front/Back office
debt issuance
cash management
risk management

European Investment Bank

European Investment Bank

Accounting
Documentation
Infrastructure (Facility)

ECB

(agent for primary & secondary bond market purchases)

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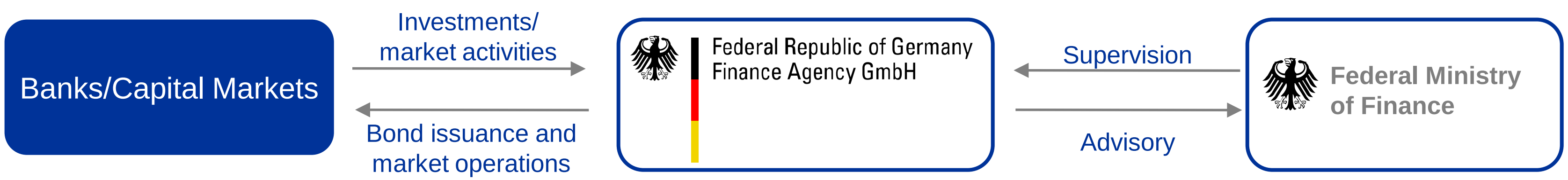
EFSF

Supported by the German debt management office

Finanzagentur (German debt management office):
Europe's benchmark issuer (€338bn funding volume in 2010)

Services to EFSF
Front office:
debt issuance
cash management
risk management



Tasks and targets

- Managing the German federal governments issuance, activities, debt and liquidity
- Reduce interest costs and optimise funding conditions
- Ensure benchmark status of German government securities
- Providing advisory services related to the funding of the fiscal budget, the cash and debt management
- Market analysis, managing the debt portfolio, risk control, investor relations

Supported by the German debt management office

Roles and achievements

Benefits of Market Practices

- Support of liquidity for German government securities
- Market insight: identifying fair pricing levels exist, liquidity situation, identifying demand structures
- Broad picture of prevailing market situation
- Close cooperation with international banks and investors contribute to optimisation of funding conditions and issuance activities
- Collecting information for structuring issuance activities on a long-term horizon
- Placement of securities along investor demand

Achievements

- Successful funding across the years (bid/cover/ average of around 2)
- Establishment of new funding tools: building up a curve in inflation-linked bonds, rare issue of FX bonds
- Permanent Interest cost savings of around €500m annually
- Broader investor base
- Transparent and reliable market appearance

Supported by the German debt management office

Market practices

Permanent cooperation with the major international banks: Primary market auctions, secondary market activities, market analysis, investor activities, syndicated issues

Market practices German Finance Agency

Primary market	Secondary market	Management of the debt portfolio	Market analysis	Investor activities	Risk control and management	Corporate communications
■ Multi price auctions (voluntary participation/web-based system) ■ Annual and quarterly issuance calendar (€338bn in 2010) ■ Bund issues auction group (33 international banks) ■ Syndicated issues	■ Market operations in German government securities ■ Liquidity support ■ Swaps ■ Money market	■ Structuring the annual issuance calendar ■ Improving diversification by more funding tools ■ Adjusting funds activities based on macro-economic analysis ■ Reaching a target portfolio ■ Implementing cost and risk preferences of the issuer	■ Valuation of Bund curves ■ Monitoring market indicators ■ Analysing auctions ■ Identifying issuance windows ■ Analysing market segments for new funding tools (e.g. inflation linked bonds) ■ Analysing peer markets	■ Serving information to investors actively and on request ■ Meeting investors globally ■ Analysing investor demand and secondary market structures	■ Monitoring counter-party and market risk permanently ■ Arranging and checking limits ■ Federal budget planning ■ Accounting	■ Reporting to press ■ Serving information to press and media ■ Arranging publications or interviews ■ Answering requests on most recent or specific topics

EFSF: AAA credit rating

	Long term	Short term
STANDARD & POOR'S	AAA wn	A-1+
MOODY'S	Aaa Stable	(P) P-1
FitchRatings	AAA Stable	F1+

The highest possible ratings reflect:

- Strong shareholder support
- Credit enhancement
- An organisation supported by the best expertise
- Conservative strategy of funding and investment

EFSF bonds are eligible as ECB collateral

A solid and simple structure

- In order to allow timely processing of payments, the effective payment dates for loans are at least 14 days prior to the scheduled payment dates
- In the case of a missed payment by a borrower, EFSF would be in charge of ensuring that **each Guarantor remits its share of the shortfall** to the EFSF
- The shortfall would be covered by the:
  1. **Guarantees**
  2. **Grossing up of guarantees (up to 165% over-collateralisation)**
- If a payment is missed by a borrower, the country programme could be interrupted and subsequently reviewed and the MoU renegotiated but the **conditionality would still exist**
- All guarantors rank equally and ***pari passu*** amongst themselves

Credit enhancement of up to 165% over-guarantee to cover payments in case of any payment default from a borrower. The guarantees cover both principal and interest.

