IN-DEPTH ANALYSIS

European Parliament

European Stability Mechanism (ESM): Main Features, Instruments and Accountability

This document presents the main features of the European Stability Mechanism (ESM), including governance, capital structure and funding sources, main financial instruments, as well as its oversight and accountability framework. It also reviews recent proposals and contributions on the possible evolution of the ESM. This note is regularly updated.

The **European Stability Mechanism (ESM)** was established in October 2012 by the governments of the Euro Area Member States, by an *ad hoc* Treaty outside the European Union Treaties.

The ESM provides loans to Euro Area Member States facing financial difficulties, conditionally on the implementation of policy measures. It borrows money on financial markets, guaranteed by 704.8 billion Euros as authorized capital by its Members.

Over the years, the ESM has provided financial assistance to Greece, Cyprus and Spain, and has contributed to the definition of both conditionality and the financial conditions on loans.

Since its establishment, the ESM legitimacy has been challenged in two aspects:

- its compatibility with Article 125 of the Treaty on the Functioning of the EU (see Box 1) and
- its accountability at the EU level (see below).

Against the backdrop of the evolution of the economic governance of the European and Monetary Union (especially the Banking Union), many proposals have been made on the possible future role of the ESM, including the recent Commission proposal for its evolution into a European Monetary Fund and its inclusion into EU legislation.

Box 1: Relevant EU and national case law on the ESM

Pringle case, ECJ, 27/11/2012

The European Court of Justice (ECJ) ruled that the TESM is compatible with the Treaty on the Functioning of the EU (TFEU), including the 'no bail out' clause of Article 125: "*(...) Article 125 TFEU does not prohibit the granting of financial assistance by one or more Member States to a Member State which remains responsible for its commitments to its creditors, provided that the conditions attached to such assistance are such as to prompt that Member State to implement a sound budgetary policy*".

German constitutional court ruling on 18/03/2014

The German Federal Constitutional Court ruled, "*Despite the liabilities assumed, the budgetary autonomy of the German Bundestag is sufficiently safeguarded. However, arrangements under budgetary law must be made to ensure that possible capital calls pursuant to the ESM Treaty can be met fully and in time within the agreed-upon upper limits*".

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Overview

The ESM was established under public international law by the Treaty establishing the European Stability Mechanism (TESM).[1] It replaced the initial rescue fund for the Euro Area, the European Financial Stability Facility (EFSF), which had provided loans to Ireland, Portugal and Greece. 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 main objective of the ESM is to provide stability support to Euro Area Member States that are experiencing or are threatened by severe financial difficulties. Despite being outside the EU Treaties, the role of the ESM is recognised in the EU Regulation 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 (472/2013), which states: *"(...) arrangements for surveillance should apply to Member States requesting precautionary assistance from (...) the European Stability Mechanism (...)"* (Preamble, para. 5).

In line with the TESM, the revised Article 136 TFEU and the ruling of the European Court of Justice, ESM financial assistance is **strictly conditional on the implementation of policy measures.** Such measures are specified in a Memorandum of Understanding (MoU) negotiated by the European Commission, the European Central Bank (ECB), the International Monetary Fund (IMF) (where applicable) and the beneficiary Member State.

After Spain and Cyprus successfully exited their programmes, Greece is today the only country left under an ESM financial assistance programme. However, those other Member States continue to be subject to the so-called "post-programme surveillance"[2], which aims to measure a beneficiary's capacity to repay outstanding loans.

Governance

The ESM is governed by the Board of Governors (BoG), composed of the 19 Euro Area finance ministers. The BoG decides either to be chaired by the President of the Eurogroup or elect a Chairperson from among its members (for two years, renewable).[3]

All major decisions within the BoG are taken by unanimity[4], including capital increases, granting of financial assistance and approval of MoUs. The European Commission, the ECB and the President of the Eurogroup may participate in the meetings of the BoG as observers, while others, including representatives of institutions or organisations, can be invited by the BoG to attend meetings as observers on an *ad hoc* basis. The voting rights of each ESM Member in the BoG are equal to the number of shares allocated to it in the capital stock of the ESM (see Annex 1 and below).

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[1] The Treaty on the Functioning of the European Union has nonetheless been amended to allow for the establishment of the ESM. The following text was inserted under Article 136, para. 3: "*The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality.*"

[2] Post-programme surveillance is foreseen by Article 14 of the two-pack Regulation (EU) N°472/2013, which sets out that "*a Member State shall be under post-programme surveillance as long as a minimum of 75 % of the financial assistance received from one or several other Member States, the EFSM, the ESM or the EFSF has not been repaid*".

