The European Financial Stabilisation Mechanism: Main Features

This document presents the main features of the European Financial Stabilisation Mechanism (EFSM). The EFSM allows the Commission to provide loans to euro area Member States threatened by severe difficulties and to access financial markets, by issuing bonds or with private placements. The amount that can be borrowed by the Commission on behalf of the European Union is limited.

1. Background

The European Financial Stabilisation Mechanism (EFSM) was established in May 2010 through Council Regulation 407/2010 (EFSM Regulation).

The EFSM allows the Commission to access markets (issuing bonds or by private placements) on behalf of the EU. The funds are then loaned to Member States in difficulties, or seriously threatened with severe difficulties caused by exceptional occurrences beyond their control.

Graph: Investor distribution of funds borrowed by the European Commission on behalf of the EU (66 bn euro - December 2019)


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The EFSM Regulation is based on article 122(2) of the Treaty on the Functioning of the European Union. On 10 May 2010, Finance Ministers adopted a set of Council Conclusions addressing the then exploding sovereign debt crisis. Among the actions adopted, the setting up of the EFSM (and of an additional intergovernmental facility, the European Financial Stability Facility; see below and the Annex). The Commission had come forward with a proposal for such mechanism the day before, the 9 May 2010.

The mechanism broadly replicates the Balance of Payments Facility (see below and the Annex), available only for non-euro area Member States. EFSM financial support is, in general, open to all Member States. Nevertheless, non-euro area Member States have available the Balance of Payments assistance facility (BoP) and, therefore, Article 1 of Regulation 407/2010 makes a specific reference to the latter, implying the EFSM should be available primarily to address financing needs of euro area Member States.

The maximum amount of outstanding loans under the EFSM is limited to the margin available under the own resources appropriation ceiling. At its inception, that limit was estimated at EUR 60 bn.

The EFSM Regulation was revised in 2015 to cater for budgetary concerns of the non-euro area Member States. Point 2a was added to Article 3, guaranteeing immediate compensation to non-euro area Member States if a debtor Member State failed to comply with any of its obligations.

The tables in the Annex provide a simplified overview of characteristics of the financial assistance mechanisms used in the EU to tackle sovereign debt crises. One may note, in particular, the size of the various facilities (and the limited amount available under the EFSM), the different legal nature and underlying legal framework (the EFSM and BoP being the only instruments adopted under the so called “Community method”) and the similarities between the BoP and the EFSM.

2. Governance

Contrary to the European Stability Mechanism and the European Financial Stability Facility, that have legal personality (see Annex), the EFSM Regulation has not created a different body with legal personality that could act as an issuer in capital markets and a creditor to the Member States requiring financial assistance. Financing is granted on the basis of an EU budget guarantee and the Commission acts as the main interlocutor, namely, obtaining the necessary financing through issuance of bonds (see section 3 below). Therefore, the governance structure for the EFSM centres on the Commission and the Council.

The Council is the decision-making body: the Council decides by qualified majority on granting financial assistance, sets and reviews the applicable conditions and monitors (through Commission reports)

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1 Article 122(2) of the Treaty on the Functioning of the European Union allows the Council, on a proposal from the Commission, to grant, under certain conditions, Union financial assistance to a Member State facing difficulties or being seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control.

2 Other provisions address concerns of non-euro area Member States due to their possible budgetary liability for EU loans granted to euro area Member States such as Article 3(2a).

3 This limitation is established to ensure the Commission will be able to service every loan it obtains. This amount – “the "margin for unforeseen expenditure" between the own resources ceiling and the ceiling for payment appropriations - has a dual role: to allow the multiannual financial framework to be revised if necessary so as to cover any expenditure which is unforeseen when the financial perspective is adopted; to leave a safety margin should economic growth be lower than forecast; should this be the case, actual GNI will be lower than expected and the ceiling for payment appropriations, which is an absolute amount, can be financed from the own resources margin, within the limits of the own resources ceiling expressed as a percentage of GNP.” (see Summaries of EU legislation).