Credit enhancement structure

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How the EFSF works: loan disbursement and funding strategy

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EFSF: loan request procedure*

Application for aid
EAMS makes **formal request** to other members

Support programme
European Commission negotiates stabilization programme – including **strong conditionality** - in cooperation with the IMF and in liaison with the ECB

Approval of loan terms
A common **Memorandum of Understanding** of loan terms is established between the EC, the IMF and beneficiary country and approved by Eurogroup and IMF Board

Loan disbursement
EFSF finalises **technical terms of loan:** term, redemption, schedule, interest rate. On defined date, EFSF **makes loan available** to borrower

3 to 4 weeks

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** Certain new instruments, such as precautionary credit lines, may have lighter procedures for swift implementation*

Financial assistance programme for Ireland

Objectives of the programme

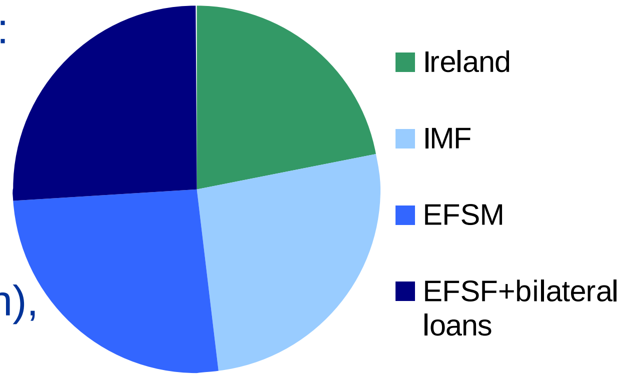
- Immediate **strengthening** and comprehensive **overhaul of the banking sector**
- Ambitious **fiscal adjustment** to restore fiscal sustainability, **correction of excessive deficit by 2015**
- **Growth enhancing reforms**, in particular on the labour market, to allow a return to a robust and sustainable growth

€35 billion

€50 billion

Financing

- The total **€85 billion** of the programme will be financed as follows:
  - €17.5 bn contribution from Ireland (Treasury and NPRF*)
  - €67.5 bn external support
    - €22.5bn from IMF
    - €22.5bn from EFSM
    - €17.7bn from EFSF + bilateral loans from the UK (€3.8bn), Denmark (€0.4bn) and Sweden (€0.6bn)



Disbursements will be made over 3 years with an average loan maturity of 7½ years**

* National Pension Reserve Fund

** Maturity and lending costs are subject to revision following euro zone summit of 21 July

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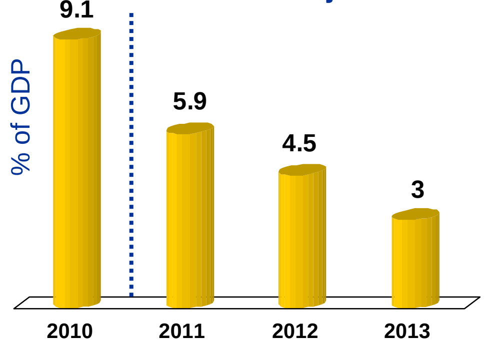
Financial assistance programme for Portugal

Objectives of the programme

- Restore fiscal sustainability through ambitious fiscal adjustment
- Enhance growth and competitiveness via reforms and measures, i.e.
  - Freeze govt. sector wages until 2013, reduce pensions over €1500
  - Reform unemployment benefits and reduce tax deductions
  - Execute an ambitious privatisation programme (TAP, Caixa Seguros …)

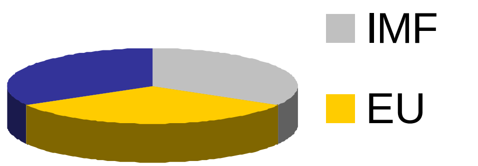
GDP deficit reduction objectives



- Improve liquidity and solvency of financial sector
  - Banking support scheme of up to €12 billion to provide necessary capital for banks to bring Tier 1 capital ratios to 10% by end 2012 in case market solutions cannot be found

