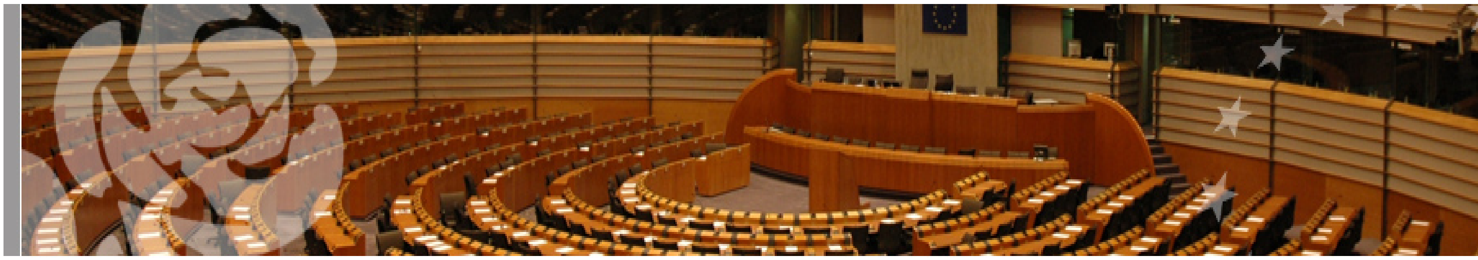
Briefing: The European Financial Stability Facility (EFSF)



Summary: This briefing relates to the European Financial Stability Facility (EFSF), the European Systemic Risk Board (ESRB), the EU supervisory authorities (ESAs) and European System of Financial Supervisors (ESFS) in Europe.

1. The European Financial Stability Facility (EFSF)

Established May 2010, the **European Financial Stability Facility (EFSF)** provides financial support for Member States in any exceptional fiscal circumstances that may be beyond the control of any one individual Member State.

Where does the money come from?

The EFSF is complimented by the **European Financial Stabilisation Mechanism** (EFSM) which, together with IMF funds and money from the EU budget, allows the EU to access up to €750 billion of financial assistance for Member States in extraordinary fiscal difficulties:

- €440bn provided by Euro Area Member States
- €60bn from the European Financial Stabilization Mechanism or EFSM (a part of the EFSF backed by EU budget)

- €250bn from the IMF

Once the loan is activated, financial assistance amounting up to €440 billion is guaranteed through a Special Purpose Vehicle by participating Member States on a pro rata basis, expiring three years after activation.

The Member State wishing to access financial assistance will apply to the European Commission which will provide assistance if warranted by borrowing on capital markets on the basis of the €440 billion guaranteed to the EFSF by participating countries.

Rating agencies have granted the EFSF top ratings (AAA from Fitch Ratings and Standard and Poor's, Aaa from Moody's Investor Services) allowing it to borrow at lower prices than most countries from capital markets and thus minimising the costs to EU countries participating in financial assistance.
The high ratings were granted to the EFSF on account of Member States' commitment to the EFSF, a cash reserve and a loan-specific liquidity buffer as well as the creditworthiness of participating Member States.

With these top ratings, agencies have signalled that the EFSF can play a central role in the restoration of financial stability in Europe.

When is a country eligible for financial assistance from the EFSF?

The activation of financial assistance from the EFSM reserves is subject to strong conditionality. The beneficiary Member State will be obliged to enter into Memoranda of Understanding with the European Commission which acts on behalf of euro zone countries. Activation prerequisites the compliance of the beneficiary Member State to economic policy guidelines and for budgetary discipline.

The process by which a country is granted financial assistance

1. A Member State looking to access the funds opens negotiations with European Commission and the European Central Bank (ECB) and submits a draft proposal to the European Commission
2. The European Commission submits the proposal to the Council, which decides by Qualified Majority Vote on the basis of

    - the amount requested, duration, pricing formula and fee
    - the conditions which the beneficiary Member State is requesting funds on, i.e. in order to re-establish a stable economy and banking sector

3. The European Commission and beneficiary Member State conclude a Memorandum of Understanding detailing agreed economic conditions, to be reviewed every 6 months.

