IN-DEPTH ANALYSIS

The ESM and the IMF: comparison of the main features

This document provides a comparison of the main objectives, tools and governance structures of the European Stability Mechanism (ESM) and of the International Monetary Fund (IMF). It contributes to the debate on recent proposal regarding the possible evolution of the ESM into a "European Monetary Fund", in the wider context of the discussions on how to strengthen the governance of Economic and Monetary Union. The note also presents summaries of three external papers prepared in spring 2017, upon a request of the Economic and Monetary Committee on this subject.

The context

The ESM is, since 2012, the permanent crisis resolution mechanism for the Member States of the Euro Area. It may provide loans to a Member State, under strict conditionality, in case of financial stability risk. The money needed to provide loans is borrowed by the ESM on capital markets, and is guaranteed by capital paid by the Euro Area Member States.

In the current debate on the deepening of the Economic and Monetary Union (EMU), one of the topical issues is the future role of the ESM: see e.g. the Commission's Reflection paper on the deepening of EMU of May 2017, and the Five Presidents Report of June 2015, which called, *inter alia,* for the integration of the ESM in the EU law framework by 2025. The Eurogroup discussed possible future roles of the ESM in autumn 2017.

On 6 December 2017, the Commission published its proposal for a "Council Regulation on the establishment of the European Monetary Fund" (EMF), as part of the Roadmap for deepening the Europe's Economic and Monetary Union. The Commission proposal is based on Article 352 of the Treaty on the Functioning of the EU, and provides for the establishment of the EMF as a Union body. The EFM "*would succeed the ESM, keeping its current financial and management structures, while enhancing its efficiency, transparency and democratic accountability*". The Commission proposal also add new features, including a backstop for the Single Resolution Fund and possible future stabilisation functions.

This note presents, in tabular format, a comparison of the main features of the ESM and of the IMF, together with relevant references. It groups the features into four main categories:

- **General**: legal form and founding act, members, general scope, staff, seniority of creditor;
- **Governance**: Decision-making and executive bodies, decision taking methods, accountability;
- **Financial assistance**: eligibility, conditionality, lending instruments and financial aspects (i.e. lending conditions), prevention and surveillance tasks;
- **Capital and funding**: funding, auditing, current exposures.

ECONOMIC GOVERNANCE SUPPORT UNIT
Authors: Tea Japuncic, Alice Zoppè
Directorate-General for Internal Policies
PE 614.485 - 15 December 2017

EN

The document presents also summaries of **three external papers** requested in spring 2017 by the ECON Committee on this subject.

It should be stressed that both the scope and the operational environment of the two institutions are different: the ESM works within a monetary union of 19 countries, while the IMF has a global reach in a multi-currency environment.

Current EU legal provisions for financial assistance in the euro area

The EU Regulation 472/2013 on "*the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability*" lays down provision for the role of the EU institutions in the design and monitoring of macro-economic adjustment programmes, as well as preventive surveillance.

This regulation includes also provisions that assign to the Commission the powers to decide on, and to carry out, *enhanced surveillance* on a Member State that is experiencing or threatened with serious difficulties with respect to its financial stability, where these are likely to have adverse spill-over effects on other Member States in the euro area.

The Commission considers its proposal on the EFM as a logical step in addition to this Regulation.

The European Stability Mechanism (ESM)

Following the financial crisis that led some EU countries to lose market access, the Euro area Member States set up in 2010 the European Financial Stability Facility (EFSF), a financial vehicle that could manage the provision of funds to Member States experiencing financial distress.

In 2012, the euro area Member States established the ESM, a permanent mechanism that could act as backstop for Member States that are experiencing, or are threatened by, severe financial problems. Today, the EFSF (which no longer can make new loans) and the ESM are separate legal entities, but they share staff, facilities and operations. The objective of the ESM is to provide stability support through a number of financial assistance instruments to ESM Members, if indispensable to safeguard the financial stability of the euro area as a whole or of its Member States. A separate EGOV note gives an overview of the ESM main features.

The International Monetary Fund (IMF)

The IMF was conceived at a UN conference in Bretton Woods in 1944. The 44 countries at that conference sought to build a framework for economic cooperation to avoid a repetition of the competitive devaluations that had contributed to the Great Depression of the 1930s.

The IMF's primary purpose is to ensure the stability of the international monetary system - the system of exchange rates and international payments that enables countries (and their citizens) to transact with each other. The Fund's mandate was updated in 2012 to include all macroeconomic and financial sector issues that bear on global stability. The IMF has evolved along with the global economy throughout its 70-year history, allowing the organization to retain a central role within the international financial architecture.

Summary of external papers: "An evolutionary path towards an EMF"

In February 2017, the ECON Committee requested three external contributions on whether, and if so how, the competences of the ESM should be expanded in the direction of those recognised internationally to the IMF, for the ESM to become the European Monetary Fund (EMF).

In his paper, **Prof Wyplosz** (*The Graduate Institute, Geneva*) argues that the evolution of the ESM into the EMF is neither necessary nor desirable. After analysing some historical experiences, he notes that the ultimate goal of an EMF (like of the IMF) should be to avoid debt crises, which requires achieving fiscal policy discipline and prevent financial sector's stress that may lead governments to borrow heavily. In the EU, the Stability and Growth Pact was established with this scope, but repeatedly failed. Nevertheless, the setup of an EMF would not make the Pact more effective, but on the contrary would make it weaker. The EMF would be an institution created to bail countries out, and by dismissing the no-bail out clause, would create moral hazard. Furthermore, the EMF would have surveillance and analytical tasks currently carried out by the Commission (fiscal and macro-economic aspects) and the Eurosystem (financial supervision). If these tasks were duplicated, then this would imply a waste of resources. If these tasks were transferred, then governance and accountability features would need to be dealt with. In the end, the only reason to have a EMF when the world already has the IMF is that the IMF's resources are insufficient to deal with a major crisis that affects developed countries deeply integrated (especially financially, as the crisis would become contagious). A possible solution, already put in practice, is for the IMF to design and implement country programmes, and to collect fund from friendly - typically neighbours - countries.

