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EUROSTAT'S PRELIMINARY VIEW ON THE RECORDING OF THE FUTURE EUROPEAN STABILITY MECHANISM

In November 2010, the members of the Eurogroup agreed to set up a permanent mechanism, the European Stability Mechanism (ESM), to be activated by mutual agreement in order to safeguard the financial stability of the euro area. The ESM will assume the role of the European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM) after June 2013 in providing financial assistance to Euro Area Member States (EAMS) facing difficulties on the basis of conditionality (macro-economic adjustment programme) with an effective lending capacity of € 500 billion.

This note provides Eurostat's preliminary view on the recording of the operations that will be undertaken by the ESM from 2013 onwards. This view is consistent with the opinion of the Committee for Monetary, Financial and Balance of Payments statistics (CMFB) as reported in annex.

This preliminary view is based on the document annexed to the Council conclusions of 24-25 March 2011¹. It is important to note that this preliminary view is conditional on the effective implementation of the features described in this annex into the future Treaty. The ESM Treaty should be signed in the coming months by all Member States participating in the ESM. Once the Treaty is signed, Eurostat will take a formal decision.

¹ http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/120296.pdf

The issue

Eurostat analysed in 2010 the arrangements related to the EFSF and concluded that it did not meet the criteria required in national accounts for being considered as an institutional unit, notably because of a lack of autonomy of decision in the conduct of its core mission. As a result, Eurostat decided that the debt incurred by the EFSF must be allocated to the guarantor Euro Area Member States (EAMS), with the exception of the part that is not lent to a borrowing country. The loans granted by the EFSF must be considered as direct claims of the guarantor EAMS on the borrowing country. As a consequence, the debt of the guarantor EAMS is increased by the same amount.

The analysis of the provisions for the new ESM, endorsed by the Council of 24-25 March 2011, has shown significant differences from the EFSF. Such differences are:

- 1) The ESM is established on a permanent basis, while the EFSF had been set up only for three years.
- 2) The ESM will be established by Treaty as an intergovernmental organisation and benefit from public international legal provisions, while the EFSF had been set up as "Société anonyme" under Luxembourgish law. Disputes between the ESM and Member States shall be submitted to the European Court of Justice.
- 3) The ESM will have a total subscribed capital of € 700 billion, of which an amount of € 80 billion will be in the form of paid-in capital provided by all the EAMS on the basis of the paid-in capital key of the ECB. The paid-in capital is phased in from July 2013 in five equal annual instalments and will reach in any case a minimum 15 percent ratio between paid-in capital and the outstanding amount of ESM issuances. For its part, the EFSF has a very limited capital (€ 30 million) compared to its borrowing (€ 440 billion) and lending (about € 220 billion) capacities.
- 4) A significant callable capital of the ESM will be used, together with possible guarantees from the EAMS, in order to provide the funds needed for support to EAMS encountering financial difficulties, while the EFSF can rely only on the issuance of debt instruments benefiting from guarantees provided by EAMS.
- 5) The ESM will be endowed with a governance structure similar to that observed in other international organisations in the financial area (such as the IMF): Board of Governors, Board of Directors, General Manager, with effective decision-making for some part of its activity (although with a limitation due to the introduction of a "mutual agreement" rule for the most important decisions to be taken²), which was not the case for the EFSF.
- 6) The ESM will provide financial assistance through loans ("ESM stability support") but also, as an exception, under the form of purchase of bonds of a Member State on the primary market ("Primary market support facility"). It must also be pointed out that the involvement of the private sector is foreseen and that the ESM will benefit from a Preferred Creditor status, similarly to some international organisations.

For all these reasons, Eurostat's preliminary view is that the future ESM should be treated as a European Union international institution, provided that the final arrangement will be fully in line with the characteristics mentioned above, especially as regards the high level of paid-in capital, independent of the effective amount of assistance provided to an EAMS.

As a consequence, the debt possibly incurred by the ESM on the markets will be recorded as ESM debt, and not rerouted to EAMS, and the debt of the borrowing country will be recorded as debt due to ESM, and not to other EAMS.

The effective payment of the initial paid-in capital would be considered as an increase in equity for the participating Member States (financial transaction with no impact on government deficit).

² Mutual agreement means that the adoption of a decision requires the unanimity of the members of the decision making body participating in the vote, the abstentions not being taken into account.

The callable capital would have no impact on government accounts as it would be considered as a contingent liability of government. The impact on government accounts of an actual call would depend on the circumstances in which it took place. If it were to cover losses of the ESM or shortfalls in payments by a debtor country to the ESM, the call would be treated as a capital transfer and thus an expenditure of government.

Any revenue from the ESM transferred to the EAMS, notably related to the investment of the paid-in capital or to the margin charged to a borrowing country, would have a positive impact on their deficit/surplus.

Conclusion

Based on the document annexed to the Council meeting conclusions of 24-25 March 2011, the future ESM would be considered as an international organisation. As a consequence, contrary to the case of the EFSF (see Eurostat decision of 27 January 2011³), the debt of the borrowing country will be recorded as due to ESM and the operations undertaken by the ESM, such as borrowing on financial markets and granting loans to EAMS requesting support, would be fully recorded in the books of ESM, as an European institution, and they would not be rerouted through Member States.

