Background note (update)
6 June 2013

European Stability Mechanism (ESM)

Main Features, Oversight and Accountability

1. Main features of the ESM

The ESM is a permanent inter-governmental mechanism, which main objective is to **provide,** through a number of financial assistance instruments, **stability support** to Member States whose access to market financing is impaired or is at risk of being impaired (see ESM Treaty). According to a recital of the ESM Treaty granting of financial assistance in the framework of new programmes under the ESM will be conditional, as of 1 March 2013, on the ratification of the TSCG Treaty ("Fiscal compact") by the ESM Member concerned.

1.1. Capitalisation and Positioning on Capital Markets

ESM members agreed to **capital contributions of €700bn** in total and shall receive ESM shares in return according to the contribution key provided in the ESM Treaty. There are 7 million shares in total (Art 8). Out of €700bn of authorised capital stock, €80bn is paid-in capital, while €620bn is committed callable capital. The former will be made in five instalments. As of 1 May 2013, the first three instalments of €48bn have already been paid in by the ESM members The two remaining tranches of paid-in capital are expected to be transferred on October 2013 and April 2014 (see also Table 2).

The ESM shall enjoy **preferred creditor status**, junior only to the IMF (Recital 13).

The ESM has been assigned the highest long-term rating by Fitch (AAA). Moody's has assigned the ESM an AA1 rating. Both Fitch and Moody's have assigned their highest short-term ratings to the ESM (F1+, P-1, respectively). S&P has not assigned its rating yet.

1.2. Funding Strategy

The ESM shall issue financial instruments or enter into financial agreements or arrangements with ESM members, financial institutions or other 3rd parties in order to raise funds (Art 3). It shall have a diversified **funding strategy**: it may issue bills and bonds with maturities from 1 month to 30 years. Funds raised are pooled and not attributed to a particular country. Issues may be made via syndications, auctions, private placements and taps of existing lines.

1.3. Financial Assistance Instruments

Raised funds shall be provided to an ESM member requesting support, which is suffering sever financial problems. It shall be provided under **strict conditionality** in order to safeguard the financial stability of the euro area as a whole and of its Member States (Art 3). Conditionality is set according to a selected financial assistance instrument. The Treaty (Art 14-17) foresees the following instruments:

- **Stability support loans with a macro-economic adjustment programme** are to assist an ESM member that has significant financing needs and it has, to a large extent, lost access to market financing. The conclusion of a MoU is part of the adjustment programme. The COM, in liaison with the ECB, and wherever possible, the IMF, are entrusted with the monitoring.

- **Financial assistance for recapitalisation of financial institutions** shall be applied in situations where roots of the crisis are located in the financial sector and not directly related to fiscal and structural policies. The MoU focuses only on the Member State's financial sector and its implementation is monitored by the COM, the ECB and in most cases the IMF.

- **Precautionary financial assistance** takes the form of a credit line to support sound policies and prevent crisis situations. It allows ESM members to secure ESM assistance before they face major difficulties raising funds in the capital markets. The Member State needs to negotiate and sign a MoU together with the COM who is responsible for the monitoring of the implementation.

- **Primary and secondary market support facility** allows the ESM to engage in primary and secondary market purchases of bonds or other debt securities issued by ESM members to allow them to maintain or restore their relationship with the dealer/investment community and therefore reduce the risk of a failed auction. This instrument would be used primarily towards the end of an adjustment programme to facilitate a country's return to the market.

In line with the the Euro Area Summit Statement of June 2012, the ESM could provide for **direct recapitalisation of banks** once a **Single Supervisory Mechanism** is in place. An immediate task of the SSM will be a comprehensive review ("asset quality review") of the banks that will fall under direct supervision of the ECB.

Ongoing ESM lending operations

The ESM has already committed up to €109bn overall, leaving €391bn out of its maximum lending capacity of €500bn.

First, the ESM transferred nearly €39.5bn to the FROB, the bank recapitalization fund of the Spanish government, in December 2012 and February 2013 following a formal request from the Spanish government for financial assistance for its banking sector. Back in June 2012, the Eurogroup had agreed on a loan up to €100bn through the ESM for the recapitalisation of Spain's banking sector.

Second, on 24 March 2013, the ESM granted, in principle, a financial support of up to €9bn to Cyprus within the framework of a fully-fledged macroeconomic adjustment programme. The first disbursement of funds took place on 13 May 2013.

