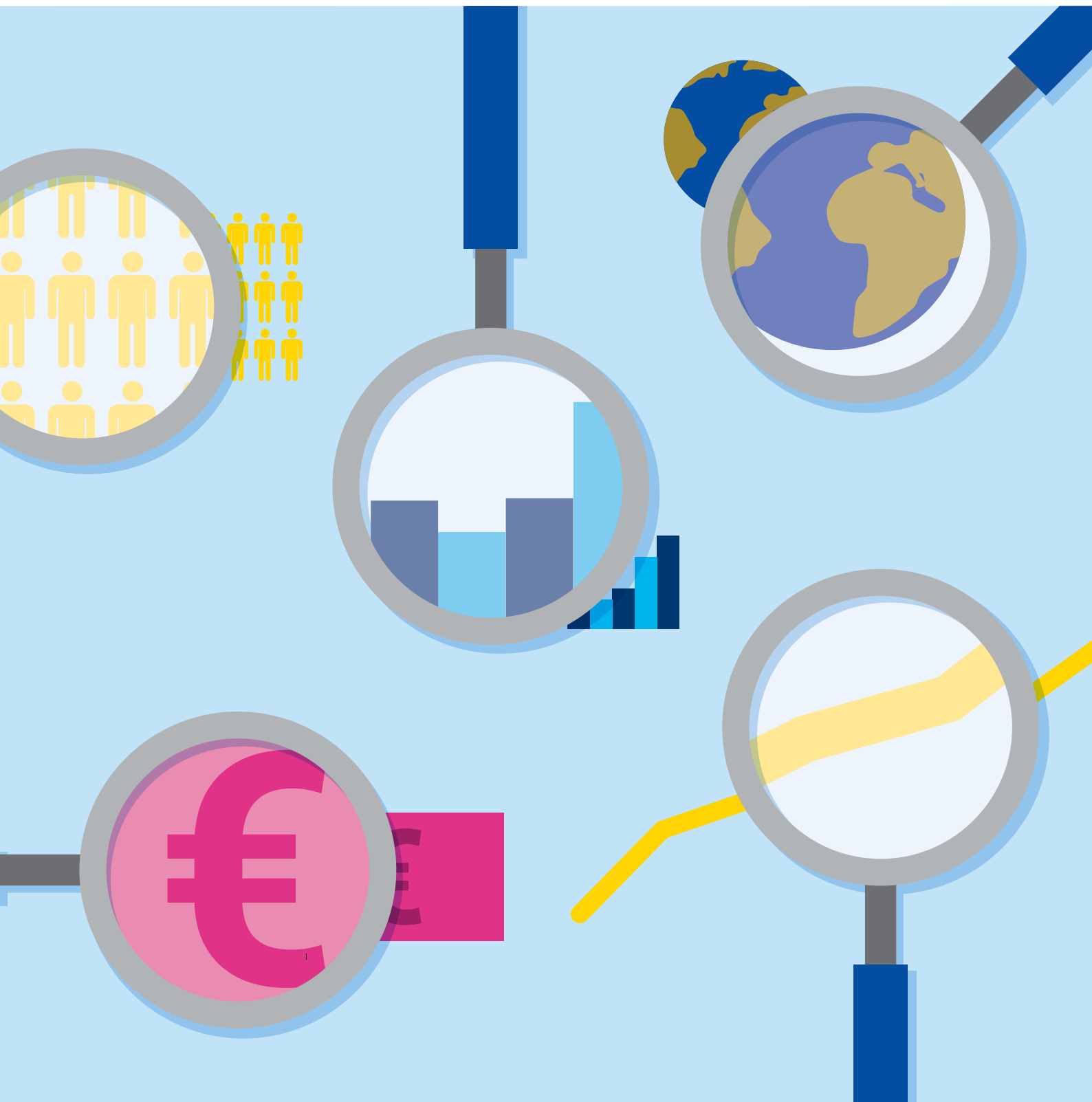


Analytical Capability of the ESM

EVALUATION REPORT



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Foreword

Following two large evaluation exercises conducted in 2016–2017 and 2019–2020 led by High-Level Independent Evaluators on European Financial Stability Facility (EFSF)- and European Stability Mechanism (ESM)-supported financial assistance programmes, the ESM Evaluation function was formally established in December 2022. It operates under the ESM Secretary General, reporting to the Management Board, and enjoys a high level of independence with quality assurance provided by external advisors in the Evaluation Reference Group. This evaluation aspires to be transformational, supporting significant and durable change in the approach to Members' challenges. While the previous programme evaluations were commissioned by the Board of Governors, this evaluation was more internally focused and obtained its mandate from the Managing Director, following resource commitments from the Management Board. Through this closer relationship with management, the exercise set out to serve the managerial team by assessing the ESM's existing analytical capabilities against business plans, peer standards, and external expectations, and by offering advice to foster continued incremental change.