Financing

- The total **€78 billion** of the programme will be financed as follows:
  - €26 billion from IMF
  - €26 billion from the EU (EFSM)
  - €26 billion from EFSF



Disbursements will be made over 3 years with an average loan maturity of 7½ years*

* Maturity and lending costs are subject to revision following euro zone summit of 21 July

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EFSF issuance

EFSF funding strategy

The funding strategy should be described as SSA (Sovereign, Supranational, Agency) type through **benchmark issuance**, with focus on a high standard of liquidity. This would permit volumes and pricing to be in line with what is expected from the EFSF mission and is in line with the ECB classification

- **Flexibility:** Funding instruments do not need to be "back to back" with lending operations, but will have in general the same profile as the related loans to the country in difficulty
- **Size/Maturity:** EFSF strategy adapts to market conditions in order to meet investors requirements for **liquidity**
- **Currencies:** The EFSF does not have any currency limitation for its funding activities but it is expected that the majority of funds would be raised in euro. The EFSF would in all likelihood need to swap the proceeds back into euro
- **Issuance method:** Syndications and auctions, private placements, new lines and tap issues
- In addition to the financing instruments already mentioned, **short-term instruments** would be used to insure the needed continuity in financing

EFSF: included in the main SSA indices

Provider	Index	EFSF weighting*
BoA ML	EMU Broad Market index	0.04%
J.P. Morgan	JPM Maggie Euro Credit Index	0.88%
iBoxx	EUR Sub-sovereigns index	0.23%
Citigroup	World Broad investment Grade index Euro Broad Investment Grade index	0.07% 0.23%
Barclays Capital	Euro Aggregate index	0.22%

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* EFSF weighting comprises the 4 benchmark bonds placed for a total amount of €16bn. Weighting include 30/11/2011

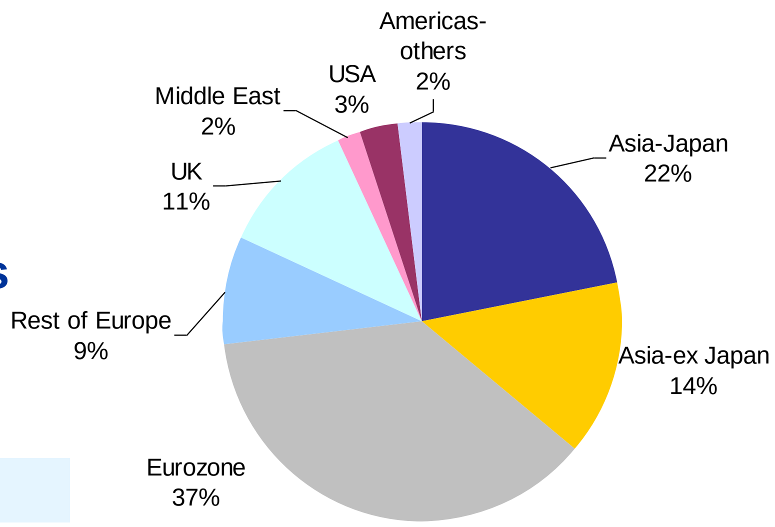
EFSF inaugural issue : record breaking investor demand

On **25 January 2011**, EFSF placed its inaugural issue in support of Ireland.

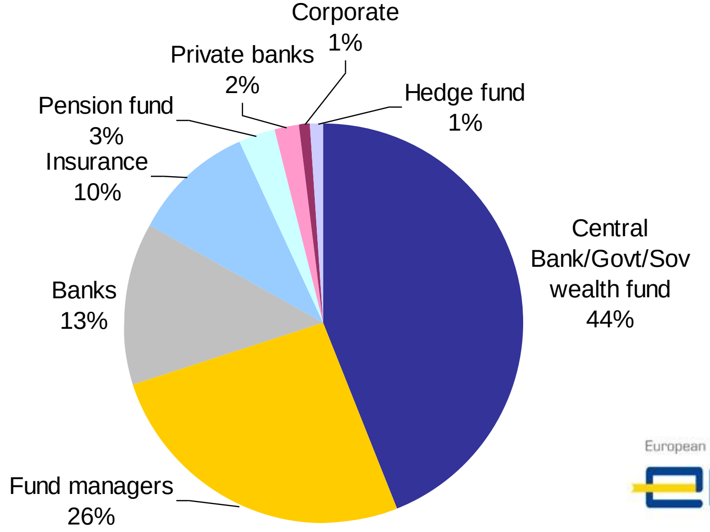
- Record breaking order book of **€44.5 bn**
- Orders received from over **500 investors**