4 See also Commission Communication to the Council and the Economic and Financial Committee COM (2010) 713 of 30 November 2010, page 4: “At the time of the adoption of the Regulation, it was estimated that, with careful management of the repayment schedules, a volume of up to EUR 60 billion for the EFSM could be accommodated below the OR [own resources] ceiling in addition to the volume of EUR 35 billion which remains available under the Balance of Payments facility.”.
implementation of the financial assistance. The Council is also the sole legislator, deciding on the EFSM Regulation and its amendments based on Commission proposals. The Council is also highly involved in the procedures set out in the Regulation:

(a) It is the sole authority approving the regulation and its amendments;

(b) Decides on granting financial assistance by means of an implementing act (Article 3(2) of the Regulation);

(c) Sets the general economic policy conditions to be detailed in a Memorandum of Understanding signed by the Commission and the assisted Member State, is informed of such Memorandum of Understanding (Article 3(5) of the Regulation) and decides any amendments thereto (Article 3(7) of the EFSM Regulation);

(d) Receives every six months a report by the Commission on implementation and possible amendments to the EFSM Regulation (Article 9).

The Commission, on the other hand, is responsible for executing all the decisions and ensuring its appropriate implementation. The Commission reports to Council and the European Financial Committee on execution. Although required by Article 9(1) of the EFSM Regulation to report every six months, where appropriate, on implementation and on the continuation of the exceptional occurrences that justify its adoption, the Commission seems to have reported only once, in November 2010.

Notwithstanding being an instrument under the EU budget, the EFSM regulation foresees limited accountability towards the European Parliament. Parliament was not involved in the adoption of the Regulation and is only informed of the Memorandum of Understanding negotiated between the assisted Member State and the Commission (Article 3(5)).

The Court of Auditors is mandated to implement financial controls or audits that it considers necessary in relation to granted financial assistance and the assisted Member States are due to cooperate in providing the necessary information. On the other hand, the Commission is asked to extensively report on application of the EFSM Regulation and is the main "executor" of the main tasks related to the financial assistance.

3. Capital and Funding

In accordance to Article 122(2) TFEU, the EU can provide loans to countries in need of financial assistance. To this scope, the Commission borrows funds from capital markets, on behalf of the EU. Such funds finance three programmes: EFSM, Balance of Payments (BoP) to non-euro EU countries and Macro-Financial Assistance (MFA) to non-EU countries.

Borrowed funds cannot finance EU budget expenditures: they can only be used to finance off-budget loans to countries. EU borrowings are direct and unconditional obligations of the EU, and the EU is legally bound by Article 323 TFEU to service EU debt. To this end, the Commission can make available its cash buffer, re-prioritise budgetary expenditure and, if needed, draw additional resources from the Member States.

Even if Article 122(2) of TFEU only foresees Parliament being informed of decisions, there are possibly a number of decisions under the EFSM regulation Parliament could be informed of (namely, on the Council decision of granting the financial assistance or a Member State decision to draw funds from a credit line). Being an EU budget instrument and considering the European Parliament is one of the budgetary authorities in the EU framework, one could have envisaged a stronger role for Parliament.

The ECA issued in 2015 its “Special Report Financial assistance provided to countries in difficulties” where it established a number of recommendations.
The total amount of EU borrowing is limited by the “budgetary margin”, which is the difference between the own-resources annual ceiling of the multi-annual financial framework and the actual payments appropriations of the EU budget. The EU has currently about 52 billion Euro in outstanding debt instruments, and around 4 billion Euro of unallocated margins and flexibilities remain available in the 2020 budget.

Funds raised are lent to countries under the same terms (same coupon, maturity and for the same nominal amount). Therefore, the debtor Member States benefit from the higher credit standing of the Union and lower interest rates. Maturities of issued bonds vary between 3 and 30 years, and outstanding maturities are up to the year 2042. According to the Commission “To date, the EU debt has been serviced through borrower repayments”. The Commission has also sometimes made available limited cash resources for short periods to service the debt when repayments from borrowers were not received in time.

Market operations are syndicated and take the form of bond issues or private placements; funding is exclusively denominated in euro. The EU issues bonds under the EUR 80 billion EU and Euratom medium-term note programme (EMTN). For private placements, German loan documentation (‘Schuldschein’) is also available.

Amounts vary from small private placements of several million euros to benchmark-size issues (at least EUR 1 billion). The timing, volume and maturity of issuances are determined by the EU’s lending activities. The EU budget does not assume any interest rate or foreign exchange risk.