It was hoped that a participatory evaluation would generate direct and indirect effects which would spur management and the relevant internal functions to ensure conditions for continuous learning and development, analytical rigour, collaboration, and a high level of preparedness – as well as appropriate accountability. As a result, the recommendations aim for clarity on objectives and priorities, even while the supporting analyses illuminate many secondary issues regarding data and tools, post descriptions, and the portfolio of personal capabilities. Multiple methods were used to address the complexity of the exercise.

Whether transformation ensues will depend largely on management's follow-up agenda. At the request of the Managing Director, efforts were made to articulate concrete examples of potential solutions and to provide points of reflection based on actual practice at peer institutions. This explains the number of boxes in the report. The Evaluation Lead recommended publication of the report, as a roadmap for future action.

The evaluation was conducted by a team of ESM staffers and a consultant, who all brought a range of experience and expertise and ensured a close relationship with ESM staff and management. The evaluation report is the work of Olga Francova, John Goossen, Kari Korhonen, Diana Zigraiova, and external expert Carsten Eppendorfer. Sotirios Giannoulis, Andres Williams, and Juergen Klaus were also involved until mid-2024. Kari Korhonen inspired and led the team until October 2024, ensuring a high level of behavioural independence for the Evaluation function. The report was completed for publication under the leadership of John Goossen.

The evaluation team is deeply grateful for substantial guidance from the Evaluation Reference Group led by David Goldsbrough. With John Hicklin, Barry Kolodkin, and Ritva Reinikka, he helped the evaluation team to focus its fact finding on relevant issues, interpret key findings, and ensure the overall quality of the report. The team found engagement with the Evaluation Reference Group to be an enriching experience.

Raquel Calero provided indispensable editorial support for this publication.

The ESM Evaluation team

Executive summary

Despite commendable progress made under the 2019 Management Plan, the ESM must do much more to meet its responsibilities in full. The evaluation finds that the analytical toolkit is insufficiently codified and consolidated and that the integration of market intelligence with financial and macroeconomic monitoring is incomplete, hindering effective crisis management and the ability to provide actionable policy advice. To make the ESM's capabilities effective, greater focus is required on proposing policy solutions to mitigate the impacts of economic shocks. This requires stronger internal coordination and independent analytical capabilities. The ESM should also share its assessments, including most importantly with the ESM Members concerned. Moreover, it needs to build up capacity to assume fully the greater role envisaged for it in programme negotiation and design. This also requires further contingency planning.

As a relatively small institution, the ESM can ease constraints on its analytical capabilities by insourcing knowledge through judicious use of external networks. Such activity can also help boost its influence. In particular, timely and independent analytical capability is hampered by dependence on publicly available forecasts and data, and by limited opportunities to leverage external expertise and partnerships. These constraints could be alleviated by insourcing knowledge through collaboration arrangements with peer institutions, partnerships with academia, and access to national authorities to mine their deep country and sectoral insights.

The ESM's ability to sustain the progress made and further enhance analytical capability rests on tackling several important challenges. These include: the absence of some key institutional policies, including periodic policy reviews; overly complex internal and analytical processes that hinder accountability; challenges in retaining and motivating staff as a result of crisis periods alternating with long non-crisis periods; and inadequate arrangements for rapidly scaling up capabilities to ensure a timely and well-informed response to a sudden increase in demand.

The evaluation makes specific recommendations to help address the constraints and challenges identified. Senior management should launch an assignment to consolidate and codify the analytical toolkit, which should be exposed to more external scrutiny to enhance quality. Management should refine the ESM's analytical system and define key concepts related to the ESM's mandate, such as financial stability. Management should also develop a more systematic approach to risk monitoring and enhance operational guidance related to the analytical tools. It should foster further synergies in the analytical process by unlocking incremental learning among the functions and between senior and junior staff, as well as by actively discouraging tendencies towards a silo mentality.

