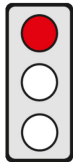


KEY ISSUES

Objective of the Regulation: The European Stability Mechanism (ESM) will be transformed into the “European Monetary Fund” (EMF) and incorporated into EU law. A financial backstop for the European Single Resolution Board (SRB) will be established by the EMF.

Affected parties: All eurozone countries, their Parliaments and tax-payers, all eurozone banks.

Pro: –



Contra: (1) The EU has no power to establish the EMF. The ability of the Council of Ministers to amend EMF decisions in an emergency procedure by way of a special qualified majority is in breach of constitutional law as laid down by the *Grundgesetz*.

(2) The Regulation does not contain any proposals for a state insolvency procedure and even excludes the mandatory collective action clauses stipulated in the ESM Treaty.

(3) The fact that conditions are no longer attached to bank recapitalisation creates false incentives and reduces the pressure to reform.

The most important passages in the text are indicated by a line in the margin.

CONTENT

Title

Proposal COM(2017) 827 of 6 December 2017 for a **Regulation** of the Council **on the establishment** of the European Monetary Fund **and Annex with Statute of the European Monetary Fund**

Brief Summary

Note: Unless otherwise indicated, Articles refer to the Statute of the EMF (in the Annex to the Council Regulation)

► **Background: European Stability Mechanism (ESM)**

- The European Financial Stabilisation Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM) of 2010 were replaced in 2012 by the European Stability Mechanism (ESM) [[see cepPolicyBrief 2012-12](#)]. The ESM is no longer temporary.
- In order to create the basis under European law for the ESM, the no-bailout clause [Art. 125 TFEU] was relaxed in the simplified treaty amendment procedure [Art. 48 (6) TEU]. This allowed eurozone countries - but not the EU - to set up a stability mechanism under international law in order to safeguard the “stability of the euro area as a whole” [new Art. 136 (3) TFEU].

► **Legal status of the European Monetary Fund (EMF)**

- The ESM will be replaced by the European Monetary Fund (EMF). The EMF will be established as an EU body with legal personality [Art. 2 g, Recital 17 Council Regulation].
- According to the Commission, the transformation of the ESM into the EMF will contribute to “transparency, judicial review and efficiency of the EU’s financial resources [...] thus offering a better support to Member States”. This will also guarantee “greater democratic accountability and legitimacy”. The Commission criticises “cumbersome national procedures” in the ESM decision-making process which are “difficult to reconcile with the speed needed for ensuring an effective crisis management”. [Recital 8 and 9, p. 3 Council Regulation]

► **Institutions of the EMF**

- The institutions of the EMF - Board of Governors, Board of Directors and Managing Director - are identical to those of the ESM [Art. 4 (1)].
- The Board of Governors is made up of the finance ministers of the eurozone countries and - as in the ESM - makes the fundamental decisions [Art. 5 (1)]. The Chair is held by the President of the Euro Group [Art. 5 (2)]; this is also the case in the ESM but is not obligatory.
- Persons with expert knowledge are appointed to the Board of Directors, generally the secretary of state for finance [Art. 6].

► **Financial resources of the EMF and liability of the eurozone countries**

- The share capital of the EMF - like the ESM - is 704 billion euro. It is made up of “paid-in shares” of 80 billion euro and “callable shares” of 624 billion euro. [Art. 8 and Annex II]
- A eurozone country’s national contribution to share capital depends - as in the ESM - on the respective national key for subscription of the ECB’s capital. The German share of roughly 27% corresponds to about 190 billion euro of which 22 billion euro is “paid in” and 168 billion euro is “callable”. (Art. 11 (1); Annex I)