In his paper, **Mr. Gross** (*CEPS*) argues that the ESM already acts as a 'European Monetary Fund' insofar it provides the backstop for sovereigns. However, he considers that other tasks performed by the IMF, namely surveillance and policy coordination, should remain with the Commission, the Eurogroup and other existing bodies. Based on his assessment, the author advocates for two substantive changes to the ESM, namely: (1) no further IMF co-financing, as opposed to technical advice, should be solicited in future ESM programmes and (2) Euro Area Member States should pool their IMF quotas into the ESM, which would represent the entire euro area at the IMF. Finally, the ESM should be brought into the Treaty in the long run. To conclude, Mr Gros argues that any evolution of the ESM should aim at enhancing flexibility and clarity of its overall mandate (financial stability), rather than revising the details of the rescue mechanism (which should be extended to the SRF) and its modus operandi. Moreover, the ESM could be seen as the nucleus of a euro area fiscal instrument for financial stability, which could later be used to bundle the euro area's contribution to global financial stability via the IMF. The balance between providing a back up to national governments, or to common euro area institutions (such as the SRF or a future deposit insurance system) is likely to change over time and in ways that are difficult to anticipate.

In his paper, **Prof Rodden** (*Stanford University*) provides an overview of the mechanisms of inter-regional insurance and redistribution in the United States. He claims that fiscal stabilization is achieved through a progressive income tax. Contrary to common opinion, federal direct expenditures and grants are targeted neither to States suffering from short-term asymmetric negative shocks, nor to relatively poor States in the long term. Fiscal policies of State and local governments are highly pro-cyclical, and partially undermine the stabilizing role of the system of federal taxes and transfers. If Eurozone reformers look at the US and other federations as they seek to create a more sustainable architecture for the Euro, they should focus more on related issues of moral hazard and fiscal discipline. However, the US experience suggests a number of design challenges facing any future Eurozone stabilization mechanism. The paper places proposals for even stronger top-down surveillance and correction mechanisms of Eurozone Member States' fiscal policies in comparative perspective, arguing that such powers are not found in unions like the United States, Canada, and Switzerland. Moreover, there are reasons for concern about the credibility of such efforts in the Eurozone as currently structured. According to Rodden, unless political will can be found for extraordinary political and fiscal centralization, reformers should assume that Member States will continue as sovereigns, and hence will be disciplined (or not) by voters and credit markets rather than European regulators. Thus it might be useful to consider policies that would make the "no-bail out clause" credible.

Table: Comparison of the main elements of ESM and IMF

General		
	ESM	**IMF**
Legal form and founding act	Intergovernmental institution under public international law based on an intergovernmental treaty: Treaty establishing the European Stability Mechanism, 2012 (TESM).	International institution based on an international agreement: Articles of Agreement of the IMF, 1945 (latest amendment in 2015) (AAIMF).
Objective	Mobilise funding if indispensable to safeguard the **financial stability** of the euro area as a whole and of its Member States. *(Art. 3 TESM, see also addendum to TFEU 136)*	Ensuring **stability of** the international **monetary system**, through surveillance of Member Countries policies and provision of loans to countries experiencing balance-of-payments problems. *(Art. 1 AAIMF and Factsheet "IMF at a Glance")*
Members	19 Eurozone Member States (MS). *EU Member States not members of the ESM: Bulgaria, Croatia, Czech Republic, Denmark, Hungary, Poland, Romania, Sweden, UK.*	189 Member Countries (MC). *UN Members not members of the IMF: Andorra, Cuba, North Korea, Liechtenstein, Monaco.*
Staff	170 employees, based in Luxembourg. *(ESM Factsheet)*	Approximately 2,700 employees, mainly based in Washington, DC. *(IMF At a Glance)*
Total amount available for loans	The initial maximum lending volume of the ESM is set **at EUR 500 billion**, including the outstanding EFSF stability support. The Board of Governors may increase it, if appropriate. *(Preamble, point 6,and Article 16 TESM)*	**USD 1 Trillion** (EUR 850 billion EUR) *(Factsheet "IMF at a Glance")*
Seniority as creditor	The ESM enjoys preferred creditor status, second to the IMF only. *(Preamble, point 8 and 13, TESM)*	The IMF enjoys absolute preferred creditor status. *(IMF Financial Operation 2016)*

Governance		
	ESM	**IMF**
Decision-making body	**Board of Governors**: each ESM Member appoints a Governor and an alternate Governor, revocable at any time. The Governor is the member of the government who has responsibility for finance. *(Art. 5 TESM, ESM Governance and Financial assistance for euro area member states)*	**Board of Governors**: each MC appoints one Governor plus one alternate Governor. The Governor is usually the Minister of Finance or the Head of the Central Bank. *(Art. 12(2) AAIMF and Factsheet "How the IMF Makes Decisions")*
Competences of the Decision-making body	The Board of Governors takes all major decisions, including: • capital increases, • granting of financial assistance, • approval of Memorandum of Understanding (MoU), and • approval of disbursements. The Board decides either to be chaired by the President of the Eurogroup or to elect a Chair from among its members, for two and half years. *(Art. 5 TESM)*	The Board of Governors approves: • quota increases, • special drawing right (SDR) allocations, • the admittance of new members, • compulsory withdrawal of members, and • amendments to the Articles of Agreement and By-Laws. The Board of Governors also elects Executive Directors and is the ultimate arbiter on issues related to the interpretation of the IMF's Articles of Agreement. *(Art. 12(2) AAIMF and IMF Governance structure)*