Management must enhance the impact of the ESM's analytical capability by embracing anticipatory governance, increasing the traction of its analytical work, and encouraging more staff-level external engagement in technical, academic, and policy domains. Furthermore, management needs to boost the ESM's policy advisory role, build the capability to convey the policy implications of its analytical work, and develop a flagship publication central to its mandate to better communicate that work to the outside world.

Management should enhance the influence of the ESM's analytical output by making greater use of external networks. It should mitigate the constraints on a small institution by insourcing more external knowledge, addressing critical data dependencies, increasing staff-level external engagement, and strengthening publication and research activities. Analytical rigour and output would also benefit from external vetting of the ESM's papers, models, and tools.

Looking ahead, senior management should ensure the sustainability of the analytical system and its adaptability to evolving circumstances. The Management Board should hold heads of division accountable for organising regular and relevant training activities, dry runs, and scenario exercises to encourage continuous learning and institutionalise quality control. Management should foster a practice of periodic review and self-evaluation to benefit from lessons learned and continue to ensure excellence in the execution of the ESM's mandate.

In line with best practices in international organisations, the ESM should follow up the recommendations with a management implementation plan to be produced, ideally, by mid-2025. The implementation plan should take effect over the next three years, clearly assigning responsibilities for each component, prioritising the measures, and reporting on the progress made, for example in the ESM Annual Report.

1. Introduction

The challenge facing policymakers and international institutions in preparing for emerging threats is apparent from various financial crises, and the more recent Covid-19 pandemic. Organisations' analytical and forecasting systems often failed to raise appropriate alarms in a timely manner. Complacency and insufficient readiness left them with inadequate policy tools to respond to changing circumstances. Adverse developments have at times also taken European institutions by surprise.

Against this backdrop, the ESM Members saw opportunities to strengthen the overall euro area crisis framework by entrusting the ESM with a more preventive role after capability gaps were revealed by the independent Evaluation Report on EFSF/ESM Financial Assistance (ESM, 2017). This enhanced role required investing in new instruments, strengthening collaborative arrangements, and improving internal organisation. The weightiest element of the response strategy entailed significant increases in ESM staffing and investing in analytical tools and procedures to develop adequate capability to monitor financial stability risk.

Financial stability analysis should be understood as a highly specialised area requiring extraordinary expertise, especially given the unique context of a monetary union. While the potential of successful monitoring to avert or reduce welfare losses from financial instability is recognised, the progress made by institutions like the ESM in building relevant analytical capabilities is less well known. Lessons from past crises, particularly the global financial crisis of 2008 (Box 1.1), underscore the importance of a rigorous and forward-looking approach to surveillance and monitoring. This provides further motivation for an evaluation of the ESM's capability to fulfil this mission.

Purpose and scope of the evaluation

It is important to assess the capability-building efforts made since the signing of the Agreement Amending the ESM Treaty in December 2018. The development of the relevant analytical capabilities was channelled through a Management Plan that is assessed in Chapter 2.

According to the Terms of Reference for the evaluation, the overarching objective is to assess the ESM's institutional capability to produce timely and relevant analytics and use the output for the benefit of its mandate, in both normal times and crises. In the process, the evaluation is to identify key achievements, relevant strengths, and remaining gaps. More specifically, the evaluation consists of:

- *A process and implementation evaluation of the Management Plan to ramp up and integrate economic, financial, and market analysis.* This asks how well the Management Plan has been implemented, and what progress has been made on the necessary skills, tools, and processes required for excellence under the new mandate.
- *A reflection on the relevance and robustness of the established analytical system.* This takes into account future needs, including under the new mandate, to look at what will be required in risk monitoring and identification, as well as programme design.
- *An effectiveness component.* This explores how effectively the organisation is using the output and whether stakeholders are taking it up. It also assesses how effectively the ESM uses

analytical outputs to inform decision-making with focused recommendations in the service of mandate execution.

- *An examination of sustainability.* Primarily this asks how well the enhanced capabilities are safeguarded for the future compared to best practice, and how well achievements are grounded in the organisation.

The evaluation covers the period from 2019 to 2023, drawing on context and experience from the initial years of operation. The Terms of Reference can be found in the technical annex.