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1.4. Governance structure

The ESM shall be governed by **the Board of Governors** (BoG) (composed of the Euro zone finance ministers) and Board of Directors (appointed by each Governor) (Art 4-5). The inaugural meeting of the BoG took place on 8 October 2012, convened by Jean-Claude Juncker, then-President of the Euro Group and the Chairman of the BoG[1]. On 5 November 2012, the Dutch Finance Minister, Jeroen Dijsselbloem took over the Presidency of the Eurogroup and also became the Chairman of the ESM BoG.

On 8 October 2012, the BoG appointed Klaus Regling as the first Managing Director of the ESM. His term is for 5 years with the possibility of one re-appointment. Regling is also the CEO of the European Financial Stability Facility (EFSF), a position he has held since the creation of the EFSF in July 2010.
Klaus Regling worked for 35 years as an economist in senior positions in the private and the public sector, including a decade with the IMF. From 2001 to 2008 he was Director General for Economic and Financial Affairs of the European Commission.

2. The role of the European Parliament

2.1. The ESM legal framework:

- Any decision from the ESM may have a direct or indirect effect on how EU primary and secondary law is implemented and can indeed have an impact on the way the economic policy coordination provided for in the TFEU is implemented. That is why the MoU must be **fully consistent** with the measures of economic policy coordination provided for in the TFEU, in particular with any act of European Union law, including any opinion, warning, recommendation or decision addressed to the ESM Member concerned (Article 13.7). Consistency with treaty provisions and EU policies is mainly entrusted to the COM.
- **COM** shall sign the MoU on behalf of the ESM, subject to the approval by the Board of Governors and –in liaison with the ECB and, wherever possible, together with the IMF– monitor compliance with the conditionality attached to the financial assistance facility.
- The **Managing Director** shall be the legal representative of the ESM and shall conduct, under the direction of the Board of Directors, the current business of the ESM.
- According to the ESM Treaty the Board of Governors shall make the annual report accessible to **the national parliaments** and supreme audit institutions of the ESM Members and to the European Court of Auditors.
- However, the ESM Treaty does not foresee any **formal oversight role for the EP with regard to the ESM**, apart from the indirect control via scrutiny of the COM and the Economic Dialogue and Exchange of Views with the other EU institutions, including the "Troika" (see below "2-pack provisions").
- The **COM and the ECB, as well as the President of the Euro Group** (if he or she is not the Chairperson or a Governor) may participate in the meetings of the Board of Governors as observers. **Other persons**, including representatives of institutions

[1] BoG can decide to be chaired either by the President of Euro Group or elect a Chairperson by QMV.

or organisations, may be invited by the Board of Governors to attend meetings as observers on an ad hoc basis.

2.2. The "2-pack" framework

- The COM shall inform the competent committee of the EP, the EFC, the Eurogroup Working Group, and the parliament of the MS concerned, where relevant and in accordance with national practice, of the measures undertake for Member State subject to enhanced surveillance (art 3 par 1).
- During the course of the enhanced surveillance process, the competent committee of the European Parliament and the parliament of the Member State concerned may invite representatives of the Commission, the ECB and the IMF to participate in an economic dialogue (art 3 par 9).
- The COM shall inform the Chair and Vice-Chairs of the competent committee of the EP orally and confidentially of the conclusions drawn from the preparation (art 7 par 1) and monitoring of the macroeconomic adjustment programme (art 7 par 4).
- The competent committee of the EP may offer the opportunity to the MS concerned and to the COM to participate in an exchange of views on the progress made in the implementation of the adjustment programme (art 7 par 10).
- The COM shall conduct, in liaison with the ECB, regular review missions in the MS under post-programme surveillance to assess its economic, fiscal and financial situation. Every six months, it shall communicate its assessment to the competent committee of the EP, to the EFC and to the parliament of the Member State concerned and shall assess whether corrective measures are needed. In addition, the competent committee of the EP may offer the opportunity to the MS concerned to participate in an exchange of views on the progress made under post-programme surveillance (art 14 par 3).