[3] The current Chair of the ESM BoG is Mário Centeno, elected on 4 December 2017 (effective from 13 January 2018). He succeeds Jeroen Dijsselbloem, who chaired the Eurogroup since 5 November 2012.

[4] The TESM also includes an emergency voting procedure, whereby financial assistance can be granted if supported by a qualified majority of 85 % of the votes.

The Board of Directors (BoD) is the executive body of the ESM, composed of 19 Directors appointed by the Governors, from among people of high competence in economic and financial matters. Today it is chaired by Klaus Regling, who was appointed as the **Managing Director of the ESM** for a first term of 5 years in 2012, and reappointed for another 5-year term until October 2022.[5] The Managing Director is the legal representative of the ESM and its top executive. With the assistance of the 6-members Management Board, he conducts the ongoing business of the ESM and is responsible for organising, appointing and dismissing staff.

The ESM is headquartered in Luxembourg and has 170 staff members.

The BoD ensures that the ESM is run in accordance with the TESM and the by-laws of the ESM adopted by the BoG, and takes decisions as provided for in the TESM (such as the approval of loan disbursements) or which are delegated to it by the BoG. The BoD takes decisions according to **qualified majority**, while for decisions delegated by the BoG the voting method is the same as the one adopted by the BoG. The voting rights of each ESM Member are the same as in the BoG.

According to the Preamble (para. 16) and Article 37 of the TESM, *"Disputes concerning the interpretation and application of the ESM Treaty arising between the Contracting Parties or between the Contracting Parties and the ESM should be submitted to the jurisdiction of the* ***Court of Justice of the European Union****, in accordance with Article 273 of the TFEU*".

Capital, Funding and Auditing

The ESM has a subscribed authorized capital totalling 704.8 billion euro, of which 80.5 billion has been paid-in. The financial contribution of each ESM Member is based on the capital key of the ECB, which reflects the respective country's share in the total population and gross domestic product of the Euro Area (see Annex 1), and **Members receive ESM shares corresponding to their subscribed capital.** The ESM lending capacity is capped at €500 billion. The ESM capital which is subscribed but not paid is 'callable' at any time, in case of need (i.e. the ESM Members commit to provide the corresponding funding at short notice under specific circumstances). The ESM paid-in capital is managed "prudently and conservatively".[6]

When a Member State adopts the Euro, it has to become a member of the ESM (no 'opt-out' clause) and thus subscribe ESM shares. In such cases of enlargement - which has happened twice since the establishment of the ESM, with the entry of Latvia and Lithuania in the Euro Area - the contribution keys of ESM Members change mechanically, while the total amount of capital increases.

Table 1: ESM capital

Subscribed capital	€704.8bn
Paid-in capital	€80.5bn
Committed callable capital	€624.3bn
Maximum lending capacity	€704.8bn
Remaining lending capacity (Jan 2018): 75%	€378bn

Source: https://www.esm.europa.eu/, January 2018

In accordance with the Article 12 of 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 that 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.

[5] *"The Managing Director shall be appointed by the Board of Governors from among candidates having the nationality of an ESM Member, relevant international experience and a high level of competence in economic and financial matters. (...)He or she may be reappointed once."* (Article 7 TESM). He also serves as CEO of the EFSF.

[6] See ESM https://www.esm.europa.eu/about-us/how-we-work

This could take the form of a standstill, extension of maturity, interest-rate cut and/or haircut, depending on the specific case.

The ESM issues bills and bonds on the market, with maturities from 1 month to 40 years. Issues may be made via syndications, auctions, private placements and taps of existing lines. The ESM can also borrow from ESM members, financial institutions or other third parties. Thanks to its good rating, the ESM enjoys good financing conditions[7]. Its creditor status is preferred, second to the IMF only. Funds raised are pooled and not earmarked for a specific country.

Inspection and verification of the ESM accounts and balance sheets is conducted through three different types of audit: two internal and an external one.

- Board of Auditors

The Board of Auditors is an independent oversight body of the ESM. It is composed of five members appointed by the BoG, in charge of auditing the regularity, compliance, performance, and risk management of the ESM. The Board also monitors the ESM internal and external audit processes and their results.

- Internal Audit

This 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

This kind of audit is conducted by independent auditors approved by the BoG and responsible for certifying the annual financial statements. The external auditor examines the ESM Financial Statements in accordance with generally accepted auditing standards. As specified in the TESM, the external auditor has the power to examine all books and accounts of the ESM and obtain 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, contained in the ESM Annual Report[8].

Financial Assistance Instruments

The ESM may provide stability support only on the basis of strict conditionality, appropriate to the financial assistance instrument chosen. "*If the ESM Member is assessed as eligible, the BoG shall entrust the European Commission – in liaison with the ECB and, wherever possible, together with the IMF – with the task of negotiating, with the ESM Member concerned, a 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*" (Article 13 TESM).

