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The Unilateral Issuance Framework for the European Stability Mechanism and the European Commission

This paper focuses on a specific regime recently enacted under Luxembourg law for the ESM and European Commission, which represents a particular case in the general framework applicable to issuers of debt securities.

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In some instances, issuers may want to retain their own debt securities from the outset in their treasury, for example to use these securities as collateral to obtain central bank liquidity. Legally, unless there are explicit exemptions or specific regimes, retaining debt securities at issuance generally requires going through an issuance and repurchase process, and results in an issuance settled with a counterparty to bring to existence the debt securities, followed by an immediate repurchase by the issuer from that counterparty. Recent legislative developments in Luxembourg provide an alternative issuance path for the European Stability Mechanism and the European Commission.

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1. *Introduction – a legal and operational premise*

The specific point in time when securities[1] are created, and validly exist from a legal point of view, cannot be defined in a uniform way. It is rather determined by substantive rules of national private law and depends on variables such as the type of the relevant securities (e.g. whether shares or bonds), form (e.g. whether bearer or registered) and the national law applicable to the issuer.

Broadly, transferable securities can exist either in certificated (paper-based) or book-entry form (immobilisation or immediate dematerialisation).[2] Immobilisation is the act of centralising the custody of physical securities (through the so-called "global note") with a Central Securities Depository (CSD) in a way that enables subsequent transfers to be made by book-entry in the CSD electronic system. Some jurisdictions, for example France, have adopted full dematerialisation, whereby securities only exist in electronic form, without any need for a global note. Book-entry form remains as of today the most common in industry practice.

The object of a book-entry securities transaction is hard to classify as either purely contractual or proprietary in nature. Contractual and property law aspects of a transfer are virtually inseparable under the general private laws of most jurisdictions.[3]

In that respect, a requirement for the valid formation of debt securities is a contractual process of offer and acceptance. As such, it envisages (i) the necessary presence of a counterparty, and (ii) an offer and acceptance processes between the issuer and the counterparty, materialising in the concept of "trade". In addition to that, the importance of the payment of the purchase price as a contractual element can be considered from different legal standpoints. For example, under English law, it represents valuable consideration that is necessary for the valid creation of bonds. In Luxembourg, bonds are traditionally considered a collective form of loan agreement[4] and loan agreements, as contracts *in rem*, only come into existence upon delivery of the object of the contract.[5]

Investor protection and market stability require that a transfer of securities should take proprietary effect, i.e. be effective against third parties, neither earlier, nor later than the crediting of a transferee's account. This is to allow for good faith acquisition (i.e. receiving the securities without any need to verify whether the disposer holds good title), which is relevant due to the negotiable character of debt securities. Securities are usually intended to be transferred, and if there were doubts about their valid creation, this would create unacceptable

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[1] Despite referring often to "securities" interchangeably, this paper intends to focus only on bearer debt securities. For other types of securities, e.g. equity securities, or the other form of debt securities (i.e. registered debt securities), it is acknowledged that certain profiles may be different and will not be considered for the purposes of this paper. Tax profiles, albeit relevant for the creation and circulation of securities, are not covered in this paper either.

[2] Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012, [2014] OJ L 257/1 (CSDR), art 3(1) requires that "any issuer established in the Union that issues or has issued transferable securities which are admitted to trading or traded on trading venues, shall arrange for such securities to be represented in book entry form as immobilisation or subsequent to a direct issuance in dematerialised form". All transferable securities must be in book-entry form from 1 January 2025 (art. 76 (2) CSDR).

[3] Haentjens, Matthias. "Between Property Law and Contract Law: the Case of Securities". *The Future of European Property Law*, edited by Sjef van Erp, Arthur Salomons and Bram Akkermans, Berlin, Boston: Otto Schmidt/De Gruyter european law pub, 2012, 182.

[4] See Article 98 of the Law dated 10 August 1915 on commercial companies, as amended.

[5] In the case of a monetary loan therefore, the traditional approach is that the loan agreement only comes into force and valid existence upon payment of the advance by the lender.

uncertainty and legal risk in the market, since the value of the securities would always be in doubt.

In most jurisdictions, for securities in book-entry form, the "issuance" stage i.e. the entry of the securities into the relevant account at the CSD,[6] thus making them available for distribution, holding/safekeeping, and onward transfer by intermediaries - coincides with their creation and valid existence.[7]

Once the entry is recorded, or simultaneously to such record, the CSD "settles" the issuance. Securities settlement is the process whereby securities are delivered usually against payment of the purchase price, reflecting the performance of contractual obligations arising out of securities trades.[8] Settlement happens electronically, which allows the synchronisation of the delivery of securities with the payment of a corresponding cash amount. This synchronisation is referred to as delivery versus payment ("DvP").

All this process, from trade to settlement, constitutes a "primary market issuance", and ensures that securities come into existence in a way that guarantees legal certainty as to their enforceability against third parties of the ownership rights vested in them.[9]

This primary market issuance process is in most cases repeated also when the issuer intends to retain from the outset in its treasury own debt securities, for example to use these securities as collateral to obtain central bank liquidity. Operationally, this occurs through an issuance and repurchase process, and results in an issuance settled with a counterparty to bring to existence the debt securities, followed by an immediate repurchase by the issuer from that counterparty, all contractually agreed in advance.

