EUROBONDS

SOVEREIGN DEBT CRISIS: EUROBONDS PART OF THE SOLUTION OR MORAL HAZARD?

A poll of European CFA charterholders reveals that the common issuance of sovereign bonds by eurozone countries (also referred to as 'Eurobonds') could help alleviate the debt crisis, but only as part of a package of structural reforms, fiscal integration and a strong common governance framework.

Overview

In the context of the intensified eurozone sovereign debt crisis, the European Commission published a Green Paper exploring the feasibility of common issuance of sovereign bonds in the Member States of the euro area – so called "stability bonds". Regarded as a potential instrument to address liquidity restraints and reinforce financial stability in the eurozone, stability bonds raise a number of interesting issues for investors and capital markets.

Clearly, the success of the proposal hinges on the attitude of investors. CFA Institute, therefore, decided to poll its members in the European Union and Switzerland to find out their opinions on the issue and allow us to better inform policy makers. The poll, which generated feedback from 798 market practitioners and professional investors, asked questions on:

(i) the extent to which these stability bonds could help solve the euro-area sovereign debt crisis

(ii) the various options for the structure of these stability bonds investigated by the European Commission

(iii) the pre-conditions to their issuance

Key Findings

When asked about the extent to which stability bonds could help solve the eurozone sovereign debt crisis, the poll generated the following key results:

- While a slight majority of respondents (52 percent) agreed that resolution of the euro-area sovereign debt crisis should require common issuance of sovereign bonds, 40 percent disagreed with this strategy
- The majority of respondents agreed that the common issuance of stability bonds would alleviate the sovereign debt crisis (55 percent), reinforce financial stability in the eurozone (52 percent) and facilitate the transmission of eurozone monetary policy (56 percent).

However, many respondents note that new financial instruments will not cure the structural issues of imbalances in trade and competitiveness of many member states. Some see stability bonds as a "necessary but not sufficient" solution for the eurozone crisis, as far-reaching structural reforms, fiscal integration and a strong common governance framework are also required.

To find out more please visit **www.cfainstitute.org/emeavoice**

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Another recurrent comment among respondents was that although stability bonds could bring temporary relief, they would only postpone the problem and prove detrimental over the long term.

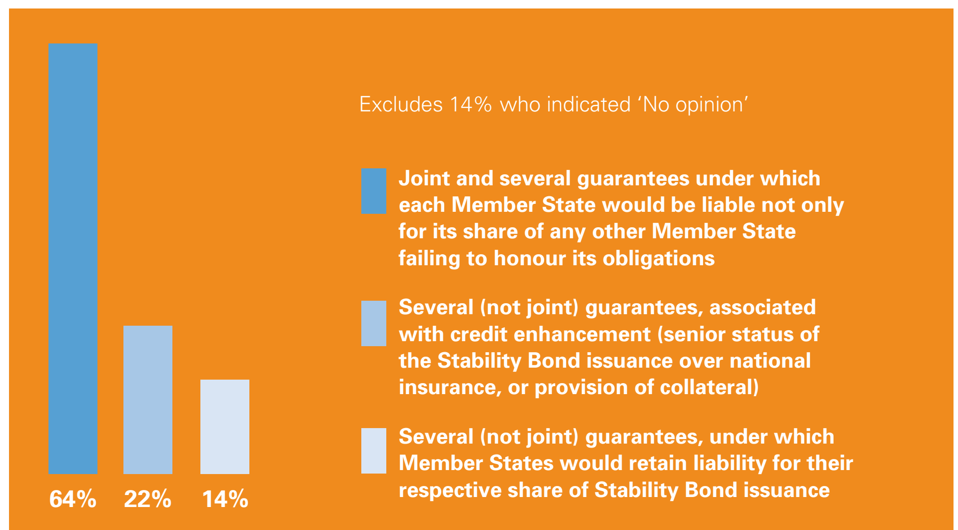
Respondents' feedback on the structure and characteristics of stability bonds was the following:

