

## The EU system for financial assistance

di Stefano Corsaro

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The sluggish economic performances of the European Member States (MSs) since 2008 prompted the European Union to reinforce the supranational system to guarantee financial stability. The arrangements, partly focused on euro area countries, are complemented by frameworks for non-eurozone members and through the intervention of other organizations and bodies (IMF, ECB).

### The new European system for financial aid

During the May 2010 Ecofin meeting, EU MSs decided to create two vehicles to respond to the challenges posed by the financial crisis: the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF).

The EFSM is an intergovernmental agreement, entitled to act in case of difficulties for MSs for reasons outside their own control. Its capacity was set at 60 billion €, of whom 48,5 billion actually triggered (22,5 billion € for Ireland, 26 billion € for Portugal, of whom 24,3 eventually used). Last disbursements took place in November 2014. The EU, represented by the European Commission, raises the capitals needed in the financial markets, guaranteeing for the repayment of interests and principal. The aided state, which receives either a loan or a credit line, will take advantage of lower rates enjoyed by the EU (thanks to its triple-A rating). In case of default, the EU steps in through its own resources and, in case the latter are insufficient, MSs resources. In order to receive the aid, the country shall present a judgment of its financial situation and needs; an economic and financial adjustment programme and the general economic policy conditions, comprising measures to recover and to regain (acceptable) access to the financial markets. Once approved by the EU Council, the country and the Commission (in cooperation with the ECB) shall agree to a Memorandum of Understanding (MoU) detailing measures to be taken. The adjustment programme will be reviewed every six months. Assistance to Portugal and Ireland has been provided by the EU and the IMF, acting independently but in a coordinated manner: the strict conditionality measures approved have been designed on the IMF experience (EC, 2014a; Olivares-Caminal, 2011).

The EFSF a SPV created by Eurozone members, entered into force in June of the same year. Funds that can be disbursed take the form of loans, credit lines or loan facility agreements, up to an amount of 440 billion €. In order to collect the capital needed, the EFSF can issue financial instruments, guaranteed by the MS

based on their share in the ECB capital. The system of the *pro-rata* guarantees, along with the consideration that only some of EMU's countries enjoy a 'triple A' rating, however, lowered the EFSF actual lending capacity to an amount between 265 and 315 billion €. Consequently, in June 2011 the maximum amount of guarantees was increased to 780 billion €, to reach an effective lending capacity of 440 billion €. Since that date, the guarantee covered 165% (up from 120%) of the value of the instruments issued. The procedure for the granting of aid is similar to that outlined for the EFSM, also with regard to the role of the IMF and the endorsement of strict conditionality measures, with a role envisaged for the Eurogroup Working Group. If the borrower does not fulfill its obligations, guarantees or reserves previously accrued by the EFSF match the commitments. The EFSF has approved Financial Assistance Facility Agreements for three countries: Ireland, Portugal, Greece. Aid to Ireland lasted between 2011 and 2013, the amounts disbursed totaled 17,7 billion €; loans to Portugal were approved between 2011 and 2014, the sum spent was 26 billion €. Assistance to Greece, approved in 2012, is currently envisaged to last until 30<sup>th</sup> June 2015. 130,9 billion € have already been accrued to Greece, 12,7 billion are still available (EC, 2013; Ioannou et al., 2015; Olivares-Caminal, 2011; EFSF, 2015).

The EFSF was only entitled to enter new programmes until June 2013: following this date, it has only been servicing existing loans, thereafter it will cease to exist. For this reason, Eurozone countries agreed to the creation of a permanent mechanism for the guarantee of financial stability: the European Stability Mechanism (ESM). The ESM entered into force in September/October 2012. It has a maximum lending capacity of 500 billion €, of whom currently 452 billion are available. Its capital amounts to 705 billion €, of whom about 70,5 in the form of paid-in capital and 624 as callable capital — quotas are distributed according to the participation in the ECB's capital. The ESM issues bonds of maturity from 1 to 30 years. Euro-denominated bonds are to be preferred in the first years of activity, but other currencies are considered. Both the varying maturity of the bonds and the choice of several currencies are viable means to diversify the risk: the task is of primary importance, given the likely volatility of financial markets and of the MSs' requests to the ESM, which could be sudden and large at the same time. The procedure for financial aid reminds the path of action of the EFSF: coherently, a role is envisaged for the IMF. IMF loans will enjoy a preferred status over all other loans, including ESM ones, which in turn will be given priority over all remaining loans. Cyprus and Spain have already received financial aid through the ESM. Payments to Cyprus started in May 2013, their availability will last until March 2016. The ESM pledged to give Cyprus up to 8,968 billion €, 5,7 of whom have already been disbursed. The agreement for Spain was much larger than the one approved for Cyprus. Relief could have

