

**WHITE PAPER  
RISK MANAGEMENT**

# A European Stabilization Bank?



*.....the lunatix are on the grass*



## Table of Contents

EXECUTIVE SUMMARY .....	4
The Super-SPV .....	4
The Implications of Extraordinary Measures .....	4
The Function of a Central Bank.....	5
The Message of this Paper .....	5
 The EU Stabilization Mechanism (EFSF).....	6
PROCESS.....	6
INSTITUTIONAL CONFIGURATION .....	7
What to think about? .....	7
 The Lunatic are on the Grass .....	8
ANCIENT HISTORY .....	8
KAPITAL & VALUE.....	8
TODAY ITS EVEN MORE CHALLENGING.....	9
WHERE ASYMPOTIX ARE COMING FROM.....	10
THE HEART OF THE MATTER.....	10
SPELLING IT OUT .....	11
A ROCK AND A HARD PLACE.....	12
 EU Debt Office, Authority For Bank Resolution Funds & European Financial Stabilisation Mechanism.....	13
The Swedish Stability Fund for Financial Institutions .....	14
European Commission Bank Tax Proposal .....	15
Semantic Confusion? .....	16
THE UK EXPERIENCE.....	17
Reducing the Probability of a Bank Failure .....	19
BEAURAUCRATS AND SUPERVISION .....	20
Thinking the Matter Through? .....	21
Application of Funds .....	21
WE ARE WHERE WE ARE.....	22
TAKING LESSONS FROM TARP.....	25
ESTABLISHMENT OF THE EFSF.....	27
The euro area's governance and coordination of economic policies.....	29
Commission Measures for A Safe & Stable Financial System In Europe .....	30
Improving EU supervision of Credit Rating Agencies .....	31
Reforming corporate governance in financial institutions .....	32
Communication on Financial Services 2010-2011 – "Regulating financial Services for sustainable growth" .....	32
 EUROPEAN STABILIZATION BANK CONCEPT.....	34
FURTHER POWERS.....	35
 CONCLUSION .....	36
OTHER REFERENCES NOT CITED IN THE TEXT.....	37
AUTHORS.....	38

## EXECUTIVE SUMMARY

This paper; "A European Stabilization Bank?" is a collection of blog posts published earlier this year on [asymptotix.eu](http://asymptotix.eu) aimed to the European Commission, MEPs, the ECB and anyone else interested in European politics. Due to the huge interest and discussions which followed, we decided to collate the material into one White Paper. This White Paper highlights our concerns over the European Institutions response to the crisis in terms of funding, regulation and supervision. It does not provide answers to all problems but it tries to formulate a few proposals, among them the need for a European Stabilization Bank.

### ***The Super-SPV***

Why is such a dodgy legal concept, key to the Credit Crisis in facilitating off-balance sheet manoeuvring, thought to be nailed by the new ethos of transparency; being phoenixed up again to support this European emergency response? (It is ironic that the SPV was designed to facilitate "bankruptcy remoteness"). The "EU" is institutionally missing a lobe of its brain, a leg of its table or a bulb in the chandelier. The SPV facilitates the European Commission (which part, which section which scion, they only know; since the concept of DG's has gone flying out of the window) behaving in the role of European Debt Management Office. We are where we are, capital has transitioned to the state, we need public institutions which can properly manage us through this second phase sovereign debt crisis and develop a roadmap for free markets beyond a properly constituted European "Bretton Woods" style "Public Debt Bank" (its not for me to coin the name); philosophically in line with Keynes' thinking.

### ***The Implications of Extraordinary Measures***

One has to take some regard of the challenges of "Kapital"; its function in society, its inherent drivers, the subtle differences in how it morphs along the liquidity spectrum and the complex interlinked signals which it sends through that wireless network. If you throw large amounts of monetary base as a stimulant to asset markets, of course they are going to gyrate a little, don't we know they are essentially adolescent? But the principal downside risk of this kind of open market operation is that its consequences are indeterminate. This kind of quasi-state activity happens so rarely that there is insufficient data to empirically support a determinate analysis of what the implication of a waterfall or hose pipe of liquidity causes in the (global) asset spectrum in the medium term. What we do know is that quantity of liquidity has to be "absorbed" i.e. it will re-shuffle the asset spectrum, altering relative yields and thus will effectively settle somewhere by creating relative winners and losers in the asset portfolio globally. The problem is we don't know who the relative winners and losers are<sup>1</sup>.

---

<sup>1</sup> <http://www.ft.com/cms/s/0/55e103f2-d495-11df-b230-00144feabdc0.html>

## ***The Function of a Central Bank***

A central bank not only has the capacity but indeed must strive to separate the conduct of its monetary policy, which must seek to ensure medium and long-term price stability, from that of its credit policy, which is driven by short-term imperatives and consists in supplying the banking system with liquidity in the event of temporary money demand shocks. During the first part of the crisis, the ECB acted in accordance with the separation principle. However, it became increasingly difficult to apply as interest rates approached the zero-lower-bound. In effect, the unconventional measures adopted by the ECB created interference between its monetary policy, its credit policy and its interest rate policy. The suspension of the separation principle raises questions about the ECB's true purpose and the incentives provided to the private sector, in particular the banking sector, in the euro area.<sup>2</sup>

## ***The Message of this Paper***

Asymptotix simple message is the following: New institutional structure needs to be planned and implemented now! The ECB is the European Central Bank for the eurozone countries, but not for non-eurozone countries such as Denmark, Sweden and the UK. Our argument here is that we are deceiving ourselves if we fail to examine how measures to mitigate the effects of the Credit crunch were actually funded. This should be done before finalising a policy for Resolution Funds to pay for orderly winding up of failed banks. If the Commission looks carefully at this aspect, perhaps with the assistance of the ECB and the BoE, it may appreciate that its policy aims and objectives can be satisfied in better ways?



---

<sup>2</sup> THE ECB ART OF CENTRAL BANKING AND THE SEPARATION PRINCIPLE, C. Bordes and L. Clerc; August 2010, Banque de France:

<http://www.banque-france.fr/gb/publications/telechar/ner/DT290.pdf>

## EU Stabilization Mechanism (EFSF)



### PROCESS<sup>3</sup>

The process is very complex involving an SPV (Special Purpose Vehicle) as the cradle for contingent funding should sovereign default of Eurozone member states occur (I will return to this in the institutional commentary).

But the key initial (immediate) objective which was to stabilize global asset markets by a "shock and awe" injection of liquidity via the secondary sovereign debt markets has been expedited but not only on that single front. We are seeing announcements from the Central Banks of a dollar swap operation involving the usual suspects (US Fed, Canada, Switzerland and the Bank of England) acting in concert to provide dollars to the European banking system. Why? Again all dollar deposits in Euro denominations have been repatriated and the ECB along with the general "Eurosystem" is actually running out of Euros!

That's the only reason this kind of concerted action ever takes place. See my depiction particularly of the fourth quarter of 2007<sup>4</sup> to see the context into which such liquidity operations generally take place. Quantitative Easing is not the correct toolset when the emergency is trans-national, QE is a domestic "overfunding" approach by a single central bank on its domestic monetary system. This is a global issue.

Of course the asset markets have responded in the manner the politicians and bureaucrats intended, if you throw that amount of monetary base as a stimulant to asset markets, of course they are going to gyrate a little, don't we know they are essentially adolescent? But the principal downside risk of this kind of open market operation is that its consequences are indeterminate. By this I do not mean that we (I mean the general "we", not "asymptotix" of course) have not studied the consequence of this kind of quasi-state activity, we have but they happen so rarely that there is insufficient data to empirically support a determinate analysis of what the implication of a waterfall or hose pipe of liquidity causes in the (global) asset spectrum in the medium term.

What we do know is that quantity of liquidity has to be "absorbed" i.e. it will re-shuffle the asset spectrum, altering relative yields and thus will effectively settle somewhere by creating relative winners and losers in the asset portfolio globally. The problem is we don't know who the relative winners and losers are<sup>5</sup>, to know that we need a model of who holds what and if any Central Banker or Politician (or trader) tells you they have a good understanding of that, you ask them when? Five seconds ago?

---

<sup>3</sup> <http://www.asymptotix.eu/content/european-rescue-package-may-2010-analysis-debate-contribution>

<sup>4</sup> <http://www.asymptotix.eu/content/anniversary-lehman-collapse-wrong-anniversary>

<sup>5</sup> <http://www.ft.com/cms/s/0/55e103f2-d495-11df-b230-00144feabdc0.html>

## ***INSTITUTIONAL CONFIGURATION***

The institutional concern is highlighted since the "EU" (using that term very loosely, which I will explain) is now using a Special Purpose Vehicle (SPV) as the key institutional player in staving off the wolf pack of speculators. But is this not playing into the wolf pack's hands?

Indeed is it not the case that the necessity of the SPV is exactly the intellectual validity of the wolfpack's determination to short the EU and its key manifestation the Euro!? Why is such a dodgy legal concept, key to the Credit Crisis in facilitating off-balance sheet manoeuvring, thought to be nailed by the new ethos of transparency; being phoenixed up again to support this European emergency response? (It is ironic that the SPV was designed to facilitate "bankruptcy remoteness").

The reason is that the "EU" is institutionally missing a lobe of its brain, a leg of its table or a bulb in the chandelier. The SPV facilitates the European Commission (which part, which section which scion, they only know; since the concept of DG's has gone flying out of the window) behaving in the role of European Debt Management Office. Control Freak bureaucrats, as I have said before, too lazy to get on with job of establishing a European sister institution to the ECB analogous to the Debt Management Offices of the individual member states; are using this SPV to exercise power (authority?) over European markets and States!

More to the point the Commission is far too power hungry to pass up the opportunity to grasp Euro debt management powers to itself, even if it has to use an SPV to do it. As you can tell this gets my goat! I am not trying to make myself popular! This is the WRONG way to go about it, it does not cover up the lack of institutional planning in Brussels, it's just wrong-headed and sloppy and in that it is naïve since you can't hide a fundamental structural gap.

### ***What to think about?***

The swap deals between the Central Banks are not necessarily symmetric indeed by definition there are asset implications from asymmetric leakage but the use of the SPV makes a mockery of standard Monetary Economic Institutional models.