Primary market processes can be either domestic (where the issuer and the CSD are in the same jurisdiction) or cross-border. The law governing the securities can also be the same one applicable to the issuer or a different one. The traditional rule, from a conflict-of-laws perspective, is that the law applicable to the relationship of the issuer with the bondholder is the *lex contractus* (i.e. the law which governs the contractual relationship between the issuer and the bondholder, as set out in the relevant terms and conditions) and the *lex societatis* (in respect of formal requirements, e.g. organisation of bondholders' meetings, and those relating to the creation of the bonds).[10]

For public sector issuers, in most cases, there may not be a statutory regime for the issuance of debt securities nor a proper *lex societatis*, which is instead tailored for national companies. Absent explicit exemptions or specific public law regimes, public sector issuers, such as

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[6] CSDs play an important role in securities holding and settlement. However, these may also take part to the creation of the securities. See Legal Certainty Group, Second Advice of the Legal Certainty Group Solutions to Legal Barriers related to Post-Trading within the EU August 2008, 99 at https://finance.ec.europa.eu/document/download/e1b1f732-926a-4db3-afe2-f31c2fe3f21d_en?filename=legal-certainty-group-2nd-advice_en.pdf .

[7] In some jurisdictions it may coincide. See the comparative survey provided in European Commission, Internal Market and Services DG, EU Clearing and Settlement Legal Certainty Group Horizontal answers to the Questionnaire MARKT/G2/MNCT D(2005), 47 and ss.. at Comparative survey at 26 7 5.doc (europa.eu) https://finance.ec.europa.eu/system/files/2016-12/comparative-survey-26072006_en.pdf .

[8] In this sense Joanna Benjamin, Interests in Securities: A Proprietary Law Analysis of the International Securities Markets (OUP 2000), 20, who however refers to the delivery of (interest in) securities, due to the legal characterisations under the intermediated structure.

[9] Phoebus Athanassiou 'Towards a more integrated primary issuance market for securities in the EU' (2020) 27(2) Maastricht Journal of European and Comparative Law 137-157.

[10] P.-H. Conac, 'Chapter 5 - Rights of the Investor', in P.-H. Conac et al. (eds), Intermediated Securities – The Impact of the Geneva Securities Convention and the Future European Legislation (Cambridge University Press, 2013), 112.

international organisations,[11] tend to conform to general civil and commercial national laws and to market practice.[12]

Practices such as the one on retained debt securities, as a rule of thumb,[13] follow the legal and operational requirements just described.

2. *Certain exceptions to the issuance and repurchase process*

Exceptions to this operational arrangement[14] are not very common, as far as we can see. A partially different arrangement is however traceable in the *Bundesschuldenwesengesetz* (BSchuWG or "Federal Debt Act"), applicable to German government bonds since 1910.[15] The European Central Bank may also issue uncertificated bonds relying on the same regime envisaged for German government bonds.[16]

Under the general regime of the German civil code (*Burgerliches Gesetzbuch*, "BGB"),[17] a bearer bond is defined as a certificate in which the issuer promises the performance of an obligation to the bearer of such certificate. The creation of bonds in bearer form traditionally requires (i) the execution of a physical certificate and (ii) the entering into of an issuance agreement, whereby the issuer undertakes to issue and deliver the bonds to the holder and the holder undertakes to accept delivery and to pay the bond issue price to the issuer.

The special regime under the Federal Debt Act[18] provides that the German Federal Debt Agency (*Bundesrepublik Deutschland - Finanzagentur GmbH*) may issue debt securities by entering collective debt register claims in the Federal Debt Register[19] in the name of a securities depository up to the amount of the nominal amount of the respective issue. In this way, the Federal Debt Act complements the regime of the German civil code. The entry in the debt register has a constitutive character[20] and replaces the execution of the physical certificate.[21]

[11] International organisations usually operate under public international law. A consequence is that some of the traditional criteria to identify the applicable law (e.g. seat of the organisation) cannot be used.

[12] On the important role of private law for public debt securities markets, see Wouter Bossu & Elsie Addo Awadzi, 'Private Law Underpinnings of Public Debt Securities Markets' (2013) 18 Unif L Rev 564.

[13] For example, in the case of debt securities issued under English law, German law and Luxembourg law.

[14] Another option, instead of a repurchase process by the issuer, is to have a counterparty operating on behalf of the issuer: this seems to be the case of the securities facility established by the *Agence France Trésor*, which issues debt securities to another public entity, the *Caisse de la dette publique – CDP.* CDP is then entitled to lend to primary dealers French government securities that are difficult to obtain on the market in exchange for other French securities of equivalent value. This alternative requires in any case the intermediation of another entity to create the debt securities – in this case CDP. See "Securities facility in the form of repos on French debt | Agence France Trésor" at https://www.aft.gouv.fr/en/french-government-securities-repo-facility

[15] As some commentators note, the recent German Electronic Securities Act (*Gesetz zur Einführung elektronischer Wertpapiere – eWpG*) only catches up with the legal status that was already achieved by the Federal Debt Register in 1910. The problem, however, is that it has different regulations than the BSchuWG. In this way, the legal divide between public and private bonds is perpetuated without there being any apparent objective reason for it - Matthias Lehmann, „Wertpapierarten", in Elektronische Wertpapiere Herausgegeben von Sebastian Omlor, Florian Möslein und Stefan Grundmann, 2021 at 70.

