European Stability Mechanism (ESM)
Main Features, Oversight and Accountability

The ESM is a permanent inter-governmental mechanism, the main objective of which is to provide, through a number of financial assistance instruments, stability support to Member States whose access to market financing is impaired or is at risk of being impaired (see ESM Treaty). Granting of financial assistance under the ESM is conditional on the ratification of the TSCG Treaty (Fiscal Compact) by the ESM Member concerned.

The ESM is governed by the Board of Governors (BoG) (composed of the Euro zone finance ministers) and Board of Directors (appointed by each Governor). The inaugural meeting of the BoG took place on 8 October 2012, convened by Jean-Claude Juncker, then-President of the Euro Group and the Chairman of the BoG. On 5 November 2012 Jeroen Dijsselbloem took over the Presidency of the Eurogroup and became the Chairman of the ESM BoG. BoG can decide to be chaired either by the President of Euro Group or elect a Chairperson by QMV.

On 8 October 2012 Klaus Regling was appointed the first Managing Director of the ESM. His term is for 5 years with the possibility of one re-appointment. The Managing Director is the legal representative of the ESM and shall conduct, under the direction of the Board of Directors, the current business of the ESM.

The COM and the ECB, as well as the President of the Euro Group (if he or she is not the Chairperson or a Governor) may participate in the meetings of the BoG as observers. Other persons, including representatives of institutions or organisations, may be invited by the BoG to attend meetings as observers on an ad hoc basis.

At its 2014 annual meeting on 19 June 2014, the BoG approved the 2013 ESM Annual Report, which shows that there is strong solidarity element in the financing programmes of ESM members receiving loans at very low interest rate and at very long maturities.

Total expected EFSF long-term funding from 2011 to 2015 is €167.8 billion and the ESM expected funding from 2013 to 2015 is €49 billion.

Oversight and accountability of the ESM

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.
The ESM Treaty does not foresee any formal oversight role for the EP with regard to the ESM. However, there is indirect control in line with the Regulation 472/2013, whereby during the course of enhanced surveillance of a Member State or an on-going macroeconomic adjustment programme linked to EU financial assistance, the competent committee of the EP may invite representatives of the COM, the ECB and the IMF to participate in an economic dialogue. It may also offer the opportunity to the Member State concerned and to the COM to participate in an exchange of views on the progress made in the implementation of an adjustment programme. The COM shall also regularly inform the Chair and Vice-Chairs of the competent committee of the EP orally and confidentially of the conclusions drawn from the preparation and monitoring of the macroeconomic adjustment programme.

In accordance with Article 13(6) of the ESM Treaty, the ESM shall establish an appropriate warning system to ensure that it receives any repayments due by the ESM Member under the stability support in a timely manner.

This so called “Early Warning System” (EWS) detects repayment risks and allows for corrective actions. It applies not only to the ESM programme countries (Spain, Cyprus), as foreseen in the Treaty, but also to the EFSF programme countries (Greece, Ireland, Portugal).

The ESM joins the bi-annual PPS mission of the COM and the ECB and when undertaking its assessment takes into account COM’s economic and fiscal analysis.

For the Member States under post-programme surveillance (PPS), the COM shall conduct in liaison with the ECB, regular review missions in the Member State concerned to assess its economic, fiscal and financial situation. Every six months, it shall communicate its assessment to the competent committee of the EP and shall assess whether corrective measures are needed. For this purpose, the competent committee of the EP may offer the opportunity to the Member State concerned to participate in an exchange of views on the progress made under post-programme surveillance.

In more general terms, consistency with Treaty provisions and EU policies is entrusted to the COM. Any decision from the ESM may have a direct or indirect effect on how EU primary and secondary law is being implemented. That is why the MoUs must be fully consistent with the measures of economic policy coordination, in particular with any act of the EU law, including any opinion, warning, recommendation or decision addressed to the ESM Member concerned.
Capitalisation and funding of ESM

ESM members receive ESM shares in return for their subscribed capital according to the contribution key (see Annex I). Part of it is paid-in capital, while the rest is committed callable capital. The former has been paid-in in five instalments.

When a new member of the euro area is to join the ESM, the ESM’s capital contribution shall increase. Consequently, the contribution keys of ESM members shall change as well as total shares and paid-in capital.

<table>
<thead>
<tr>
<th>Capitalisation</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subscribed capital</td>
<td>€701.9bn</td>
</tr>
<tr>
<td>Paid-in capital</td>
<td>€80.2bn</td>
</tr>
<tr>
<td>Committed callable capital</td>
<td>€621.7bn</td>
</tr>
<tr>
<td>Maximum lending capacity</td>
<td>€500bn</td>
</tr>
<tr>
<td>Creditor status</td>
<td>Preferred (after IMF)</td>
</tr>
</tbody>
</table>

The ESM shall issue financial instruments or enter into financial agreements or arrangements with the ESM members, financial institutions or other 3rd parties in order to raise funds. It shall have a diversified funding strategy: it may issue bills and bonds with maturities from 1 month to 30 years.