totalized 100 billion €: between December 2012 and February 2013, two tranches, for a total of 41,2 billion €, were approved. On 31<sup>st</sup> December 2013, the ESM programme for Spain expired (ESM, 2015a; Olivares-Caminal, 2011; ESM, 2015b; ESM, 2015c).

Grounded on art. 143 of the TFEU, the Balance of Payments (BoP) system assistance, on whose example the EFSM has been created, is directed towards non-euro MSs which experience serious difficulties in financing. The country presents a draft adjustment programme, on the basis of whom the Council, backed by a Commission's recommendation, decides on the approval of a loan (or other facility). The loan agreement, which usually lasts about five years, shall be accompanied by a Memorandum of Understanding. Example of requisites included in the MoU are: fiscal reforms, financial stabilization measures, modifications in the taxation and spending systems. Funds are raised on international markets and delivered on several tranches, provided economic conditions are respected; a facility providing medium-term assistance was created in 2002, with a capacity of 12 billion €, which between 2008 and 2009 was raised to 25 and then 50 billion. Most recent aids have seen the participation of both the EU and other international bodies (like the IMF): they concerned Hungary (total aid granted until 2010: 13,5 billion € and 6,5 billion by the EU – 5,5 billion actually used), Latvia (total aid granted until 2012: 4,4 billion € and 3,1 billion by the EU – 2,9 billion actually used), Romania (total aid granted until 2011: 15 billion € and 5 billion by the EU; between 2013 and 2015, 9 billion €, of which 3,4 by the EU, have been precautionary raised but have remained inactivated) (EC, 2014b; EC, 2014a).

### **An appraisal of the new framework**

The creation of the EFSF was unpredicted by investors: accordingly, on the 9<sup>th</sup> May 2010, when the new institution was presented, banks' stock values and bank CDS spreads of a sample of 48 banks respectively increased by 8,4% and decreased by 44,8 basis points, a change which was mostly weakened in the following days. The decline in country CDS spreads were not immediately reduced; both bank and country CDS spreads' decreases, however, were reversed after the announcement had been incorporated. The 2011 increase of the EFSF capacity was expected by shareholders, but the size was not known in advance: data show that investors in 'peripheral' Europe were unsatisfied about the magnitude of the enlargement, whereas the narrow increase made the loss of creditworthiness for non-peripheral countries limited (Horváth and Huizinga, 2015).

Discussions on the ESM mainly concerned the optimal size of the mechanism for financial rescue. The unresolved predicaments in Greece, Ireland, Portugal, Cyprus, coupled with the possibility of financial crises in Spain and Italy would indeed put a strain on the ESM firewall. The current size of 500 billion € is unanimously judged insufficient: the firewall should be increased to an amount of 600-1800 billion, with some consensus on a capacity of 600-700 billion €. Although in the ESM, unlike the EFSF, private involvement is foreseen (through the existence, since mid-2013, of Collective Action Clauses –CACs– in government securities of Eurozone countries), legal provisions about this topic have been criticized. When privates' participation is necessary, engaging in discussions is a prerequisite for receiving financial aid: however,

making a deal with creditors should have been required, instead of merely trying to reach it. The presence of CACs in securities issued since mid-2013 doesn't solve the problem of previous bonds, which miss a provision for facilitating changes to the terms of payment: their complete maturity will only be reached in many years. Finally, the possibility of private losses is only foreseen when results cannot be reached in any other way: as is the case in the private sector, creditors' participation to the risks should be present with no limitations (Kapp, 2012; Kapoor, 2011; Giovannini and Gros, 2012; Christova, 2011).