[16] Under article 10(2) of the *Headquarters Agreement of 18 September 1998 between the Government of the Federal Republic of Germany and the European Central Bank Concerning the Seat of the European Central Bank on 19 December 1998* Headquarters agreement (europa.eu) . On how central bank securities may be used, see Issuing central bank securities (bankofengland.co.uk) .

[17] Section 793 thereof.

[18] See Section 6 thereof.

[19] For completeness, Section 5 provides a distinction between individual and collective debt register claims. Individually debt registered claims are not securities (*Wertpapiere*), but mere claims, as their original German title, *Einzelschuldbuchforderungen* (literally, individual debt book-entry claims) denotes. If, however, government bonds are issued in the name of the national CSD, Clearstream Banking Frankfurt (CBF) by registering CBF in the Federal Debt Register, these bonds are called a Collective Book-Entry Claim (*Sammelschuldbuchforderung*) (Art. 6(1)).

[20] Section 5(3) of the Federal Debt Act.

[21] Section 6(1) of the Federal Debt Act.

The entry of the CSD into debt ledger is equal to the existence of a pool of certificates (*Wertpapiersammelbestand*). However, in addition to creation by registration, an issuance agreement is still required, for the issuance to have legal and dispositive effects.[22] The issuance agreement is an agreement between the issuer and the original holder of the bond to be issued. Under such agreement, the issuer undertakes to issue and deliver the bonds to the holder and the holder undertakes to accept delivery and to pay the issue price of the bonds to the issuer.

An issuance agreement implies that the issuer and the subscriber are different. In the case of a collective bond, an entry by the CSD prior to the issue does not create a debt claim. The CSD only holds the bonds as a trustee for the beneficial holders.[23] If the latter do not (yet) have any rights, the authorisation to dispose of the former is irrelevant. The dematerialised debt securities are acquired by the investors through an auction procedure where the investors submit bids and the securities are subsequently allotted.[24]

Despite still requiring a counterparty to make the debt securities effective, the German Federal Debt Agency can avoid a securities issuance and repurchase process, piling up own debt securities holdings in its treasury simply by entry into the Federal Debt Register. The German Federal Debt Agency can then use these reserves in its treasury to borrow in the form of sales on the market and in the form of repo transactions (to borrow on the money market or as part of liquidity management measures).[25] These own holdings of debt securities, as mentioned above, become effective only when they are sold by the German Federal Debt Agency on the secondary market.

No court decisions or any statements in legal literature seem to address the issue as to when such debt securities come actually into existence, i.e. when the relevant claim is entered into the Federal Debt Register, or at a later stage, when the investor subscribes the bond.[26]

Similar practices and deviations from the ordinary issuance and repurchase process can be found in the practices of the Italian Treasury Department and the Belgian Debt Agency.

The Italian Treasury Department, pursuant to the Public Debt Consolidated Act[27] and the Ministerial Decree of 18 May 2021 on repo operations, can tap previous series of outstanding debt securities without any exchange with a counterparty, with only a record in the books of the relevant clearing system (*Monte Titoli*) being sufficient for issuance purposes. The bonds issued specifically to constitute the own portfolio and to execute repo operations have no effect

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[22] Such separate issuance agreement/terms and conditions become part of the entry in the register upon publication, provided that they are referred to in the entry in the register. In this sense, Urs B. Lendermann, Kreditaufnahme des Bundes und Bundesschuldbuch, in Schuldverschreibungsrecht : Kommentar - Handbuch – Vertragsmuster by Klaus J. Hopt and Christoph H. Seibt, 2016, at 1101.

[23] Section 6(2) of the Federal Debt Act. CBF's status as trustee is not understood as a fiduciary trustee, but merely a trustee by authorisation (in accordance with Article 185(1) of BGB), according to Siegfried Kümpel & Ernst Decker, Das Depotgeschäft, 2d ed. (Köln: Bank-Verlag Medien, 2007) at para.at para. 11.259.

[24] An issuance agreement is deemed to be entered into between the issuer and the investor when the securities are allotted in the auction.

[25] See Bundesministeriums der Finanzen, Kreditaufnahmebericht des Bundes 2022, 37.

[26] One may take the view that the issuer may issue bonds to itself, acting as an attorney without power of attorney (*Vertreter ohne Vertretungsmacht*) on behalf of future investors and enter into an issuance agreement with itself. The validity of a contract which is entered into by an attorney without power of attorney is deemed to be suspended (*schwebend unwirksam*) until the person on whose behalf the contract was entered into approves the contract by giving consent. If consent is given, the contract is regarded as valid with effect from the date it was entered into. Thus, if an investor subscribes to such bonds, the subscription may be construed as consent by the investor to the issuer acting on behalf of such investor. Alternatively, one may take the view that such bonds only come into existence at the time they are subscribed for, i.e. when the issuer enters into a contract with an investor. According to this view, the bonds would not be validly created before such agreement is entered into.