The Commission Emperor has no clothes when viewed through the lens of someone trained in this topic. There is no excuse for this kind of activity from the people who run our lives. I don't care what the internecine power struggles are in Rond Pont Schuman! Get over it! I just think it is fundamental that politicians and bureaucrats all over Europe start to "do the right thing" now, not just in the UK and I am happy to go on the record to expose them when they are completely out of control.

Remember in this context the Central Banks are executive agencies of the state (however morphed) and the state in the case of the EU is the Commission, un-elected! I hope I am articulating what the more savvy of you are feeling in response to this announcement.



## The Lunatix are on the Grass<sup>6</sup>

We are where we are, capital has transitioned to the state, we need public institutions which can properly manage us through this second phase sovereign debt crisis and develop a roadmap for free markets beyond a properly constituted European "Bretton Woods" style "Public Debt Bank" (its not for me to coin the name); philosophically in line with Keynes' thinking.

### **ANCIENT HISTORY**

One of my friends, who is a very senior executive now in one of the global household names in the computer industry was required about ten years ago to fulfill the troubleshooting "international rescue" role on a very large scale software development project in a European city. As an analyst in this process I was asked to sum up the position in a single sentence; my view as I expressed it at the time, later came to hang round my neck a bit; being often quoted by other people with no connection to that particular project at all; "this is all bol\*\*x"! Professionally my friend then proceeded through a rigorous due diligence process and he came to that final meeting, the showdown, facing off the Project Managers and Technical Experts, the cadre at that time running that mammothly ballooning monstrosity (as many of the e-banking projects of the turn of the millennium were, of course). Maybe my influence on him was partial but he famously concluded that meeting with the question "...And you have been doing this for how long?" In fact in this particular instance the bursting of the "dotcom" bubble saved face for all, as it became the premise upon which an exit route could be found from this disaster without any member of the cadre taking any responsibility for anything. The only people burned were the investors who had put their capital on the line in good faith. Isn't this becoming a recurring story in a sort of a way, over the last ten years? Do we just blame "Generation X" or is it the oldies like me who are actually running this situation?

### **KAPITAL & VALUE**

One has to take some regard of the challenges of "Kapital"; its function in society, its inherent drivers, the subtle differences in how it morphs along the liquidity spectrum and the complex interlinked signals which it sends through that wireless network. It takes years of training to grasp that and you must have a quantitative brain, which not all of us do. It also helps of course if you get the opportunity in your life to train with a real expert; maybe you are lucky enough like me, to have met several along your road. Real experience like that teaches you what it is that thinkers have been banging on about from Aristotle's consideration of value through Smith and Marx, Keynes, Friedman, right up to the modern day Quantitative precision engineering of Zurich and Edinburgh.

---

<sup>6</sup> <http://www.asymptotix.eu/content/lunatic-are-grass-new-bretton-woods-proposition-europe-now>

## **TODAY ITS EVEN MORE CHALLENGING**

There is a key difference today though from my model of ten years ago above, which makes the whole thing different, the challenge today as a consequence of idiocy has a different jurisprudential imperative (if I use the word 'moral' or 'ethical' you will all just switch off). The BBC journalist Paul Mason<sup>7</sup> painted the picture last night on Newsnight in his depiction of his view that not since the Medicis had banking and the state become so intertwined. As is becoming a commonplace now, we all know that a huge transference of Kapital has occurred at lightening speed all over the globe from the private sector to the state. This obfuscates the quantitative appraisal of that capital. But it means we have a different kind of cadre running the process today and that cadre is responding to a challenge which is not just mammoth, the word global doesn't quite capture it.

Zoom in to the European position and picture the cadre sitting in the room in Brussels where the proposition was made, the cadre gave the advice, to create a Special Purpose Vehicle stuffed full of billions of euros to rescue Greece. I actually do not blame the politicians at all, how could they assess the no-doubt hundreds of powerpoint slides which beat them into the submission of accepting that bizarre mechanic. Le Petit Sarko is reputed to have started screaming at Mrs Merkel, that night, no wonder! Angela for her part then kept her head and has made sensible propositions of a roadmap to get us beyond this disaster towards some kind of steady state which global capital markets can stomach. But Barroso; unelected, leader of the current cadre, those brilliant minds in the European Commission, uses his absurd position to contradict the German chancellor. Whilst from an ironic perspective world capital markets are actually cheering on the German boss. OK it's not doing her or anyone else any good, right now. The commission whirligigs, self regarding super brains, degrees in economics from all the fine schools in Europe and not one single practical clue amongst them must be the only group of people in the world who do not realize that it is their error which sits the whole world on the edge of a precipice right now. You and me have no way to challenge them, we don't know who they are (well we might if we were anoraks); and they speak a private language of their own which allows them to dismiss us like scum as they pass us in the street.

---

<sup>7</sup> [http://www.bbc.co.uk/blogs/newsnight/paulmason/2010/02/greece\\_the\\_pigs\\_fight\\_back.html](http://www.bbc.co.uk/blogs/newsnight/paulmason/2010/02/greece_the_pigs_fight_back.html)

## **WHERE ASYMPOTIX ARE COMING FROM**

My office in Brussels is no more than 400 metres in a straight line from Justus Lipsius which is the name of the building where the committees meet which control European lives today (and hey you Brits, head out the sand, even if you don't like the EU; it has a helluva influence on your life)! You cannot help but get in the swing of the cycle of the European Committees today, particularly when the military helicopters fly low overhead as is becoming more and frequent in recent months, dropping officials and ministers off on the helipad which is on the roof of Justus Lipsius. Finance on a Tuesday, Security on a Thursday, like clockwork that well financed Commission controlled power game ticks on, tightly managed; on its weekly clock. When everything is going well, we don't care; just get on with it we say; what did we elect you for anyway?

## **THE HEART OF THE MATTER**

My problem is the unelected aspect of the Commission cadre which is actually taking the complex decisions which not only control European lives today for starters but massively influence global citizens right down to the handmade shawl business in Kampala, never mind the burger van in Greenock. This is where the Medici point plays in you see, that clockwork orange I have described has now suddenly been handed responsibility for the European banking system, doubling its power overnight. Has it the authority do you think? Has it the capability? Can it do the work? Clearly global capital markets are answering in the negative to all three questions. I suppose Barroso in a way has no choice but to defend his status quo as he sees it and main street is no ally of wall street right now, so main street doesn't know what to say, my point is that this time Wall Street is right, the Commission emperor has no clothes!

There are no arcane quantitative issues underlying the basic lack of trust in the Greek solution being exhibited in capital markets, the problem in Europe is that capital markets smell an institutional rat. The arcane quantitative issues are still not resolved but they are phase one crisis challenges we are now in phase two. The "Greek Tragedy" is also just a scapegoat coathanger since the problem at the centre of the world is in Justus Lipsius. The rat which global capital markets smell & which you should catch a whiff of on Main Street is institutional. The capital markets are pointing at Brussels and saying "Hey, you are not setup to manage the European banking system!" Crisis or No Crisis. Anyone could have told the Commission powerpoint jockeys arguing over fonts and bullet styles that night that establishing an SPV to bailout Greece was a suicidal insanity; we knew that in "Nouveau Pont"! But off they went with their brilliant "new" idea, no clue that they were resurrecting Frankenstein's monster.

## **SPELLING IT OUT**

Let me spell it out, there is nothing wrong with the European Central Bank<sup>8</sup>, it's the Bundesbank writ large, its history its research, indeed the current boss and bosses before him give it a luster and reputation second to none, crucial to European survival right now, crucial to world survival; how they must detest the dollar swaps they are induced to currently and the subterfuge of open market operations which they are clearly involved in, even yesterday, the deputy chairman has no hang ups about letting anyone who knows how to listen, see the signals! The relationship with the Commission is massively dysfunctional however and potentially deeply threatening to our way of life, it's the Commission and its bulwarks we have to look at.

If an unelected body of experts is to run our political lives and our banking system even for the next five years on a path to exiting this disastrous position we are in, is it not obvious that an institutional structure is necessary which clearly delineates functional responsibilities for that management process?

Under the European Commission ("Cion" is the self referencing code word) there are already European financial institutions which are state owned, this is not going to be a detailed discussion of European institutional structures so I am describing apocryphally a rough model for you to work with. The European Bank for Reconstruction and Development (EBRD) is located in London and The European Investment Bank (EIB) is located in Luxembourg; there are other related institutions but these two Lego bricks will suffice for my argument. These institutions are constituted distinctly under a sort of "separation of powers" logic<sup>9</sup>, Cion manages that through the proposals it puts in front of ministers in Justus Lipsius. So right now if Cion wants anything done to influence capital markets, manage sovereign debt or influence credit supply it has to use the ECB to do it; pushing at the personal boundaries of that key institution and causing European tensions, serious ones. The ECB is big enough and powerful enough to talk back to Cion, up to a point since in the end if Sarko and Merkel want something done and they don't have the institutional framework to expedite it, then the ECB has to go along. This is what is killing the euro right now. But the poison at the centre of this systemic institutional dysfunctionality is the unwillingness of the Cion cadre to relinquish the power it maintains by fragmenting European state owned financial institutions other than the ECB.

The right policy is to propose to ministers via the Justus Lipsius Committee process a new European Financial Institution which would in the first instance subsume EBRD and EIB, re-prioritize those balance sheets and then constitutionally charter that new institution to expedite those Financial Market responsibilities which the German chancellor is calling for.

---

<sup>8</sup> WHEN CENTRAL BANKS BUY BONDS, INDEPENDENCE AND THE POWER TO SAY NO  
Adam S. Posen, EXTERNAL MEMBER, MONETARY POLICY COMMITTEE, BANK OF ENGLAND  
AND SENIOR FELLOW, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS.

<http://www.bankofengland.co.uk/publications/speeches/2010/speech436.pdf>

<sup>9</sup> [http://en.wikipedia.org/wiki/Separation\\_of\\_powers](http://en.wikipedia.org/wiki/Separation_of_powers)

George Osborne's Office of Budget Responsibility<sup>10</sup> is a brilliant idea and Allan Budd is the man to run it; hey Cion are you just going to walk by with your nose in the air? Merkel has called for consolidated government budget scrutiny, noone wants to see France peering over Holland's books but if we had a proper Bretton Woods style IMF for Europe then that requirement might fly. For me in particular sovereign debt issuance in Europe is so highly discredited today that it is a "no brainer" that we need a new European Financial Institution to manage that in cooperation with the ECB as a service to Cion and the member states, a financial institution which would be of sufficient scale to command world authority.