According to Article 7 of EU Regulation 472/2013, the European Commission signs the MoU on behalf of the ESM, observing Article 152 of the TFEU ("role of social partners") and taking into account Article

[7] The ESM current external rating is AAA (Fitch) or Aa1 (Moody's). Although the ESM has a negative leverage (i.e. its capital base is larger than its lending capacity), its rating is sensitive to rating changes of its larger Members, because not all the capital is paid-in. In case of downgrading of an ESM Member, rating agencies may assess that the risk of non-payment of the callable capital of that Member is higher.

[8] *"The BoG 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"* (Article 30, para. 5 TESM).

28 of the Charter of Fundamental Rights of the European Union ("right of collective bargaining and action").

Six different financial instruments are available in the ESM toolbox. Most of them are clearly crisis management tools, to be used as last resort instruments when the situation of a Member State or its financial sector is already quite deteriorated, and only one – the precautionary financial assistance – has a preventive nature. Two instruments target specifically the financial sector, namely the financial assistance for recapitalisation of financial institutions ('indirect recapitalisation') and the direct recapitalisation instrument (DRI). Conditionality varies with the nature of the instrument: it is typically less strict in the case of precautionary assistance. Only two of the instruments have been used so far: the stability support loan and the 'indirect recapitalisation' instrument.

- Stability support loan

Such loan is granted by the ESM to the requesting ESM Member – that has significant financing needs and, to a large extent, lost access to market financing – as part of a macro-economic adjustment programme. The Commission, in liaison with the ECB, and wherever possible, the IMF, is entrusted with the monitoring of the programme. Such support loan has been granted to Cyprus in 2013 and Greece in 2015.

- Primary market support facility

The ESM may engage in primary market purchase of bonds and other securities issued by Member States at market price to allow them to restore their relationship with the investment community and therefore to reduce the risk of a failed auction. This instrument can complement the regular loan or a precautionary programme. The purchase is limited to 50% of the final issued amount. Such instrument was designed to be used primarily towards the end of an adjustment programme, to facilitate a country's return to the market.

- Secondary market support facility

This facility aims at supporting the functioning of regular government debt markets when lacking market liquidity threatens the financial stability in the context of a loan, either with a macroeconomic adjustment programme or without it, if the Member's financial and economic situation is sound. If the Member is not under a programme, specific conditionality applies.

- Financial assistance for recapitalisation of financial institutions ('indirect recapitalisation')

Such instrument is to be used where the roots of the crisis are located in the financial sector and not directly related to fiscal or structural policies. The policy conditions in the MoU focus only on the ESM Member's financial sector and their implementation is monitored by the Commission, the ECB and in most cases the IMF. Such financial assistance instrument was used for Spain in 2012, when the ESM provided a total amount of €41.3 billion (see Box 2).

- Direct recapitalisation instrument (DRI)

DRI is the most recent instrument in the ESM's toolbox, introduced in December 2014**.** It may be used in very specific circumstances to directly recapitalise financial institutions, as a last resort instrument when all other instruments, including bail-in as mandated by the Banking Recovery and Resolution Directive (BRRD), have been applied and after the Single Resolution Fund (SRF) has been used. In order to preserve ESM's high credit worthiness and lending capacity for other instruments, the total amount of ESM resources available for the new instrument is limited to €60 billion (see Box 2).

- ESM precautionary financial assistance

Such 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 when raising funds in the capital markets. The granting of such precautionary credit line is not conditioned to the launch of a full macro-adjustment programme, but to a lighter set of conditions enshrined in a MoU agreed with the Commission. The monitoring of the implementation of the policy conditions takes place under enhanced surveillance.

Box 2: The ESM and the banking resolution regime

The ESM primary objective is to provide funding to Member States. However, it can also be used to provide funding to failing financial institutions either indirectly (via the indirect recapitalisation instrument) or directly via the direct recapitalisation instrument (DRI).

How does this articulate with the Banking Union resolution framework?

ESM money can only be used in banking resolution in compliance with the burden sharing cascade as defined in the BRRD and SRM regulations. Any capital needs should be met with (sequentially):

- i) First private sources (current/new shareholders, bail-in of junior and senior creditors - up to 8 % of total liabilities);
- ii) If private sources are insufficient, the SRF can make a contribution under strict conditions. Its intervention is capped at 5 % of total liabilities;
- If the bank remains undercapitalised, but its continuation is imperative to safeguard financial stability, public funding can be used. The funding can come from national budgets that can be financed if needed by an ESM loan (**ESM 'indirect recapitalisation'**) or from the ESM directly (**DRI**);
- To be eligible for the implementation of the DRI, the ESM Member should be unable to provide financial assistance to the beneficiary institution without very serious effects on its own fiscal sustainability. The beneficiary institution should be failing or likely to fail. It should also be unable to obtain sufficient capital from private sources (including bail-in). Last, the beneficiary institution must be of systemic relevance and supervised by the ECB. The DRI is, in any case, excluded for precautionary recapitalisation.