[27] Article 3(1) (b-bis).

on the Treasury's liquidity and, as long as they remain in the own portfolio, they do not represent additional debt according to Eurostat criteria.[28]

The Belgian Debt Agency, under the Royal Decree of 16 October 1997 on linear bonds,[29] is entitled to provide securities on a temporary basis[30] for the purposes of its repo facility transactions. Under such decree, the Belgian Debt Agency is enabled to create securities avoiding an exchange with a counterparty.

3. *Building a special regime under Luxembourg law: introducing the "unilateral issuance"*

Several public sector entities are using Luxembourg law, and market participants have noticed a gradual increase in its use by international financial institutions, and other types of issuers.[31]

As for debt securities retained at issuance, Luxembourg law does not have any specific provision dealing with such practice. It is therefore questionable whether this practice could be smoothened, operationally, for example with a view to allow issuers to retain debt securities without a passage with a counterparty to have validly existing securities in their books.

Under Luxembourg law, securities issuance without transfer to a third party and without payment of the subscription price, at the time of issuance, is not specifically regulated nor is considered market practice.

It is therefore standard practice for issuers to go through an issuance and repurchase process.

However, recent specific legislative developments have changed the approach that could be used by two public sector institutions in particular: the European Stability Mechanism and the European Commission, the latter in its capacity as representative of the European Union and the European Community of Atomic Energy (EURATOM).[32]

Both institutions now benefit from the following provision[33]:

"Debt securities created by the [European Stability Mechanism/ European Union or EURATOM] which are subject to Luxembourg law do not need to be given to a third party at the time of their creation. They may be issued for no consideration[34]. The securities and the debts they represent validly exist as soon as they are created. As long as the [European Stability Mechanism/ European Union or EURATOM] possesses such a security, all rights

[28] FAQ Repurchase Agreement, available at https://www.dt.mef.gov.it/en/debito_pubblico/gestione_liquidita/repo/faq/#faq_0003.html

[29] Available at https://www.debtagency.be/sites/default/files/content/download/files/19971016_ar_olo_fr.pdf

[30] Ibid, art. 4(7).

[31] See in that sense, Luxembourg Capital Markets Association, "Issuance of debt securities in Luxembourg: Immobilisation, dematerialisation and beyond, 2024 at 18, available at https://www.luxcma.com/wp-content/uploads/2024/06/20240625-I-Listing-Act-I-Dematerialised-Securities-Issuance.pdf .

[32] See 4.3 below: issuers of debt securities are the European Union and EURATOM. The Commission represents both issuers under Article 335 of the Treaty on the functioning of the European Union and Article 106a EURATOM Treaty.

[33] The relevant provisions are mentioned in paragraphs 3.2 and 3.4 below.

[34] « Consideration » is the term used in the English version of the law published on L_210121_Treaty_ESM.pdf. Accordingly, the term is used in this paper to indicate "payment or counterparty" for the French term "*contrepartie*".

attached to the security shall be suspended. The suspension shall end as soon as the security is transferred to a third party"[35]

This provision brings clarity in several respects.[36]

- *No consideration or counterparty required.* Firstly, it does not contain any specific requirements for the creation of these securities from a process or form perspective and clarifies that the valid creation of debt securities by the European Stability Mechanism or the European Commission does not require that consideration be received or that they be transferred or transmitted to a third party at the time of their creation.
  Securities can be therefore issued "unilaterally" without any other, additional, requirements either as to process, or as to the form or the substance of such security and may be introduced into a clearing system as soon as they are created, in a manner similar to any other securities.
  In practice, this means that there is no requirement for a DvP confirmation of the payment of the issuance price, given that the debt securities are and can, as per the statutory provision, be issued without consideration.
- *Valid existence of the securities.* Secondly, the provision clearly states that the debt securities (as well as the claim incorporated therein) exist validly as of the time of the creation of the debt securities. This is an important confirmation, as without the statutory basis the question could have been raised whether such securities indeed exist at such time or only exist in a "suspended form" until such time as they have been transferred to a third-party owner.
  The point in time of creation is not specifically defined by the provision. The creation occurs once the debt securities are materialised in a manner which corresponds to the form they will take. The immobilisation in a CSD through a process of recording in book-entry would not differ from an ordinary one, as it would always rely on the introduction into the clearing systems by way of a collective bearer certificate (global bearer note) and their recording in an account of the CSD, which in this case would be the account of the issuer as initial holder.
- *Suspension of rights*. Finally, the provision states that until such time as the securities thus issued unilaterally are held by the Issuer, any rights attaching thereto (notably any rights to payment of interest or voting rights) will be suspended. Such rights will be exercisable as of the time the securities are transferred to a third party. An analogy can be drawn with the situation where an issuer purchases its own bonds in the secondary market and temporarily holds these in treasury. This clarification is analogous to the relevant provision of the Luxembourg Civil Code (Article 1300(2))[37] and does not