Amount placed	€5 billion
Maturity	18/07/2016
Coupon	2.75%
Initial pricing	Mid swap +6bp
Reoffer yield	2.892%
Reoffer price	99.302%
Settlement date	1 February 2011
Lead managers	Citi, HSBC, Société Générale
Effective lending cost	5.9%
Amount transferred to Ireland	€3.6 billion

Geographical breakdown



Breakdown by investor type



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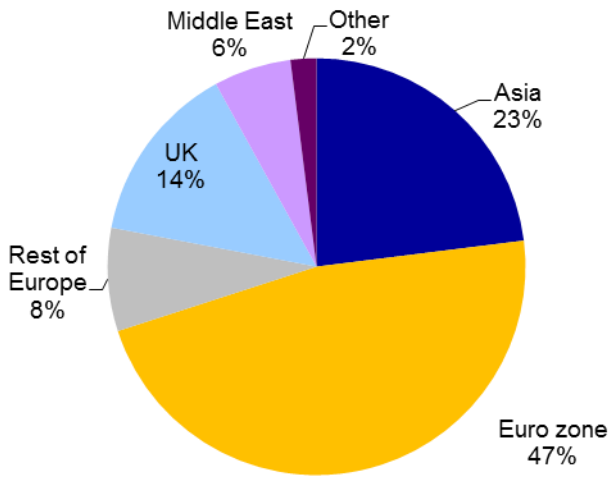
Second issue for Ireland

On **7 November 2011**, EFSF successfully placed its second issue in support of the Republic of Ireland

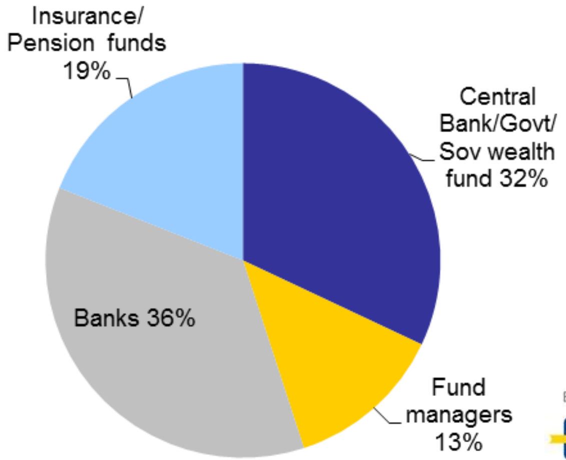
- **€3 billion issue** with a long **10 year maturity**

Amount placed	€3 billion
Maturity	04/02/2022
Coupon	3.50%
Initial pricing	Mid swap +104bp
Reoffer yield	3.591%
Reoffer price	99.216%
Settlement date	14 November 2011
Lead managers	Barclays, Crédit Agricole CIB, J.P. Morgan
Amount transferred to Ireland	€3 billion

Geographical breakdown



Breakdown by investor type



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Short-term funding programme

On 13 December 2011, EFSF held its first t-bill auction

Tenor	3 month (91 days)
Maturity	15/03/2012
Volume	€1.971
Currency	Euro
Weighted average yield	0.2222%
Average Price	99.94386%
Bid/Cover ratio	3.2

- Auction carried out by Finanzagentur using the Deutsche Bundesbank EFSF bidding system 'EBS'
- Regular bill auctions are expected to be held throughout 2012

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Going forward

Optimising EFSF's firepower

On 29 November, euro area Finance Ministers agreed to increase EFSF's firepower by optimising its lending capacity within the existing Framework Agreement and without extending the amount of guarantees by Member States whilst also preserving EFSF high credit rating.

Two options are available:

1. **Partial risk protection** – EFSF provides partial protection certificate to a sovereign bond issued by a Member State. After issue, certificate could be detached and freely traded separately. Holder received fixed credit protection of 20-30% of principal. To be used primarily under precautionary programmes

2. **Creation of a Co-Investment Fund (CIF)** – Combine public and private capital. CIF buys bonds in primary and/or secondary markets. It could be funding through the following classes of instrument:
   - Senior debt instrument : credit rated and targeted at traditional fixed income investors
   - Participation capital instrument : Junior to senior debt instrument, aimed at sovereign wealth funds, risk capital investors, would participate in upside generated
   - EFSF investment: absorbs first proportion on any losses incurred

EFSF would benefit from the flexibility to deploy both options which are not mutually exclusive