According to the Commission proposal package of 6 December 2017, the ESM could become the common backstop to the SRF. This would enable the SRF to act as a last resort lender, to facilitate the orderly resolution of distressed banks (see also Box 5). The objective would be to instil confidence in the banking system, by underpinning the credibility of actions taken by the Single Resolution Board. The creation of such a backstop has already been agreed upon in principle by the Member States, but needs to be made operational.

The issue has been discussed at the Eurogroup meeting of 22 January 2018 and at the ECOFIN Council on 23 January 2018 , but neither reached a conclusion yet.

Lending Activities

The ESM has provided financial support to Spain (for the recapitalization of its banking system), Cyprus and Greece. Spanish (in December 2013) and Cypriot (in March 2016) programmes ended, but both countries still have to repay their loans - the average maturity of ESM loans is much longer (from 12 to 30 years) than the length of the programme, which usually expands over 3 years. Greece is today the only country remaining under a macro-economic adjustment programme. The ESM lending activities are summarized in Table 2 below.

Table 2: EFSF and ESM lending

Assistance	Start Date	End date	Amount		
			agreed	disbursed	repaid
Ireland (EFSF)	Dec 2010	Dec 2013	€17.7bn	€17.7bn	-
Portugal (EFSF)	May 2011	May 2014	€26bn	€26bn	-
Spanish banking sector (ESM)	Nov 2012	Dec 2013	€41.3bn	**€41.3bn**	€9.6 bn
Cyprus (ESM)	Apr 2013	Mar 2016	€9 bn	**€ 6.3 bn**	-
Greece (ESM)	Aug 2015	Aug 2018	€86 bn	**€ 31.7 bn**	€ 2 bn

Source: ESM Financial Assistance, January 2018; See also EGOV Financial Assistance Table.

The EFSF and ESM lending rates fully cover their funding and operational costs, and reflect the varying risk profiles of each funding instrument. For this purpose, the ESM and EFSF have used different funding and lending approaches over time. As of 31 October 2017, the ESM average blended rate equals to 1.0565 %., while EFSF's equals to 1.3852 %.

In all its programmes, the ESM passes on the recipient Member State its low funding cost. Table 3 shows that this generates substantial budgetary savings, compared to market financing sources.

Table 3: Estimated budget savings on interests paid on sovereign debt (% of GDP)

Total budget savings (% of GDP)	2011	2012	2013	2014	2015	2016
Ireland	0.1	0.3	0.3	0.4	0.4	0.4
Greece		1.6	3.7	4.3	4.6	5.6
Spain		0.0	0.2	0.2	0.2	0.2
Cyprus			0.1	0.2	1.9	2.1
Portugal	0.1	0.4	0.6	0.7	0.7	0.7

Source: ESM Factsheet "Impact on Budgets", January 2018

The ESM itself has created an Early Warning System to detect loan repayment risks and allow for corrective actions. 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 Commission and the ECB perform during and after a programme.

Following a request from the Eurogroup, the ESM has undertaken a technical work on short term debt relief measures for Greece (see a specific EGOV document on Greece and Box 3).

Box 3: Debt relief measures for Greece

In May 2016, the Eurogroup considered the sustainability of Greek public debt, assessed in terms of Gross Financing Needs (GFN), which should remain below 15% of GDP during the post programme period for the medium term, and below 20% of GDP thereafter.
The Eurogroup recalled the following general guiding principles for possible additional debt measures:
(i) facilitating market access in order to replace over time public financed debt with privately financed debt;
(ii) smoothening the repayment profile;
(iii) incentivising the country's adjustment process even after the programme ends; and
(iv) flexibility to accommodate uncertain GDP growth and interest rate developments in the future.

On 9 May 2016 the Eurogroup 2016 had reconfirmed that **nominal haircuts are excluded,** and that all measures taken will be in line with existing EU law and the ESM and EFSF legal frameworks.

For the short-term, the Eurogroup agreed on a first set of measures, to be implemented after the closure of the first review up to the end of the programme (August 2018) and which includes:

- Smoothening the EFSF repayment profile under the current weighted average maturity
- Use EFSF/ESM diversified funding strategy to reduce interest rate risk without incurring any additional costs for former programme countries
- Waiver of the step-up interest rate margin related to the debt buy-back tranche of the second Greek programme for the year 2017.