Box 1.1 Global surveillance misses before the global financial crisis

As the ESM is introducing monitoring activities with the objective of identifying financial stability vulnerabilities in the euro area and preparing to warn Members concerned, one should recall the advice offered by Nobel Prize-winning economist Paul Krugman in the International Monetary Fund's 2014 triennial surveillance review – that it is “offering analysis and advice to countries not, or not yet, in crisis that reduces the risk of crises, their severity [...], and the damage”.

Experience from past crises, and particularly the global financial crisis, has shown that the institutions were surprised by some of the features of the emerging threats, and were left insufficiently prepared to advise policymakers. Literature on the failings of surveillance activities in the context of the global financial crisis demonstrates the importance of a systematic approach to continuous monitoring and preparedness with effective policy responses.

Key lessons of relevance for the ESM's role in preparing for future crises include:

- Excessive focus on individual institutions or countries blindsided surveillance, which failed to spot critical interconnections and cross-border risks, including abrupt capital flows.
- Unresolved data limitations that left the institutions with inadequate analytical tools and frameworks. Macroeconomic and financial surveillance frameworks for risk detection were still in development, leading to limited integration of financial risks into macroeconomic models. This resulted in insufficient efforts to understand complex financial products, market structures, and market behaviour.
- Because of incomplete understanding of the role of macrofinancial linkages and leverage, the institutions failed to appreciate how these could amplify shocks, and so expose even innocent bystanders.
- Surveillance institutions' organisational constraints, such as undeveloped governance frameworks, accommodated silo structures; pressure from governments hampered candour and allowed asymmetric country treatment in analyses. Such political pressure led to ineffective communication on the buildup of vulnerabilities to unsustainable levels. Organisational practices that undermined rigour included group-think, confirmation bias, and the neglect of both contrarian views and the duty to speak truth to power.
- Authorities' weak political commitment to early corrective policies, as well as insufficient recognition of the importance of policy buffers and effective safety nets, allowed events to develop into deep crises.
- Overconfidence in regulatory standards and the response capability of authorities fostered complacency and weak commitment to investment in crisis preparation through relevant scenario exercises, simulations, and dry runs.^{1a}

Analytical capability

The ESM's mission to enable Members “to avoid and overcome financial crises, thus contributing to long-term financial stability and prosperity” entails active preparation for a crisis situation through risk assessment, a focus on Members' reform strategies, and sharing ESM expertise in a broad manner, as stated in the ESM's 2023 strategic plan. Carrying that out requires excellence in analytical capabilities, given the demanding, fluctuating, and dynamic operating environment.

^{1a} Sources: ASEAN+3 Macroeconomic Research Office (2022), International Monetary Fund Independent Evaluation Office (2014) and (2011), McKibbin and Stoockel (2009); Poole (2015).

Analytical capability refers to an organisation's ability to use data, evidence, and analysis to inform decision-making and drive results in a timely manner. It includes the capacity to collect and analyse data, develop and use analytical tools and models, and produce and disseminate high-quality reports and recommendations. It may involve conducting research and data analysis, or producing reports and other knowledge products that provide insights and recommendations for action. Performing a capability may happen quite autonomously, but its development is infused with conscious deliberation, planning, and expertise. To qualify as a capability, an activity must have been practised enough for it to work in a reliable manner.

Capability development relies on learning. The practice of iterative cycles of exploration and experimentation, application of systems thinking, regular performance management, and knowledge management processes, or evaluations, form a foundation for learning. To develop a capability, the new action patterns that have been selected must be reused over time and across space. An instance of problem-solving can trigger development of capability, but it does not constitute a capability as such unless this new pattern becomes 'habitualised' by individuals (Bridoux et al., 2017).

An organisation with strong analytical capability is considered able to use this information effectively to achieve its goals and improve its performance over time. As an organisational capability, it embeds managerial and leadership functions. Generally, excellence in this capability is considered to require a collaborative and interdisciplinary approach, cutting-edge tools and methods, commitment to learning and improvement, as well as clear communication and dissemination strategies.