[35] Original text in French: « *Les titres de créance créés par [le MES / la UE ou EURATOM] et qui sont soumis au droit luxembourgeois n'ont pas besoin d'être remis à un tiers au moment de leur création. Ils peuvent être émis sans contrepartie. Les titres et les créances qu'ils représentent existent valablement dès leur création. Tant que [le MES / la UE ou EURATOM] possède un tel titre, tous les droits afférents au titre sont suspendus. La suspension prend fin dès le transfert du titre à un tiers.* »

[36] As also specified in the relevant Parliamentary documents, see Doc. Parl. N°7839, p. 6

[37] To be clear, this is not an issue of merger of debtor and creditor (*confusion*), which is a mechanism for the definitive extinction of a debt, where the creditor and the debtor become the same person, following a transfer of rights. This process assumes a prior valid existence of the claim. It is worth noting, however, the evolution of the confusion provision which in Luxembourg, through the law of 15 May 1997 excludes the effects of the extinction in case the claim is incorporated into a security (*titre*), by providing that in such case issuers may keep the security until maturity or until cancellation or sell the

affect the creation process of the securities or their valid existence during such suspension. Nor does it affect the characterisation of the instruments as securities under Luxembourg law from the point in time of their creation.

3.1 The European Stability Mechanism: mandate and financial features

The European Stability Mechanism (ESM) was established by the member states of the euro area in October 2012, on the basis of an intergovernmental treaty (ESMT) signed on 2 February 2012.[38] Its mission[39] is to provide financial assistance to euro area member states facing financial difficulties under strict conditionality, if indispensable to safeguard the financial stability of the euro area as a whole and of its member states. The ESM and its temporary predecessor, the European Financial Stability Facility (EFSF), disbursed a total of €295 billion in loans to Ireland, Portugal, Greece, Spain, and Cyprus,[40] with the last active programme – the ESM programme for Greece – concluded in August 2018.

The ESM's financial assistance is financed through the issuance of bonds and bills[41] on the capital markets via syndications, auctions and private placements. These instruments are issued under the ESM's Debt Issuance Programme.[42] The ESM's funding strategy follows policies similar to those of a debt management agency at national or international level. It relies on a diversified funding strategy, i.e. the ESM uses a variety of financial instruments and maturities to ensure the efficiency of funding. One feature of this strategy is that funds raised through various instruments are not attributed to a particular beneficiary country. The funds are pooled and then disbursed to programme countries. The size and maturity of the bonds and bills issued therefore do not need to mirror exactly the size and maturity of the disbursements to a beneficiary country as if it was "back-to-back".

The ESM can borrow money from the markets at much lower interest rates than those charged to financially distressed countries, since it enjoys the highest credit ratings. The ESM credit strengths are represented by its substantial capital buffers,[43] low leverage,[44] preferred creditor status[45] as well as its prudent capital and liquidity management.

On 27 January and 8 February 2021, the ESM member countries signed the Agreement Amending the ESM Treaty.[46] The Agreement provides a legal basis for a set of new tasks

security. A similar pattern in relation to the interpretation of the "confusion" principle, to allow the circulation of securities, can be noticed also in other jurisdictions.

[38] The Treaty on the Functioning of the European Union was amended to allow for the establishment of the ESM, by including the following text under Article 136, para. 3: "The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality."

[39] Article 3 of the ESMT.

[40] See https://www.esm.europa.eu/financial-assistance/programme-database/programme-overview.

[41] Article 3 refers also to the "entering into financial or other agreements or arrangements with ESM Members, financial institutions or other third parties."

[42] For a comparison between the ESM and the EU debt issuance programmes, see also Sebastian Grund and Michael Waibel, EU Borrowing and Safe Assets, in Fiscal Federalism in the European Union (Alicia Hinarejos and Robert Schutze, eds, Oxford University Press, 2023, pp. 205 – 232).

[43] The capital base currently amounts to €708.5 billion subscribed capital of which €81 billion is paid in.

[44] The maximum lending capacity is capped at €500 billion.

[45] Recital 13 of the ESMT.

[46] Available at https://www.esm.europa.eu/sites/default/files/migration_files/esm-treaty-amending-agreement-21_en.pdf

assigned to the ESM.[47] The reformed Treaty will come into force when ratified by the parliaments of all the twenty ESM Members.

3.2 The provision applicable to the European Stability Mechanism

The unilateral issuance[48] provision relating to the European Stability Mechanism is included as article 2 of the law dated 21 July 2021 through which Luxembourg ratified the agreement amending the ESM Treaty (the **"ESM Unilateral Issuance provision**").

In the context of the agreement amending the ESM Treaty, this provision was introduced to facilitate ESM operations,[49] yet the law does not set out expressly the use cases for such unilateral issuance. Generally, the ESM must be able to retain bonds and transfer them to third parties providing them with legal certainty that these bonds are validly created and existing before the transfer. This could be the case, for example, in the context of liability management exercises or transactions for the purposes mentioned in the ESM Borrowing Guidelines.[50]

The issuance and repurchase process was used also in the context of the short-term debt relief measures approved in 2016 by the Eurogroup. One of the measures implemented to reduce interest rate risk was a bond exchange.[51]

This new provision may also be useful in the context of financial assistance, for one of the lending techniques of the ESM, namely the disbursement "in kind".[52]

This technique envisages the direct lending of ESM debt securities, rather than cash, so that these debt securities may be used as collateral, for example by financial institutions in a country requesting assistance.

