

## Deepening the European Monetary Union and the role of the European Stability Mechanism



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### ABSTRACT

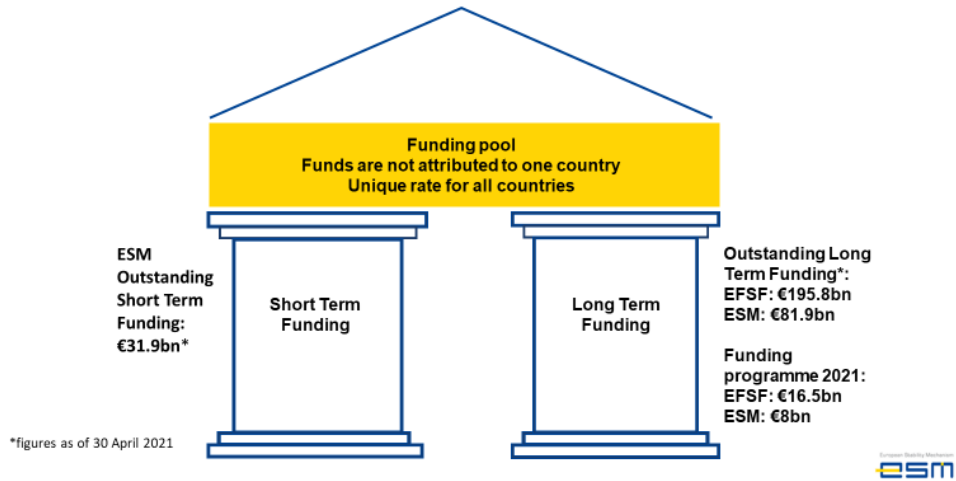
**This is the report of the speech given by Klaus Regling, Managing Director of the European Stability Mechanism, during the Belgian Financial Forum Webinar of May 5, 2021.**

The European Stability Mechanism (ESM) has the mandate to preserve financial stability in the euro area by providing financial assistance to euro area countries with severe financial problems. Through an ESM programme, euro area countries at risk of losing market access can obtain cheaper financing to improve their debt sustainability.

### The ESM as a successor to the EFSF

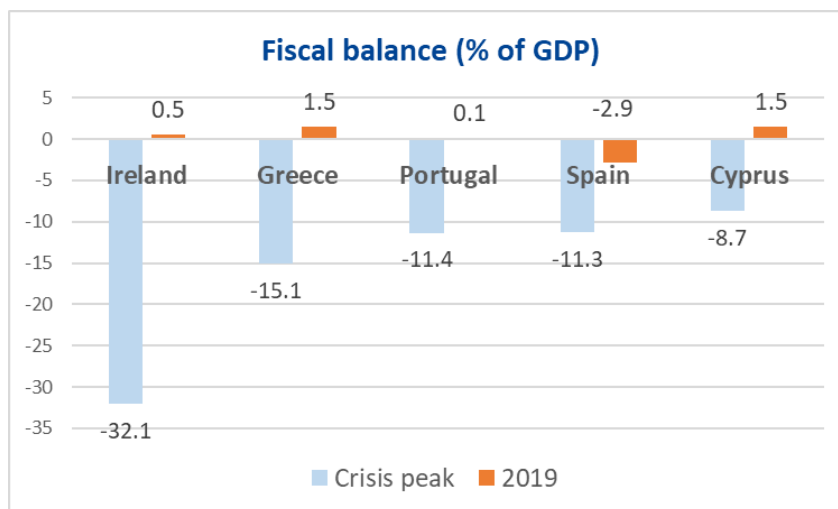
It is useful to look back to have a better view on the current activities of the ESM, which was created in 2012 as a permanent inter-governmental institution under international law. The ESM replaced the European Financial Stability Facility (EFSF), created in 2010 as a private company under Luxemburgish law. The EFSF had a framework of lending between June 2010 and June 2013, but with funding until 2070. While the capital structure of the EFSF relied on backing by guarantees from euro area countries, the ESM has a subscribed capital of 704,8 billion (bn) euros of which 80,5 bn euros were paid in. Belgium already contributed 2,8 bn euros. That capital is invested in high-quality liquid assets and cannot be used for lending. The maximum lending capacity of the ESM is fixed at 500 bn euros. The EFSF had a *pari passu* creditor status, while the ESM has a preferred creditor status (after the IMF). The credit rating of both organisations was and is AAA (stable), Aa1 (stable) and AAA (stable).

FUNDING STRATEGY WITH TWO PILLARS



The EFSF ran programmes for Ireland (2010-2013) with 17,7 bn euros, Portugal (2011-2014) with 26 bn euros and Greece (2012-2015) with 141,8 bn euros. The ESM intervened in favour of Spain (2012-2015) with 41,1 bn euros, Cyprus (2013-2016) with 6,3 bn euros and once more in Greece (2015-2018) with 61,9 bn euros. The total amount disbursed by the EFSF and the ESM is 295 bn euros.

All five programmes were successful. The financial assistance gave these countries time to implement vital reforms. All of them were able to regain market access, i.e. they could finance themselves again by issuing bonds. The five countries returned to economic growth, with rates above the euro area average until the outbreak of the pandemic.