Voting method of the Decision-making body	The decisions of the Board of Governors may be taken by: • **mutual agreement, that means unanimity** of the members participating in the vote. Abstentions are not counted; or • **qualified majority** (80% of vote cast) or • **simple majority** (majority of votes cast) An **emergency procedure** (on request by COM and ECB) allows decisions to be taken with 85% qualified majority. Major decisions, to be taken according to "**mutual agreement"** (unanimity), include: • the provision of financial assistance to a MS and the related financial conditions; • the delegation to the Board of Directors of these decisions. **Qualified majority** is requested for managerial/executive tasks. **Simple majority** is requested to call in capital (to restore the initial amount) or distribute dividends. *(Art. 4, 5, 6 and 9 TESM and Article 1 of the Rules of procedure of the Board of Governors)*	The decisions in the Board of Governors are taken by a **majority of votes cast**, unless otherwise specified in the Articles of Agreement. *(Art. 12(5) AAIMF)*
Voting rights of the Decision-making body	The **voting rights** of each ESM Member, both in the Board of Governors or Board of Directors, correspond to the number of shares allocated in the capital stock of the ESM. *(Art. 4 (7) TESM;* see below under "Funding" and graph in Annex 1)	The voting rights of each member are equal to the sum of its quota-based votes and its basic votes: • the **quota-based votes** of each member is proportional to its quota, expressed in Special Drawing Rights (see below under "Funding")*;* • the **basic votes** of each member is fixed and equal for all members, and corresponds to 0.03% of total votes. *(Art. 12(5) AAIMF and Factsheet "How the IMF makes decisions";* see graph in Annex 2)
Executive body	**The Board of Directors**: composed of 19 Directors appointed by the Governor and chosen from among people of high competence in economic and financial matters. The Governor also appoints an alternate Director. *(Art. 6 TESM and ESM Governance)*	**The Executive Board**: currently composed of 24 Executive Directors elected by the Board of Governors, each representing a country or a group of countries (whose votes counted toward his/her election). Each Executive Director nominates an alternate. *(Art. 12(3) AAIMF and Factsheet "IMF at a Glance")*

Head of the Executive body	The ESM Board of Directors is chaired by the **ESM Managing Director**, who is the ESM's top executive and legal representative. The Managing Director is appointed by the Board of Governors for five years and may be reappointed once; the Board of Governors may decide to dismiss him. He/she is chosen from among candidates having the nationality of an ESM Member, relevant international experience and a high level of competence in economic and financial matters. Whilst holding office, the Managing Director may not be a Governor or Director or an alternate of either. With the assistance of the 6-member Management Board, he/she conducts the on-going business of the ESM, under the direction of the Board of Directors. *(Art. 7 TESM and Explainers: "The ESM decision-making")* The current Managing Director is **Klaus Regling**, who was appointed when the ESM was established in 2012.	The **IMF Managing Director is** both Chairperson of the Executive Board and Head of IMF staff. He or she is appointed by the Executive Board for a renewable term of five years, and selected by a majority of votes cast, among nomination submitted by the IMF Governors. The Managing Director: • is the chairman of the Executive Board, but has no vote except a deciding vote in case of an equal division; • may participate in meetings of the Board of Governors, but shall not vote at such meetings; • conducts, under the direction of the Executive Board, the ordinary business of the Fund. *(Art.12(4) AAIMF and Factsheet "Managing Director Selection Process")* **Christine Lagarde** became the IMF's eleventh Managing Director on July 5, 2011. She was appointed for a five-year term and was selected to serve a second five-year term starting on July 5, 2016.
Competences of the Executive body	The Board of Directors: • ensures that the ESM is run in accordance with the ESM Treaty and the by-laws of the ESM adopted by the Board of Governors, • takes decisions as provided for in the ESM Treaty (such as the approval of loan disbursements) or which are delegated to it by the Board of Governors. *(Art. 6 TESM and ESM Explainers: "ESM decision-making")*	The Executive Board: • conducts the daily business of the IMF and • exercises the powers delegated to it by the Board of Governors. *(Art. 12(3) AAIMF)*
Voting method of the Executive body	The Board of Directors takes decisions according to qualified majority. For decisions delegated by the Board of Governors, the voting method is the one adopted by that same Board. *(Art. 4 and 6 TESM)*	The Executive Board normally makes decisions based on consensus, but sometimes, formal votes are taken. In such a case, Executive Directors' votes correspond to the sum of the votes of the countries that counted towards his/her election. *(Art 12(5) AAIMF and Factsheet "IMF at a Glance")*
Accountability	The Governors, i.e. the Ministers of Finance, are accountable to their **national parliaments**, and in some cases need their explicit approval before voting in favor of important ESM decisions. (*Explainer on the Transparency International Report on the ESM*)	The Governors are accountable to their Member Country's governments. (*Factsheet "IMF at a Glance"*)