This lending arrangement has been used so far for the indirect bank recapitalisations, as well as for bank recapitalisation purposes under macroeconomic adjustment programmes and enables the ESM to avoid offering the debt securities in the market, receiving the cash proceeds, and then on-lending the money.

The rationale for this type of cashless assistance is mainly related to time constraints (funds need to be disbursed in a very short period), and high-volume requests. The creation and delivery of securities in kind can be done quickly and in high volumes, as there is no need to tap the market (selling the debt securities to final investors). Banks receiving the assistance do not necessarily need cash, but an asset to be injected in their balance sheet to strengthen their capital structure. Finally, while the lending terms contain selling restrictions applicable to the debt securities, these restrictions do not apply to repo operations and the banks can use these

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[47] More broadly on the ESM reform, see Jasper Aerts, Pedro Bizarro, The reform of the European Stability Mechanism, *Capital Markets Law Journal*, Volume 15, Issue 2, April 2020.

[48] The Parliamentary documents refer to the "creation/issuance without transfer", which could also be generally referred to as "unilateral issuance".

[49] The ESM started issuing bonds governed by Luxembourg law in 2019, see Why ESM bonds changed to Luxembourgish law | European Stability Mechanism.

[50] "*The ESM retains the flexibility of holding own bonds for a limited amount. This offers the possibility to raise additional funding either by selling the bonds in the secondary market or by using them as collateral in the secured money market. It also helps testing real demand from market participants to secure the success of taps or auctions*".

[51] See ESM, Explainer on ESM short-term debt relief measures for Greece, press release, 4 December 2017.

[52] Disbursements in kind were used also by the ESM's predecessor, the European Financial Stability Facility (EFSF), no longer active for financial assistance purposes since 1 July 2013.

debt securities as collateral in exchange for liquidity, either with the Eurosystem or with other commercial banks.

As recalled in the law ratifying the agreement amending the ESM Treaty[53], the reform triggered by the agreement amending the Treaty considers ESM's role in the management and prevention of crises and extends the responsibilities of the ESM for this purpose. As additional task set out in the reform, the ESM is expected to provide the common backstop to the Single Resolution Board (SRB) for the Single Resolution Fund (SRF).

Disbursements in kind may also be used in such context.

When providing the backstop to the SRF, one of the criteria for granting and disbursing loans is that the requested funds are available to the ESM,[54] which can be in cash or in kind. In the case of disbursements in kind, this means that the notes must be legally created and held in custody of the applicable security depository.[55]

As noted above, under the current framework, the issuance and repurchase process takes time (up to five business days), incurs costs and poses operational risks, thereby affecting the efficiency of the disbursement in kind by the ESM.

In the context of a bank resolution case, the timeline for prefunding is very tight and the disbursement process must be approved within 12 hours from the SRB's request for disbursement, extendable up to 24 hours in complex resolutions.[56] This presents the ESM with constraints, from a volume and timing perspective.

The unilateral issuance provision allows the ESM to confirm that the condition under Annex IV, 2(c) of the ESM Treaty as amended is satisfied (i.e. the debt securities are legally created and held in custody of the applicable security depository) without any exchange with a counterparty – which would be normally required under Luxembourg law.

3.3 The European Union and EURATOM as issuers. The role of the European Commission

The European Union (EU) and EURATOM are supranational entities with legal personality established by treaty.[57] The European Commission is an institution of the European Union[58] and EURATOM[59] and it represents both, based on Article 335 TFEU and Article 106a EURATOM Treaty. The European Commission carries out borrowing and lending activities on behalf of the EU and EURATOM.

The EU operates loan programmes that aim at providing financial assistance to Member States and third countries experiencing financial difficulties, which are funded through debt securities issued on capital markets. Every borrowing and lending programme of the EU is enshrined in a legal act ("basic act") published in the Official Journal of the EU.

Borrowings of the EU are direct and unconditional obligations of the EU, assumed within the limits of the own resources and the "Multiannual Financial Framework" (MFF). The EU's legal

[53] Doc. Parl. n°7839.
[54] Annex IV of the ESM Treaty, as amended.
[55] Ibid, 2(c).
[56] Recital 15(b) of the ESM Treaty, as amended.
[57] For the European Union, Treaty on European Union (TEU) and Treaty on the Functioning of the European Union (TFEU); for EURATOM, Treaty Establishing the European Atomic Energy Community (EURATOM Treaty).
[58] Article 13 TEU.
[59] Article 106a Euratom Treaty.

obligation to service its debt is enshrined in the TFEU. In particular, Article 323 of TFEU requires the EU's institutions to ensure that financial means are made available to allow the Union to fulfil its legal obligations in respect of third parties. The EU's debt service is ensured via multiple layers of debt-service protection.

In accordance with Article 223(1) of Regulation (EU, Euratom) 2024/2509 (Financial Regulation), the European Commission is empowered – each time, in the relevant basic act - to borrow the necessary funds on behalf of the EU on the capital markets or from financial institutions. Moreover, the Commission is empowered under Article 5(1) of Decision (EU, Euratom) 2020/2053 to contract borrowings on the capital markets on behalf of the EU to provide financial assistance to the Member States in the form of loans and borrowings to be used for expenditure, under the conditions laid down in Regulation (EU) 2020/2094 and in the respective sectoral programmes.