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Going forward: creation of a permanent crisis mechanism

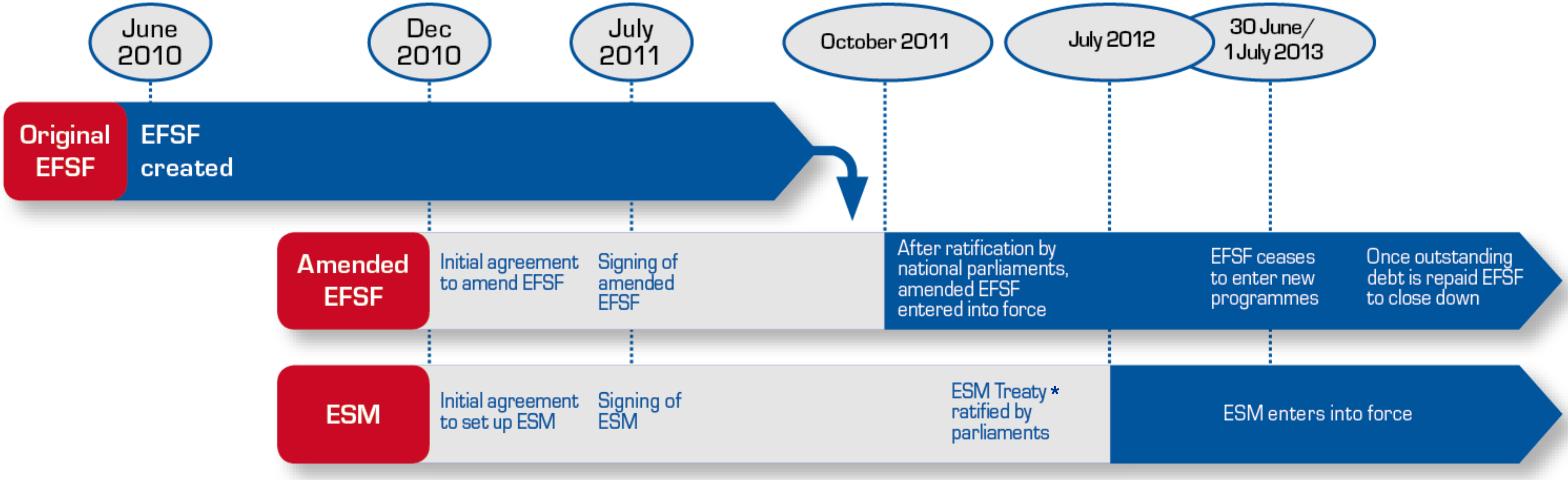
The creation of the **European Stability Mechanism (ESM)**

- an **intergovernmental organisation** under public international law, operational from mid-2012
- ESM will take over **all the features** of the amended EFSF
- **effective lending capacity of €500 billion***
- **total subscribed capital of €700 billion**, with paid-in capital (€80 billion) and committed callable capital and guarantees (€620 billion)
- Following established IMF policies regarding private sector involvement
  - ESM will claim preferred creditor status (except for countries under a European financial assistance programme in June 2011)
  - Standardized and Collective Action Clauses (CACs) will be included for all new euro area government bonds from June 2013

* Following the EU summit held on 9 December 2011, Euro Area Heads of State or Government agreed to reassess the adequacy of the overall ceiling of the EFSF/ESM of €500 billion in March 2012

Going forward

EFSF/ESM timeframe



**ESM treaty will enter into force as soon as Member States representing 90% of the capital commitments have ratified it.*

Contacts

Christophe Frankel

CFO and Deputy CEO

+352 260 962 26

c.frankel@efsf.europa.eu

www.efsf.europa.eu

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EFSF: issuance

Long term

Bond issue	Issue date	Coupon	Maturity	Amount	Issued at MS	Programme
EU000A1G0AA6	25/01/2011	2.75%	18/07/2016	€5 billion	+6bp	Ireland
EU000A1G0AB4	15/06/2011	3.375%	5/07/2021	€5 billion	+17bp	Portugal
EU000A1G0AC2	22/06/2011	2.75%	05/12/2016	€3 billion	+6bp	Portugal
EU000A1G0AD0	07/11/2011	3.50%	04/02/2022	€3 billion	+104bp	Ireland

Short term

	Date	Tenor	Maturity	Volume	Weighted average yield	Average price	Bid/Cover
EU000A1G0BS6	13/11/2011	3 month	15/03/2012	€1.972 billion	0.2222%	99.94386%	3.2