Revue européenne de Droit bancaire & financier

European Banking & Financial Law Journal

EUREDIA

2011 • 4 Trimestriel / Quarterly

Banque-notes
Blanche Sousi

Tribune. Living in Euroland
Luc FRIEDEN

What's what in Europe. The European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM)
Ralf JANSEN

Point de vue. "On ne peut qu'être pour"- Proposals of Consumers International to the G20 for reform of consumer protection in financial services
Robin SIMPSON

The European Commission's proposal for a directive on residential mortgages
Sarah LYNCH

La banque et la RSE (Responsabilité Sociétale des Entreprises)
Arnaud BERGER et Fabienne QUERAN

Taxe sur les transactions financières – La proposition de directive de la Commission
Karim BERTHET

European retail banking services: 2011 was a year of consultation, 2012 will be a year of negotiation
Alexandre GIRAUD

Chronique de législation & jurisprudence nationales / National Legislation & Case Law
France by Christophe ARNAUD et Laurence THEBAULT
Italy by Giorgio AFFERNI
Luxembourg par Myriam OLIVIE
Spain by Vésela ANDREEVA ANDREEVA

Chronique de législation de l'Union européenne / EU Legislation
Le règlement du Parlement européen et du Conseil sur les agences de notation de crédit : de nouvelles compétences - de pleine juridiction en matière d'amendes - pour le Tribunal et la Cour de justice qui suscitent quelques interrogations
Michel VAN HUFFEL

Tables 2011

Sommaire complet p. 407

BRUYLANT

Sommaire/Contents

Banque-Notes

Blanche Sousi 409

Tribune

Living in Euroland
Luc Frieden 413

What's what in Europe

The European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM) – A Legal Overview
Ralf Jansen 417

Point de vue

«On ne peut qu'être pour»
Proposals of Consumers International to the G20, for reform of consumer protection in financial services
Robin Simpson 425

Articles

The European Commission's proposal for a directive on residential mortgages
A knee-jerk reaction to the financial crisis or a genuine attempt to enhance the single market?
Sarah Lynch 435

Les banques et la Responsabilité Sociétale des Entreprises (RSE)
Arnaud Berger et *Fabienne Quéran* 441

Taxe sur les transactions financières dans l'Union européenne
La proposition de directive du 28 septembre 2011
Karim Berthet 451

European Retail banking services: 2011 was a year of consultation, 2012 will be a year of negotiation
Alexandre Giraud 457

Tribune

LIVING IN EUROLAND

BY

Luc FRIEDEN

LL.M (Cantab.), LL.M. (Harv.)
Minister of Finance, Luxembourg

About ten years ago, as a citizen and as "Euro-Minister", i.e. minister of the Luxembourg Government in charge of the introduction of the euro, I participated with enthousiasm in the challenging change-over from our national currencies to the euro. Today, we are faced with questions by ordinary citizens, politicians and academia whether in retrospect the euro lived up to its promises and whether the European Monetary Union has a future. In this contribution, I shall briefly try to look back to some of the achievements, describe the challenges that lie ahead and describe the future of European monetary integration as I see it.

The current difficulties in the sovereign debt market overshadow the advantages of the euro which have not disappeared during the recent years. In particular, the elimination of exchange rate fluctuations, the absence of devaluations to create competitive advantages, increased price transparency, no transaction costs and above all an historically low inflation of less than two percent over the past ten years are just a few of the successes of the euro since its creation.

But, the absence of a political union, or at least of a common economic and fiscal policy, led to problems that we now have to sort out in order not to put in jeopardy the European monetary union. Serious mistakes were done that have to be acknowledged. A number of Member states did not adequately deal with their structural problems when they occured and thus lost competitiveness. Some were taken into the eurozone without a sufficient assessment of the sustainability

of their public finances. Others did not, for several years, comply with the deficit and debt criteria set forth in the Stability and Growth Pact and no action was taken at eurozone level to bring them back on the path of sound public finances. But the crisis has shown to us that public finances and competitiveness issues are matters of common interest in a monetary union. And failure to adopt the appropriate policy actions even affects non euro zone countries as some recent examples have shown.

Thus, decisive policy action has to be taken at mainly four different levels.

First, we need to provide liquidity assistance to Member states that are experiencing difficulties in accessing financial markets. Greece, Ireland and Portugal were granted financial assistance through bilateral loans and the European Financial Stability Facility, a private corporation governed by Luxembourg law and set up by the Member states of the eurozone. The loans given to those countries are subject to strict policy conditions aimed at restoring sound public finances, the overall competitiveness of the economy and the stability of the financial sector. Those conditions, which are, of course, difficult to be implemented by the respective governments and to be accepted by the people of those countries, are however indispensible to restore the sustainability of public finances and of economic growth, as well as the access of those countries to financial markets.