Furthermore, in accordance with Article 224 of the Financial Regulation, the Commission implements a diversified funding strategy for the borrowing activities of the EU, establishing also the necessary arrangements for its implementation. The diversified funding strategy was initially introduced by the Commission in 2021 to finance NextGenerationEU (NGEU) programmes.[60] It was later extended to all other financial assistance programmes of the EU,[61] and thus replaced, as a general funding method, the "back-to-back" model.[62] Detailed rules for the internal governance of borrowing and lending operations on behalf of the EU are established in Commission Implementing Decision (EU, Euratom) 2023/2825.[63]

Euratom is a supranational entity whose Member States are the same as those of the EU. Euratom has not merged with the European Union and therefore retains a separate legal personality with its own borrowing powers, while sharing the same institutions. While Euratom is a separate legal entity, its credit characteristics are identical to those of the EU. The Union's budget covers both, the Union's and Euratom's expenditure and provides guarantees for all their liabilities in the same way.

The European Commission is empowered by Article 172 of the Euratom Treaty to borrow from international capital markets on behalf of Euratom.[64] Lending activities of Euratom are financed back-to-back and any debt repayment obligations are backed by the EU's budgetary

[60] *Communication from the Commission to the European Parliament and the Council on a new funding strategy to finance NextGenerationEU*, [COM(2021) 251 final of 14.04.2021]: https://commission.europa.eu/strategy-and-policy/eu-budget/eu-borrower-investor-relations/legal-documents-and-reports_en.
"NGEU Programmes" are programmes financed under Article 2(2) of Regulation (EU) 2020/2094, in so far as they implement measures referred to in Article 1(2) of that Regulation.

[61] Regulation (EU, Euratom) 2022/2434 of the European Parliament and of the Council of 6 December 2022 amending Regulation (EU, Euratom) 2018/1046 as regards the establishment of a diversified funding strategy as a general borrowing method (OJL 319, 13.12.2022, p. 1–4). See in particular Recital 7: "*A diversified funding strategy should provide the Commission with more flexibility concerning the timing and the maturity of single funding transactions and allow regular and steady disbursements to different beneficiary countries. Such a strategy should be based on the pooling of funding instruments. This would give the Commission flexibility to organise payments to the beneficiaries independently of market conditions at the time of disbursement, while also reducing the risk that the Commission would have to raise fixed amounts in volatile or adverse conditions*".

[62] In that model, the issuer borrows on behalf of the beneficiary at favourable prices (by virtue of its high credit standing) and then passes the loans on to the beneficiary on the same terms and conditions. Back-to-back borrowing operations are still allowed "*in duly justified cases*" (see again Article 224 of the Financial Regulation).

[63] Commission Implementing Decision (EU, Euratom) 2023/2825 of 12 December 2023 establishing the arrangements for the administration and implementation of the Union borrowing and debt management operations under the diversified funding strategy and related lending operations (OJ L, 2023/2825, 18.12.2023).

[64] While Euratom is a separate legal entity, its credit characteristics are identical to those of the EU. The Union's budget covers both, the Union's and Euratom's expenditure and provides guarantees for all their liabilities in the same way.

and cash resources and by the Commission's right to call for additional resources from Member States.

3.4 The provision applicable to the European Union and EURATOM

The law dated 22 December 2023 relating to the issuance of debt securities by the European Commission (with respect to the EU and Euratom) in the framework of the diversified funding strategy contains the same legal certainty provision regarding the unilateral issuance of debt securities by the European Stability Mechanism (the **"EU Unilateral Issuance provision**").[65]

One difference is however that the EU Unilateral Issuance provision includes in its scope only debt securities issued under the diversified funding strategy of the Commission under article 224 of Regulation (EU, Euratom) 2024/2509 (the "**Financial Regulation**"),[66] whereas the ESM Unilateral Issuance provision did not refer to any provision of the Treaty (or any other provision) in the context of ESM funding operations.

Borrowing operations conducted by the Commission with the "back-to-back" technique fall outside of the scope of the Unilateral Issuance provision, which indeed, as a fundamental tool of repurchase transactions, is instrumental to borrowing, debt management and liquidity management transactions conducted under the diversified funding strategy.[67]

The explanations of the parliamentary documents for the EU Unilateral Issuance provision (Doc. Parl. n°8289) focus on the reason why certain instruments and operations of the diversified funding strategy require the Commission to be able to hold its own debt instruments in the context of some of the market operations further described therein. The adoption of a legal certainty provision on unilateral issuance for the Commission is justified in that manner, and a parallel is created with the ESM Unilateral Issuance provision. In particular, the explanatory document[68] refers to the fact that the legal certainty provisions would allow the Commission to carry out public debt management operations[69] that may imply entering into secured or unsecured money market transactions with certain counterparties, including repurchase agreement, reverse repurchase agreements and buy-sell back agreements – to the extent necessary to ensure a better management of interest rate risk or other financial risks

[65] The unilateral issuance provision in the EU Unilateral Issuance provision is expressly stated to be closely inspired ("*étroitement inspiré*") by and to operate in a similar manner to the unilateral issuance provision in the ESM Unilateral Issuance provision.