Financial assistance		
	ESM	IMF
Eligibility	All ESM Members may ask for financial assistance. When a Member State requires financial assistance, the Chairperson of the Board of Governors entrusts **the European Commission, in liaison with the ECB**, with the tasks to assess: • the existence of a risk to the financial stability of the euro area as a whole or of its Member States, unless the ECB has already recognised the existence of exceptional financial market conditions under Article 18(2) TESM; • whether public debt is sustainable. Wherever appropriate and possible, such an assessment is expected to be conducted together with the IMF; • the actual or potential financing needs of the ESM Member concerned. *(Art. 13 TESM)* Where a Member State requests financial assistance from the EFSM, the ESM, or the EFSF, the **Commission shall assess**, **in liaison with the ECB and, where possible, with the IMF**, the **sustainability** of that Member State's government debt and its actual or potential financing needs. The Commission shall submit that assessment to the Eurogroup Working Group where the financial assistance is to be granted under the ESM or the EFSF (*Art 6 EU Regulation 472/2013*). *"The ESM will consider publishing on its website summary information about the key assumptions underlying **its debt sustainability analyses** to provide additional information to the general public about the ESM's work. Such disclosure would follow the standard practice at peer institutions. This will be in addition to the extensive programme-related information that is already available on our website, including links to programme-related debt sustainability analyses*." (*ESM note on "Transparency international"*)	All IMF Members may ask for financial assistance. A member country may request IMF financial assistance if it has an actual or potential **balance of payments need** - that is, if it lacks or potentially lacks sufficient financing on affordable terms to meet its net international payments (e.g., imports, external debt redemptions) while maintaining adequate reserve buffers going forward. The IMF provides loans to a **MC if its debt is sustainable**. In case it is not, debt restructuring is required. The IMF has developed a formal framework for conducting public and external debt sustainability analyses (DSAs). The objective of the framework is threefold: • assess the current debt situation, its maturity structure, whether it has fixed or floating rates, whether it is indexed, and by whom it is held; • identify vulnerabilities in the debt structure or the policy framework far enough in advance so that policy corrections can be introduced before payment difficulties arise; • in cases where such difficulties have emerged, or are about to emerge, examine the impact of alternative debt-stabilizing policy paths. (*Factsheet "IMF Lending"*)

Scope and instruments of individual lending	Mobilization of **funding and** providing **stability support** to the benefit of ESM Members that are experiencing, or are threatened by, severe financing problems. (Art. 3 *TESM)* The ESM can: • grant loans to its members (stability support loans), • provide precautionary financial assistance: Precautionary Conditioned Credit Line (PCCL) or Enhanced Conditions Credit Line (ECCL), • purchase bonds of beneficiary member states in primary and secondary markets, • finance recapitalization of financial institutions through loans to governments ('indirect recapitalization'), • directly recapitalize banks, only if private investors have been bailed-in under the Bank Recovery and Resolution Directive. *(Art. 13-18 TESM, ESM Explainers: "Lending")*	Giving confidence to Members by **making the general resources** of the Fund **temporarily available,** under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity. *(Article 1(5) AAIMF)* The IMF provides two main types of lending instruments to member governments: concessional and non-concessional. For developed countries, loans are non-concessional, that is they are provided with a market-based interest rate. There are five non-concessional possible instruments: • the Stand-By Arrangements (SBA), • Extended Fund Facility (EFF), • Flexible Credit Line (FCL), • Precautionary and Liquidity Line (PLL), • Rapid Financing Instrument (RFI). *(IMF Factsheet on "Lending")*

Conditionality	The ESM may provide stability support on the basis of **strict conditionality**, appropriate to the financial assistance instrument chosen. If the MS is assessed as eligible, the Board of Governors shall entrust the European Commission – in liaison with the ECB and, wherever possible, together with the IMF – with the task of negotiating a memorandum of understanding (an "MoU") detailing the conditionality attached to the financial assistance facility. The content of the MoU shall reflect the severity of the weaknesses to be addressed and the financial assistance instrument chosen. The European Commission signs the MoU on behalf of the ESM. *(Preamble, Art. 3 and 13 (3 and 4) TESM).* The draft macroeconomic adjustment programme shall take into account the practice and institutions for wage formation and the national reform programme of the Member State concerned in the context of the Union's strategy for growth and jobs. The draft macroeconomic adjustment programme shall fully observe Article 152 TFEU and Article 28 of the Charter of Fundamental Rights of the European *Union (Regulation 472/2013).* Reforms normally focus on three areas: 1. Fiscal consolidation – measures to cut government expenditure, by reducing public administration costs and improving its efficiency, and to increase revenue through privatizations or tax reform; 2. Structural reforms – measures to boost potential growth, create jobs, and improve competitiveness; 3. Financial sector reforms – measures to strengthen banking supervision or recapitalize banks. The ESM, European Commission, ECB and, wherever possible, the IMF check whether the programme country is implementing the reforms it has agreed to. (*ESM Explainer*) The European Commission ... will only sign a MoU with countries entering an ESM programme if it is satisfied as to its compliance with the EU Charter of Fundamental Rights. (*ESM note on "Transparency international"*)	Conditionality in its broad sense covers both the design of IMF-supported programs—that is, the macroeconomic and structural policies—and the specific tools used to monitor progress toward the goals outlined by the country in cooperation with the IMF. All conditionality under an IMF-supported program must be **"macro-critical"**—that is, either critical to the achievement of macroeconomic program goals or necessary for the implementation of specific provisions under the AAIMF. The member country has primary responsibility for selecting, designing, and implementing the policies that will make the IMF-supported program successful. The program is described in a letter of intent (which often has a memorandum of economic and financial policies attached to it). The program's objectives and policies depend on country circumstances, but the overarching goal is always to restore or maintain balance of payments viability and macroeconomic stability. *(IMF conditionality)*