2.3. Other positions taken

- On 24-25 March 2011, the European Council concluded that "*the Council and the Commission will **inform the European Parliament on a regular basis** about the establishment and the operations of the ESM.*
- As part of the political compromise reached in the negotiations on the Fiscal Compact, the President of the European Council, Herman Van Rompuy, confirmed in his remarks to the European Parliament on 1 February 2012 that the ESM operation will be "*subject to the scrutiny of your Parliament".*
- On 14 December 2012 (and then again on 14-15 March 2013), the European Council concluded that "*any new steps towards strengthening economic governance will need to be accompanied by further steps towards stronger legitimacy and accountability*."
- The EFSF (and now ESM) Managing Director, Mr Klaus Regling, appeared in ECON on 23 January 2012.

- The FAQ of the EFSF (ESM predecessor) indicated that "although there is no specific statutory requirement for accountability to the European Parliament, EFSF has a close relationship with the relevant committees." The ESM homepage does not mention the European Parliament.

- Recommendations in the 20 November 2012 **EP resolution** (Thyssen INI-Report) "Towards a Genuine Economic and Monetary Union":

  - "*the European Parliament should hold a hearing and consent to the appointment of the ESM Chairperson. The Chairperson should be subject to regular reporting to the European Parliament*".

  - "*Key decisions, such as the granting of financial assistance to a Member State and the conclusion of memorandums, should be subject to proper scrutiny of the European Parliament."*

Disclaimer: this background note is drafted by the Economic Governance Support Unit (EGov) of the EP based on publicly available information and is provided for information purposes only. Any opinions expressed in this document are the sole responsibility of the author(s) and do not necessarily represent the official position of the European Parliament.

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Table 1: Comparison EFSM-EFSF-ESM

	EFSM[2]	EFSF	ESM
Legal basis	Council Regulation 407/2010	EFSF Framework Agreement	ESM Treaty
Status	EU funding programme under general EU legal framework	Private company under Luxembourg Law	Intergovernmental Organisation under public international law
Launched on	11 May 2010	7 June 2010	8 October 2012
End by	...	June 2013 as final date for entering into new programmes	...
Funds	€60bn	€440bn	€500bn[3]
Guaranteed by	EU budget	€780bn guarantees by EA17[4]	-€700bn capital subscription by EA17 -out of this €80bn paid-in capital and €620bn in committed callable capital
Preferred Creditor Status	No	No	Yes
MS eligible	EU27	EA 17	EA17
Conditionality	MoU with general economic policy conditions	MoU on chosen financial support instrument	MoU on financial assistance facility
Oversight/Accountability	-COM monitoring at least every 6 months (in practice more often through EC-IMF review missions) -Council to decide on revisions by QMV	-COM to monitor in liaison with the ECB and where possible with the IMF -national parliaments	-COM to monitor in liaison with the ECB and where possible with the IMF -Annual report of BoG to be sent to the national parliaments
Formal EP role	-MoU is (shall be) communicated to the EP by the COM -EC reports to the EP on borrowing and lending activities on regular basis -EP control via EU budget	None (indirectly via democratic scrutiny of the COM, Council, Euro Group, ECB)	None (indirectly via democratic scrutiny of the COM, Council, Euro Group, ECB)

[2] EFSM is for all EU Member States what the Balance of Payments Assistance is for non-euro area Member States. More on these two instruments can be found in the EP study of May 2012.

[3] During transitional phase of parallel functioning of the EFSF and the ESM their consolidated lending shall not exceed €700bn (*Euro Group decision, March 2012*).

[4] As amended by stepping out of Greece, Ireland and Portugal (Member States may step put of the guarantee scheme when they request financial assistance themselves). This is not the case for ESM.

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Table 2: Capital contribution of ESM members

Member	**ESM Key (%)**	**Capital Subscription (€bn)**	**Paid-in capital (€bn)**
Austria	2.783	19.48	2.22
Belgium	3.477	24.34	2.77
Cyprus	0.196	1.37	0.16
Estonia	0.186	1.30	0.15
Finland	1.797	12.58	1.43
France	20.386	142.70	16.31
Germany	27.146	190.02	21.72
Greece	2.817	19.71	2.25
Ireland	1.592	11.14	1.27
Italy	17.914	125.39	14.33
Luxembourg	0.250	1.75	0.20
Malta	0.073	0.51	0.06
Netherlands	5.717	40.02	4.57
Portugal	2.509	17.56	2.00
Slovakia	0.824	5.77	0.66
Slovenia	0.428	2.99	0.34
Spain	11.904	83.32	9.52
Total	**100**	**700.00**	**80.00**