This financial assistance is not just an expression of solidarity, but also of ensuring the stability of the eurozone as a whole. Accepting the default of a European country, in particular but not only one of the eurozone, might have a major effect on other economies and is, for economic and political reasons, simply not an option.

Second, we have to ensure budgetary discipline. The Stability and Growth pact is the framework within which sound public finances must evolve. I strongly support the amendments leading to a substantial reduction of the public debt levels and deficits in the eurozone as well as strengthening with adequate sanctions the preventive arm of the pact. This will be painful for the citizens and their political leaders in the short term, because it entails cuts in their budget expenses and, in some cases, higher taxes. However, in the medium term, they will have sound public finances, will be able to finance themselves on

the markets at reasonable rates and ensure stable economic developments of their countries.

Third, temporary financial or economic problems can never be completely excluded. In order to be able to intervene quickly with appropriate instruments in place, we need to set up a European monetary fund, which will have to work in close cooperation with the International Monetary Fund. As of 2013, the Luxembourg based European Stability Mechanism, an intergovernmental organization governed by international public law, can fulfill this role by extending loans to Member states experiencing liquidity problems, subject to strict conditionality and to some *ab initio* clearly defined private creditors' involvement.

Fourth, there is a clear need for a much more coordinated economic policy within the eurozone and the European Union as a whole. A new monitoring procedure of macroeconomic imbalances which are harmful to the entire economic zone must be put in place shortly, with appropriate mechanisms of sanctions to give to this exercise the necessary credibility.

Living in Euroland is a reality that requires us to pool our sovereign rights. Unless and until we have a common economic and budgetary policy, we have to accept common rules to make sure that the European monetary zone can function adequately. The membership of the euro-club requires the respect of the commonly adopted rules, not more and not less. We have to be more aware than ever before of the effects our national policy decisions have on other countries.

But, the euro is much more than a currency. The euro, i.e. the common currency of seventeen countries, and Schengen, i.e. free movement of the citizens *are* Europe. The are the symbols and the reality that tie together the nations of the European continent, too long torn apart by conflict. In today's interdependent world, both politically and economically, the nation-state cannot alone face the challenges of our times. At a European level, we therefore must strengthen the tools of cooperation to find answers to so diverse questions as energy, migration, environment, security, financial markets. And this also means that Europe must learn to speak with one voice if it wants to efficiently contribute to the solution of those issues in international fora.

What's what in Europe

THE EUROPEAN FINANCIAL STABILITY FACILITY (EFSF) AND THE EUROPEAN STABILITY MECHANISM (ESM) – A LEGAL OVERVIEW

BY

RALF JANSEN

HEAD OF LEGAL, EFSF

I. – EFSF

Establishment

On 9 May 2010 a comprehensive European Financial Stability Package of measures has been decided including (a) a Council Regulation establishing the European Financial Stabilisation Mechanism ("EFSM") based on Article 122(2) of the Treaty on the functioning of the European Union ("TFEU") and (b) the EFSF (a temporary stability mechanism) in order to financially support euro area Member States in difficulties caused by exceptional circumstances beyond such euro area Member States' control with the aim of safeguarding the financial stability of the euro area as a whole and of its Member States.

The €750 billion European package comprises three components: €60 billion are managed by the European Commission, via the EFSM. This is guaranteed by the EU budget. Then, there is the EFSF and finally, the International Monetary Fund (IMF) made a commitment to add 50 % to whatever the European countries provide to one of their Member States.

Objective

The initial scope of activity of EFSF was to safeguard financial stability in Europe by raising funds in capital markets to make stability support to euro area Member States.The lending activity is always in the context of an overall economic adjustment programme for the Member State with strict economic conditionality.

EFSF loans are guaranteed by commitments from the euro area Member States which amount to a total €440 billion. The guarantee amount for each country is defined according to the capital contribution key of the European Central Bank.

Creation

It is of interest to note that the EFSF was established not as a European or international public institution but as a private company. This was mainly due to time constraints allowing the EFSF to be operational as quickly as possible. By notarial deed dated 7 June 2010, the EFSF was formed as a Luxembourg public limited liability company (*société anonyme*) governed by the laws of the Grand Duchy of Luxembourg and in particular the Luxembourg law of 10 August 1915.