Funds raised are pooled and not attributed to a particular country. Issues may be made via syndications, auctions, private placements and taps of existing lines.

After joining Euro on 1 January 2015, Lithuania will become the 19th Member of the ESM. Following the approval by the BoG, its membership becomes effective once Lithuania has deposited the ESM accession instrument. The BoG shall agree on detailed technical terms, including an adaptation of the capital key.

Financial Assistance Instruments

Raised funds shall be provided to an ESM member requesting support, which is suffering severe financial problems. It shall be provided under strict conditionality in order to safeguard the financial stability of the euro area as a whole and of its Member States. Conditionality is laid down in a Memorandum of Understanding (MoU), which the COM signs on behalf of the ESM, subject to the approval by the BoG. Conditionality is set according to a selected financial assistance instrument:

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

♦ Financial assistance for recapitalisation of financial institutions (i.e. "indirect recapitalisation") shall be applied in situations where roots of the crisis are located in the financial sector and not directly related to fiscal and structural policies. The MoU focuses
only on the Member State's financial sector and its implementation is monitored by the COM, the ECB and in most cases the IMF. This financial instrument has been agreed with Spain.

♦ **Precautionary financial assistance** takes the form of a credit line to support sound policies and prevent crisis situations. It allows ESM members to secure ESM assistance before they face major difficulties raising funds in the capital markets. The Member State needs to negotiate and sign a MoU together with the COM. Monitoring of the implementation takes place under enhanced surveillance. This financial instrument is currently under discussion for Greece (see Eurogroup meeting of 6 November 2014).

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

♦ **Direct recapitalisation instrument (not yet in force):** in line with the euro area summit statement of June 2012, euro area Member States reached on 10 June 2014 a political understanding on its operational framework. The instrument with maximum recapitalisation capacity of €60 billion may be activated in case a bank fails to attract sufficient capital from private sources and if the ESM Member concerned is unable to recapitalise it, including through the instrument of indirect recapitalisation of the ESM.

For a transitional period until 31 December 2015, a bail-in of 8% of all liabilities will be a precondition for using the instrument, as well as the use of the resources available in the ESM Member's national resolution fund. From 1 January 2016, full bail-in in line with the rules of the Bank Recovery and Resolution Directive (BRRD) will be required.

The financial assistance will be provided in accordance with EU State aid rules and the ESM Member will be asked to invest alongside the ESM.

For the new instrument to become fully operational, the ESM BoG needs to review the list of financial assistance instruments in line with Article 19 of the ESM Treaty. It shall be done in accordance with relevant national procedures of all ESM Members (e.g. see draft law as submitted to German Bundestag on 22 September 2014). Thereafter the new instrument is expected to be added to the ESM financial instruments, since the other additional criteria of the Single Supervisory Mechanism (SSM) to become fully operational was fulfilled on 4 November 2014.

For detailed information on all on-going financial assistance (Balance of Payments, EFSF, ESM) see a separate EGOV table (“Financial Assistance to EU Member States”).

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Annex I: Capital contribution of the ESM members

<table>
<thead>
<tr>
<th>Member</th>
<th>ESM Key (%)</th>
<th>Capital Subscription (€bn)</th>
<th>Paid-in capital** (€bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>2.7757</td>
<td>19.48</td>
<td>2.22</td>
</tr>
<tr>
<td>Belgium</td>
<td>3.4675</td>
<td>24.34</td>
<td>2.77</td>
</tr>
<tr>
<td>Cyprus</td>
<td>0.1855</td>
<td>1.30</td>
<td>0.15</td>
</tr>
<tr>
<td>Estonia</td>
<td>1.7924</td>
<td>12.58</td>
<td>1.43</td>
</tr>
<tr>
<td>Finland</td>
<td>20.3297</td>
<td>142.70</td>
<td>16.31</td>
</tr>
<tr>
<td>Germany</td>
<td>27.0716</td>
<td>190.02</td>
<td>21.72</td>
</tr>
<tr>
<td>Greece</td>
<td>2.8089</td>
<td>19.71</td>
<td>2.25</td>
</tr>
<tr>
<td>Ireland</td>
<td>1.5878</td>
<td>11.14</td>
<td>1.27</td>
</tr>
<tr>
<td>Italy</td>
<td>17.8643</td>
<td>125.39</td>
<td>14.33</td>
</tr>
<tr>
<td>Latvia*</td>
<td>0.2575</td>
<td>1.94</td>
<td>0.22</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>0.2497</td>
<td>1.75</td>
<td>0.20</td>
</tr>
<tr>
<td>Malta</td>
<td>0.0729</td>
<td>0.51</td>
<td>0.06</td>
</tr>
<tr>
<td>Netherlands</td>
<td>5.7012</td>
<td>40.02</td>
<td>4.57</td>
</tr>
<tr>
<td>Portugal</td>
<td>2.5023</td>
<td>17.56</td>
<td>2.00</td>
</tr>
<tr>
<td>Slovakia</td>
<td>0.8217</td>
<td>5.77</td>
<td>0.66</td>
</tr>
<tr>
<td>Slovenia</td>
<td>0.4264</td>
<td>2.99</td>
<td>0.34</td>
</tr>
<tr>
<td>Spain</td>
<td>11.8709</td>
<td>83.32</td>
<td>9.52</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100</strong></td>
<td><strong>701.94</strong></td>
<td><strong>80.22</strong></td>
</tr>
</tbody>
</table>