The EU is rated AAA/Aaa/AAA/AAA (outlook stable) by Fitch, Moody’s, DBRS and Scope and AA (outlook stable) by Standard & Poor’s.

The EU’s ratings are a reflection of the fact that:

- borrowings are direct and unconditional obligations of the EU, guaranteed through the EU budget by all EU Member States.
- investing in an EU bond is purely linked to the credit quality of the EU and entirely unrelated to the credit risk of the related EU loan to a beneficiary country.
- the debt issued by the EU is backed by several levels of debt-service protection.
- by lending funds raised on identical terms, the EU budget does not assume any interest rate, maturity, or foreign exchange risk.

More details on the EU’s financing strategy can be found in the EU investor presentation document.

4. Financial Assistance

The recitals of the EFSM Regulation state that the activation of the mechanism must take place in the context of a joint EU/IMF support, and that the decisions to grant Union financial assistance is conferred to the Council. In addition, “strong economic policy conditions should be imposed in case of activation of this mechanism”.

The financial assistance can take the form of a loan or of a credit line (Art. 2).

Article 3 specifies the procedure to be followed to grant the assistance:

- The Member State seeking Union financial assistance shall discuss with the Commission, in liaison with the European Central Bank (ECB), an assessment of its financial needs and submits a draft economic and financial adjustment programme to the Commission and the Economic and Financial Committee.
The European Financial Stabilisation Mechanism: Main Features

- Union financial assistance shall be granted by a decision adopted by the Council, acting by a qualified majority on a proposal from the Commission.

In accordance to Article 3, the decision to grant a loan shall contain:

1. the financial conditions (amount, average maturity etc.);
2. the general economic policy conditions, defined by the Commission in consultation with the ECB;
3. an approval of the adjustment programme prepared by the beneficiary Member State to meet the economic conditions attached to the Union financial assistance.

Similar conditions are established for the granting of a credit line. The costs incurred by the Union in concluding and carrying out each operation shall be borne by the beneficiary MS (art. 7).

The Commission and the beneficiary Member State shall conclude a Memorandum of Understanding detailing the general economic policy conditions laid down by the Council, which will be communicated to the European Parliament and to the Council.

Loan disbursements depend on compliance with policy conditionality, subject to regular reviews. At least every six months the Commission re-examines, in consultation with the ECB, the general economic policy conditions and discuss with the beneficiary Member State the changes that may be needed to its adjustment programme.

5. Lending Activities

The EFSM provided financial assistance to Ireland (22.5 bn euro)\(^7\) and to Portugal\(^8\) (24.35 bn euro).

For Ireland, the next eligible loans are maturing in 2021. The average maturity of EFSM loans is currently 17.1 years.

According to the Commission (February 2020), “It is not expected that Ireland will have to refinance any of its EFSM loans before 2027. However, the revised maturity dates of individual EFSM loans will only be determined as they approach their original maturity dates.”. EUR 3.9 billion were re-financed in 2018, following the first refinancing operations of 2015 (EUR 5 billion).

For Portugal, the next eligible loans are maturing in 2025. The average maturity of EFSM loans is currently 15.3 years.

According to the Commission (October 2019) “In view of the benefits for Portugal’s debt sustainability, the Commission intends to grant a conditional waiver of the pari passu mandatory parallel repayment to the EFSM. The accompanying conditions include the firm commitment to roll over the amount of EUR 6.75 billion due to the EFSM in 2021, a first repayment of EUR 500 million to the EFSM in 2022 and ensuring that there will be no additional costs to the EU budget. The schedule for the remaining repayments to the EFSM will be reviewed, smoothing the debt redemption profile and avoiding significant peaks in any given year.”. An amount of EUR 600 million was re-financed in 2018, following the first refinancing operations of 2016 (EUR 4.75 billion).

Ireland and Portugal have the option to lengthen the maturity of their EFSM loans up to a weighted average maturity of 19.5 years. All loans/bonds with maturities up to 2026 may be refinanced prior to their redemption date.

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\(^7\) The Irish loan programme comprised € 67.5 billion in total including EFSF, IMF and bilateral loans.

