Background Brief
Exchange of views with the Managing Director of the European Stability Mechanism (ESM)
ECON on 24 September 2013

1. Recent developments/discussions

What is the ESM?

The ESM is an inter-governmental mechanism. Its main objective is "*to mobilise funding and provide stability support, under strict conditionality to the benefit of ESM Members which are experiencing, or are threatened by, severe financing problems, if indispensable to safeguard the financial stability of the euro area as a whole and of its Member States*" (ESM Treaty).

As for the governance structure, each ESM Member shall appoint a Governor. The Governor is the member of the government who has responsibility for Finance. The Chairperson of the Board of Governors is currently the President of the Eurogroup. The Managing Director of the ESM is appointed by the Board of Governors for a term of 5 years. The current ESM Managing Director is Klaus Regling.

An ESM Member may address a request for stability support to the Chairperson of the Board of Governors of ESM who shall entrust the COM (in liaison with ECB) to assess the request (i.e. risk to financial stability, debt sustainability, potential financing needs). Based on this assessment the Board of Governors may decide to grant stability support to the Member concerned.

Today most steps regarding a financial assistance request (information on envisaged request, evaluation of debt sustainability, preparation and approval of macro-economic adjustment programmes etc.) are regulated in EU law (See Regulation No 472/2013 of the "2-pack"".

*** *ESM direct bank recapitalisation instrument***

In line with the euro area summit statement of June 2012, euro area Member States agreed in June 2013 to allow the ESM to recapitalise banks directly ─ in accordance with article 19 of the ESM Treaty ─ under certain conditions (see below). The maximum amount allowed was limited to €60bn ("*which can be reviewed by the Board of Governors if deemed necessary*"). This instrument would only be made available to ESM Member States experiencing financial distress and unable to recapitalise their banking sector without jeopardising their own fiscal sustainability and access to financial markets. According to the June agreement, ESM direct bank recapitalisation can only be granted once the Single Supervisory Mechanism is in place and the Bank Recovery and Resolution Directive (BRRD) and the Deposit Guarantee Scheme Directive are finalised.

On 10 July 2013 Commission made a proposal for a Single Resolution Mechanism (SRM) that would cover all banks in the Euro Area and in other Member States participating in the Banking Union. The Commission proposal does not foresee a role for ESM in the SRM (since the ESM is an inter-governmental body outside the remit of EU law). However, as ex-ante private-sector contributions might not be sufficient to cover resolution needs before the fund reaches its target size (the transitional period is estimated to be nearly 10 years), potential use of the ESM as part of EU banking resolution have been raised in the public domain. ECB Board Member Jörg Asmussen suggested that "*the ESM could lend money to the [single resolution] fund that could be reimbursed to the ESM so there is no permanent* *transfer*" although this would most likely require an ESM Treaty change. Commissioner Michel Barnier stated in ECON on 16 September that it was an "*interesting idea*" while reminding that COM's proposal for a SRM would allow the single resolution fund to borrow from the bond markets over the transitional period, if deemed necessary.

Conditions attached to the ESM direct bank recapitalisation tool
(in accordance with the June 2013 agreement**)**
The requesting ESM Member State has to inject sufficient capital to reach the minimum level of Common Equity Tier 1 of 4.5%, if this credit institution falls (or is likely to fall) short of this level. The ESM intervenes on top to bring the bank to the level required by the supervisor. If the bank is already above the minimum regulatory requirement, the ESM member is asked to invest alongside the ESM and provide 20% of the total injection of public funds. Importantly, the ESM direct bank recapitalisation tool applies only if a share of private-sector investors has been bailed in first, in line with the BRRD principles and EU state-aid rules. Finally, "*the potential retroactive application of the instrument should be decided on a case-by-case basis and by mutual agreement*".