Financial conditions on loans	Each loan is usually disbursed in several tranches. Each tranche has its own specified repayment, or maturity, date. There is always a certain period before the beneficiary ESM Member starts repaying the principal amounts to the ESM ("grace period"). Cyprus, for example, will start repaying its loans in 2025 and Ireland in 2029. Loan interest starts accumulating immediately after the disbursement and the beneficiary countries pays it annually. There is no single interest rate on loans for beneficiary Member States. The ESM passes on to programme countries its costs in funding the loans, specifically its cost of borrowing money from financial markets, by issuing bonds and bills. This cost is expressed as the 'base rate' and is calculated daily. Apart from the base rate, there are three other components that make up the total cost of a loan: • a service fee (covering the ESM's operational costs), • margin, and • commitment fee. The base rate is by far the largest component of the total interest paid by programme countries. At the end of 2015, the interest rate charged by the ESM was below 1% for all beneficiary countries. As explained, this rate fluctuates according to market conditions. *(ESM Explainers: "ESM loans (in support of adjustment programme)")*	Loans are typically disbursed in a number of installments over the life of the program, with each installment conditional on targets being met. IMF programs typically last up to 3 years, depending on the nature of the country's problems, but can be followed by another program if needed. For all instruments, the lending rate comprises (1) the market-determined *Special Drawing Rights (SDR) interest rate*, and (2) surcharges, which are proportional to the amount and time that credit is outstanding (Greece is paying interests of around 4%). Financial conditions on non-concessional loans: • SBA - Repayment within 3¼-5 years of disbursement. • EFF - Repayment period of between 4½–10 years, with repayments in twelve equal semiannual installments. • FCL - The FCL works as a renewable credit line, which could initially be for either one or two years renewable. • PLL - PLL arrangements can have duration of either six months, or one to two years. • RFI - Access under the RFI is limited to 37.5 percent of quota per year and 75 percent of quota on a cumulative basis. The level of access in individual cases depends on the country's balance of payments need. Financial assistance provided under the RFI should be repaid within 3¼ to 5 years. Concessional loans are granted to low-income countries at a concessional zero interest rate through the Poverty Reduction and Growth Facility. *(Lending by the IMF)*
Limits on loan amounts	No formal limits on individual loans have been set so far.	The amount of financing a MC can obtain from the IMF (its "access limit") is based on its quota and the loan instrument. For example, under Stand-By and Extended Arrangements, a member can borrow up to 145 percent of its quota annually and 435 percent cumulatively. However, access may be higher in exceptional circumstances (it reached 1144% for Greece). *(Factsheet "IMF at a Glance" ; Factsheet "IMF Quotas")*

Debt restructuring	**Private sector involvement** will be decided on a case-by-case basis, fully in line with IMF usual practices. There will be no automatic solutions and no prior requirement. The exact form of the participation by private creditors will depend on the specific nature of the problem to be addressed and will be fully consistent with IMF practices. In accordance with the Art. 12(3) TESM, all new euro area government securities with maturity above one year issued on or after 1 January 2013 have to include **Collective Action Clauses**, in a way which ensures that their legal impact is identical. Collective Action Clauses will enable the creditors to pass by qualified majority a decision agreeing a legally binding change to the terms of payment. This could take the form of a standstill, extension of maturity, interest-rate cut and/or haircut, depending on the specific case. *"The insertion of collective action clauses does not per se increase the risk of restructuring. The clause is a simple tool to facilitate the discussion between a debtor and its creditors. The risk of restructuring depends on one thing and one thing only: the sustainability of the debt of the Member State concerned."* (*European Stability Mechanism (ESM) - Q&A*) The Member State concerned shall consider, in close cooperation with the Commission, whether to take all necessary measures to invite private investors to maintain their overall exposure on a voluntary basis. (art. 7 *Regulation 472/2013)*	The role of IMF's financing is put to the test in cases where members with significant external indebtedness have lost—or are losing—market access. In these circumstances, the needs of the member are normally of such a magnitude that they exceed both the amount of financing that can be provided by the Fund and the adjustment capacity of the member. In the event that the financing gap cannot be filled with fresh resources, the Fund's policy explicitly encourages "the restructuring of creditors' claims on the country on terms compatible with balance of payments viability. *(p. 7)* If the problem is one of illiquidity but there are good prospects that market access will be restored, the debt restructuring would typically involve the rescheduling of maturing obligations. If there are solvency concerns, the debt restructuring may need to involve a reduction in the debt stock. **In all cases, the Fund is precluded from providing financing unless steps are taken to address the member's debt problems in a manner that restores sustainability, including via the restructuring of claims of the private and/or official sectors, and that will lead to renewed market access**. *(p. 8)* A decision to restructure sovereign debt is taken by the member state. When a member decides to proceed with a debt restructuring, the Fund encourages the member to engage with its creditors in a collaborative process. The Fund signalized its support for a contractual-based approach; i.e. the inclusion of **collective action clauses** in international sovereign debt contracts through multilateral and bilateral surveillance. *(p. 12-13)* *(Sovereign debt restructuring - recent developments and implications for the Fund's legal and policy framework)*