## **A ROCK AND A HARD PLACE**

This seems so obvious to me that it should have been bullet one on the Greek rescue powerpoint that night in Justus Lipsius. I cannot hear this type of idea being aired from the Commission right now & I think my paranoia that the whole motivating force is the greed for power of that Generation X cadre in Justus Lipsius is what is constraining that proposal, they are relishing their new aggrandizement, reveling without a clue and they will not puncture their own bubble by doing the right thing and ceding power to a properly constituted European "Bretton Woods" style "Public Debt Bank" (its not for me to coin the name); philosophically in line with Keynes' thinking in his little hotel room in 1946. To free-marketeers like me, proper social democrats, another European institution is anathema, I know but its Hobson's choice now, a rock and a hard place, either these faceless powerpoint-geniuses run our means of exchange and capital management or we constitute a transparent and possibly partially accountable institution to do it properly. We are where we are, capital has transitioned to the state, we need public institutions which can properly manage us through this second phase sovereign debt crisis and develop a roadmap for free markets beyond, Geithner telling Europe to Stress Test is so embarrassing and it would not be necessary if we had the right institution in place, the ECB has been advising how to do it for years. This new institutional structure needs to be planned and implemented now, we pay these Commission wonks to think beyond us, well I am doing it for free, I am putting the proposition out there<sup>11</sup>.

---

<sup>10</sup> <http://budgetresponsibility.independent.gov.uk/>

<sup>11</sup> <http://www.asymptotix.eu/content/john-morrison>

## EU Debt Office, Authority For Bank Resolution Funds & European Financial Stabilisation Mechanism<sup>12</sup>

Michel Barnier, Commissioner in charge of the Internal market and Services presented last week a proposal for Bank Resolution Funds. This came two weeks after the EU Heads of State presented the 750 bn euro rescue package with that mysterious Special Purpose Vehicle (SPV), which aimed at calming down the markets. The turmoil continued and it felt kind of weird that there were no panic news this last Friday (no bad news is good news).

We are where we are, capital has transitioned to the state, we need public institutions which can properly manage us through this second phase sovereign debt crisis and develop a roadmap for free markets beyond a properly constituted European "Bretton Woods" style "Public Debt Bank" (its not for me to coin the name); philosophically in line with Keynes' thinking. Any state like Sweden and the UK has the following structure (bodies) to manage finance:

- A Ministry of Finance (Swedish Ministry of Finance, UK HM Treasury)
- A National Bank (Swedish Riksbank, UK Bank of England)
- A Financial Supervisory Authority (Swedish FI Finansinspektionen, UK FSA Financial Services Authority)
- A Debt Office (Swedish Debt Office Riksgälden, UK Debt Management Office)

So what do we have at EU level? We can try our best to map this:

The European Commission basically have three "Directorate Generals" that handle policy related to financial affairs: DG Internal Market and Services. Its main role is to coordinate the Commission's policy on the European Single Market and to seek the removal of unjustified obstacles to trade, in particular in the field of services and financial markets. The Directorate General for Economic and Financial Affairs (DG ECFIN) strives to improve the economic wellbeing of the citizens of the European Union, by developing and promoting policies that lead to sustainable economic growth, a high level of employment, stable public finances and financial stability. DG Competition works to enhance competition in Europe's banking, insurance and securities markets.

The ECB is the European Central Bank for the eurozone countries, but not for non-eurozone countries such as Denmark, Sweden and the UK. There is no European Financial Supervisory Authority, although the McCreevy paper (see below)<sup>13</sup> proposes a European Banking Authority. There is no European Debt Office. Asymptotix simple message is the following: New institutional structure needs to be planned and implemented now!

---

<sup>12</sup> <http://www.asymptotix.eu/content/eu-debt-office-authority-bank-resolution-funds-european-financial-stabilisation-mechanism>

<sup>13</sup> <http://www.asymptotix.eu/content/charlie-mccreevy-speech-about-outlook-regulation-mid-and-post-crisis-environment>

## ***The Swedish Stability Fund for Financial Institutions<sup>14</sup>***

In Sweden, a special stability fund has been set up as a part of the Government's stability plan for financial institutions. The purpose of this fund is to finance measures needed in order to counteract the risk of serious disturbance to the financial system in Sweden. The fund, which in 15 years is targeted to reach 2.5 per cent of GDP, will be built up with the help of fees paid by banks and other credit institutions. The Swedish Government has initially allocated funds from the central government budget to the fund, but the aim is



that the costs should be carried by the industry itself. All banks and other credit institutions incorporated in Sweden that are covered by the Act (SFS 2008:814) on state support to credit institutions will pay a stability fee to finance the stability fund. The fee, which amounts to 0.036 per cent per year, is levied on certain parts of the institutions' liabilities according to an approved balance sheet. The basis for calculating the fee is all liabilities excluding equity capital, junior debt securities that are included in the capital base, according to capital adequacy rules, and group internal debt transactions. To develop the system further the Government intends to make the fee risk differentiated and considers a combined system with the deposit guarantee scheme.

The Swedish National Debt Office has been appointed Support Authority and is responsible for managing the fund.

Letting banks and other institutions finance the stability fund creates a financing system that is similar to a funded deposit insurance system. Costs for reconstructing banks will primarily be paid by the credit institutions, which increases the protection of the taxpayers' interests. In the case of a truly systemic event where several major banks have to be rescued, the reconstruction cost might exceed what has been funded ex ante and what the industry could bear going forward. In these cases it will be necessary to supplement the stability fund with other public funds; a systemic financial crisis almost inevitably has effects that touches national fiscal responsibilities. This implies, for example, that a stability fund does not eliminate the need to have procedures for ex post burden sharing. Building pan-European funding should not be a priority at this stage as there will be clear difficulties to combine such a system with national supervision and powers of taxation. However, a harmonization of the funding within a revised directive of the DGS is clearly warranted.

On the issue of how to make the financial sector contribute, the debate has narrowed the alternatives down to some form of stability fee, and a tax on financial transactions. Both the IMF and the European Commissions seem to favour a stability fee and the issue is on the G20 agenda. The US, UK, Germany, France and some other countries have proposed

<sup>14</sup> <http://www.asymptotix.eu/content/peter-lindmark>

similar fees on their financial sectors. Compared to a transaction tax, the stability fee has a number of obvious advantages: it addresses risk; it does not hurt liquidity in the financial markets; it can mitigate the ‘too big to fail’ problem by capturing an institution’s contribution to systemic risk; and, most importantly, it does not require global participation.

### ***European Commission Bank Tax Proposal***

The European Commission proposes a tax on banks to build Resolution Funds to pay for orderly winding down of banks that have failed (become insolvent) and cannot be saved. This is proposed as part of a new EU-wide Crisis Management Framework that includes setting up an European Banking Authority. Note that the word banks includes investment firms as well.

The proposal is pictured in a very big context, colored by a grand statement:

*“...governments throughout the European Union and internationally have provided massive amounts of public money to support their financial sectors. This support was necessary to ensure financial stability and to protect depositors, and was accompanied by measures to support the real economy. However the overall effect has been to impose a heavy economic burden to be borne by today's taxpayers and future generations.”<sup>15</sup>*

No data is provided to support the grandiosity of this, perhaps because it is a popular presumption! It is easy to misread, to conclude that the cost of supporting the financial system is by itself the cause of, “a heavy economic burden to be borne by today’s taxpayers and future generations”; no mention of the words recession, nationalisation or asset swaps. Could public funding to aid banks (finance sector) have involved taxpayers’ money directly (plus cost of measures to support the real economy) on such a scale of fiscal loss that it will take numbers of generations to recover? This seems a very long time; longer than one lifetime perhaps? Banks and central banks will know this is not so.

All governments expect to get aid funding recompensed over the medium term (3-5 years), and to earn a profit or only minimal loss. The Commission should know this from its evaluations of bank aid schemes and individual cases that it must approve. It knows state aid is secured and that fees, rates and other charges on banks are at commercial rates, as per EU state-aid rules.

The hyperbole equates high national debt ratios with aid to the banks, but is this generally so? The UK, by far the biggest provider of funding support to the banks, has almost none of the aid to banks in the government budget, in its budget deficit or in UK national debt. The IMF Fiscal Report that the Commission defers to support its assertion, paragraph 10 says, “Taking into account asset recovery through end-2009, the net cost of direct support in advanced G-20 economies is estimated at 2.7% of GDP. Given the gradual cost recovery in past crises, the medium-term net cost is likely to be even lower,

---

<sup>15</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the European Central Bank - Bank Resolution Funds /\* COM/2010/0254 final \*/  
<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0254:FIN:EN:HTML>

including in countries at the center of the financial crisis, and well below historical norms of 8% of GDP.” The Commission or the IMF must be wrong; they cannot both be right?

The Commission's reference to heavy long term burdens on taxpayers does not make obvious sense in the context of Resolution Funds given the conditions attached and the narrow scope of applying the funds only to banks after they have failed (as discussed below). Of 39.1% increase in G20 countries' public sector debt by 2015 (IMF forecast), only 3.2% is finance sector support.

Our argument here is that we are deceiving ourselves if we fail to examine how measures to mitigate the effects of the Credit crunch were actually funded. This should be done before finalising a policy for Resolution Funds to pay for orderly winding up of failed banks. If the Commission looks carefully at this aspect, perhaps with the assistance of the ECB and the BoE, it may appreciate that its policy aims and objectives can be satisfied in better ways?

### **Semantic Confusion?<sup>16</sup>**

After considering how aid has been funded, we may find, aside from questions of how big the Resolution Funds should be and if internalised within government budgetary finance or not, that this tax (a bank levy from which bank customers are to be protected) is not efficacious from the point of view of taxpayers or banks.<sup>17</sup>

At work here, in the Commission's proposal, is a political-economic or semantic confusion between public money and funding where the latter covers guarantees, insurance and asset swaps, where no net payments by government to banks were involved and using transactions off-budget and off-balance sheet. What is missing but critical is to consider how massive government interventions were financed when they do not appear in government budgets, and then to ask if it is correct to call off-budget funding public money or taxpayer's money, or something else entirely? The difficulty for the Commission and the Euro Area is that the range and flexibility available to the UK, Sweden and USA central banks is not available to Euro Area central banks.