- In the EMF, as in the ESM, each country is liable for losses up to its own share in share capital. The EU is not liable. [Art. 8 (4) and (5)]
- As in the ESM, the Board of Governors of the EMF decides unanimously on changing the level of share capital or lending capacity of the EMF as well on as making capital calls [Art. 5 (6)].
- ▶ **Transfer of existing ESM instruments to the EMF, decision-making procedure**
 - If indispensable to safeguard the financial stability of the euro area [in some cases also: “as a whole”] or [in some cases: “and”] its Members, the EMF borrows on the capital markets and passes these funds on, “subject to appropriate policy conditions”, to eurozone countries with financing problems [Art. 3 (1) and (2), Art. 12 (1), Art. 19].
 - Permitted: EMF support by way of general loans to affected eurozone countries, precautionary credit lines for eurozone countries, primary or secondary market purchase of government bonds, loans to eurozone countries to recapitalise banks as well as direct bank recapitalisation up to a total ceiling of 60 billion euro. [Art. 13 - Art. 18]
 - The Board of Governors generally decides by way of a majority of 85% of EMF capital – unanimously in the ESM – on the necessity, conditionality and activation of support [Art. 5 (7)].
 - The Board of Directors decides on direct bank recapitalisations with a majority of at least 80% of the EMF capital
 - unanimously in the ESM [Art. 19 (5) in conjunction with Art. 6 (5)].
- ▶ **EMF support for the bank resolution board (SRB backstop)**
 - In order to safeguard the stability of the euro area and the non-eurozone countries that are members of the banking union, the EMF - by contrast with the ESM - may grant credit lines or guarantees to the Single Resolution Board (SRB) totalling 60 billion euro (“backstop”) [Art. 22].
 - Any loans that are accepted must be repaid by way of special contributions by the banks to the Single Resolution Fund (SRF). [Art. 3 (1) and (2) (b), Art. 22 (3)]
 - The EMF Board of Governors decides unanimously on the “financial terms and conditions” of the backstop. The EMF Board of Directors adopts general guidelines for implementing the backstop with a majority of at least 80% of the EMF capital. The Managing Director of the EMF decides within 12 hours on requests to use the backstop made by the SRB. This may take place before the adoption of a definitive resolution scheme. [Art. 22 (7) and (8) and Art. 23]
- ▶ **Conditionality of EMF support**
 - EMF loans, EMF loans to recapitalise banks, precautionary EMF credit lines and EMF primary and secondary market purchases of government bonds – like those of the ESM – must have conditions attached that are set out in a Memorandum of Understanding (MoU) [Art. 12].
 - The conditions must
 - “respect the autonomy of the social partners” [Art. 152 TFEU], particularly their ability to negotiate collective agreements [Art. 28 Charter of Fundamental Rights] [Art. 12 (2)],
 - take account of social impact [Art. 13 (3)],
 - “be consistent” with the macroeconomic adjustment programme [Art. 13 (3) in conjunction with Art. 7 Regulation (EC) No. 472/2013]; the macroeconomic adjustment programme is accepted by way of a qualified majority of 55% of the eurozone countries.
 - The Commission negotiates the conditions, “in liaison with the ECB” and “in cooperation with the EMF”, with the affected Member States. The Commission and the ECB monitor their compliance. By contrast with the ESM, the International Monetary Fund (IMF) is no longer involved. The Commission and the EMF must sign the MoU; in the ESM, the Commission signs on behalf of the ESM. [Art. 13 (3) and (4)]
 - No EMF conditions are proposed for the SRB backstop [Art. 22]. Neither are any mandatory conditions attached to direct recapitalisation of banks by the EMF – by contrast with the ESM [Art. 19].
- ▶ **Involvement of the Council of the European Union**
 - All discretionary decisions of the Board of Governors and the Board of Directors must be approved by the Council of Ministers. This affects, in particular, increases in share capital, lending capacity and the EMF’s SRB credit line as well as the adoption of EMF support schemes including the accompanying conditions. [Art. 3 Council Regulation]
 - This requires a special qualified majority of 72% of the eurozone countries [currently: 14 of 19 eurozone countries], comprising 65% of the population of the eurozone. [Art. 3 (1) and (4) Council Regulation in conjunction with Art. 238 (3) (b) TFEU]
 - The Chair of the Board of Governors – i.e. the President of the Euro Group – can initiate an emergency procedure for EMF loans and the SRB backstop. Under this procedure, the Council of Ministers can reject or amend the decisions of the Board of Governors by way of a double majority of 72% of the eurozone countries and 65% of the population of the eurozone countries. [Art. 3 (2) and (4) Council Regulation]

► Waiver of Collective Action Clauses

- The provision of the ESM Treaty, that government bonds with a maturity of more than one year must contain Collective Action Clauses (CACs), is no longer contained in the EMF Regulation.