Preventive surveillance tasks	In order to ensure closer coordination of economic policies and sustained convergence of the economic performances of the Member States, the **Council shall, on the basis of reports submitted by the Commission**, monitor economic developments in each of the Member States and in the Union ... and regularly carry out an overall assessment. For the purpose of this multilateral surveillance, Member States shall forward information to the Commission about important measures taken by them in the field of their economic policy and such other information as they deem necessary. (*Art. 121 TFEU - see also Art. 136 for Euro area MSs)* The Commission may decide to subject to **enhanced surveillance** a Member State experiencing or threatened with serious difficulties with respect to its financial stability which are likely to have adverse spill-over effects on other Member States in the euro area (*Art 2 of Regulation 472/2013*).	The IMF oversees the international monetary system in order to ensure its effective operation, and oversee the compliance of each member with its obligations regarding **exchange arrangements**. The IMF encourages members to adopt sound economic and financial policies as a **precaution** against the emergence of balance of payments difficulties, or to take corrective measures at an early stage of the development of difficulties. IMF monitoring includes: • Bilateral surveillance, focused on individual member countries: IMF monitoring typically involves annual visits to member countries, according to art. IV of the AAIMF. During these visits, IMF staff engage government and central bank officials in discussions about risks to domestic and global stability. These discussions focus on exchange rate, monetary, fiscal, and regulatory policies, in addition to macro-critical structural reforms. Upon completion of their evaluation IMF staff present a report to the Executive Board for discussion. Staff reports, EB conclusions, MS' authorities conclusions are published. • Multilateral surveillance, or oversight of the global economy - IMF also monitors regional and global economic trends and analyzes the impact that member country policies may have on neighboring countries and the global economy. It issues periodic reports on these trends and analysis. *(Factsheet "IMF Surveillance")*

Program monitoring tasks	The Commission, in liaison with the ECB and, where appropriate, with the IMF, **shall monitor the progress made** by a Member State in the implementation of its macroeconomic adjustment programme (*Art 7.4 of Regulation 472/2013*). The European Commission – in liaison with the ECB and, wherever possible, together with the IMF – shall be entrusted with monitoring compliance with the conditionality attached to the financial assistance facility. (Art 13(7) *TESM*) The ESM, European Commission, ECB and, wherever possible, the IMF check whether the programme country is implementing the reforms from MoU it has agreed to. For this purpose, **review mission** with representatives of the four institutions periodically meet with the country's authorities. Disbursement can only be made if the institutions assessment of the reform performance is positive. *(ESM Explainers: "Policy conditions attached to loans")* Also, the ESM has created an **Early Warning System** to detect loan repayment risks and allow for corrective actions. The EWS also applies to EFSF loans. The objective is to determine a programme country's ability to repay its loans. This requires an assessment of the country's short-term liquidity, market access, and the medium- to long-term sustainability of public debt. This work takes into account and complements the fiscal and debt sustainability analysis that the European Commission and the European Central Bank (ECB) perform during and after a programme. *(Art. 13(6) TESM and ESM Explainers: "How the ESM ensures that loans are repaid")*	Most IMF financing features disbursements made in installments that are linked to demonstrable policy actions. This aims to ensure progress in program implementation and to reduce risks to the IMF's resources. **Program reviews** provide a framework for the IMF's Executive Board to assess periodically whether the IMF-supported program is on track and whether modifications are necessary for achieving the program's objectives. Reviews combine a backward-looking assessment (were the program conditions met according to the agreed timetable?) with a forward-looking perspective (does the program need to be modified in light of new developments?). Disbursements under an IMF-supported program can take place only upon its approval, or completion of reviews, by the IMF's Executive Board. Program approval or reviews are based on various policy commitments agreed with the country authorities. These can take different forms: • Prior actions • Quantitative performance criteria (QPCs) • Indicative targets • Structural benchmarks. *(IMF conditionality)*

Post program monitoring	The Commission shall conduct, in liaison with the ECB, **regular review missions** in the Member State **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 European Parliament, to the EFC and to the parliament of the Member State concerned and shall assess, in particular, whether corrective measures are needed. (*Art 14 Regulation 472/2013*)	Under **post-program monitoring**, countries undertake more frequent formal consultations with the IMF than is the case under the IMF's normal surveillance, with a particular focus on macroeconomic and structural policies that have implications for the country's external viability. There is normally one standalone post-program monitoring paper issued for Board consideration in a twelve-month period. Post-program monitoring remains in effect until outstanding credit falls below the applicable thresholds. Nonetheless, the IMF's Executive Board could agree to discontinue post program monitoring—even before outstanding credit falls below the thresholds—if strong policies are in place and the external position is sound. In cases where post-program monitoring is found to be required even though outstanding credit is below the above-specified thresholds, the monitoring will normally be carried out for an additional year. (*IMF Post programme Monitoring*)