---

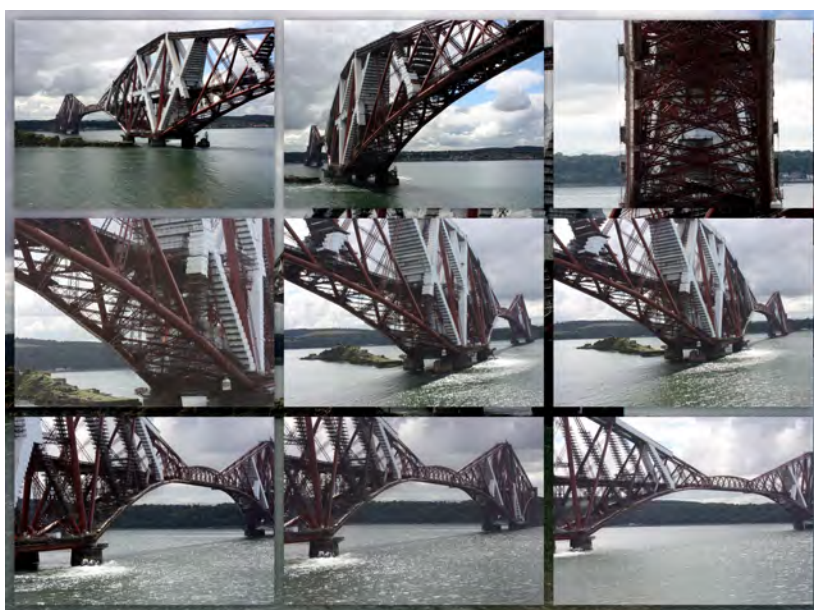
<sup>16</sup> <http://www.asymptotix.eu/content/robert-mcdowell>

<sup>17</sup> Note: I have argued in the past for bond issuance rights for The European Commission and the ECB up to €1 trillion. In the 80s and 90s (before The Lisbon Treaty introduced majority voting) this idea came up three times in different forms at IGCs, only to be voted down by UK and Germany, despite the self-financing nature of each proposal. Therefore, I am not making a case against The Commission finding a way of securing a large facility of sufficient size to iron out macroeconomic imbalances or other disparities.

## THE UK EXPERIENCE

Therefore, when The Bank of England (BoE) purchased 20% of UK National Debt under the Quantitative Easing (QE) programme, even though the bank is 100% government-owned, this was not subtracted from government borrowing in the same year, which had it been would have netted off all UK net borrowing on-budget in tax year 2009-10. The news media and market analysts, however, neglected to ask publicly how QE was funded. To the authorities involved there seemed little purpose to be served in enlightening the media on this point? When BoE took £285bn of RBS assets into its Asset Protection Scheme, this was publicly described as an asset insurance scheme, notwithstanding central bank speech and announcements, including by the IMF, describing this as off-balance sheet asset swap (actually a repo agreement) where BoE purchased the assets, which it heavily discounted, for a number of years, and annually renewable. Added to this are agreements between bank and central bank regarding division of liability for any loss of market value and cash-flow in those assets between first-loss borne by the bank and second loss by the central bank. Only this latter aspect can be defined as publicly provided insurance, but which in reality is a very small insurance risk. It meant that net income from the assets are tax-free until the scheme ends.

Central banks are public enterprises, not government agencies. Their asset and liability balances, income and expenditure, are not part of governments budgets. In the EU, under the Maastricht Criteria of the Stability and Growth Pact, only gross government fiscal deficit and national debt are counted in ratio to GDP, while the balances of public enterprises are excluded. No one publicly asked how BoE funded QE on or off its balance sheet? The IMF in its Fiscal Report judiciously notes that these QE assets can be resold back into the market at some time. If so, this would increase supply to the market without increasing UK or USA national debts. In the UK's case this is 14.5% ratio to GDP not counting government bonds held in government accounts of roughly the same again.<sup>18</sup>



<sup>18</sup> Note: It may be that the balance facilitating QE derived from the discount haircut exerted on banks' assets pledged as collateral to the central banks (BoE and Federal Reserve).

There are valuable questions regarding the flexibility of the UK to intervene in the crisis, using off-budget treasury bills and off-balance sheet repo asset swaps, as by far the largest provider of public sector aid to banks. The European Central Bank (ECB) took a long time hesitating to follow the US and UK examples, before it announced on May 10, 2010 that it too will conduct interventions in the euro area bond markets, but „sterilised“, having previously only provided liquidity at the short dated end of the markets.<sup>19</sup>

With the launch of the Euro, national central banks of the Euro Area no longer possess money market operations or bank reserves since these are vested in the national independent (or supra-national) ECB. Consequently they no longer possess the range of intervention choices available to BoE, Sveriges Riksbank and others outside the Euro Area. In the Euro Area, only the ECB, not its constituent central banks, may engage in asset swaps and purchases paid for by treasury bills or by crediting the banks with assets (deposits) held at the central bank.

The ECB, unlike the Federal Reserve or BoE, is less politically motivated to intervene; it lacks regulatory definition in respect of securing the solvency of national financial systems unless there is a palpable EU-wide systemic risk and a Euro risk, and it must otherwise above all retain its much vaunted political independence that in some quarters is highly prized.

Euro Area member states are obliged therefore when providing emergency aid to their banks (recapitalisation and asset swap purchases etc.), beyond the level that the ECB could agree to do by itself, to do so only on-budget financed by tax revenues and by borrowing (issuing new government bonds). Only in these cases it is valid to describe intervention as using taxpayers' money or public funds, similar to the US TARP scheme with the difference that Euro Area member states may not first have to pass a bill in parliament, but they must obtain Commission approval, which takes longer. Whether a bill is passed or not to authorise emergency aid, all bank aid schemes in the EU are subject to Commission scrutiny regarding macroeconomic and competition issues, and, furthermore, any resulting breaches of Maastricht borrowing and debt ratios are examined and may incur penalties.

---

<sup>19</sup> Note: It began these operations the same day. The presumption until March of this year was that the Euro system provides implicit security for cross-border sovereign lending and borrowing within the Euro Area. In cross-border financing in the early months of the financial crisis, the ECB's governing council insisted "the euro area does not suffer from major imbalances", and as recently as March, Mr Trichet continued this line lauding the security provided by the "special" virtue of the euro. To reassure German opinion, Jean-Claude Trichet, told Der Spiegel magazine that it was "ridiculous" to believe that ECB's decision to buy bonds, in the early hours of May 10th, was bowing to political pressure. Mr Trichet said the ECB's operations are "totally different" to QE as practiced by the Federal Reserve and the Bank of England, because ECB's bond purchases are sterilised. The ECB has to avoid the charge of providing support for governments' fiscal stances, a criticism leveled by Axel Weber, President of the Bundesbank. In the Euro Area system there is no institution other than the ECB to help individual countries in crisis. The mutual-support package announced on May 10th, of €440bn "special-purpose vehicle" to guarantee loans to governments, will fill a gap, but in the meanwhile the ECB has to mount a holding operation.

We can see further confusion in the political debate and media comment on Europe's sovereign debt crisis as to how much EU states' fiscal embarrassments are due to four factors:

- aiding the banks; and/or
- securing recovery in economic growth; and/or
- deficient competitiveness in external trade and balance of payments; and/or
- improvident impecunious governments.

It is easiest to lard all or most blame on the last (4), when it is the hardest of the four to analyse, but the only one covered by the EU Stability and Growth pact when read sans caveats. It is an enormous irony for the Euro system, set up to protect against currency and government bond speculation, that its central agreement is now used very effectively by currency and capital market speculators to hold the Euro Area to ransom. In these respects, the Credit Crunch and its sovereign crisis successor have exposed Euro-member governments and their national central banks to the cost of having given away domestic funding flexibility compared to that demonstrated by the UK, USA, and others, which, in extremis such as the Credit Crunch lasting as long as the life of a parliament, has been shown to be so serious that non-Euro EU members will now not join the Euro so long as the present system retains its inflexible shape.<sup>20</sup>

### ***Reducing the Probability of a Bank Failure***

The Commission announcement says: "A clear political message that emerged from the G-20 meeting in Pittsburgh in September 2009, strongly backed by the EU, is that taxpayers' money should not be used again to cover bank losses. The European Commission is working to achieve this in at least two complementary ways by:

Reducing probability of banking failure through stronger macro and micro-economic supervision, better corporate governance and tighter regulatory standards and; ensuring that, if in spite of these measures, failure does occur, appropriate tools including sufficient resources are available for orderly and timely resolution.

The establishment of resolution funds constituted from private sector sources are an important part of this response (to)...avoid contagion, allow the bank to be wound down in an orderly manner and in a timeframe which avoids the "fire sale" of assets ("principe de prevoyance"). Problems facing these laudable objectives in our view are:

Neither the Commission nor the ECB have a macroeconomic model to support financial sector supervision and they are not in the process of building one. Therefore commitment to macro-economic supervision has to be advised from elsewhere. The IMF, Cebs and national financial sector regulators are not equipped to help. BoE is building a macro-model and the Federal Reserves has some related projects in train that will take a few years to complete.

---

<sup>20</sup> Note: The ECB cannot be blamed for operating within its constitutional charter. It provided short term liquidity facilities of over €1 trillion. It how its operations were framed the role of central banks in support of short term government financing was for some reason either overlooked or deemed no longer relevant?

## BEAURAUCRATS AND SUPERVISION

The Commission is not equipped to anticipate and reduce probability of banking failure. That too has to be advised elsewhere, by central banks and regulators. The IMF, Commission and Euro Area may intervene macro-economically as per Greece but that does not translate into ‚reducing probability of banking failure‘.



Micro-economic supervision of banks is either without precise meaning in the absence of a macro-economic model or it means micro-prudential supervision, which is what regulators do, and already fully scoped and half-implemented, but not fully detailed in Pillar II of the CRD (Basel II), and in Solvency II for insurers, and Pillar II is not fully implemented yet for compliance purposes by any banks or insurers.