[66] Regulation (EU, Euratom) 2024/2509 on the financial rules applicable to the general budget of the Union (recast) (*OJ L, 2024/2509, 26.9.2024*). Its article 224 (Diversified funding strategy) states: "*1. The Commission shall implement a diversified funding strategy comprising borrowings authorised under Article 5(1) of Decision (EU, Euratom) 2020/2053 and, except in duly justified cases, borrowing and debt management operations to fund programmes of financial assistance. The diversified funding strategy shall be implemented through all necessary transactions aiming at a regular capital market presence, shall be based on pooling of funding instruments and shall make use of a common liquidity pool.*
2. The Commission shall establish the necessary arrangements for the implementation of the diversified funding strategy. The Commission shall regularly and comprehensively inform the European Parliament and the Council about all aspects of its borrowing and debt management strategy".
Regulation (EU, Euratom) 2024/2509 has repealed the former Regulation (EU/EURATOM) Regulation (EU, Euratom) 2018/1046 on the financial rules applicable to the general budget of the Union.

[67] See Recital 19 of Commission Implementing Decision (EU, Euratom) 2023/2825: "*In order to implement borrowing, debt and liquidity management operations under the diversified funding strategy, appropriate operational capacities should be established, including transaction settlement capacities, an auction platform, and the possibility to have recourse to repurchase transactions and swaps".*

[68] Doc. Parl. n°8289

[69] Commission Implementing Decision (EU, Euratom) 2023/2825 defines debt management operations as "*market operations related to the debt resulting from the borrowing operations to optimise the structure of the outstanding debt, to mitigate interest rate risk, to support the secondary market liquidity or to mitigate other financial risks".*

stemming from the implementation of the diversified funding strategy. The legal certainty therefore enables the Commission to issue and hold validly its own bonds and use them in the context of repurchase operations (including for the purpose of supporting secondary market liquidity).

The Commission has consequently implemented in October 2024 a liquidity backstop[70], namely the EU Repurchase Agreement (Repo) Facility with a view to deepen the market ecosystem for EU debt securities. Repo facilities are commonly used by large sovereign issuers. This facility, available only for the European Union as issuer,[71] supports primary dealers in "posting firm and public quotes on EU-Bonds so that investors can be confident in the terms on which they can trade EU-Bonds in the secondary market, hence improving the efficiency and fluidity of the market for EU-Bonds."[72]

In accordance with the EU Unilateral Issuance provision, the Commission can perform unilateral issuances and hence create EU debt securities for each trade requested by its primary dealers. Upon conclusion of the transaction, the securities are cancelled, so that the volume of outstanding bonds returns to its previous level. The trades are executed via a trading platform to minimise risks and the securities are listed on the Luxembourg Stock Exchange.

The EU Repo Facility, also through the EU Unilateral Issuance provision, is expected to contribute significantly to the overall efficiency and liquidity of the EU-Bonds market.

4. Conclusion

The traditional route for creating treasury bonds consists in issuing bonds to a third party who subscribes to them and pays the subscription amount and in the issuer repurchasing such bonds immediately upon subscription, to hold them in treasury for later transfer.

The introduction of the unilateral issuance provision certainly deserves to be commended. By reinforcing the legal certainty on a scenario where there is no third party contributing to the creation of the debt securities, it provides an alternative process of securities issuance to the European Stability Mechanism and the European Commission.

In fact, the unilateral issuance would not be based on any subscription by a third party nor on any payment of the subscription price but would merely involve the internal decision of the relevant authorised body of the issuer to create the debt securities.

The issuance process resulting from the new provision is operationally more efficient from several perspectives.

The first benefit can be observed in terms of speed of execution. Secondly, the settlement/counterparty risks relating to the creation stage of the bonds is removed, as there is no counterparty required for settlement. Finally, the unilateral issuance significantly reduces

[70] See also the "*Notice to Noteholders relating to the Debt Issuance Programmes*" of the EU and EURATOM, published on the webpage of the Luxembourg Stock Exchange on 1 October 2024.

[71] The EU Unilateral Issuance provision refers to the EU and EURATOM. However, as explained supra, EURATOM issues under the back-to-back model. Hence, debt and liquidity management operations, including repurchase transactions, are automatically ruled out.

[72] See Factsheet on Repo Facility on EU debt securities, October 2024, available at https://commission.europa.eu/document/download/a7ffc097-ef3d-4951-8e6b-dd11aa253b92_en?filename=Factsheet_Repo%20Facility.pdf

the costs connected to the creation of treasury bonds, notably custody costs, allowing to create the bonds swiftly when the issuer deems necessary.

As this paper has shown, the benefits of the unilateral issuance can be deployed in different contexts from financial assistance to support of secondary market liquidity. It also represents a further alignment with the practices of some euro area sovereign issuers.

In times when the financial sector is searching for a new, more efficient blueprint for capital markets infrastructure, efforts such as the introduction of the unilateral issuance framework serve as an important reminder that changes to the substantive law concepts underpinning the traditional transactional structures are an option that should not be completely discarded.

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