Statement on Subsidiarity by the Commission

Member States cannot unilaterally “solve” risks to financial stability and “have difficulties” in mitigating them “on their own”.

Policy Context

An initial discussion took place at the Euro Summit on 15 December 2017 but with only an acting German Government. Consequently, the finance ministers of the eurozone discussed the subject in the Eurogroup without any apparent progress. Discussions will continue at the European Council in June.

Legislative Procedure

20 June 2018	Adoption by the Commission
Open	Adoption by the Council, Approval by the European Parliament, publication in the Official Journal of the European Union

Options for Influencing the Political Process

Directorates General:	DG Economic and Financial Affairs (leading)
Committees of the European Parliament:	Economic and Monetary Affairs (leading), Rapporteur: TBA
Federal Ministries:	Finance Ministry (leading)
Committees of the German Bundestag:	Budget (leading), Finance
Decision-making mode:	In the Council: Unanimity: The German Government has a right of veto. The German Government can only give its approval if the Bundestag has passed a law on it (Section 8 Act on Cooperation in Matters concerning the European Union). In the European Parliament: Simple majority.

Formalities:

Competence:	Art. 352 TFEU (Flexibility Clause)
Form of legislative competence:	Shared competence (Art. 4 (2) TFEU)
Procedure:	Art. 289 (2) and Art. 352 TFEU (special legislative procedure)

ASSESSMENT

Economic Impact Assessment

The actual objective of the EMF is inconsistently worded. EMF financial support is only justifiable if the financial stability of the eurozone *as a whole* is in jeopardy. **In order to prevent all state refinancing problems from resulting in EMF support, a set of rules on state insolvency is urgently needed.** Such a set of rules will use restructuring to make the debts of the affected countries once more sustainable (cf. [cepStudy](#) proposal for small amounts of automatic debt relief). The incidental participation in the cost by private investors (“bail-in”) would persuade states to maintain a sustainable budgetary policy by way of market-based interest which, in the medium term, would avoid refinancing problems. This is more sustainable than solving them ex post via the EMF at the expense of other countries. **It is not justifiable, therefore, that the Regulation contains no suggestions for this sort of restructuring scheme and – even worse – actually excludes the mandatory collective action clauses stipulated in the ESM Treaty.**

The agreement of reform conditions in return for financial support is essential for the recovery of the affected country. **The IMF should, in future, also be involved in negotiating the conditions and monitoring compliance with them. As a global institution, the IMF does not have to give as much consideration to internal European sensitivities as the Commission does.** Its involvement will counteract a softening of the ESM conditions. The fact that the Commission only has to negotiate the conditions “in cooperation” with the EMF increases fears that the conditions will be softened further.

The fact that, in the case of direct bank recapitalisation, bank or sector specific conditions are – by contrast with the ESM – no longer imposed, creates false incentives and reduces the pressure to reform. It is equally unclear why decisions about direct bank recapitalisation can be reached with 80% of EMF capital. It is important that existing ESM guidelines continue to apply to this instrument, without limitation, where they contain mandatory provisions for a bail-in or comprehensive participation of the affected Member State, for example.

The preceding comprehensive participation of creditors in the bank that is subject to the resolution and a substantial participation of the affected Member State in the resolution costs should be mandatory requirements for the SRB

backstop (cf. [ceplinput](#)). In addition, it should not be possible to activate the SRB backstop without a resolution concept that has been approved by the Commission because otherwise there is a risk that assessment under aid rules will be too lax.

Legal Assessment

Legislative Competency

The EU has no power to establish the EMF. In particular, the EMF cannot be established on the basis of Art. 352 TFEU (Flexibility Clause).