Its shareholders are the euro area Members States. EFSF's Board of Directors (the "Board") consists of as many directors as there are EFSF Shareholders.

The President of the Economic and Financial Committee of the European Union ("EFC") serves as Chairman of EFSF's Board. The tasks of the EFC are those specified in article 134(2) TFEU. When the EFC meets in a euro area configuration, it meets as the so-called Eurogroup Working Group ("EWG"), in which only the euro area Member States, the Commission and the European Central Bank are represented.

Each EFSF Shareholder shall propose for nomination to the Board of EFSF its representative in the EWG (or such person's alternate as representative on such group). As a result, its Board comprises high-level representatives from each of the euro area Member States i.e. Deputy Ministers or Secretaries of State or Director Generals of national treasuries. The European Commission and the European Central Bank each have observers on the EFSF Board.

Article 4 of EFSF's Articles of Incorporation clearly reflects its temporary nature by stating that "it shall be dissolved and liquidated when its purpose is fulfilled, i.e., when the Company has received full payment of the financing granted to the Member States and has repaid its liabilities under the financial instruments issued and financing arrangements entered into. No new financing programme and no new loan facility agreements will be established or entered into after 30 June 2013 (it being understood that financings granted prior to such date may have scheduled maturities falling after such date and that disbursements thereunder (and related issuances of financial instruments by the Company) may occur after such date)".

Therefore, after June 2013, EFSF will no longer enter into any new lending programmes but will continue to manage all outstanding debt until its repayment. The ESM will assume the tasks currently fulfilled by the EFSF after June 2013 (see II below).

EFSF was awarded the highest possible rating (triple A) by the three major credit rating agencies. In order to obtain the triple A rating, EFSF has put into place a credit enhancement structure, which is designed to cover payments to investors in the unlikely event of a payment default from a borrower. These credit enhancements include a cash reserve and a loan specific cash buffer but also a 120 % over-guarantee from the euro area Member States.

The EFSF itself is a very small organisation. At the date of writing this overview, there are 16 members of staff covering activities such as funding and lending, legal, economic research, risk management, audit and accounting, communication and administrative services. The Legal Function comprises 1 lawyer and is expected to grow to a team of 3 lawyers over the next months. It is possible for the organisation to be this lean as certain services and activities have been outsourced. The Legal Function manages external counsel and debt issuance is supported by the German Debt Management Agency, Finanzagentur, in Frankfurt. The European Investment Bank, also based in Luxembourg, provides administrative services to the EFSF.

Lending programmes

In November 2010, Ireland made a formal request for financial assistance to the other euro area Member States. A support programme including strong conditionality was negotiated by the Euro-

pean Commission in cooperation with the IMF and in liaison with the European Central Bank. The objectives of the programme were to strengthen the banking sector, an ambitious fiscal adjustment to restore fiscal sustainability aiming to correct the excessive deficit by 2015 and finally growth enhancing reforms, particularly on the labour market, to allow a return to robust and sustainable growth. Following the negotiation process, a common Memorandum of Understanding of the terms of the loan was established between the European Commission, the IMF and Ireland.

Of the total €85 billion of the 3-year programme, EFSF is scheduled to finance €17.7 billion. The remainder is to be financed by a €17.5 billion contribution from Ireland itself, €22.5 billion from the IMF, €22.5 from the EFSM and bilateral loans from the UK (€3.8 billion), Denmark (€0.4 billion) and Sweden (€0.6 billion)

The EFSF made its inaugural issue in support of the Irish programme on 25 January 2011. It issued a €5 billion benchmark bond with a 5-year maturity. Orders were received from over 500 investors from around the world and amounted to €45 billion. Investors included central banks and governments, sovereign wealth funds, asset managers, banks, pension funds and insurance companies.

On 7 April 2011, Portugal made a formal request for financial assistance. The €78 billion programme will last for 3 years and aims to restore fiscal sustainability through ambitious fiscal adjustment with an objective to reduce the deficit to 3 % of GDP by 2013. It also aims to enhance growth and competitiveness and improve the solvency of the financial sector. EFSF will finance €26 billion of this programme and accordingly issued 2 benchmark bonds in June. The first issue was a 10 year maturity for an amount of €5 billion and the second was a 5 year maturity of €3 billion.

At the euro zone summit held on 21 July, a second support package for Greece was agreed in principle. This second programme of €109 billion will be financed through the EFSF and the IMF and will include private sector involvement.