*Source: ESM Investor Presentation, October 2014*

*Latvia* became 18th ESM member on 13 March 2014. Its payment of paid-in capital will be made in five annual installments of €44.24 million each.

** Paid-in capital refers to the final amount once all of the five installments have been made.
Annex II: Who buys ESM bills and bonds (ESM investors)?

Source: ESM Investor Presentation, October 2014
ANNEX III: Procedure for granting financial support to an ESM Member

Member State (MS) Requests ESM BoG Requests COM for an assessment Submits BoG for YES/NO decision

ESM and MS/Central Bank Signature of FAFA ESM BoD approval of FFA FAFA

COM and MS Signature of MoU with policy conditionality BoG approval of MoU Memorandum of Understanding (MoU)

Disbursement of 1st (2nd, 3rd...) tranche BoD/Eurogroup approval of disbursements

COM (with ECB/IMF) policy compliance monitoring End of disbursements and exit from financial assistance

ESM Warning System for Repayments

COM (+ECB) Post Programme Surveillance; IMF Post Programme Monitoring
Annex IV: Positions taken as regards the relationship between ESM and other EU institutions

Currently the ESM does not mention any kind of relationship with the EP on its website, not even an informal one, despite ESM’s managing director mentioning such option in an ECON hearing, reflecting that its predecessor EFSF does so.

There has been no 2014 hearing of the ESM Managing Director in the ECON Committee as of yet.

11 December 2013: during the debate on the establishment of an administrative tribunal for the ESM in the EP plenary, representatives of the Council and the COM addressed the Members with several statements. The Council declared that it is in no position to comment this proposal. It described the ESM as a "separate intergovernmental institution", the set-up of which should and could not be discussed in the Council. The COM also declared itself as "only an observer" in the ESM governance framework. It stated that the ESM is outside the Treaty, not an EU institution or an EU agency and thus has no access to the EU civil service tribunal of the ECJ for its staff complaints. To change the latter, an agreement between the EU and the ESM should be concluded, which could take 18 months. No such agreement has been initiated as of yet.

24 September 2013: during the ECON Exchange of views with ESM Managing Director Klaus Regling stated that “The relation between the ESM and the EP has to be ad-hoc and informal. Nevertheless, I think it is very important to have this dialogue because I understand fully your political interest in the operations of the ESM and EFSF. (...) If you send us written questions, we will make every effort to answer them.”

“We provided our annual report and audit report to the EP” (ESM Annual Report of 2013 was published on the ESM website on 19 June 2014 and sent to the EP President, the ECON Chair and the EP Secretary General).

“In the long-run, I see that the ESM is integrated into the Treaty and becomes an EU institution, but that would be my personal view.”

14 December 2012 and 14-15 March 2013: the European Council concluded that "any new steps towards strengthening economic governance will need to be accompanied by further steps towards stronger legitimacy and accountability."

November 2012: recommendations in the EP resolution "Towards a Genuine EMU":

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

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

1 February 2012: as part of the political compromise reached in the negotiations on the Fiscal Compact, the President of the European Council, Herman Van Rompuy, confirmed in his remarks to the EP that the ESM operation will be "subject to the scrutiny of your Parliament".
24-25 March 2011: the European Council concluded that "the Council and the Commission will inform the European Parliament on a regular basis about the establishment and the operations of the ESM".

22 March 2011: the President of the Euro Group and the Ecfin Commissioner committed on behalf of the Council and the COM in a letter to inform the EP on a regular basis about the establishment and the operations of the ESM (see also Annex III of EP resolution).