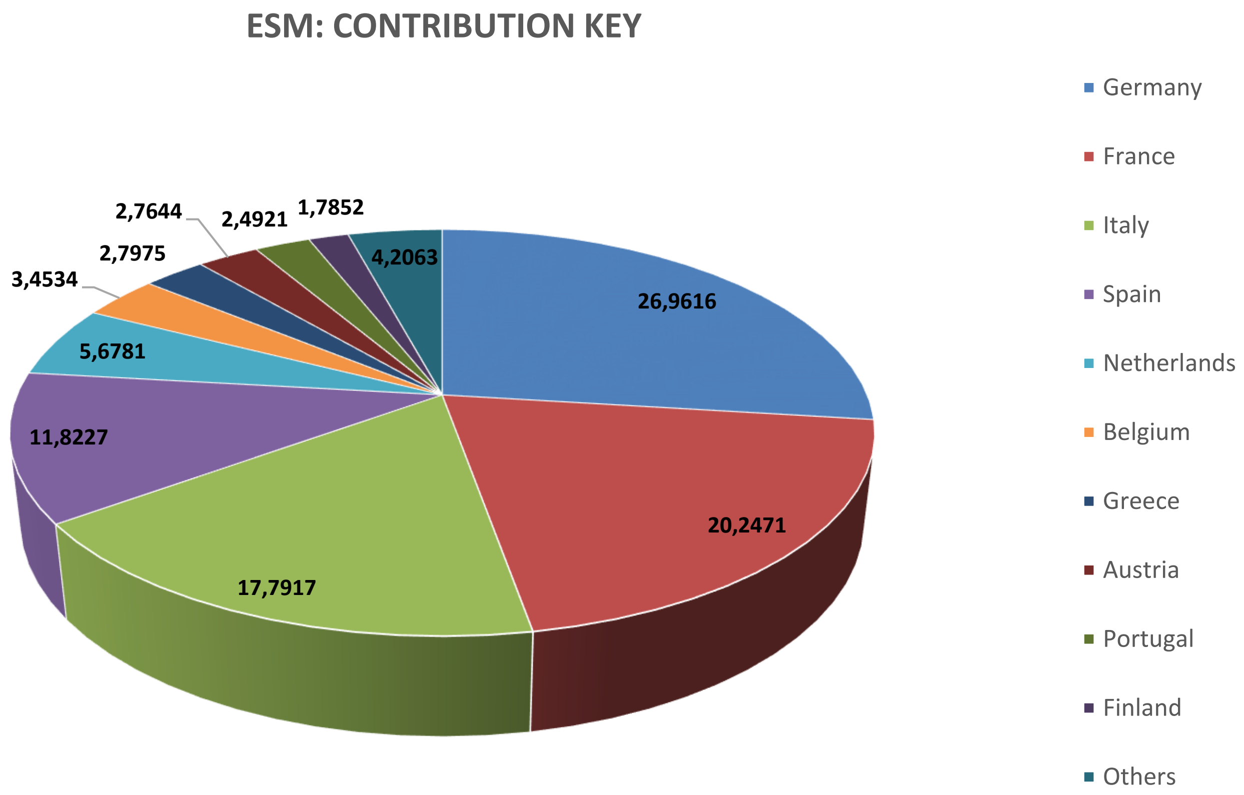
Capital and funding		
	ESM	IMF
Own capital and funding	The ESM has a subscribed authorized capital totaling 704 billion euro. The financial contribution of each ESM member to the ESM capital is based on the capital key of the European Central Bank, which reflects the respective country's share in the total population and gross domestic product of the euro area (see graph in Annex 1). The ESM authorised capital is divided into: • paid-in shares, now set at EUR 80 billion. It is invested in high quality liquid assets and serves as a guarantee for the bonds and bills issued by the ESM. It cannot be used to make loans. • callable shares or "authorised unpaid capital" - amounts that may be called in accordance with terms set in the ESM Treaty. The total value of callable shares stands at EUR 624 billion. To finance its loans, the ESM borrows money from financial markets. This is done by issuing bonds (with maturities of up to 43 years), bills and other funding instruments. Due to its high creditworthiness, the ESM is able to borrow money from the markets at much lower interest rates than those charged to financially distressed countries. Also, in accordance with Art. 21(1) TESM, ESM is empowered to borrow from banks, financial institutions or other persons or institutions. Borrowing activities are managed within an appropriate risk management framework, as specified in the High Level Principles for Risk Management and in the risk policies. *(Art. 8-11 TESM and ESM Explainers: "Raising Funds")*	The IMF has total quotas SDRs 475 billion (570 billion euro). Most resources for IMF loans are provided by member countries, primarily through their payment of quota subscriptions (see graph in Annex 2). Each member country of the IMF is assigned a quota, based broadly on its relative position in the world economy. The Fund may supplement its quota resources through borrowing: 1. Multilateral borrowing • The New Arrangements to Borrow (NAB) is IMF's main backstop for quota resources. NAB is a set of credit arrangements between the IMF and 38 member countries and institutions, including several emerging market countries, which stand ready to lend additional resources to the IMF in circumstances in which the IMF needs to supplement its quota resources for lending purposes. • The General Agreements to Borrow (GAB) enables the IMF to borrow specified amounts of currencies from 11 advanced countries (or their central banks), under certain circumstances. The GAB may only be activated when a proposal to activate NAB is rejected by NAB participants. 2. Bilateral borrowing The IMF has at times supplemented its resources through bilateral borrowing. In particular, the IMF entered into bilateral borrowing agreements in 2009-2010, which were subsequently incorporated into the NAB. In 2012, with the deepening of the euro area crisis, the IMF and several members agreed on another round of bilateral borrowing for a period of four years. *(Factsheet "Where the IMF Gets Its Money")*

