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European Commission
DG Economic and Financial Affairs

Attention: Director John Berrigan

CFA Institute
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1000 Brussels
Belgium

Interest Representative
Register ID (EC register):
ID 89854211497-57

Brussels, 7 January 2012

Re: Green Paper on the feasibility of introducing Stability Bonds

Dear Mr. Berrigan,

CFA Institute is pleased to comment on the European Commission's Green Paper on the feasibility common issuance of sovereign bonds among the Member States of the euro area[1] (COM(2011)818). A consultation and a thorough debate on these so-called "Stability Bonds", which are regarded by the European Commission as a potentially powerful instrument to address the current liquidity constraints in several euro-area Member States and to ultimately reinforce financial stability in the euro area, is essential in the context of the intensified euro-area sovereign debt crisis.

CFA Institute is a global, not-for-profit professional association of more than 106,000 portfolio managers, investment analysts, advisers, and other investment professionals in 137 countries, of whom almost 97,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 135 member societies in 58 countries and territories. The mission of CFA Institute is to lead the investment profession globally by setting high standards of education, integrity, and professional excellence. CFA Institute represents the views of investment professionals before standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and on issues that affect the efficiency and integrity of global financial markets.

[1] http://ec.europa.eu/economy_finance/consultation/stability_bonds/pdf/green-pepr-stability-bonds_en.pdf

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In order to inform our feedback to the European Commission, CFA Institute has decided to poll its members in the European Union and Switzerland, who are well placed as market practitioners and investors to express their opinion on the (i) various options for the structure of these Stability Bonds investigated by the European Commission, and (ii) the pre-conditions to their issuance.

I. About the Survey

I.1. Methodology

All CFA Institute members in the European Union and Switzerland were invited to participate in an online survey to collect their opinion on the introduction of Stability Bonds and to inform CFA Institute feedback to the European Commission. 15,297 members with a valid email address received the email invitation for the survey on 20 December 2011 and one reminder was sent to non-respondents on 28 December 2011. The survey was closed at 12:00p.m. EST on 4 January 2012. 798 members responded for an overall response rate of 5% and a margin of error of ± 1.62%.

I.2. Demographics of respondents

The main occupations of respondents were: portfolio manager (26%), financial analyst (21%), consultant (7%), risk manager (6%), chief executive (6%), relationship manager/sales and marketing (5%), financial advisor (4%). 82% of respondents had 6 or more years of working experience in the financial industry. The largest number of answers came from the UK (23%), Germany (18%), Switzerland (13%), Italy (5%), France (4%), the Netherlands (4%).

II. Results of the Survey

The survey included a set of closed questions focused on (i) the relevance and potential benefits of Stability Bonds, (ii) various options for the structure and issuance of Stability Bonds, and (iii) the pre-conditions to their common issuance.

While the full results of the survey are available in Annex 1 and on CFA Institute website[2], the below section describes the main results, linking them to the main comments, suggestions and recommendations made by the respondents to the poll.

II.1. Relevance, potential benefits and challenges of Stability Bonds

The majority of members (52%) agrees or strongly agrees that resolution of the euro area sovereign debt crisis should require common issuance of sovereign bonds among euro area Member States. 40% disagree and 8% neither agree nor disagree.

[2] http://www.cfainstitute.org/Survey/stability_bonds_survey_report.pdf

The majority of respondents agree that the common issuance of sovereign bonds among Member States of the euro area would alleviate the sovereign debt crisis (55%), reinforce financial stability in the euro area (52%), and facilitate the transmission of euro area monetary policy (56%). 41% disagree that it would improve market efficiency while 38 percent agree.

While a majority of respondents agrees that resolution of the euro area sovereign debt crisis should require common issuance of sovereign bonds among euro area Member States, many underline in their comments that new financial instruments will not cure the fundamental and structural problems of imbalances in trade and competitiveness and public over-indebtedness in many Member States. Some see Stability Bonds as a "necessary but not sufficient" element to a viable resolution of the Eurozone crisis, which would have to be associated with deeper reaching structural reforms, fiscal integration and a strong common governance framework.