Financial relationships between aided countries and creditors does not end with the end of the programmes: indeed, the average maturity of EFSF and ESM loans is 15 – 30 years. MSs can however decide the path of action when programmes end. Three options exist: full exit, precautionary credit line, new programme. In the first case, which was chosen by Ireland in end-2013, post-programme surveillance will go on until 75% of EFSF/EFSM/ESM loans have been repaid (a similar system exists for non-euro area countries which have acceded to aid programmes). Missions on-field by European institutions in Ireland, Portugal and Spain (and by the IMF in Portugal and Ireland) usually take place twice per year.

In order to help countries to issue new debt safely, Precautionary Conditioned Credit Lines (PCCL) and Enhanced Conditions Credit Lines (ECCL) can also be approved. Their advantage lies in the possibility for the ESM financing to be directly obtained in case of shock, without having to resort to a new programme. PCCL criteria are stricter than ECCL's, comprising respect of the Stability and Growth Pact, no presence of Excessive Imbalances Procedures, absence of concerns on the solvency of banks; on the other hand, PCCL impose less conditions on receiving countries (Darvas et al., 2014; Angerer and Hradisky, 2015).

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## Informazioni tecniche sul tasso di interesse risk-free

11/06/2015 13:44

L'EIOPA ha pubblicato delle informazioni tecniche sulle strutture temporali del tasso di interesse risk-free. Sono state inoltre aggiornate le Q&A.

Informazioni tecniche Q&A

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## Utilizzo dei metodi avanzati di misurazione per il rischio operativo

11/06/2015 12:46

L'EBA ha pubblicato gli standard che le autorità devono utilizzare per stabilire se le istituzioni possa utilizzare i metodi avanzati di misurazione (in inglese, AMA) per valutare il proprio rischio operativo.

Comunicato stampa Report

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## Gestione del rischio nel banking book

11/06/2015 12:37

Il Comitato di Basilea ha pubblicato un documento consultivo su gestione del rischio, trattamento patrimoniale e supervisione del rischio del tasso di interesse nel banking book. La consultazione, che prevede due proposte, si chiuderà l'11 settembre 2015.

Comunicato stampa Documento consultivo

## Pubblicato ITS interattivo sulle segnalazioni di vigilanza

05/06/2015 10:34

L'EBA ha pubblicato gli Implementing Technical Standards (ITS) interattivi sulle segnalazioni di vigilanza.

Comunicato stampa Documento ufficiale

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## EBA — report sui rischi nel settore bancario

05/06/2015 10:04

L'EBA ha aggiornato i propri giudizi sulla rischiosità del settore bancario europeo, valutando i dati dell'ultimo trimestre del 2014.

Comunicato stampa Report

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## EBA — linee guida sulla valutazione del merito creditizio e su arretrati e pignoramenti

03/06/2015 20:44

L'EBA ha pubblicato due linee guida, sulla valutazione del merito creditizio e su arretrati e pignoramenti immobiliari. Le linee guida si applicheranno dal 21 marzo 2016.

Comunicato stampa Linee guida su valutazione del merito creditizio  
Linee guida su arretrati e pignoramenti  
Opinione EBA

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## La Commissione richiede a 11 stati di adottare pienamente la BRRD

03/06/2015 20:32

La Commissione europea ha richiesto a 11 stati, tra cui Italia e Francia, di attuare pienamente la BRRD.

Comunicato stampa

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## Gestione del rischio di credito

03/06/2015 20:30

Il Joint Forum ha pubblicato un report sulla gestione del rischio di credito in tutti i settori, in cui sono presentate quattro raccomandazioni per i supervisori.

Comunicato stampa Report

# Istituzioni soggette al comprehensive assessment

30/05/2015 10:29

La decisione della BCE circa le istituzioni da sottoporre a comprehensive assessment è stata pubblicata sulla Gazzetta Ufficiale.

Decisione 2015/839

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## EBA: aggiornato report sugli strumenti dell'Additional Tier 1

30/05/2015 10:27

L'EBA ha aggiornato il report col quale analizza gli strumenti di capitale emessi dalle istituzioni europee che compongono l'Additional Tier 1.

Report

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