This evaluation concentrates on the analytical capability that is created in the context of the ESM reform for the enhanced mandate (Box 2.1). More specifically, given resource and time constraints, the evaluation primarily focuses on the 2020 Management Plan and the initiatives it set in motion:

- first, to establish and deploy the new monitoring capability that maintains vulnerability assessments and an alerting procedure on actual risks to financial stability; and
- second, to develop and maintain preparedness for programme engagement.

Literature in the field typically uses preparedness and readiness interchangeably. In this evaluation, readiness refers to an individual mental or cultural disposition for particular activities and responsibilities, while preparedness is considered an institutional feature. The ESM has no formal definition for these terms.

Given the unfinished ratification process of the amended ESM Treaty, the progress made and level of preparedness reached to assume the ESM's new responsibilities is the key metric of success for the purpose of this evaluation. It is assumed that the mission embodied in these new responsibilities represents an organisational transformation in which an organisation previously primarily focused on financing establishes a complementary macroeconomic and macrofinancial identity. The new features do not nullify the financial capabilities that are required to ensure the feasibility of market funding; they do respect balance sheet constraints that arise from liquidity and other risk management requirements.

The concept of capability is further discussed in Chapter 2 of the technical annex. Given the conceptual nature of analytical capability, this evaluation report ties such capability to the operationalisation of the ESM mandate and aims to respond to management's call for concrete conclusions and recommendations. Some issues nonetheless call for points of reflection rather than single-handed recommendations. The report, therefore, also features several boxes that elaborate on specific themes that came up during the evaluation process.

Evaluation approach

The evaluation approach is based on good practice at international financial institutions and the United Nations, which aims to ensure broad stakeholder input and to corroborate information sources with other data to ensure an adequate level of robustness.

The evaluation's design contains multiple analytics (elaborated further in the technical annex):

- To assess the analytical processes and key products, the evaluation team reviewed ESM analysis around five shock events to the euro area – the United Kingdom's departure from the European Union (EU) as a Member State (Brexit), the Covid-19 pandemic, the 2022 energy crisis, recent monetary policy tightening, and the failure of Credit Suisse.
- Staff and management contributions through self-evaluations, surveys, and related focus group discussions were important to keep the evaluation grounded in concrete practice. One country team explained their country risk assessment process step by step in a walkthrough; the roles of horizontal workstreams were assessed with network analysis, and a broad bibliometric study explored the ESM's publication and research activities.
- Specific document studies examined staff job descriptions and training, while broader document research helped to assess progress in tool and product development.
- Finally, 87 stakeholder interviews fed into a benchmarking approach, and allowed the team to collate these professionals' expectations of the ESM's new responsibilities and their personal experiences of the institution. The team interviewed academics, Member representatives, central bankers, representatives of other national authorities such as fiscal councils and resolution funds, think-tank experts, officials from other international institutions, and former ESM staff. This provided a dataset to benchmark the ESM's analytical system against that of relevant institutions or institutional backgrounds. Chapter 2 of the technical annex includes descriptive statistics.
- The fact that the evaluation team comprised mainly ESM staff allowed them to observe internal events such as committee meetings and to engage in informal discussions with colleagues.

The evaluation benchmarks the ESM against peer institutions, namely the European Commission, European Central Bank (ECB), and International Monetary Fund (IMF), unless otherwise specified. The World Bank, the Organisation for Economic Co-operation and Development (OECD), and the ASEAN+3 Macroeconomic Research Office (AMRO) are also used as reference institutions for specific comparisons. Some shock event studies weigh ESM output against that of private investment banks or think tanks. Where this evaluation refers to management, it pertains to the relevant ESM department, its Management Board member, and division heads. Senior management refers to the level of the internal Management Board, which advises the Managing Director.

While the approach is functional, the evaluation questions focus in organisational terms on the activities of three departments, the relevant roles of which are summarised in Table 2.1. The findings nevertheless also raise issues relevant for other organisational functions, such as Human Resources, Communications, and Corporate Governance and Internal Policies. The evaluation did not address all ESM analytical capabilities – it should be recognised that such capabilities exist across the organisation and beyond the focus of this evaluation.

Data collection ran largely from May 2023 to April 2024, and most datasets collected had cut-off dates of end-2023. A preliminary version of the report was shared with the ESM's Management Board for feedback. Division heads were also given an opportunity to comment, including on the final draft. The Evaluation Reference Group discussed evaluation design, work plans, and key interim products, bringing external expertise and helping to maintain analytical rigour.