A recurrent comment from respondents is that Stability Bonds could bring temporary relief in the short run but would only postpone the problem and be detrimental in the long term, possibly fuelling the next crisis. Some respondents believe that the long-term negatives would outweigh the short-term benefits, as Stability Bonds would further systemize risk and ultimately replace a national sovereign debt crisis with a European-wide debt crisis.

Many respondents underline in their comments the risks of moral hazard introduced by Stability Bonds, as the pressure exercised by the market on weaker Member States to undergo the necessary structural reforms will disappear. In their opinion, it is the fundamental causes of the crisis that need to be tackled: lack of competitiveness in many EU countries, lack of growth, and large and recurrent national public deficits leading to solvency issues at national level.

Alternatives to Stability Bonds suggested by some respondents include: printing of euros by the European Central Bank (ECB) to depreciate the euro and stimulate exports and growth; stepped-up national sovereign bonds buying by the ECB; central guarantee of national bonds up to a certain limit.

II.2. Options for the structure and issuance of Stability Bonds

In its Green paper, the European Commission is exploring various options for the structure and issuance of Stability Bonds.

Type of guarantees associated with Stability Bonds

When asked which type of guarantee would make the issuance of Stability Bonds most effective, a clear majority of respondents (64%) chooses "joint and several guarantees under which each Member State would be liable not only for its share of liabilities under the Stability Bond, but also for the share of any other Member State failing to honour its obligations". 14% of respondents believe that "several but not joint guarantees, under which Member States would retain liability for their respective share of Stability Bond issuance" would make the issuance of Stability Bonds most effective, while 22% choose "several but

not joint guarantees, associated with credit enhancement such as senior status of the Stability Bond issuance over national issuance, or provision of collateral". These figures exclude 14% of respondents who have no opinion, some of them because they do not believe that Stability bonds would be effective.

Full or partial substitution of Stability Bonds for national issuance

64% of respondents support a partial substitution of Stability Bond issuance for national issuance (where a portion of government financing needs would be covered by Stability Bonds, the rest being covered by national sovereign bonds), while 36% support the full substitution of Stability Bond issuance for national issuance (where all government financing needs would be fully covered by Stability Bonds, with national issuance discontinued). These figures exclude 19% of respondents who have no opinion, some of them because they do not believe that Stability bonds would be effective.

Many supporters of the partial substitution cite a reduced moral hazard as a justification for their position. Some supporters of a full substitution argue that, without it, Stability Bonds will find no buyers.

Accelerated or gradual phasing-in of Stability Bonds

A large majority of respondents (65%) support a gradual phasing-in of Stability Bonds, where new issuance would be in the form of Stability Bonds but outstanding national government bonds would remain in circulation until their expiration, while 35% favoured an accelerated phasing-in, where outstanding national government bonds would be converted into new Stability Bonds at a pre-determined date. These figures exclude 16% of respondents who have no opinion, some of them because they do not believe that Stability bonds would be effective.

Several respondents argue that an accelerated phasing-in would be extremely difficult to implement in practices, if not impossible.

II.3. Pre-conditions to the common issuance of Stability Bonds

The Green paper explores the various possible pre-conditions to the issuance of stability Bonds in order to limit or manage the risk of moral hazard, where some member States may follow poor budgetary discipline with limited implications for their financing costs.

CFA members have been polled on the necessity of these pre-conditions, and the likelihood that each of them could be established to the satisfaction of capital markets. The below figures those who expressed no opinion.

- 86% of respondents believe that a "significant enhancement of economic, financial and political integration of participating Member States" is necessary (14% think it is

not necessary). 38% of respondents believe it is not likely to be established to the satisfaction of capital markets, while 35% believe it is likely (26% are neutral).