\(^8\) The Portuguese programme comprised programme comprised € 76.3 billion in total including EFSF and IMF.
## Annex: simplified overview of characteristics of financial assistance mechanisms

### Table A1: Existing mechanisms

<table>
<thead>
<tr>
<th>Mechanism</th>
<th>Legal basis</th>
<th>Legal nature</th>
<th>Addressees</th>
<th>Who decides on lending</th>
<th>Maximum lending capacity</th>
<th>Funding</th>
<th>Conditionality</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>BoP Facility – Balance of Payments Facility</strong></td>
<td>Art 143 TFEU; Council regulation 332/2002</td>
<td>Facility (no legal personality)</td>
<td>Non-euro area Member States</td>
<td>Council (qualified majority)</td>
<td>EUR 50bn</td>
<td>Borrowings by Commission guaranteed by the EU budget</td>
<td>Full programme</td>
</tr>
<tr>
<td><strong>EFSM – European Financial Stability Mechanism</strong></td>
<td>Art 122 TFEU; Council regulation 407/2010</td>
<td>Facility (no legal personality)</td>
<td>All Member States</td>
<td>Council (qualified majority)</td>
<td>Depending on EU Budget limits (60 bn euro in 2010)</td>
<td>Borrowings by Commission guaranteed by the EU budget</td>
<td>Full programme</td>
</tr>
<tr>
<td><strong>ESM – European Stability Mechanism</strong></td>
<td>Intergovernmental agreement based on Art 136 TFEU</td>
<td>International financial institution established under Luxembourgish law</td>
<td>All Euro Area Member States</td>
<td>ESM Board of Governors by mutual agreement, qualified majority or simple majority depending on subject matter</td>
<td>Around EUR 704bn (704 798.7 million)</td>
<td>Borrowings in international capital markets guaranteed by ESM capital</td>
<td>Depending on financial assistance instrument chosen</td>
</tr>
<tr>
<td><strong>MFA – Macro-Financial Assistance</strong></td>
<td>Article 212 of TFEU and Joint Declaration by the European Parliament and the Council adopted together with the decision providing further macro-financial assistance to Georgia</td>
<td>Facility (no legal personality)</td>
<td>Partner countries (candidate and potential candidate countries, countries bordering the EU covered by the European Neighbourhood Policy and other third countries)</td>
<td>Co-decision procedure</td>
<td>Depending on EU Budget limits</td>
<td>Borrowings by Commission guaranteed by the EU budget</td>
<td>Respect of human rights and effective democratic mechanisms, including a multi-party parliamentary system and the rule of law, the existence of a non-precautionary credit arrangement with the IMF and a satisfactory track-record of implementing IMF programme reforms. Conditions are documented in a MoU.</td>
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</tbody>
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### Table A2: Discontinued mechanisms

<table>
<thead>
<tr>
<th>Mechanism</th>
<th>Legal basis</th>
<th>Legal nature</th>
<th>Addressees</th>
<th>Who decides on lending</th>
<th>Maximum lending capacity</th>
<th>Funding</th>
<th>Conditionality</th>
</tr>
</thead>
<tbody>
<tr>
<td>EFSF – European Financial Stability Facility (discontinued)</td>
<td>Intergovernmental agreement between Euro Area Member States</td>
<td>Company by shares incorporated in Luxembourg</td>
<td>Euro Area Member States</td>
<td>Unanimity of Euro Area Member States</td>
<td>EUR 440bn</td>
<td>Borrowings guaranteed by Euro Area Member States in accordance with ECB capital key</td>
<td>Full programme</td>
</tr>
<tr>
<td>Greek Loan Facility - Mechanism for financial assistance for Greece (discontinued)</td>
<td>Intergovernmental agreement between Euro Area Member States and agreement for the programme under Art 126/9 TFEU</td>
<td>Facility (no legal personality)</td>
<td>Greece (created in 9 May 2010)</td>
<td>Unanimity of participating Euro Area Member States</td>
<td>EUR 80bn (minus EUR 2,7 as Ireland and Portugal stepped down and Slovakia did not take part)</td>
<td>Bilateral loans of each participating Member State in accordance with EB capital key</td>
<td>Full programme</td>
</tr>
</tbody>
</table>