For the medium term, the Eurogroup expected to implement a possible second set of measures **following the successful implementation of the ESM programme**. These measures will be implemented if an update of the debt sustainability analysis produced by the institutions at the end of the programme shows they are needed to meet the agreed GFN benchmark, subject to a positive assessment from the institutions and the Eurogroup on programme implementation:

- Abolish the step-up interest rate margin related to the debt buy-back tranche of the 2nd Greek programme as of 2018.
- Use of 2014 SMP profits from the ESM segregated account and the restoration of the transfer of ANFA and SMP profits to Greece (as of budget year 2017) to the ESM segregated account as an ESM internal buffer to reduce future gross financing needs.
- Liability management - early partial repayment of existing official loans to Greece by utilizing unused resources within the ESM programme to reduce interest rate costs and to extend maturities. Due account will be taken of exceptionally high burden of some Member States.
- If necessary, some targeted EFSF re-profiling (e.g. extension of the weighted average maturities, re-profiling of the EFSF amortization as well as capping and deferral of interest payments) to the extent needed to keep GFN under the agreed benchmark in order to give comfort to the IMF and without incurring any additional costs for former programme countries or to the EFSF.

For the long-term, the Eurogroup expressed its confidence on the sustainability of Greece's public debt. At the same time, the Eurogroup agreed **on a contingency mechanism on debt** which would be activated after the ESM programme to ensure debt sustainability in the long run, in case a more adverse scenario were to materialize. The Eurogroup would consider the activation of the mechanism, provided additional debt measures are needed to meet the GFN benchmark and would be subject to a decision by the Eurogroup confirming that Greece complies with the requirements under the SGP. Such mechanism could entail measures such as a further EFSF re-profiling and capping and deferral of interest payments. The Eurogroup recognized the uncertainty of long time horizon forecasts, due to the high degree of uncertainty over macroeconomic developments.

Accountability and Oversight of Financial Assistance Programmes

Being outside the EU Treaties, the ESM it is not subject to the provisions relating to EU institutions, bodies or agencies (e.g. the Commission, the ECB, the European Investment Bank, the European Banking Authority), including provisions on control and oversight (e.g. the Access to Documents Regulation, European Ombudsman, Court of Auditors, Anti-Fraud Office, European Data Protection Supervisor, the EU Staff Regulations).

The ESM is not accountable to the European Parliament (EP), even though, in practice, the ESM's Managing Director has made himself available for hearings in the EP.[9] This practice has yet not been formalised.

The Ministers of Finance, composing the ESM BoG, are accountable to their national parliaments.

Despite the fact of being outside EU legal framework, **the ESM is referred to in the Regulation 472/2013, which establishes the modalities of the control of macro-economic adjustment programmes**, whereby *"where a Member State is in receipt of financial assistance on a precautionary basis from one or several other Member States or third countries, the EFSM, the ESM, the EFSF, or another relevant international financial institution such as the IMF, the Commission shall subject that Member State to enhanced surveillance"* (Article 2, para. 3).

Furthermore, "*The **power to adopt recommendations** on the adoption of precautionary corrective measures and on the preparation of a macroeconomic adjustment programme; **the power to approve macroeconomic adjustment programmes**; the **power to adopt decisions** on the main policy requirements which the ESM or the EFSF plan to include in the conditionality for financial assistance granted on a precautionary basis, loans for the recapitalisation of financial institutions or any new financial instrument agreed within **the** framework of the ESM; and **the power to recommend the adoption of corrective measures** to Member States under post- programme surveillance, should be **conferred on the Council**. Those powers are of particular relevance to the policy of economic coordination of Member States, which, pursuant to Article 121 TFEU, is to take place within the Council*" (Preamble, para. 18).

For the Member States under post-programme surveillance (PPS), "*the Commission conducts, in liaison with the ECB, regular review missions in the Member State concerned to assess its economic, fiscal and financial situation"* (Article 14, para. 3). The Commission also regularly informs orally and confidentially the Chair and Vice-Chairs of the ECON committee of the conclusions drawn from the preparation and monitoring of the macroeconomic adjustment programme.

Following an invitation from the Greek Prime Minister, the EP decided to strengthen its efforts to ensure a stronger parliamentary scrutiny of financial assistance programmes. A dedicated Working Group, the Financial Assistance Working Group (FAWG), was established inside the EP in 2016.

[9] K. Regling has also attended upon invitation the Conference of Presidents of the EP and taken part in workshops organised by the EP.

Box 4: Independent evaluation report of ESM financial assistance (June 2017)

At its annual meeting in 2016, the ESM agreed to start an evaluation process of former stability support programmes to carefully examine the financial support provided in past programmes and to draw lessons from them with the aim of increasing the efficiency and effectiveness in the future.