We know, technically and in practice, that there are at least six distinct ways of determining solvency/insolvency, but that regulators and central banks will intervene before insolvency, when many matters remain unclear. Therefore precisely determining what may trigger the release of emergency funds cannot be precisely specified and is a

matter of judgment. This may be why the Resolution Funds are conceived for action *ex ante*.<sup>21</sup>

In response to moral hazard concerns, the Commission strongly says, “A number of countries have already introduced, or are in the process of introducing levies on banks, although these differ across jurisdictions... resolution funds must not be used as an insurance against failure or to bail out failing banks, but rather to facilitate an orderly failure.” The resolution funds may not be used to recoup losses for taxpayers in the current crisis or shareholder or creditors or depositors (except depositors secured by Deposit Guarantee Systems). But, if creditors are not recompensed and there is no funding to cover excessive risk-taking then the systemic risk of failure is not avoided and the resolution is unlikely to be orderly?

It follows from the above that national governments and regulators are the first line of intervention. Their interventions will tend to pre-date failure to cope with systemic risk and restore confidence. The biggest interventions in the Credit Crunch substituted government and central banks for private sources of loans to banks to refinance banks' funding gaps, and this involved asset swaps as collateral for government money market paper.

<sup>21</sup> Note: The concept of living will (implied but not directly referred to by the Commission) will be applied to the biggest banks that pose the biggest cross-border systemic risk. This idea is deemed necessary to ensure a more orderly failure of banks. It is in reality no advance on the three pillars of Basel II. The ‚living will? perspective is implicit in Pillars I & II of Basel II regulation, which applies more widely than just the biggest firms. But, as we have seen in the Credit Crunch, the biggest failures coincide with failures in accuracy of financial and risk accounting, which are operational risks, as well as in failure to comply with Basel II prudential principles.

The Resolution Funds are not in this category. If national governments levy taxes for emergency funds to bail-out banks or otherwise to prevent failure, these are not the same as Resolution Funds.

Only when the costs of intervention crystallize and there is failure to find a way to save a bank from insolvency, which usually means buying time, and when resolution of that failure can be costed, then application to the Resolution Funds can be made. But, it is not clear why funding may not be raised at the time instead of ahead of time or why it needs to be substantial if a bank's creditors are not to be recompensed?

If there is a hole in the roof and it is raining the resolution fund is available to pull the house down in an orderly manner if the hole in the roof cannot be fixed? But, if the hole cannot be fixed the likelihood of an orderly resolution must be remote, legal costs and liquidation fees will be enormous? When Lehman Brothers failed the orderly resolution involved indirectly \$1.5trillion of interventions in the money markets to solve transaction delivery failures! It is unlikely that this is what the Commission has in mind for its proposed Resolution Funds.

The Commission says its proposal is to levy taxes on banks to build resolution funds is a response to growing political support to apply the polluter pays principle as one of several options in setting up its new crisis management framework. The media picked on this to wonder aloud if this is gesture politics more than fully thought-through policy?

### ***Thinking the Matter Through?***

The idea of a new Crisis management Framework began with a Commission Communication in October 2009. The Commission proposal page 7 says that the idea of a levy on banks was not considered until April 2010. It is unreasonable to place a lot of weight therefore on the first communication about the idea. Page 4 says, “The establishment of bank resolution funds will form a part of the new crisis management framework. It is acknowledged that this will entail costs for banks at a time when they are in the process of implementing additional measures in response to the crisis. The Commission recognises that it is essential to develop a clear understanding and careful assessment of the cumulative impacts of the broad set of reforms dealing with levies, deposit guarantee schemes and bank capital, and adjust the individual elements of the reform package accordingly. It is necessary to ensure that the costs are calibrated in such a way as to avoid stifling the economic recovery and increasing the cost of credit to the real economy. It should also be avoided that increased costs are passed on to bank customers in the form of higher charges. The Commission will ensure that all these elements are properly taken into account in the accompanying impact assessment work.”

## ***Application of Funds***

The Commission has not indicated how big the funds might be and clearly states that many details need to be worked on. This caused some exaggerated notions in media comment, especially when the narrow scope of the funds was missed and the idea took hold that these funds would deal with all intervention costs of failing banks as in another credit crunch i.e. €trillions? When Lloyds TSB took over HBoS, which could be classed as a resolution of a failed bank, HBoS the legal costs alone were hundreds of £millions. Some resolution funding might conceivably also be repayable? There are uncertainties all across the accounts of a failed bank that may take years to unravel. For example, financial audits of the failures of Lehman Brothers and Fortis in different ways are not yet complete. The Commission paper states: The details of the governance arrangements will have to be further developed. In this context, three questions are particularly relevant for the management of a fund:

1. How should the money collected be held,
2. Under which conditions should the funds be used to resolve banks and
3. How to decide the allocation of costs payable by funds in case of a cross-border resolution:

(i) Investment of funds would need to be in a geographically well diversified portfolio in highly liquid non-bank assets with low credit and market risk and in a way that supports the real economy.”

This suggests the fund will be invested in government bonds, but which are currently in high demand by banks in which to hold their new higher buffer reserves.

(ii) With regard to the use of funds, the Commission intends to put in place a harmonised resolution framework which should aim to avoid any differences resulting from the way national authorities apply resolution powers and tools, thus limiting competitive distortions. This will determine when and how resolution funds can be used.

This follows the framework for Commission evaluation and approval of government bank-aid schemes and cases (“use of bank resolution funds will need to respect the EU state aid rules.”)

(iii) With regard to arrangements in case of a cross-border resolution, the Commission intends to come forward with proposals to establish clear rules on how coordination will be expected to take place. At the core of these arrangements could be colleges involving authorities in charge of resolution with a view to taking joint decision on the preparation for the resolution of a cross-border banking group under the oversight of an entity such as the future European Banking Authority as proposed by the Commission. Such resolution plans, based on clear principles to be established by law, would include discussion about how burdens might be fairly shared and the sharing of costs between privately financed resolution funds.

Colleges involve governments, regulators, central banks, the Commission, the banks and everyone's advisors.

## ***WE ARE WHERE WE ARE***

The context for which Resolution Funds are proposed appear hubristic. The necessity for a levy to provide cash money is not demonstrated. The scale and usefulness to governments or banks or taxpayers is not determined and are conceptually unclear and questionable. At present, it is conceivable that in the Euro Area when banks have had to be placed in what appears similar to the resolution period there are costs borne by government, but the banks are nationalised. There could be relevance to the Euro Area given the difficulty of fewer options for funding aid to banks.

It seems to us that the Resolution Fund idea distracts from due consideration of the competing ways how the financial crisis has been and continues to be resolved. Such an examination might posit the limitations of the Euro system. Those limitations are already under scrutiny because of the sovereign debt crisis and speculators shorting the Euro and national debt of Greece, Spain, Portugal, and Ireland.

According to the FT<sup>22</sup>, the UK and USA, Osborne and Geithner, rejected the idea, arguing it introduces “moral hazard” by encouraging banks to think of the levy as an insurance premium that entitles them to help if they got into trouble.

This critique does not appear closely related to the actual proposal of funds only to pay for orderly winding-down banks in a resolution period. The Commission wants to offer the basis for a standard collectively agreed approach by EU states that in the context of G20 agenda would agree with a global standard framework. US Treasury Secretary Geithner said countries are likely to implement it differently: “It’s not going to be perfectly uniform.” UK Chancellor Osborne insists his own bank levy – which could be in his first Budget on June 22 – will go into government accounts. A French finance ministry official said privately that Paris supported the principle of a tax but did not want to create a standalone “resolution” fund and was also reported as fearing moral hazard. The German finance ministry said the package appeared to be “moving in the right direction”. Finance minister Schäuble wants German banks to pay about €1bn per year into a fund to wind-down troubled banks. German government officials noted that Franco-British concerns about “moral hazard” issues around a bank resolution fund might have more to do with the fact that both countries needed the cash from a bank levy to ease their budgets. The German banking association, the BDB, welcomed the levy proposals but warned against countries taking a “piecemeal approach” by building a series of national funds.

Commissioner Barnier said<sup>23</sup> he is conscious of moral hazard adding: “It is unacceptable that taxpayers should continue to bear the heavy heavy cost of rescuing the banking sector – they should not be in the front line.” Our view is that they are not in the front line. He also said, “The purpose of the bank levy is to raise money for general expenditure purposes.” This is not quite what the proposal states; it insists on a narrow precise set of uses. Barnier believes his plan can be agreed by qualified majority voting under the EU’s single market rules. The UK insists this is about taxation and must be agreed by unanimity.

<sup>22</sup> <http://www.ft.com/cms/s/0/61265884-68cf-11df-96f1-00144feab49a.html>

<sup>23</sup> <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/610>



## Euro Area EC Stabilisation Fund - Operational?

24

This EFSE, €440bn +€310bn IMF contribution is Euro Area's equivalent to TARP<sup>25</sup>. Klaus Regling is the chief executive of the European Financial Stability Fund (EFSF), two years after he stepped down as the European Commission's most senior economy official. He is German, reflecting the fact that Germany is supplying up to €148bn in debt guarantees, the largest slice of backing for the fund. The German national debt agency will help the fund arrange the guarantees in July.



Some time later this month the fund will become 'active' in theory when at least 90% of state guarantees are finalised. After borrowing, however quickly or long that takes, and once it is lending it can issue loans until June 13, 2013, only for three years. The 12 man tag team who will manage this will be in Luxembourg, probably in the glasshouse of the EIB. It will borrow from markets to provide financial rescue funds to any indebted euro zone member government needing cheaper debt, except the loans won't be cheap, not at all, and not when reputational risk of accepting IMF austerity packages is included, if that is what they will be?

Governments provide guarantees to secure a Triple-A rating for EFSF and it will then with European Investment Bank (EIB) and Bundesrepublik Deutschland Finanzagentur (BDF)<sup>26</sup> raise the funding to back the loans. If all €750bn is raised this year (v.unlikely) it would equal half again as much as all government borrowing in Europe in 2010 or equal to all government net borrowing after repaying maturing debt.