The following criteria of Art. 352 TFEU are met: The EMF pursues an EU objective (“balanced economic growth and price stability”) and relates to a policy area established under primary law (Economic Policy, Art. 120 et seq. TFEU). In addition, the EU has no other competence for establishing the EMF. However, the establishment of the EMF changes the distribution of economic policy responsibilities between the EU and its Member States which is conclusively laid down under primary law, since the TFEU “limits the role of the Union in the field of economic policy to the adoption of coordinating measures” [CJEU in Case C-370/12 (Pringle), para. 64]. With the proposed economic policy requirements, in particular, the EMF goes far beyond pure coordination. Art. 352 TFEU cannot be used as a basis for the “adoption of provisions [...], whose effect would, in substance, be to amend the Treaty [...]” (CJEU Opinion 2/94, para. 30).

In addition, the necessity for EU action in order to achieve an objective, as required under Art. 352 TFEU, does not exist. The ESM - largely identical in function to the planned EMF - is sufficient to achieve the objective. The arguments put forward by the EU supporting the need to integrate the ESM into EU law in order to achieve the objective, are unconvincing. In matters of transparency, efficiency (speed of decisions) and judicial review, there are no significant differences between the intergovernmental ESM and the union-law-based EMF. The Commission confuses cause and effect when setting out the democratic legitimation: Scrutiny by the European Parliament would simply be the logical effect of integrating the ESM into Union law; it is not proper to use this as grounds for such integration. Under the intergovernmental construct of the ESM, national parliaments exercise these powers of scrutiny.

Subsidiarity.

Unproblematic.

Proportionality with Respect to Member States

The intergovernmental ESM is equally as appropriate as the EMF to achieve the objectives.

Compatibility with EU Law in other Respects

According to the case law of the CJEU in the Meroni Case [Judgements dated 13 June 1958, Case no. C-9/56 and C-10/56], EU organs are not permitted to delegate powers with a broad scope for discretion to EU agencies. The provision under which the Council of Ministers has to take important decisions of the EMF is compatible with this.

Impact on German Law

The ability of the Council of Ministers to amend EMF decisions in an emergency procedure by way of a special qualified majority is in breach of constitutional law as laid down by the *Grundgesetz*. The Federal Constitutional Court is demanding a German right of veto for the ESM as “required under constitutional law” in order to “ensure the overall budgetary responsibility of the Bundestag” (2 BvR 1390/12, Judgement dated 18 March 2014, para. 193 and 190). The Bundestag exercises this responsibility by way of the provisions of the law on financial involvement in the European Stability Mechanism (ESMFinG). This states that any decision by the Federal Government in the ESM with budgetary relevance, requires the prior approval of the Bundestag. Under the emergency procedure, this parliamentary requirement will in future be ineffective because the Federal Government can be overridden in the Council of Ministers. The same applies to the activation of the SRB backstop which is decided by the Managing Director of the EMF - rather than the government representatives in the Board of Governors or the Board of Directors. As a result, such EMF support will be possible even where it is contrary to the express will of the Bundestag.

Conclusion

The EU has no power to establish the EMF. The ability of the Council of Ministers to amend EMF decisions in an emergency procedure by way of a special qualified majority is in breach of constitutional law as laid down by the *Grundgesetz*. In order to prevent all state refinancing problems from resulting in EMF support, a set of rules on state insolvency is urgently needed. It is not justifiable, therefore, that the Regulation contains no suggestions on this and actually excludes the mandatory collective action clauses stipulated in the ESM Treaty. The IMF should, in future, also be involved in negotiating conditions and monitoring compliance with them. As a global institution, the IMF does not have to give as much consideration to internal European sensitivities as the Commission. The fact that conditions are no longer attached to bank recapitalisation creates false incentives and reduces the pressure to reform. The preceding comprehensive participation of creditors in the bank that is subject to the resolution and a substantial participation of the affected Member State in the resolution costs should be mandatory requirements for the SRB backstop.