In September 2016, Ms G. Tumpel-Gugerell was appointed as the high-level independent evaluator of the past EFSF and ESM financial assistance programmes.

In June 2017 she presented an **evaluation report**, focused on EFSF and ESM financial assistance programmes for Ireland, Portugal, Greece, Spain and Cyprus. She made six recommendations to the ESM BoG:

1. the ESM should focus on programme credibility and support ownership;
2. programme design should have clear objectives and priorities;
3. the programmes should address financial sector issues upfront, but associated disbursements should be phased, based on progress;
4. the Board should further refine and develop the ESM governance framework;
5. the ESM should enhance programme transparency and evaluability;
6. ESM Members may clarify the ESM's role in euro area institutional development.

The BoG committed to ensure that the report's findings and recommendations are appropriately followed up to improve future programmes.

Possible Evolution of the ESM in the Future

The on-going debate on possible new roles for the ESM has recently intensified. With only one remaining on-going programme, the ESM appears to be in a less active phase than at the peak of the crisis.[10]

The Five Presidents' Report (published in June 2015) proposed the integration of the ESM in the EU law framework by 2025.

The Commission, following the publication of the Reflection Papers on the Deepening of the Economic and Monetary Union and the Future of EU Finances (in spring 2017), set out a Roadmap for deepening the Economic and Monetary Union, proposing **the establishment of a European Monetary Fund (EMF)**. According to the proposal, the EMF would become a Union body with legal personality, based on Article 352 of the TFEU (see Box 5). The proposal is subject to the consent of the EP.

A separate EGOV note provides a comparison of the ESM's and IMF's main features.

[10] E.g. ESM staff has started to produce Working papers and Discussion papers on many topical issues.

Box 5: Commission's proposal for a Council Regulation establishing the European Monetary Fund

On 6 December 2017, the Commission published its Proposal for a Council Regulation on the establishment of the European Monetary Fund as part of the Roadmap for deepening the Europe's Economic and Monetary Union**.** The proposed EMF "*will be established as a unique legal entity under Union law. It will succeed the European Stability Mechanism, with its current financial and institutional structures essentially preserved. This means that the European Monetary Fund will continue to provide financial stability support to Member States in need, to raise funds by issuing capital market instruments and to engage in money market transactions. The membership will not change and the participation of additional Member States will remain possible, once they adopt the euro*" (p. 5).

All its discretionary decisions will be **endorsed by the Council**, according to the Meroni doctrine*.

In addition to the current ESM functions, the proposed EMF will have the following **four new features**:

1. **Common backstop to the Single Resolution Fund (SRF)**, with a ceiling of EUR 60 billion, increasable, in the form of credit lines or guarantees. The backstop would be fiscally neutral over time, since any funds used would be recovered from the banking sectors in the Member States participating in the Banking Union.
2. **Management of financial assistance programmes**: a more direct EMF involvement alongside the Commission.
3. **Possible new financial instruments**: the EMF shall be able in the future to develop new financial instruments, e.g. a macro-economic **stabilisation function** of Member States whose currency is the euro**.** A stabilisation function is the possibility to rapidly activate resources in an automatic way subject to eligibility criteria defined in advance. Member States should first activate their national automatic stabilisers and discretionary fiscal policy in compliance with the Stability and Growth Pact (SGP); if not sufficient, the stabilisation function would be triggered.
4. **A fast decision-making voting procedure,** with four types of voting rules:
   - unanimity, for decisions having a major direct financial impact on Member States (e.g. decisions on the lending capacity, on capital calls not urgently needed);
   - reinforced qualified majority (85%), for decisions related to granting financial support or disbursements to EMF Members;
   - qualified majority (80%); and
   - simple majority.

In specific urgent situations, the EMF's BoG can take decisions that will be transmitted immediately to the Council, which will have 24 hours to discuss them and object, adopting another decision, or to refer the matter back to the BoG, which will respect the reasons given by the Council.

A consultative role in the **appointment process of the Managing Director has been foreseen for the EP**.

The EMF will be accountable to the Council, the Commission, the EP, with the submission of an annual report, hearings, oral and written questions, and to national parliaments with a more explicit scrutiny role.

* The Meroni doctrine, which arose from Cases 9/56 and10/56 (Meroni v High Authority [1957/1958] ECR 133), relates to the extent to and conditions under which EU Institutions may delegate their tasks to regulatory agencies.

The EP has recently published the following three external papers[11]:

- *An evolutionary path for a European Monetary Fund? A comparative perspective*, Jonathan A. Rodden, Stanford University, 15 May 2017;
- *A European Monetary Fund*, Charles Wyplosz, The graduate institute Geneva, 3 May 2017;
- *An evolutionary path towards a European Monetary Fund*, Daniel Gros, Center for European Policy studies, 3 May 2017.