<sup>24</sup> <http://www.asymptotix.eu/content/euro-area-ec-stabilisation-fund-operational>

<sup>25</sup> <http://www.asymptotix.eu/content/robert-mcdowell>

<sup>26</sup> <http://www.deutsche-finanzagentur.de/de/startseite/>

Who is going to write all the Medium Term Note paperwork along the lines of what private sector lenders normally require, with supporting financial account projections, a host of assurances, and then negotiate the borrowing rates? Law firms and investment banks of course, I imagine, for a generous % fee. The scale and complexity of this is I think beyond both EIB and BDF in terms of their experience, relationships and possibly too their predictive analytics systems<sup>27</sup>.

It is unlikely that the borrowing will transpire on the basis of a few covering letters and government signed assurances, not when the Euro system's continuity is less than 100% certain, and although the total program period is short, only three years? It is another reason why governments want banks to borrow longer term, which is to reduce competition for their short to medium term needs such as to finance the EFSF. The EFSF will have a staff of 12, a fact I shall repeat several times just because I find it most incredible (worse than the 15 at UKFI Ltd who manage £60bn of government bank investment in London or the 15 who manage €20bn of structured finance at legacy Fortis). Tell it to any banker who knows what's involved professionally to staff up MTN programmes, even when still using external advisors, and they will laugh until it hurts.

But EFSF will have help of EIB, IMF, ECB and BD Finanzagentur we hear. Are 12 core staff enough to contract and relationship manage all of that, even just coordinating, assuming they have a detailed roadmap of what to do, which I have good reasons to doubt? The US similar package, TARP, was staffed by 120, then 150, then another 200 staff on stability issues by 2010, and that was only in the US Treasury. More staff were employed on TARP in the Federal Reserve and in FDIC. TARP is qualitatively different from EFSF but only if one thinks that government finances are easier to understand than those of large financial groups and that making agreements over loans and their conditions with governments is easier than with banks or insurers or motorcar manufacturers.

## ***TAKING LESSONS FROM TARP***

It may not be the case that all of this amount is required. TARP took from Spring to Autumn of 2008 to get approved and that process helped to detail it more fully than the the few pages setting out EFSF for political approval within a few days rather than over 6 months. It may be that EFSF will not have to commit all its funding. No doubt the proponents of TARP thought the same until the Lehman Brothers was spectacularly allowed to fail.

TARP allocated \$250bn for buying preference shares of distressed banks, for example, but only spent about \$180bn on that. Some loans amortised and the money rolled over. Unexpected crisis funding came up, however, such as AIG and GMAC. EFSF cannot be sure what unexpected requirements it may be called upon to deal with. The ECB can help in providing liquidity support for EFSF if there are unexpected delays or other technical problems as it did recently by retiring nearly €500bn of liquidity on the one hand while extending €800bn on the other hand. Perhaps the IMF standby contribution will not be called upon?

---

<sup>27</sup> <http://www.asymptotix.eu/content/robert-mcdowell>

For EFSF's borrowers (governments in financial distress) there is only so much preferred stock in banks that can be bought without shareholder protests and nationalisation and European Commission approval involving considerable political overheads and economic uncertainties. Similarly, if buying bank assets, toxic or not, that should also be capable of being financed as a repo swap at central banks. In the US example, about \$400bn of TARP was allocated to buy banks' loanbook assets and another \$50bn to cover against bank insolvencies.

Unlike EFSF, which appears to be a small office operation, TARP involved large staffing, teams from US Treasury, Federal Reserve and FDIC, and an audit unit, the Special Inspector General for the Troubled Asset Relief Program (SIGTARP). EC programmes will require a similar independent audit agency - who will do this; is one being established, or is this the IMF's job? There was also Congressional Oversight Committee on the job, but where is the European Parliament in this matter. This is all complicated by the Euro Area for which the EFSF is to exclusively apply being light on governance, it being only a big sub-section of the EU?

How much authority should the European Commission and European parliament have over a Euro Area somewhat exclusive matter? Thank goodness the direct borrowers and indirect lenders are governments who may be trusted entirely. In the USA's TARP, SIGTARP reported to Congress that it found that "Inadequate oversight and insufficient information about what companies are doing with the money leaves the program open to fraud, including conflicts of interest facing fund managers, collusion between participants and vulnerabilities to money laundering" - strong stuff, no punches pulled, and all in glaring light of day. The Euro Area Council like the EU Council deliberations are not transparent, and of course the ECB and IMF are both NGOs whose democratic accountability (reporting) are not legendary.

When the IMF lends on the basis of an agreed austerity package it has in the past turned up the gas to provoke indebted emerging market governments to default on interest or payments so that it can claim on insurance and exert penalty interest rates. That would not be appropriate for any OECD countries, let alone for EU states. But, the question arises what if any penalties are envisaged for default. The answer is probably none since matters will not be allowed to get to that point; there is too much flexibility available. The underlying banks who borrow from their governments may face domestic penalties asserted by their national governments and regulators should they default or misapply the funds, perhaps as recommended by the IMF?

The history of TARP is instructive and should be closely examined by all involved in EFSF. The Senate Congressional Oversight Panel created to oversee the TARP concluded on January 9, 2009, concerned about refloating the property market and maintaining or raising bank lending in the economy to help recovery, "In particular, the Panel sees no evidence that the U.S. Treasury has used TARP funds to support the housing market by avoiding preventable foreclosures" and "Although half the money has not yet been received by the banks, hundreds of billions of dollars have been injected into the marketplace with no demonstrable effects on (bank) lending." These are problems already being discovered nationally, not least in the UK where there is an embarrassing

mismatch between survey data among corporate and small firm borrowers and what banks are saying they are doing to lend more.

Such issues are not explicitly part of the EFSF, but the solvency of banks and therefore of economic recovery underpinning governments ability to repay loans will be of some considerable interest. IMF, ECB, EIB, EC and member states' central banks or Germany's Debt management agency do not have models however to be able to track the feed through effects. There will be a lot of finger in the air forecasting and reliance on short term data; three years is not long enough for macroeconomic data to be sufficiently revised to be accurate.

## **ESTABLISHMENT OF THE EFSF**

Regling expects the eurozone's €440bn fund to be given triple-A rating by August to allow it to borrow most cheaply at German Bund or French Government Bond rates. Triple-A reflects long term financing solvency quality. We may be dubious about ratings for such a short term programme. Therefore the ratings will merely be an aggregation of the member states' guarantees i.e. their sovereign ratings.

One has to wonder what board, governance, staffing, systems of analysis, policy documents and procedures will be in place and by when to safely command a fund worth five times one years European Commission budget? Regarding when (more than how) the European Financial Stability Facility will operate, Regling as CEO dutifully answered: "We will be ready to act whenever the politicians tell us to act."

We may imagine that this fund can only become speedily operational by trusting to the professional good sense of governments (the borrowers) and on how they in turn on-lend to stricken banks. Each transaction that becomes a state aid scheme for banks will require detailed assessment by Commission experts followed by discussions to reach agreement with national supervisory regulators, central banks and governments. That may or may not interfere with the speed of granting EFSF loans. The IMF will also be involved to dictate how budget austerity measures are affected and the ECB in each case to make systemic risk assessments of banking in the Euro Area.

That would be sensible if cumbersome. The cumbersomeness is why the European Commission backtracked on engaging two sets of panel experts last Autumn at a cost of a few €millions to do asset valuations of banks' loan collateral and predictive economic valuations over the cycle including competition issues. The state aid scheme assessment process and agreed legal requirements was set back a whole year at least, and now we cannot be sure exactly how it is to work. In effect, the process has been pushed back to member states.

One problem was lack of tools, models, economics and banking data, and lack of self-belief in ability to organise any and all of that. Such self-doubts do not figure at the higher level of President van Rompuy and CEO Regling. They have yet to appoint a board for the fund. Hopefully the cost of lawyers, accountants, raters, loan underwritings, external advisors, other insurance etc. will not approach 4% as typical of M&A i.e. €7-15bn a year maybe over 3 years, which is far more than enough to ensure the big 4 audit

firms and bulge bracket investment banks will be seeking to get themselves enthroned with this fund, an outcome for lack of basic infrastructure that any such enormous financial undertaking would normally put in place. Should the fund not have been simply handed to the ECB out of which adjunct the Euro Area Council could build its own fully equipped meta-treasury department?

Setting up EBRD, EIB and other such institutions takes a few years and never started with just a team of 12.

The EFSF tasks are bureaucratically and analytically onerous. It takes a good six months of every efficient work to get away an MTN program of say €50bn, which is huge, but which can only be done through very well trodden paths in effect rolling over deals with previous lenders. I would say that raising €750bn takes at least one year to get underway and all of 2 years to book. The three year timescale from lending to repayment is absurd, doubly so against a back-drop of Euro governments borrowing over €1 trillion gross excluding EFSF this year alone. All might go easier if governments pay a little extra to bondholders to insist that the €700bn of maturing bonds repaid this year should be directed in lending to the EFSF, but that's just naive imagining.



## Coordination With The EIB Group And The EBRD<sup>28</sup>

The EIB Group consists of the European Investment Bank (EIB) and the European Investment Fund (EIF).

The EIB's task is to contribute, through the financing of investments, to the integration, balanced development and economic and social cohesion of the EU. DG ECFIN is responsible for the formulating the Commission's position on the strategic orientation of the EIB. DG ECFIN also coordinates the preparation of the Commission's opinion on the EIB's compliance with EU rules and policies in its loan proposals.

The EIF specialises in providing venture capital and guarantee instruments for the development of small and medium-sized enterprises (SMEs). DG ECFIN ensures the appropriate coordination between the EIF and other Commission departments on specific questions arising in relation to EU policies and legislation.

The European Bank for Reconstruction and Development (EBRD) is an international financial institution designed to foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative in countries from Central Europe to Central Asia. It is owned by 61 countries (including all EU Member States), the European Community and the EIB. The total EU shareholding is 63%. The EBRD provides project financing mainly for private enterprises, usually together with

---

<sup>28</sup> [http://ec.europa.eu/economy\\_finance/financial\\_operations/coordination/index\\_en.htm](http://ec.europa.eu/economy_finance/financial_operations/coordination/index_en.htm)

other commercial lending partners. It also works with public partners to support privatisation, restructuring and improvement of municipal services.

### ***The euro area's governance and coordination of economic policies***<sup>29</sup>

.....must be improved. This will involve both deepening and broadening economic surveillance arrangements to guide fiscal policy over the cycle and in the long term and, at the same time, address divergences in growth, inflation and competitiveness."