To find out more about the EFSF, and to read the framework agreement, please follow this link.

2. Financial Supervision Reform

The European Parliament (EP) has agreed on new regulations which guarantee the supervision of cross-border financial groups whose activities could not previously be effectively regulated by individual Member States.

A single rule book for financial institutions throughout the EU will contribute to the performance of the internal market by ensuring the uniform application of rules. Thus, the new financial supervisory authorities will be responsible for ensuring a single set of harmonised rules and ensuring the consistent application of these EU rules.

In September 2010 the European Parliament successfully concluded negotiations with the European Commission and EU Member States on the future architecture of financial supervision in the EU. In January 2011 the **European Systemic Risk Board (ESRB)** and three **EU supervisory**

authorities (ESAs) will commence work.

3. European Systemic Risk Board (ESRB)

The **European Systemic Risk Board (ESRB)** will monitor the financial system and give an early warning of any impending instability. It will issue recommendations and warnings to Member States and the European Supervisory Authorities (ESFS). In order to make sure EU countries act upon the information provided by the ESRB, it will also inform the European Parliament which will ensure the implementation of the ESRB's recommendations.

The ESRB will be responsible for assessing the risks to the stability of the financial system as a whole and will thus engage in prudent macro-economic and fiscal supervision.

4. European System of Financial Supervisors (ESFS)

The **European System of Financial Supervisors (ESFS)** will consist of a network of national financial supervisors who will work along with the new ESAs. The supervisors will monitor financial institutions deemed important enough to pose any threat to EU economies if they encounter difficulties.

Alongside national supervisory systems, three authorities will be responsible for assessing the risks to the stability of particular markets and thus engage in prudent micro-economic and fiscal supervision.

Ultimate responsibility remains with national governments but the powers of the new supervisory authorities are sufficient to help overcome difficulties of coordination encountered before and during any financial crisis.

National governments will continue to be responsible for day-to-day supervision, the new authorities are only granted special powers in emergency situations.

5. European System of Financial Supervisors (ESFS)

The European System of Financial Supervisors (EFSF) will consist of

- **The European Banking Authority** (EBA)

With its seat in London, the EBA will work to contribute to the stability of the European financial system, economy, and Europe's citizens and businesses.

- **The European Insurance and Occupational Pensions Authority** (EIOPA)

EIOPA will be entitled to develop binding technical standards in defined areas (see above link).The rapporteur responsible for piloting the successful ratification of the EIOPA was **Labour MEP for the South East Peter Skinner**.

- **The European Securities and Markets Authority (ESMA)** (ESMA)

ESMA will help to ensure closer coordination of national securities by developing binding technical standards and prevent distortion of competition in order to safeguard the internal market.

Powers and Objectives of the ESAs

Developing binding technical standards

ESAs adopt binding technical standards with a qualified majority voting, which are subsequently formally adopted as a regulation or decision by the European Commission. The ESAs must not be involved in policy decisions.

Three-step mechanism for a consistent application of EU supervisory rules

Step 1: If a national supervisory authority is not deemed to act in accordance with EU-law, an ESA may recommend action to the authority in order to comply with EU-law.

Step 2: If this recommendation is not followed, the ESA may ask for action and name an implementation deadline.

Step 3: If action fails to take place, the ESA may address institutions concerned to take necessary action. This may include the suspension or cessation of practice.

Settlement of disagreements

ESAs are responsible for resolving conflicts and disagreements when these hamper cooperation between national supervisory authorities to implement EU-law. The binding settlement is decided by the ESA with a simple majority. Failure to act upon this decision may result in the ESA addressing institutions requiring them to take the necessary action.

Special powers in emergency situations

If developments occur which may seriously harm the stability of the financial system, the ESA may take a decision that requires national supervisory authorities to take necessary actions.

Safeguard Clause

The safeguard clause protects budgets of Member States and allows Member States to suspend ESA decisions if concern is voiced.