³ http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/methodology/decisions_for_GFS

To whom it may concern:

The CMFB opinion on the recording in national accounts of the European Stability Mechanism (ESM) should be read within the context in which it was taken.

The euro area Finance Ministers agreed in November 2010 to establish a new permanent crisis mechanism, the European Stability Mechanism (ESM). An expert group preparing the features of the ESM asked at an early stage Eurostat for advice in order to understand fully the statistical implications of the future ESM. Eurostat decided to seek the opinion of the CMFB in February 2011.

The *ex-ante* nature of the consultation was underlined throughout the CMFB consultation process, i.e. the CMFB Opinion is based on the information, which was available to the CMFB members during the period 28 February 2011 to 4 March 2011. The CMFB reserves its right, because of the *ex-ante* nature of the consultation, to re-examine the statistical accounting in national accounts depending on the final features of the ESM.

(Signed)

João Cadete de Matos

CMFB Chairman

Lisbon, 23 March 2011

CMFB opinion

on the recording in national accounts of the European Stability Mechanism (ESM)

1. At Eurostat's request the CMFB Chairman, with the assistance of the CMFB Executive Body, asked the CMFB Members on 28 February 2011 to state their opinion on the recording in national accounts⁴ of the "European Stability Mechanism" (ESM). The deadline for the replies was 4 March 2011. Twenty-four (24) national statistical institutes and twenty-five (25) national central banks from the EU Member States returned the questionnaire by 4 March 2011. The ECB also provided its opinion. The IMF provided comments.
2. A CMFB Opinion on the recording in national accounts of the "European Financial Stability Facility" (EFSF) was finalised on 25 January 2011. The EFSF has been created as a temporary institution and it will be liquidated on the earliest date after 30 June 2013 when all outstanding amounts have been repaid in full. The euro area Finance Ministers agreed in November 2010 to establish a new permanent crisis mechanism, the European Stability Mechanism (ESM), to replace the EFSF and the European Financial Stability Mechanism (EFSM).
3. The preparatory work for setting up the ESM is under way. In this context, the CMFB examined the recording in national accounts of the ESM on the basis of the possible main features of the future ESM, see annex.
4. The results of the consultation were as follows:
 - 4.1 A very large majority of the CMFB considers that the ESM would have the status of an international organisation;
 - 4.2 A majority of the CMFB considers that the possible features of the ESM constitute a sufficient set of criteria for the classification of ESM as an institutional unit. In particular, the ESM may enter into legal agreements, may issue liabilities and own assets on its own account, will publish complete set of accounts, has a considerable amount of paid-in capital implying a capability of the ESM to bear risks, and has a large range of types of intervention, similar to existing international financial institutions. Specifically regarding the governance structure, a majority of the CMFB considered that it would

⁴ Council Regulation (EC) No 2223/96 of 25 June 1996 on the European system of national and regional accounts in the Community as amended.

provide the ESM with autonomy of decision. Nevertheless, a number of members expressed concerns that the governance structure could jeopardize the "*decision making autonomy in respect of its principal function*" as required by ESA-95 for institutional units (paragraph 2.12 and related paragraphs).

- 5 Further details on these considerations are provided in the background document prepared in support of this CMFB consultation.
6. The CMFB reserves its right, because of the *ex-ante* nature of the consultation, to re-examine the statistical accounting in national accounts depending on the final features of the ESM.
7. This opinion has been transmitted to Eurostat and will be kept in the records of the CMFB secretariat.

João Cadete de Matos, CMFB Chairman

Lisbon, 10 March 2011

Annex

This annex outlines *possible* main features of the future ESM as available to the CMFB at the time of the consultation and the related references in National Accounts manuals.

Relating to paragraph 4.1 of Opinion

SNA 1993 (4.164) specifies two conditions for international organisations: (1) they are entities established by formal political agreements between their members that has the status of international treaties and their existence is recognised by law in their member countries; (2) they are accorded sovereign status; that is they are not subject to the laws or regulations of the country, or countries, in which they are located.

The CMFB assumed that the new ESM would be permanent and established by a treaty among Euro area member states as an intergovernmental organisation under public international law.

Relating to paragraph 4.2 of Opinion

SNA 1993 says that "Certain international organisations have all the essential attributes of institutional units". This implies that not all international organisations have these essential attributes.

The CMFB assumed that the possible structure of the ESM would have some characteristics of an institutional unit as listed in paragraph 2.12 of ESA 95. In particular, ESM would have a full set of accounts, ownership of assets and ability to incur liabilities on own behalf, and it would have a very significant capital and the range of types of financing envisaged for the ESM would be large and similar to existing international financial organisations.

Furthermore, paragraph 2.12 of ESA-95 mentions the necessary "*decision making autonomy in respect of its principal function*". The CMFB assumed that decisions to grant and to adjust the terms and conditions of financial assistance would be taken by the Board of Governors on the basis of unanimity, and that the Board of Governors would replicate the composition of the Eurogroup.