The exceptional combination in Greece of lax fiscal policy, inadequate reaction to mounting imbalances, structural weaknesses and statistical misreporting led to an unprecedented sovereign debt crisis.

On 9 May, based on a proposal of the Commission, the ECOFIN decided on the establishment of a temporary European stabilisation mechanism to deal with the immediate needs of the crisis. This was part of a wider package, including strong commitments to fiscal consolidation where warranted and involvement of the IMF through its usual facilities in line with the recent European programmes. This mechanism was created to respond to the current exceptional circumstances and entails an overall financial support of up to EUR 500 billion. Financial assistance will be subject to strong conditionality, in the context of a joint EU/IMF support, and will be on terms and conditions similar to the IMF. This mechanism will be financed through two complementary sources. The first, building on a Council Regulation based on Article 122(2), can mobilize up to EUR 60 billion. In addition, the euro-area Member States stand ready through an intergovernmental agreement to complement such resources through a Special Purpose Vehicle. This SPV would borrow using financial guarantees of the participating Member States up to EUR 440bn.

This mechanism largely respects the basic principles for a permanent robust crisis resolution mechanism. Therefore, the Commission considers that the first priority must now be to make this mechanism fully operational. Based on this experience, the Commission intends in the medium-to-long term to make a proposal for a permanent crisis resolution mechanism.

The Commission will develop the reform proposals presented in this Communication, in line with its responsibilities under the Treaty. It considers it important to make swift progress on the reform agenda laid out in this Communication: the present economic situation requires urgent action to implement the measures proposed to improve the economic governance of the EU and the euro area. The first European Semester should start with the beginning of 2011.

The Commission stands ready to follow-up swiftly with legislative proposals, including amending the regulations underpinning the Stability and Growth Pact, to enhance the

---

<sup>29</sup> [http://www.europarl.europa.eu/meetdocs/2009\\_2014/documents/com/com\\_com\(2010\)0250\\_/com\\_com\(2010\)0250\\_en.pdf](http://www.europarl.europa.eu/meetdocs/2009_2014/documents/com/com_com(2010)0250_/com_com(2010)0250_en.pdf)

prevention and correction of macroeconomic imbalances within the euro area, and to establish a more permanent framework for crisis management.

## Commission Measures for A Safe & Stable Financial System In Europe<sup>30</sup>

As part of its work on preventing a future financial crisis and strengthening the financial system, the European Commission has today put forward amendments to the EU rules on Credit Rating Agencies (CRAs) and launched a public consultation on reforming corporate governance in financial institutions. Furthermore, in order to advance swiftly in completing the necessary reforms to ensure a safe and stable financial system in Europe, the Commission has adopted a more general Communication where it commits itself to table the remaining financial reform proposals in the next six to nine months from now. Following discussion and hopefully strong support from all heads of State and government at the forthcoming European Council, the Commission will present all these proposals – together with its recent ideas on bank resolution funds – at the G-20 Summit in Toronto on 26-27 June 2010. On CRAs, the Commission has two main objectives: ensuring efficient and centralised supervision at European level, and increased transparency on the entities requesting the ratings so that all agencies have access to the same information. These changes would improve supervision, increase competition in the CRA market and improve investor protection. On corporate governance, the Commission has launched a public consultation on a number of issues including how to manage risk more effectively in financial institutions and how to empower shareholders. The deadline for responses is 1 September 2010. To complement this package of proposals, the Commission has also published two reports on how Member States have put into practice the Commission's two Recommendations of 2009 on remuneration policies in the financial services sector and for directors of listed companies. In both cases, progress has been made but a significant number of Member States have yet to implement the Recommendations fully.

Commission President José Manuel Barroso said<sup>31</sup>: "Today the Commission is launching the final push to complete the EU's financial services reform. This is part of our wider agenda to stabilise, consolidate and restore sustainable growth to the European economy".

Internal Market and Services Commissioner Michel Barnier said: "The changes to rules on Credit Rating Agencies will mean better supervision and increased transparency in this crucial sector. But they are only a first step. We are looking at this market in more detail. On corporate governance, I am convinced that true crisis prevention starts from within companies. If we are to prevent future crises, financial institutions themselves need to change. We need to ensure more effective internal controls. Promote better risk management. Strengthen the role of supervisory authorities. And existing rules on sound remuneration policies should be implemented quickly to help curb excessive risk-taking."

---

<sup>30</sup> <http://www.asymptotix.eu/content/commission-measures-safe-and-stable-financial-system-europe>

<sup>31</sup> [http://ec.europa.eu/unitedkingdom/press/press\\_releases/2010/pr1054\\_en.htm](http://ec.europa.eu/unitedkingdom/press/press_releases/2010/pr1054_en.htm)

## ***Improving EU supervision of Credit Rating Agencies***

As rating services are not linked to a particular territory and the ratings issued by a CRA<sup>32</sup> can be used by financial institutions all around Europe, the Commission is proposing a more centralised system for supervision of Credit Rating Agencies at EU level<sup>33</sup>. Heads of State and government had called the Commission to come forward with proposals on this in June 2009.



Under the proposed changes, the new European supervisory authority – the European Securities and Markets Authority (ESMA) – would be entrusted with exclusive supervision powers over CRAs registered in the EU. This would include also the European subsidiaries of well-known CRAs such as Fitch, Moody's<sup>34</sup> and Standard & Poor's.

It would have powers to request information, to launch investigations, and to perform on-site inspections. Issuers of structured finance instruments such as credit institutions, banks and investment firms will also have to provide all other interested CRAs with access to the information they give to their own CRA, in order to enable them to issue unsolicited ratings.

These changes mean that CRAs would operate in a much simpler supervisory environment than the existing varied national environments and would have easier access to the information they need. Users of ratings would also be better protected as a result of centralised EU supervision of all CRAs and increased competition among CRAs.

---

<sup>32</sup> Background: CRAs issue opinions on the creditworthiness of companies, governments and sophisticated financial products. They contributed to the financial crisis by underestimating the risk that the issuers of certain more complicated financial instruments might not repay their debts. In response to the need to restore market confidence and increase investor protection, the Commission put forward new EU-wide rules that put in place a common regulatory regime for the issuance of credit ratings. Under these rules, which will become fully applicable in December 2010, all CRAs that would like their credit ratings to be used in the EU now need to apply for registration. Registrations open this month. The risks of conflicts of interest affecting ratings are also addressed (for example, a CRA cannot also offer consultancy services) CRAs will need to be more transparent as they will need to disclose the methodology and internal models and key rating assumptions they use to make their ratings. This should allow investors to perform better their due diligence.

<sup>33</sup> <http://www.asymptotix.eu/is-the-European-Union-legislating-the-Ratings-process-towards-an-Open-Source-Model>

<sup>34</sup> <http://tiny.cc/24iuf>

The Commission's proposal, which amends Regulation 1060/2009, will now pass to the EU Council of Ministers and the European Parliament for consideration. If adopted, the new rules would be expected to come into force during 2011.

### ***Reforming corporate governance in financial institutions***

In response to the financial crisis, the Commission committed itself in its March 2009 Communication on "Driving European Recovery"<sup>35</sup> to improving corporate governance in financial institutions. The Commission wanted to ensure that the interests of consumers and other stakeholders are better taken into account, businesses are managed in a more sustainable way and bankruptcy risks are reduced in the longer term.

As a first step, the Commission is now launching a public consultation on a Green Paper that details possible ways forward to deal with the following issues:

- How to improve the functioning and the composition of boards of financial institutions in order to enhance their supervision of senior management;
- How to establish a risk culture at all levels of a financial institution in order to ensure that long-term interests of the business are taken into account;
- How to enhance the involvement of shareholders, financial supervisors and external auditors in corporate governance matters;
- How to change remuneration policies in companies in order to discourage excessive risk taking.

The consultation is open until 1st September 2010. Any future legislative or non-legislative proposals will be adopted in the course of 2011.<sup>36</sup>

### **Communication on Financial Services 2010-2011 – "Regulating financial Services for sustainable growth"<sup>37</sup>**

The recent market turbulence has confirmed the need for the Commission to move swiftly in completing the necessary reforms to ensure a safe and sound European financial system. That is why the Commission has committed itself to table the remaining proposals financial reform proposals needed to implement fully our G20 Commitments in the next six to nine months from now. Key proposals include:

---

<sup>35</sup> [http://ec.europa.eu/financial-crisis/index\\_en.htm](http://ec.europa.eu/financial-crisis/index_en.htm)

<sup>36</sup> Background: The financial crisis revealed significant weaknesses in corporate governance in financial institutions: board supervision and control of management was insufficient; risk management was weak; inadequate remuneration structures for both directors and traders led to excessive risk-taking and short-termism; and shareholders did not exercise control over risk-taking in the financial institutions they owned. These weaknesses played a role in the crisis and timely and effective checks and balances in governance systems would help preventing any future crisis.

<sup>37</sup> [http://ec.europa.eu/internal\\_market/finances/docs/general/com2010\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/general/com2010_en.pdf)

**Transparency:** the Commission will come forward with proposals to improve the functioning of Derivatives markets in the summer. This will be instrumental in increasing transparency on a market which is important but currently very opaque. In order to restore further confidence in financial markets, the Commission will propose appropriate measures on short selling and credit default swaps, including 'naked short-selling'. The Commission will also table improvements on the Markets in Financial Instruments Directive (MiFID) in order to strengthen pre- and post-trade market transparency and bring more derivatives onto organised trading venues.

**Responsibility:** In order to protect investors and depositors, the Commission will propose a revision of the Deposit Guarantee Schemes Directive and the Investor Compensation Schemes Directive. Also, legislative proposals on packaged retail investment products will be presented to promote consumers' interests in the sales process. The Market Abuse Directive will also be revised in order to extend its rules beyond regulated markets and to include derivatives in its scope of application. The Commission will come forward with amendments to the Capital Requirements Directive (CRD IV) to improve the quality and quantity of capital held by banks, introduce capital buffers and ensure the build up of capital in good times which may be drawn on in more adverse economic conditions. Furthermore, on



enforcement, sanctions in the financial sector are largely unharmonised, leading to diverging practices among national supervisors. As a first step, the Commission will present a Communication on sanctions in the financial services sector to promote convergence of sanctions across the range of supervisory activities.