Auditing	• The Board of Auditors is an independent oversight body of the ESM. The Board of Auditors inspects the ESM accounts and verifies that the operational accounts and the balance sheet are in order. It audits the regularity, compliance, performance, and risk management of the ESM and monitors the ESM internal and external audit processes and their results. • The Internal Audit function is an independent and objective assurance function, reporting directly to the ESM Managing Director. It is designed to add value and improve the ESM's operations. It assists the ESM by bringing a systematic and disciplined approach to evaluating and improving the ESM's risk management, internal control and governance processes. • External audit is conducted by independent auditors approved by the Board of Governors and responsible for certifying the annual financial statements. The external auditor examines the ESM Financial Statements in accordance with generally accepted auditing standards. As defined in the ESM Treaty, the external auditor has the power to examine all books and accounts of the ESM and obtains all information about its transactions. The audit findings in relation to the ESM Financial Statements are reflected in the external auditor's report on the Financial Statements as contained in the ESM Annual Report. The work of the external auditor is monitored and reviewed by the Board of Auditors.	Two IMF offices are in charge of auditing: • **Office of Internal Audit and Inspection** (OIA): Provides independent and objective assessments of the governance, risk management, and internal control processes of the Fund; acts as consultant and catalyst for the improvement of the Fund's business processes; conducts internal investigations, as requested by the Managing Director; and assists with external audit processes. • **Independent Evaluation Office (IEO):** conducts independent and objective evaluations of IMF policies and activities. It is fully independent from the Management of the IMF and operates at arm's length from the Board of Executive Directors. Its mission is to enhance the learning culture within the IMF, strengthen the IMF's external credibility, and support Institutional governance and oversight The External Audit Committee (EAC) has three members, all of whom are independent of the IMF and its Executive Board. The EAC reports to the Board of Governors and is responsible for the oversight of the IMF's external audit, internal audit, financial accounting and reporting, risk management and internal control functions. EAC members each have the accounting and financial expertise required to fulfil the EAC's oversight responsibilities.
Current exposures	Outstanding amounts (ESM+EFSF, November 2017): Greece: EUR 171.1 billion Cyprus: EUR 6.3 billion Ireland: EUR 17.7 billion Portugal: EUR 26 billion Spain: EUR 41.3 billion See also EGOV note on Macro-economic financial assistance to EU MSs.	Total committed amounts under current lending arrangements (September 2017): SDR 113 billion (ca EUR 135 billion), of which SDR 101 not drawn. Largest borrowers (outstanding): Greece: SDR 9642 million (ca EUR 11.5 billion) Ukraine : SDR 8893 million (ca EUR 10.6 billion) Portugal : SDR 7708 million (ca EUR 9.2 billion) Pakistan: SDR 4393 million (ca EUR 5.2 billion)

Disclaimer and Copyright

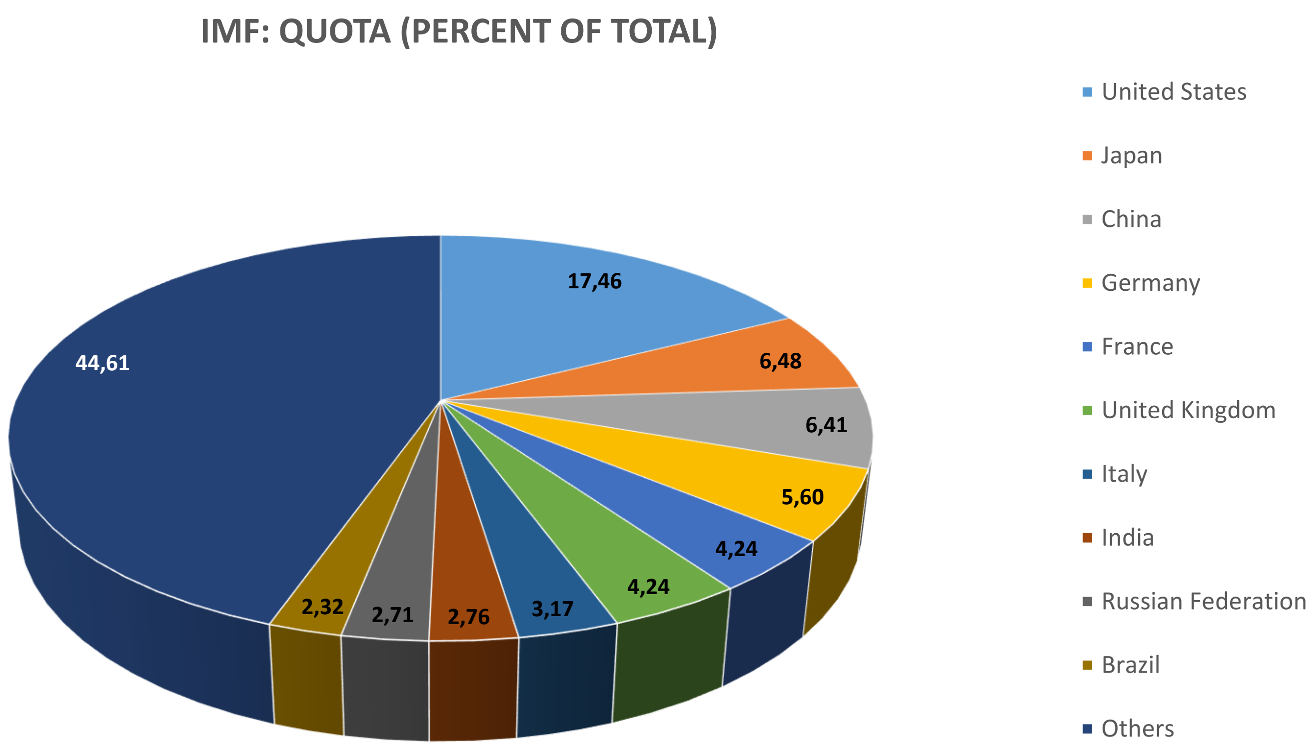
Contact: egov@ep.europa.eu
This document is available on Internet at: www.europarl.europa.eu/supporting-analyses

ANNEX 1



Source: ESM factsheet (November 2017)

ANNEX 2



Source: IMF Members' quotas (November 2017)