SQUIRE PATTON BOGGS

Reform of the European Stability Mechanism

The European Stability Mechanism's (ESM's) aim is to provide financial assistance to EU member states experiencing or threatened by severe financial problems. Like its predecessor, the temporary European Financial Stability Facility (EFSF), the ESM provides financial assistance, which is granted only if it is proven necessary to safeguard the financial stability of the euro area as a whole and of the ESM members.

To achieve this aim, the ESM relies on several instruments, including loans within a macroeconomic adjustment programme, such as the one used by Cyprus, Greece, Ireland and Portugal, or an indirect loan to recapitalise banks, such as the one provided to Spain. Together with its predecessor, the EFSF, the ESM can lend a total of €700 billion. With a paid-in capital of more than €80 billion, the ESM is one of the largest international financial institutions in the world and the only official institution of the euro area.

On 9 April 2020, the euro area finance ministers (Eurogroup) decided on a comprehensive economic policy response to the COVID-19 crisis. Concretely, three important safety nets for workers, businesses and sovereigns were established, amounting to a package worth €540 billion, the Pandemic Crisis Support (PCS). On 23 April, the EU Heads of State of Government (European Council) endorsed this agreement. On 8 May, the Eurogroup agreed on the details attached to this financial assistance. After national procedures, the financial assistance was made operational by the ESM Board of Governors (the ESM's highest decision-making body composed of the 19 euro area finance ministers) on 15 May 2020. Accordingly, it was agreed that the ESM should provide a credit line worth up to €240 billion to help euro area member states cover healthcare costs related to COVID-19.

The PCS is available until the end of 2022, and it has had a positive impact on the EU markets already. The International Monetary Fund (IMF), in its consultation, also confirmed that it has the same assessment – that PCS has already served its purpose by being available. The IMF funding has also provided financial support to various countries worldwide.

Nevertheless, on 30 November 2020, the Eurogroup agreed to proceed with the reform of the ESM. The reform entails a number of new tasks for the ESM and will further develop the ESM measures and strengthen the role of the ESM in the oversight of financial assistance programmes. It also provides for establishing a funding tool to the Single Resolution Fund (SRF) in the form of a credit line from the ESM to replace the direct recapitalisation instrument, providing a financial safety net for bank resolutions in the EU, which will help to protect financial stability and is regarded as a step forward to a Banking Union.

At present, according to the current ESM Treaty, the ESM can only lend to governments. Therefore, as SRF is a European institution (seated in Luxembourg), the ESM is not permitted to lend to the SRF. As a result of reforming the ESM Treaty, financial instruments will be adapted. In particular, the precautionary credit line will be made easier to use. After the ratification, which will happen publicly next year, the amended ESM Treaty will allow the ESM to become the funding recourse to the SRF. If the resources of the SRF are not sufficient, the ESM can lend money to the SRF to finance the resolution of a bank. This new funding possibility is very much comparable to the situation in the US, where the Federal Deposit Insurance Corporation (FDIC) collects money from the banks, which is what the SRF does with European banks to cover bank failures.

The early introduction of the coverage in 2022 is very important and needed, particularly during the current situation where all member states are suffering the economic consequences of COVID-19. This will increase confidence in the EU markets, minimise contagion in case of bank failures and support financial stability in the euro area.

Contact

Dr. Andreas Fillmann
Partner
T +49 69 1739 2423
E andreas.fillmann@squirepb.com

40061/12/20