II. – ESM

It soon became apparent that a permanent stability mechanism would be necessary to continue to safeguard the financial stability of

the euro area as a whole and of its Member States and to prevent further crises. Therefore, the European Council adopted the Decision 2011/199/EU of 25 March 2011 amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro (the "Decision"). Article 1 of the Decision states that the following paragraph shall be added to Article 136 of the TFEU:

"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." The Decision is expected to enter into force on 1 January 2013. According to preamble 4 of the Decision "The stability mechanism will provide the necessary tool for dealing with such cases of risk to the financial stability of the euro area as a whole as have been experienced in 2010, and hence help preserve the economic and financial stability of the Union itself. At its meeting of 16 and 17 December 2010, the European Council agreed that, as this mechanism is designed to safeguard the financial stability of the euro area as a whole, Article 122(2) of the TFEU will no longer be needed for such purposes. The Heads of State or Government therefore agreed that it should not be used for such purposes."

In parallel euro area Member States started negotiations to set up the ESM.

In terms of activity, the ESM will fulfil the same role as the EFSF, that is to say, providing financial assistance to euro area Member States experiencing financial difficulties. However, the ESM will differ from the EFSF in terms of legal structure. The ESM will be an international financial institution based on the treaty establishing the ESM. The ESM will therefore be an inter-governmental organisation and will operate under public international law. Its members will also be the euro area Member States and, as for the EFSF, its Board of Directors will be high-level representatives from each of the euro area Member States. The ESM will have an additional level of governance, the Board of Governors. Each ESM Member shall appoint a Governor and an alternate Governor. The Governor shall be a member of the government of that ESM Member who has responsibility for finance.

Regarding its capital structure, the ESM will have a total authorised capital stock of €700 billion with a mix of paid-in capital (€80 billion) and committed callable capital.The contribution key for subscribing to ESM authorised capital stock shall be based on the key for subscription, by the national central banks of ESM Members, of the European Central Bank's capital pursuant to Article 29 of Protocol (No 4) on the Statute of the European System of Central Banks and of the European Central Bank annexed to the Treaty on European Union and to the TFEU. Because of this new structure, no over-guarantee or credit enhancements will be required in order to ensure that ESM is assigned a triple A rating by the credit rating agencies.

On 11 July 2011, the first ESM Treaty was signed by the contracting parties. On 21 July 2011, the Heads of State or Government of the euro area and of the EU institutions agreed on further measures to improve the effectiveness of the ESM (see III below).

III. – Going forward (improving the effectiveness of the EFSF and the ESM)

In order to improve the effectiveness of the EFSF, euro area Member States announced to increase the maximum guarantee commitments of the euro area Member States from the original €440 billion to €780 billion (again according to the ECB capital contribution key). It was also agreed to revise the credit enhancement structure. The future structure includes an over-guarantee of up to 165 % by the euro area Member States. Therefore the cash reserve and loan specific cash buffer would no longer be required making for a more efficient lending structure. Furthermore, the euro area Member States have by unanimous decision on 11 March 2011 decided that EFSF may, on an exceptional basis, provide stability support to euro area Member States by arranging for the purchase of bonds of such euro area Member States on the primary market as financial assistance.

On 21 July 2011, the Heads of State or Government of the euro area and of the EU institutions agreed to improve the effectiveness of the EFSF and of the ESM and to fight contagion by, inter alia, increasing the flexibility of the EFSF and ESM. Linked to appropriate conditionality, EFSF and ESM will be allowed to:

- Act on the basis of a precautionary programme;
- Finance recapitalisation of financial institutions through loans to governments including in euro area Member States that do not have a financial assistance programme;
- Intervene in the secondary markets on the basis of an ECB analysis recognizing the existence of exceptional financial market circumstances and risks to financial stability and on the basis of a decision by mutual agreement of EFSF Member States to avoid contagion.

European leaders initiated the procedures for the implementation of these decisions and improvements as soon as possible.

It is expected that at the time of publication of this overview the decisions will be fully implemented in the EFSF framework (both at EFSF and euro area Member State's level) and full implementation of the updated ESM framework is close to being finalised.

In less than 18 months, a significant amount has happened from the creation of the EFSF, a temporary stability mechanism designed to act as a measure to safeguard the euro, to the financial assistance programmes for Ireland, Portugal and Greece to the decision to enlarge the scope of activity of the EFSF and to establish a permanent stability mechanism, the ESM. The euro zone is certainly experiencing a very challenging period in its history but measures like the creation of the EFSF and the ESM have been designed to create a stronger monetary union and make the euro zone work better for the citizens.