The evaluation was conducted by a team of ESM staff drawn from several functions, giving it a participative nature, featuring intensive interaction with the rest of the staff and with management. The evaluation team was supported by one external consultant.

Limitations of the evaluation

Boundary decisions made by the evaluation team considering various constraints, including resource limitations, led to exclusions; the ESM's Investment function and lending instruments, analytical work related to these, and the ESM's Risk Management function were dropped from this evaluation, despite having certain interlinkages with the core topic. Operational aspects of service provision, such as the Single Resolution Board (SRB) backstop, funding, and investment were also considered beyond the scope. The team did not assess the modelling of the backstop. Instead, they took note of it having been validated externally. Likewise, in the review of monitoring products not all high-frequency products were included, due to the evaluation team's resource limitations.

Time constraints affected the completeness of the qualitative analysis, although external participants' availability proved better than was anticipated at the outset. The number of interviewees was deemed adequate, with a focus on balanced data capture and deeper understanding through interactions with internal interlocutors.

The team could not visit all member countries but invited all Members to participate in a Board survey. After they had completed the survey, Member representatives indicated that the questionnaire had helped them prepare detailed views in advance. Identifying informed external stakeholders – bellwethers – produced a high rate of successful, productive interviews. Even when interviewees were unfamiliar with the ESM, they provided valuable benchmarking insights.

The qualitative approach, while powerful, may introduce subjective bias. This was mitigated through organisational knowledge, stakeholder analysis, contextualising findings, and triangulation among members of the evaluation team.

Key person risk materialised as three team members left during the drafting stage, causing delays and reducing the time for synthesis. Limited control over team members' availability due to workload in their principal day-to-day roles also impacted the process. Artificial intelligence (AI)-based analysis was used to compensate for this shortfall when source data confidentiality was not deemed a barrier.

Finally, the evaluation team notes that the small staff size of the ESM creates challenges in taking statistically significant samples. Given that this report is strictly based on concrete findings, lower response rates to questionnaires among certain groups of staff may translate to those business areas receiving less mention.

Without resource and time constraints, the team could have conducted a broader benchmarking study on market analysis and intelligence. Access to Human Resource records was limited. A job satisfaction survey could have further informed the evaluation. So could exit conversations with staff who had resigned, or summaries of coaching objectives. An online chat box could have collected more staff views, and AI solutions could have facilitated structured interviews and yielded microlessons. Access to staff emails and calendars could have enabled deeper social network analysis.

Report structure

Chapter 2 outlines the Plan to build the necessary analytical capabilities for the ESM's enhanced mandate and evaluates its implementation.

Chapter 3 maps the main components of the ESM analytical system to assess its robustness, examining the relevance of the profiles and capabilities of staff recruited to analytical needs. The chapter reviews key products, processes, and recurrent analytical tools used to assess risks to financial stability, or to measure risks to ESM/EFSF operations. It considers priority setting and quality assurance.

Chapter 4 evaluates the effectiveness of the ESM's analytical capability in terms of preparedness for risk detection and financial assistance programmes, outreach and influence, and modalities for profiting from external engagement.

Chapter 5 centres around the evaluation criterion of continuity which is also called sustainability. Through this concept, the report examines the capability of the institution to maintain operations when staff rotate or leave the organisation, as well as its ability to apply anticipatory approaches and the potential for future scale-up. Furthermore, it considers to what extent the relevant inter-institutional framework contributes to the ESM's ability to excel.

The final chapter draws conclusions on the basis of the findings and lays out a set of recommendations for management and other stakeholders to consider.

The report is accompanied by a technical annex that provides supplementary details and elaborates how the evaluation was designed and conducted. The annex also contains details of an externally prepared bibliometric study.

2. Building new capabilities

This chapter assesses the Management Plan, which addressed the challenges of the ESM's implementation of its enhanced mandate. This plan needs to be considered a process of constant improvement and transformation. The chapter considers the following questions:

- To what extent have recent efforts advanced the ESM's capability to deploy and integrate economic and macrofinancial analysis with market intelligence to identify relevant risks and policy options?
- How closely did implementation of the Management Plan correspond to this objective?