**Crisis prevention and management:** The Commission will publish an action plan on crisis management leading to legislative proposals for the prevention and resolution of failing banks. The Commission will also work towards global convergence on one set of high quality international accounting standards. The Commission will press for the rapid adoption of these measures by both the European Parliament and the Council so that Europeans can regain full confidence in the soundness of the financial system as one of the pillars for growth.



## THE EUROPEAN STABILISATION BANK

Asymptotix is not actually the first to call for a European Stabilization Bank, CEPS made the argument as early as October 2008<sup>38</sup> (maybe a little premature) but asymptotix were the first to argue towards an ESB from a logical critique of the EFSF establishment and taking lessons from Sweden the UK and TARP. Since we published our first critique in May 2010 significant academic effort has gone into publications which support our idea. Thus we feel that a fully worked out concept would be egregious at this point. There are a number of issues which not fully establishing the EFSF as an institution fails to address and we hope to have pointed most of them out in this paper and provided sufficient references should you wish to make a further study.

Without the immediate installation of any sovereign default mechanism such as a European Monetary Fund, the ECB risks to degenerate to the 'Bad Bank' of the euro area as timid investors are offloading sovereign bonds with uncertain repayment values on the ECB's balance sheet.<sup>39</sup> Think about this for a second. Suppose the Fed set up a program to buy municipal bonds but wouldn't announce how much came from California or Florida or other states or cities. How long would this survive before members of Congress demanded a full explanation of the program? But that's where we are right now in Euroland.<sup>40</sup>

Capital Comparison; European Stabilization Mechanism (ESM [EFSF]).<sup>41</sup>

Institution	Balance sheet	Revenue
<b>ESM spv</b>	<b>440</b>	<b>Limit 750</b>
<b>EBRD</b>	<b>18</b>	<b>2</b>
<b>EIB</b>	<b>18</b>	<b>2</b>
<b>European Bank levy</b>	<b>60</b>	<b>@6</b>
<b>ECB Balance Sheet</b>	<b>4TRILLION</b>	
<b>France's 2010 budget deficit</b>		<b>152</b>

### EUROPEAN STABILIZATION BANK CONCEPT

What you need to do is simple, Take the European Bank levy funding, capitalise it in the balance sheet of a European Development Bank, add the SPV funding limit by acquiring the SPV and calling the institution the European Stabilisation Bank. Merge and integrate

<sup>38</sup> <http://www.ceps.eu/files/book/1749.pdf>

<sup>39</sup> Gros, D. and T. Mayer (2010), How to deal with sovereign default in Europe: Create the European Monetary Fund now!, CEPS Policy Brief No. 202, Centre for European Policy Studies (CEPS), Brussels, May.

<sup>40</sup> <http://www.irisheconomy.ie/index.php/2010/06/03/ecb-sovereign-bond-purchase-program/>

<sup>41</sup> Figures in billions of Euros except ECB Balance Sheet obviously

the functions and balance sheets of EBRD and EIB into the ESB. Bobs your uncle you have a European institution with global credibility for a limited cost of one trillion euros budget roof.

## **FURTHER POWERS**

- Scrutiny authority over all paper issued in euro, Including sovereign
- Compliance oversight on standards, (with teeth – no compliance, no issuance)
- Effective control of the sovereign /federal issuance order book in euros.

Give these current commission duties some credibility

- All current duties of DG RCFIN (commissioner)
- All Basel, solvency and exchange duties of the EC
- All that regulation management which Lamafussy overcomplicates
- Let the ESB handle euro ministerial economics
- Give it the budgets to do so

Esb becomes the quasi-treasury of the EU, it is thus the debt management office for Europe a role which the European central bank is coming perilously close to and should not be pushed any further to play. Thus, the objective is a BIZ<sup>42</sup> for the euro, The federal reserve of the euro, if you like. Duties to be the sole “issuing house” for European sovereign, “federal”; government underwritten (including “covered”) paper. A key function being the Duty of care & attention to existing markets and market infrastructure given that the ESB will overnight become such a significant and authoritative player.

Only such an institution can overnight consolidate the pathetically fragmented European central authority banking strategy. An institution like the ESB would overnight provide that massive liquidity injection simply by funneling velocity, changing expectations, the liquidity leakage which crowded out capital markets cant seem to produce right now.

ESB has absolute “Bang the Table” authority in Transparency disputes in Europe it has direct channel to European Courts to kill the debates if necessary, it has objectives to 1) re-design the Ratings Process acceptable in Europe for European paper and 2) Develop intra-institutional exchanges for that now acceptably rated paper to standards all ready specified in Europe.

Just as CEPS argued in 2008; “Until the EU develops a unified market for bonds denominated in euro and backed jointly by EU member states – or, better, by euro-area member states – its claim for the status of reserve currency for the euro will not be met. As a result, capital is not coming to Europe, where it is badly needed to shore up its shaken financial system; moreover, the United States will continue to dictate the agenda in international monetary affairs, even now, after the colossal damage inflicted on the world by their misguided macro and regulatory policies.” The EFSF is just not doing the business and Europe needs to take the next step, in our view.

---

<sup>42</sup> Biz is insiders code for the bank for international settlements in Basel

## CONCLUSION

The EFSF is a sort of European Monetary Fund – any loans will come with stringent conditions set by the eurozone. That makes it more likely to succeed, and less likely to be used. Form an orderly queue. What do you call a cross between a supranational, a sovereign and a structured derivatives product? Until somebody comes up with a more elegant name, you can call it the European Financial Stability Facility. This is the new funding vehicle for eurozone countries which find themselves on the brink. It has office space (in Luxembourg), the staff (no more than 12) of a minnow and the borrowing powers of a behemoth (perhaps €350bn in practice). The good news is that it does not yet have any customers.<sup>43</sup>

The EFSF was set up by the 16 countries whose currency is the euro to provide a funding backstop should a euro area Member State find itself in financial difficulties. The EFSF will have the capacity to issue bonds guaranteed by euro area members for up to € 440 billion for on-lending to euro area Member States in difficulty, subject to conditions to be negotiated with the European Commission in liaison with the European Central Bank and International Monetary Fund and to be approved by the Eurogroup. EFSF SA is a Luxembourg-registered company owned by euro area Member States. It is headed by Klaus Regling, former Director-General for economic and financial affairs at the European Commission.<sup>44</sup>

What you need to do is simple, Take the European Bank levy funding, capitalise it in the balance sheet of a European Development Bank, add the SPV funding limit by acquiring the SPV and calling the institution the European Stabilisation Bank. Merge and integrate the functions and balance sheets of EBRD and EIB into the ESB. Bobs your uncle you have a European institution with global credibility for a limited cost of one trillion euros budget roof.

The eurozone must be able to cope with serious market disruption. It requires an effective stabilisation mechanism. The proposals contemplated in the task force led by Herman Van Rompuy, which met on Monday night, will be decisive for the future of EMU. They should include the transformation of the EFSF into a permanent European instrument. Other decisions are needed, but this is the first and easiest to implement – and of critical importance.<sup>45</sup>

Do the thing properly Europe!

---

<sup>43</sup> <http://www.asymptotix.eu/content/european-financial-stability-fund>

<sup>44</sup> <http://www.efsf.europa.eu/>

<sup>45</sup> <http://www.ft.com/cms/s//aec-cac-df-a-feaba.html>

## OTHER REFERENCES NOT CITED IN THE TEXT

### Clickable Links

The European Stabilization Mechanism (JP Morgan)	<a href="http://tiny.cc/52y9h">http://tiny.cc/52y9h</a>
ECB Sovereign Bond Purchases & The Securities Markets Programme	<a href="http://repec.rwi-essen.de/files/REP_10_194.pdf">http://repec.rwi-essen.de/files/REP_10_194.pdf</a>
Europe's Bank Stress Tests Minimized Debt Risk	<a href="http://www.asymptotix.eu/content/europes-bank-stress-tests-minimized-debt-risk">http://www.asymptotix.eu/content/europes-bank-stress-tests-minimized-debt-risk</a>
ECOFIN Council 7 September 2010	<a href="http://www.asymptotix.eu/content/ecofin-council-7-september-2010-eu-finance-ministers-new-bank-levy-bank-resolution-funds">http://www.asymptotix.eu/content/ecofin-council-7-september-2010-eu-finance-ministers-new-bank-levy-bank-resolution-funds</a>
Central Banks Doing A Good Job Or Not?	<a href="http://www.asymptotix.eu/content/central-banks-doing-good-job-or-not">http://www.asymptotix.eu/content/central-banks-doing-good-job-or-not</a>
Stress Of Stress Tests - A Sovereign Debt Battle At Sea	<a href="http://www.asymptotix.eu/content/stress-stress-tests-sovereign-debt-battle-sea">http://www.asymptotix.eu/content/stress-stress-tests-sovereign-debt-battle-sea</a>
European War Against The Markets	<a href="http://www.asymptotix.eu/content/european-war-against-markets-750-bn-eur">http://www.asymptotix.eu/content/european-war-against-markets-750-bn-eur</a>
Are The Ratings Agencies Finally Going To Admit Defeat?	<a href="http://www.asymptotix.eu/content/new-york-ciy-court-judgment-are-ratings-agencies-finally-going-admit-defeat">http://www.asymptotix.eu/content/new-york-ciy-court-judgment-are-ratings-agencies-finally-going-admit-defeat</a>
The Role Of The Central Bank In A Financial Crisis	<a href="http://www.asymptotix.eu/content/ecb-and-managing-risk-role-central-bank-financial-crisis">http://www.asymptotix.eu/content/ecb-and-managing-risk-role-central-bank-financial-crisis</a>
Misleading Incentives And The Super-Supervisor Scrum-Down	<a href="http://tiny.cc/r0qhkkryi">http://tiny.cc/r0qhkkryi</a>
Greek Tragedy Or A PIGS Tale?	<a href="http://www.asymptotix.eu/content/greece-debt-crisis-greek-tragedy-or-pigs-tale">http://www.asymptotix.eu/content/greece-debt-crisis-greek-tragedy-or-pigs-tale</a>

## AUTHORS



**Robert McDowell**

**Peter Lindmark**

**J A Morrison**



Summer/Autumn 2010

 **Asymptotix**