** Potential use of ESM precautionary credit line*

Irish Finance Minister Michael Noonan revealed in an interview with the *Irish Independent* on 5 September 2013 that his country might seek a precautionary credit line of about €10bn after the end of the financial assistance programme scheduled for the fourth quarter of 2013. The ESM Chairman and Eurogroup President Jeroen Dijsselbloem confirmed in ECON on 5 September that the euro area would stand ready to "support [Ireland's] gradual exit" while any decision on this might only occur in late October or early November. In addition, the ECB may decide to activate its Outright Monetary Transactions (OMTs), if necessary, provided that Ireland respects the conditions set in its MoU, is able to issue bonds along the yield curve and has the possibility to access the ESM primary market purchase instrument (see OMT conditions).

2. On-going ESM lending operations

** Spain*

After the submission of a request by the Spanish government, the Eurogroup granted financial assistance on 20 July 2012 with the aim to recapitalise the Spanish banking sector and restore market confidence in Spain. A sum of €100bn was agreed, which the Eurogroup found sufficient to cover the estimated shortfall in capital requirements along with an additional safety margin. Spain received two disbursements so far; around €39.5bn was transferred on 11 December 2012 and close to €2bn was transferred on 5 February 2013. The conditions outlined in the MoU consists of bank-specific measures, including in-depth bank restructuring plans in line with EU state aid rules and sector-wide structural reforms. Reforms concerning the governance, supervision and regulation of the financial sector are also being implemented. The latest review conducted by the COM and the ECB in May 2013 concluded that "the programme remains on track".

Box: **ESM lending instruments**

- Stability support loans with a macro-economic adjustment programme
- Financial assistance for recapitalisation of financial institutions
- Precautionary financial assistance (PCCL and ECCL)
- Primary and secondary market support facility

egov@europarl.europa.eu

** Cyprus*

Following the request of the Cypriot Government in 2012, the granting of financial assistance to Cyprus within the framework of a full-fledged economic adjustment programme was approved by the Eurogroup on 25 March 2013. The programme addresses Cyprus's financial sector imbalances including an appropriate downsizing of the country's financial sector, fiscal consolidation, structural reforms and privatisation.

Concerning the amount of the programme, it was decided that Cyprus receives a package of up to €10 billion. The ESM provides €9 billion and the IMF is expected to contribute around €1 billion. Thus far, there have been two disbursements, the first disbursement of €2 billion was transferred on 13 May 2013, and the second disbursement of €1 billion was transferred on 26 June 2013. The next tranche was endorsed by the Eurogroup on 13 September, following the fulfilment of the prior actions by Cyprus and the completion of the relevant national procedures. The disbursement of €1.5bn is to take place by end-September, after the formal approval by the ESM Governing bodies. The IMF Board approved the disbursement of €84.7 million on 16 September.

Please see table for financial assistance to EU Member States for a more comprehensive view.

3. The role of the EP

- The ESM Treaty does not foresee any **formal oversight role for the EP with regard to 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. According to the "2-pack" legislation to EP is informed during the various stages of financial adjustment programmes (see box below).
- 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*". The President of the European Council 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 EP resolution of 20 November 2012 "*Towards a Genuine Economic and Monetary Union*" stated that**:**

  - "*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*."

Box: the "2-pack" legal framework (and the role of EP)

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 EP 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).

ANNEX: Comparison of EFSM-EFSF-ESM

	EFSM[1]	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	...
Lending capacity	€60bn	€440bn	€500bn[2, 3]
Total amount already committed	€48.5bn	€188bn	€109bn
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 ("pari passu")	No ("pari passu")	Yes for loans, no for the other instruments
MS eligible	EU28	EA 17	EA17
Conditionality	MoU with general economic policy conditions	MoU with different conditions depending on the nature of the instrument	MoU with different conditions depending on the nature of the instrument
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)

[1] 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.
[2] During transitional phase of parallel functioning of the EFSF and the ESM their consolidated lending shall not exceed €700bn (*Euro Group decision, March 2012*).
[3] The ESM has a total subscribed capital of €700bn: of this amount, €620bn are committed callable capital from euro area Members and €80bn are the paid-in capital provided by euro area Member States. Conversely, the EFSF are only secured by guarantees from the euro area Member States.
[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.

egov@europarl.europa.eu