- 88% of respondents believe that "increased surveillance and intrusiveness in the design and implementation of national fiscal policies for participating Member States" is necessary (12% think it is not necessary). 42% of respondents believe it is likely to be established to the satisfaction of capital markets, while 33% believe it is not likely (25% are neutral).

- 74% of respondents believe that "central approval of draft budgets for all participating Member States" is necessary (26% think it is not necessary). 50% of respondents believe it is not likely to be established to the satisfaction of capital markets, while 30% believe it is likely (19% are neutral).

- 90% of respondent believe that "adoption of binding medium-term fiscal frameworks by participating Member States" is necessary (10% think it is not necessary). 48% of respondents believe it is likely to be established to the satisfaction of capital markets, while 26% believe it is not likely (27% are neutral).

- 84% of respondents think that "establishment of ex-ante ceilings for national borrowing by participating Member States, limiting access to the Stability Bonds issuance to a specific percentage of each Member State's GDP" is necessary (16% think it is not necessary). 51% of respondents believe it is likely to be established to the satisfaction of capital markets, while 27% believe it is not likely (23% are neutral).

- 90% of respondents think that "limiting the access of a participating Member State to the Stability Bond issuance in case of non compliance with rules and recommendations under an euro-area governance framework" is necessary (10% think it is not necessary). 48% of respondents believe it is likely to be established to the satisfaction of capital markets, while 29% believe it is likely (23% are neutral).

The above numbers and the comments from respondents show that the overwhelming majority of respondents believe that financial, fiscal, and to some extent economic and political integration are necessary pre-conditions to the issuance of Stability Bonds. Fiscal integration is seen as particularly essential, with 88% of respondents considering that increased surveillance and intrusiveness in the design and implementation of national fiscal policies is necessary, and 74% thinking that central approval of draft budgets for all participating Member States is necessary. An interesting suggestion from some respondents is to limit central approval of national budgets to countries which are exceeding a pre-determined maximum public debt ceiling.

Comments of respondents also reveal that strict rules governing the issuance of Stability Bonds are also considered necessary by the majority, in order to limit moral hazard and force the implementation of much-needed structural and financial reforms at national level. Some respondents however underline that investors will not trust that such strict rules will be enforced in case of crisis, based on past experiences. Since 2003, a large number of Eurozone countries including the largest ones have been breaching the maximum government debt (60% of GDP) and maximum annual government deficit (3% of GDP) established by the Maastricht Treaty, and no sanction was taken against them.

III. Summary and Conclusion

In summary, while a slight majority of respondents (52%) agrees that resolution of the euro area sovereign debt crisis should require common issuance of sovereign bonds among euro area Member States, many underline that new financial instruments will not cure the fundamental and structural problems of imbalances in trade and competitiveness and public over-indebtedness in many Member States. Given the risk of moral hazard associated with Stability Bonds, many underline the need for the issuance of stability Bonds to be associated with fiscal integration and a strong common governance framework as well as deeper reaching structural reforms.

In terms of structure of Stability Bonds and the options for their issuance, respondents were more in line with Approach No 2 investigated by the Green Paper: “partial substitution of national issuance with Stability Bond issuance with joint and several guarantee”. In fact, 64% of respondents believe that joint and several guarantee would be the most effective approach for the common issuance of sovereign bonds among euro area member states, and 64% also believe that the partial substitution of Stability Bonds for national issuance would be most effective.

Lastly, the vast majority of respondents believe that financial, fiscal, and to some extent economic and political integration are necessary pre-conditions to the issuance of Stability Bonds, fiscal integration being seen as particularly essential.

CFA Institute is pleased to submit the views of its EU and Swiss members to the European Commission on its Green Paper on the feasibility of introducing Stability Bonds.

If you or your staff have questions or seek clarification of our views, please feel free to contact either:

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Sincerely,

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