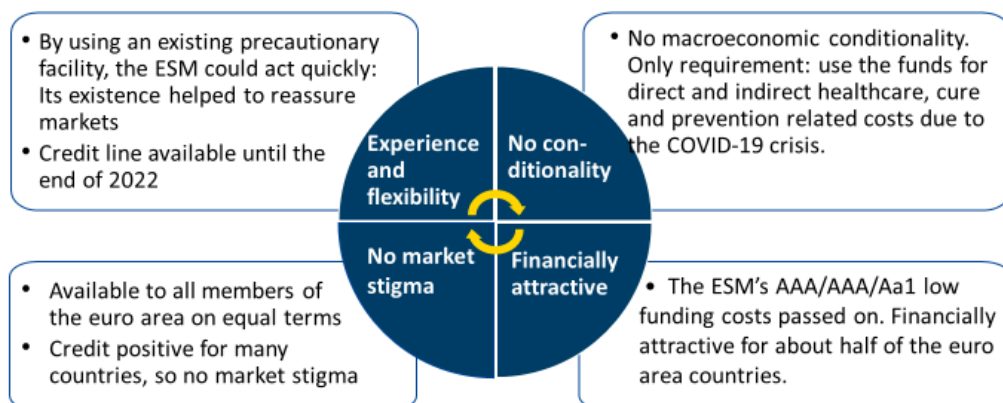


### Fight against the pandemic

The support of the ESM in the fight against the coronavirus pandemic consists of a precautionary credit line for countries with a total volume of up to 240 bn euros, which is available to all euro area countries until the end of 2022 to support healthcare-related costs of up to 2% of GDP. This supplements the support for workers - up to 100 bn euros in loans via the SURE programme of the European Commission in support of national unemployment schemes - the support for companies via a pan-European guarantee fund by the European Investment Bank of 25 bn euros, which could provide around 200 bn euros of financing for companies, especially SMEs.

The next figure summarises the ESM contribution:

#### THE ESM CONTRIBUTION



The long-term response of the European Union to the pandemic is the Next Generation EU programme of 750 bn euro. There is also the Recovery and Resilience Facility of 672,5 bn euros, composed of 312,5 bn euros worth of grants and 360 bn euros of loans.

### Deepening of the EMU

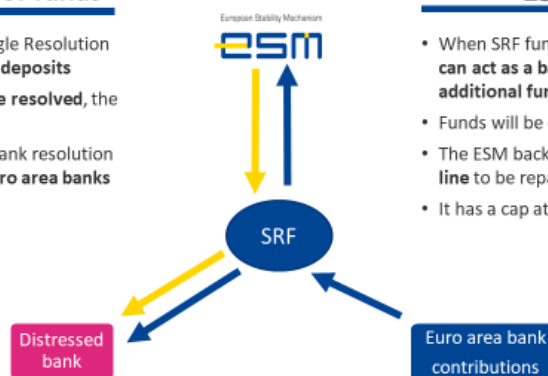
In order to support a deepening of the Economic and Monetary Union (EMU), the ESM is being reformed. While the revised ESM treaty was signed on 21 January 2021, it will be ratified in all 19 euro-area countries in 2021. The stronger role of the ESM comprises five pillars:

- Backstop to Single Resolution Fund (see next figure)
- More effective precautionary credit lines
- Promoting debt sustainability
- New role outside programmes
- Stronger role in preparing and monitoring future programmes

### ESM BACKSTOP TO THE SINGLE RESOLUTION FUND

#### SRF/banking sector funds

- The target size of the Single Resolution Fund (SRF) is **1% of bank deposits**
- **When a bank needs to be resolved**, the SRF funds may be used
- The funds used for the bank resolution **must be repaid** by all euro area banks



#### ESM funds

- When SRF funds are depleted, **the ESM can act as a backstop by providing additional funding**
- Funds will be disbursed in **12-24 hours**
- The ESM backstop is a **revolving credit line** to be repaid in 3 to 5 years by SRB
- It has a cap at **68 billion euro**



In the last decade, significant institutional progress was made to further deepen the EMU:

- 2010: new European supervisory institutions (ESRB, EBA, EIOPA, ESMA)
- 2010: European Financial Stability Facility (EFSF)
- 2012: European Stability Mechanism (ESM)
- 2014: Single Supervisory Mechanism (SSM)
- 2015: Single Resolution Board (SRB)
- 2021: ESM Treaty revision

The promotion of private and public sector risk sharing is crucial in the deepening process of the EMU. There are four domains in which reforms are still needed:

- Completing the banking union to enable greater private sector risk sharing. The SSM and SRM are already operational. The missing third pillar elements are: the European Deposit Insurance Scheme (EDIS), cross-border integration, the crisis management framework and the regulatory treatment of sovereign exposures.



- The creation of a capital markets union (CMU) to facilitate the flow of investments and savings across the EU. The European Commission has identified 16 CMU-actions to strengthen the single market, including:
  - enhancing the single rulebook for capital market and encouraging supervisory convergence,
  - harmonising insolvency rules across countries,
  - simplifying withholding tax procedures,
  - enhancing cross-border settlement services in the EU through CSD passporting,
  - strengthening the protection of shareholders and further facilitating cross-border investments through improved dispute resolution mechanisms,
  - reviewing the Solvency II framework to encourage insurers and banks to invest in equity and other long-term assets,
  - simplifying the listing rules for public markets to give small and innovative companies easier access to funding,
  - reviewing the securitization framework.
  
- Reforming the EU's fiscal framework. The existing fiscal rules are rightly suspended until 2022. Reform considerations should centre around:
  - relying more on observable variables,
  - the annual 3% deficit limit remains relevant,
  - overall, a 60% debt limit could be reconsidered,
  - reducing complexity.
  
- The issuance of more safe euro assets to increase the international role of the euro.