The Management Plan

The ESM reform (Box 2.1) includes the processes to put in place the ESM's enhanced mandate.¹ This comprises the further development of ESM lending instruments, expanding the ESM's role in the design, negotiation, and monitoring of financial assistance programmes, following and assessing macroeconomic and financial risks and debt sustainability, and setting up a common backstop for bank resolution supported by the Single Resolution Fund (SRF). The Management Plan provides the conceptual framework for this evaluation to focus on the key analytical capabilities resulting from the ESM reform, as opposed to the administrative (executorial) and organisational aspects delivered within the corporate project known as the Enhanced Mandate Project.²

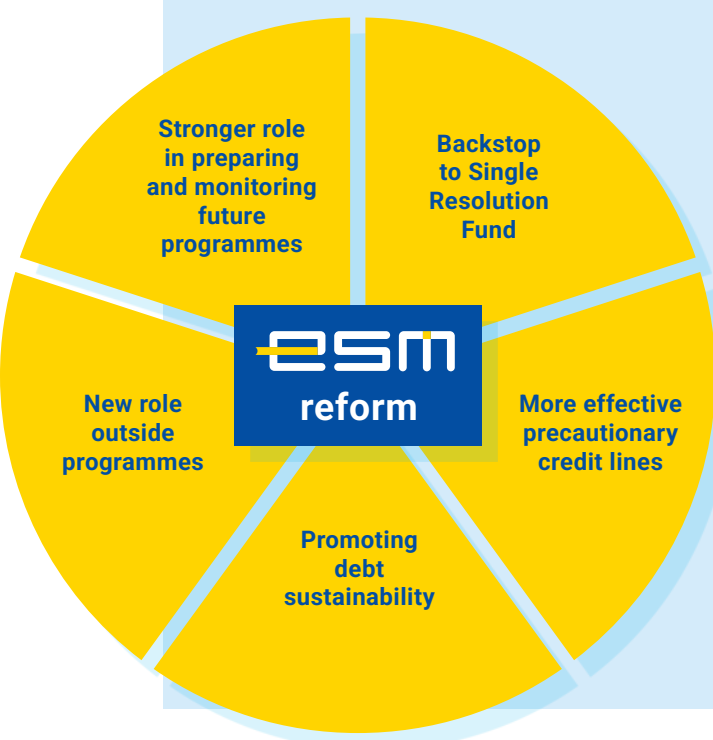
Box 2.1 The ESM reform

In June 2017, the ESM's Independent Evaluator, Gertrude Tumpel-Gugerell, recommended that the Members clarify the ESM's role in euro area institutional development: "Going forward, ESM Members may discuss a broader preventive mandate for the financial stability of the euro area, including the ESM's role." The ESM's Governors took note of the recommendation and agreed that clarifying the institution's role might be part of a broader debate on governance of the euro area rather than demanding immediate action by ESM management.

Following further discussions, ESM member countries all signed the Agreement Amending the ESM Treaty in early 2021. This agreement provides the legal basis for a set of new tasks assigned to the ESM. These include providing a backstop for the SRF and a stronger role in future economic adjustment programmes and crisis prevention. To create this legal basis, Article 3 of the ESM Treaty was modified to read as follows (new text in *italics*):

Purpose

1. The purpose of the ESM shall be to mobilise funding and provide stability support under strict conditionality, appropriate to the financial assistance instrument chosen, to the benefit of ESM Members which are experiencing, or are threatened by, severe financing problems, if indispensable to safeguard the financial stability of the euro area as a whole and of its Member States. *Where relevant in order to internally prepare and*



enable it to appropriately and in a timely manner pursue the tasks conferred on it by this Treaty, the ESM may follow and assess the macroeconomic and financial situation of its Members including the sustainability of their public debt and carry out analysis of relevant information and data. [...]

2. The ESM may provide the backstop facility for the SRF to support the application of the resolution tools and exercise of resolution powers of the SRB as enshrined in European Union law.

3. For these purposes, the ESM shall be entitled to raise funds by issuing financial instruments or by entering into financial or other agreements or arrangements with ESM Members, financial institutions or other third parties.

As is clear from the new text of Article 3, while the provision of the SRF backstop is an outright addition to the ESM's current mandate, the monitoring mandate is connected with the ESM's existing mandate to safeguard financial stability. The new monitoring role therefore constitutes a deepening rather than a widening of the existing mandate, and reflects the recommendation for the ESM to have a broader preventive mandate for the financial stability of the euro area.