- 64 percent of survey respondents believe that if sovereign bonds were commonly issued, the most effective approach would be joint and several guarantees, under which each member state would be responsible not only for its share of liabilities under the stability bond but also for the share of any other member state that fails to honor its obligations
- Also, 64 percent of respondents support a partial substitution (versus a full substitution) of stability bond issuance for national issuance, in which a portion of government financing needs would be covered by stability bonds, with the rest covered by national sovereign bonds
- Lastly, 65 percent of respondents support a gradual phase-in of stability bonds (versus an accelerated approach), where new issuances would be in the form of stability bonds but outstanding national governments' bonds would remain in circulation until their expiration

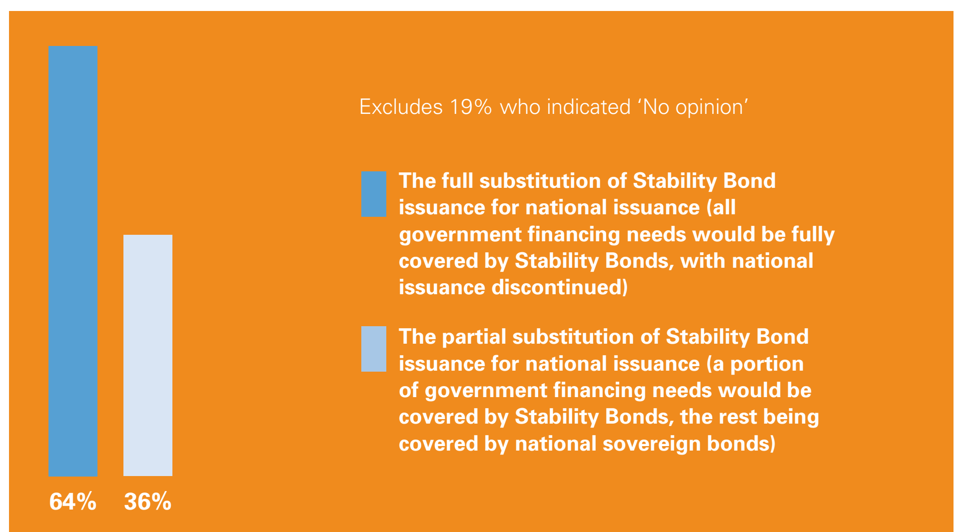
However, the risk of moral hazard, where some member states may follow poor budgetary discipline with limited implications for their financing costs, is a key concern of CFA Institute members. Therefore the issuance of stability bonds has to be associated with more extensive structural reforms, fiscal integration and a strong common governance network. Consequently respondents view the following as **necessary preconditions to the issuance of stability bonds**:

- 86 percent support significant enhancement of economic, financial, and political integration
- 88 percent back increased surveillance and intrusiveness in the design and implementation of national fiscal policies
- 74 percent endorse central approval of draft national budgets

GRAPH 1: IN YOUR OPINION, WHICH OF THE FOLLOWING TYPES OF GUARANTEES WOULD MAKE THE ISSUANCE OF STABILITY BONDS MOST EFFECTIVE? (N=682)



GRAPH 2: DO YOU BELIEVE A FULL OR PARTIAL SUBSTITUTION OF STABILITY BONDS WOULD BE MOST EFFECTIVE? (N=640)



- 84 percent back establishing ex ante ceilings for national borrowing, which would limit access to the stability bonds' issuance to a specific percentage of each member state's GDP
- 90 percent support limiting access to the stability bonds' issuance if a participating member state doesn't comply with the rules and recommendations under a euro-are governance framework

Demographics of the survey

The survey was conducted between 20 December 2011 and 4 January 2012, among 15,297 CFA Institute members in the European Union and Switzerland. 798 members responded for an overall response rate of 5% and a margin of error of ± 1.62%.

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.

To review the CFA Institute survey report on Stability Bonds, visit: **bit.ly/stabilitybonds**