Box 6: K. Regling's speech "The role of the ESM in a deepening EMU" of 2 February 2018,

*"...A first likely new role the ESM could take on is that as a backstop for the SRF. There is also a growing consensus among the euro area countries that the **ESM needs to prepare for a bigger role in assistance programmes, as the IMF may participate less in the future**. (...)*

*Taking the crisis experience into account, designing, negotiating and monitoring an adjustment programme, and the conditionality that is at its core, should become **a joint task of the Commission and the ESM**. (...).*

*But that would not give the ESM a role in economic policy coordination in Europe or in the implementation of the Stability and Growth Pact, nor the Macroeconomic Imbalances Procedure. Here, this prerogative of the Commission is fully preserved by European law. I am sure **the ESM and the Commission will be able to agree on an efficient cooperation framework**, respecting their legal remits...*

*Another possible task for the ESM could be to provide new facilities, such as a **macroeconomic stabilisation function**. These could work through shorter-term ESM loans, to be repaid within a cycle, with a lighter conditionality than in regular programmes. The loans could also serve to stabilise investment, or reward structural reforms.*

*Furthermore, the ESM could play a role if member states were to define more clearly a **Sovereign Debt Restructuring Framework** to make settlements with private creditors more predictable and transparent. The framework should, in my opinion, not contain any automatic extension of maturities, while Collective Action Clauses could be improved to prevent lengthy hold-out battles. If Europe were to agree to introduce such a framework, the ESM could provide the debt sustainability analysis, and help organising negotiations between creditors and the debtor, with the aim of a fair solution for all stakeholders.*

*With such added tasks, the ESM's role would become more similar to the IMF. Many people have suggested that "European Monetary Fund" would then be a better name for our institution. But this might cause confusion, because we will continue to refinance our lending operations in the market – and not in any monetary way. In my view the name "**European Stability Fund**", or ESF, could therefore be more appropriate for an ESM with a more developed mandate. (...)*

*The model that I foresee for the integration of the ESM into the EU-framework is along the lines of the **European Investment Bank,** a body with its own capital - independent from the EU budget – and accountable to its shareholders. For this to happen, the ESM Treaty and the EU Treaty would need to change..."*

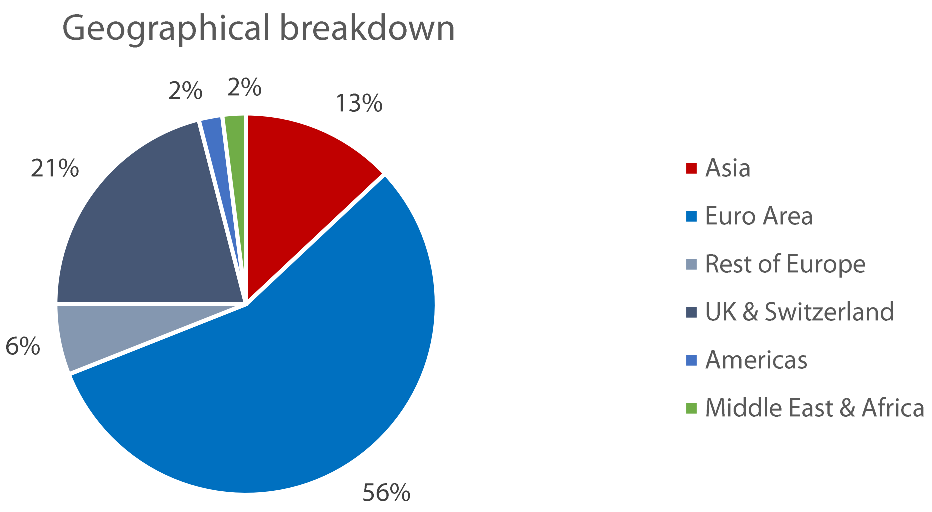
[11] Other think tanks have also published papers on the subject, e.g. Bruegel, Jacques Delors Institut, Egmont Institute.

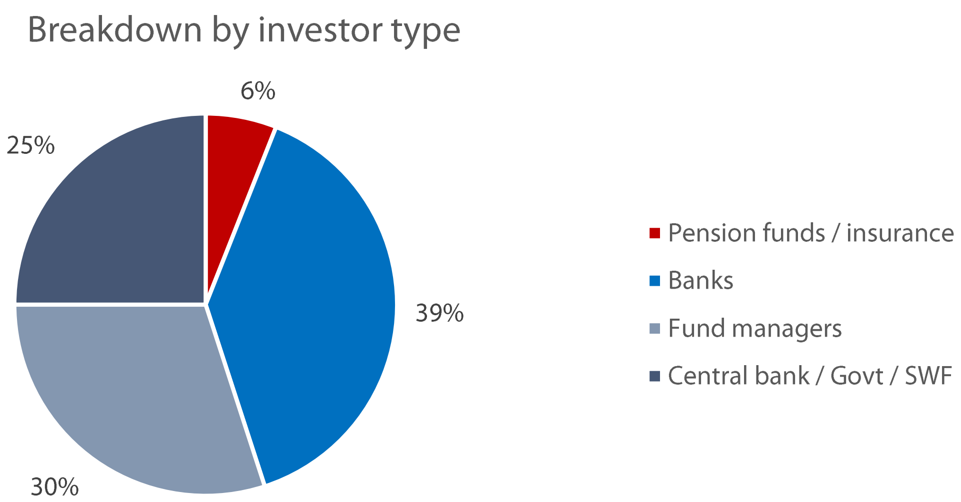
Annex 1: Capital Contribution of ESM Members

Member	ESM Key (%)	Capital Subscription (€bn)	Paid-in capital (€bn)
Austria	2.7644	19.48	2.23
Belgium	3.4534	24.34	2.78
Cyprus	0.1949	1.37	0.16
Estonia	0.1847	1.30	0.15
Finland	1.7852	12.58	1.44
France	20.2471	142.70	16.31
Germany	26.9616	190.02	21.72
Greece	2.7975	19.72	2.25
Ireland	1.5814	11.14	1.27
Italy	17.7917	125.40	14.33
Latvia	0.2746	1.93	0.22
Lithuania	0.4063	2.86	0.33
Luxembourg	0.2487	1.75	0.20
Malta	0.0726	0.51	0.06
Netherlands	5.6781	40.02	4.57
Portugal	2.4921	17.56	2.01
Slovakia	0.8184	5.77	0.66
Slovenia	0.4247	2.99	0.34
Spain	11.8227	83.33	9.52
Total	**100**	**704.80**	**80.55**

Source: ESM website
Note: Paid-in capital refers to the final amount once all of the five installments have been paid.

Annex 2: Who Buys ESM Bills and Bonds (ESM Investors)?





Source: ESM investor presentation, January 2018

Annex 3: Some Positions in the Public Domain on the Future Role of the ESM

Institution	Date	Position
European Parliament	16/02/2017	In its resolution on "Budgetary capacity for the euro area", the EP stressed the need for the European Monetary Fund **to be equipped with adequate lending and borrowing capacities and a clearly defined mandate.** "*...The ESM, while fulfilling its ongoing tasks, should be further developed and turned into a European Monetary Fund (EMF) with adequate lending and borrowing capacities and a clearly defined mandate,* ***to absorb asymmetric and symmetric shocks***."
European Commission	06/12/2017	**The Commission proposed that the European Stability Mechanism (ESM) shall become a European Monetary Fund (EMF)**, i.e. a European **funding facility,** capable of providing financial assistance under pre-agreed rules and conditions. The EMF shall be the **backstop for the Single Resolution Fund (SRF)** for Euro Area banking institutions; in future, it could extend its functions becoming a macro-economic stabilisation fund, or the fiscal backstop of Euro Area Member States in financial needs.
European Council	14-15/12/2017	The debate built up on a note circulated by President Tusk ahead of the summit as part of the Leaders' Agenda. This note outlined a number of ideas on which there is a broad convergence, such as: – putting into operation a common backstop for the SRF, possibly in the form of a credit line ESM; – further developing the ESM, possibly to become a so-called EMF; – further developing the Ecofin Council Roadmap of June 2016 on completing the banking union. *"The summit participants agreed with my proposal that in the next 6 months, the work of our finance ministers should concentrate on areas where the convergence of views is the greatest"*, said Mr D. Tusk in his remarks following the meetings.
President of the Eurogroup (Mário Centeno)	17/01/2018	The Eurogroup President stated in his speech that *"the IMF will lose relevance in future euro crises. This invites us to consider an upgrade to the European Stability Mechanism. We should also broaden the scope of the ESM and arrange for it to swiftly become the common backstop for the Single Resolution Fund. (...) in coming months, we will be able to find sufficient common ground and to reconcile the different views that are out there on the*

		completion of the banking union and the future role of the ESM."
ECOFIN Council	23/01/2018	The [presidency note] on the outcomes of the ECOFIN meeting reads *"the proposal to create a European Monetary Fund to replace the European Stability Mechanism (ESM) raises questions that will need to be addressed. The presidency considers that* ***it should be left to the Eurogroup to take these up in the context of work on the further development of the ESM****"*.

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