The reformed treaty will come into force when ratified by the parliaments of all 20 ESM Members.

The core of the Management Plan is the integration of the various strands of analysis at the ESM, particularly the ramping up and integration of macrofinancial and market analysis.³ Combining the experience, knowledge, and tools available across the respective divisions in the organisation improves the ESM's ability to monitor macrofinancial risks, contributes to effective market operations, and enhances the ESM's reputation as a core euro area risk management institution for the benefit of a robust safety net and the stability of the euro area.⁴ The ESM rapidly revised its organisational structure (Table 2.1) to prepare for the enhanced mandate. This task was complicated by the fact that the ESM had been operating as a project-based institution, focused on restoring financial stability after the euro area sovereign debt crisis, and so had to be converted into an institution driven by ongoing, forward-looking processes, with new priorities deepening and going beyond that original crisis-resolution mandate.

Implementation fidelity

The Enhanced Mandate Project was closed “most satisfactorily” in December 2020, with all planned workstreams completed, according to the project report. The deliverables⁵ established the necessary organisational changes and approvals – most importantly from the capability perspective, an agreement on staff planning. The Chief Economist (CE) department was reorganised (Table 2.1) and a Review function created within the Secretary General (SG) department. Table 3.1 in the technical annex provides further details of the Enhanced Mandate Project.

Table 2.1
Revised organisational structure for the enhanced mandate

Division	Restructuring	Key tasks under the enhanced mandate
Chief Economist department		
Economic and Market Analysis	Setting up new euro area and market analysis teams.	Performs macroeconomic analysis to monitor euro area aggregate vulnerabilities and risks, conducts market analysis to monitor developments in fixed income markets and activity of issuers. Conducts and coordinates policy-relevant research in the department and prepares flagship internal document, the Economic and Financial Risk Report (EFRR), with input from other units. Some economists participate in country monitoring activities.

Division	Restructuring	Key tasks under the enhanced mandate
Financial Sector and Market Analysis	Non-bank financial sector team added.	The existing banking focused unit enlarged its focus to prepare for the common backstop to the Single Resolution Fund and to cover non-bank financial institutions. It develops analytical tools and deploys financial market information to capture system-wide risks and ensure ESM crisis preparedness. It also provides specialised expertise to (post-)programme activities, sharing responsibilities with the Economic and Market Analysis and Economic Risk Analysis divisions.
Economic Risk Analysis	New division.	The division is dedicated to country monitoring. It leads and coordinates all aspects of country work related to ongoing programmes or post-programme surveillance, both internally and with formal stakeholders – the beneficiary Member State, the European Commission, the ECB (including the Single Supervisory Mechanism for banks), and the IMF. It provides a creditor's view on design, implementation, and monitoring of financial assistance to Members and the SRF backstop.
Secretary General department		
Policy Strategy and Institutional Relations	Setting up the horizontal Review function.	This division supports the Chief Economist department divisions for quality assurance regarding products and policies. In addition, the unit conducts rating analysis and policy strategy coordination.
Chief Financial Officer department		
Funding and Investor Relations	Setting up new teams.	Established Derivatives and Market Intelligence, Investor Relations, and Planning and Execution teams. There is a prominent focus on market intelligence. The Derivatives and Market Intelligence unit together with the enhanced EMA, Investment and Treasury, and Financial Sector and Market Analysis divisions cooperate on monitoring financial market risks and collecting their feedback.
Asset and Liability Management	No change.	The division monitors on- and off-balance sheet structural risks such as funding, liquidity, interest rate, and FX risks, and proposes and implements hedging strategies. It also provides financial expertise to the country teams.
Investment and Treasury	No change.	When implementing the ESM's investment strategy for the paid-in capital, the team also performs market monitoring activities and produces regular market intelligence reports for the institution's internal purposes.

Notes: Situation at end-2023. Country monitoring was broadened according to four principles: a) risk-based approach; b) focus on the assessment of macroeconomic and financial risks; c) resources devoted to each country calibrated to the potential risks to financial stability; and d) possible spillovers to other euro area member states. This framework went into operation in 2021 and was further modified in 2022. In May 2024, the country teams were monitoring five former programme countries, one high-risk country, two countries whose large size entails high spillover risks, and five medium-risk countries.

Source: ESM Enhanced Mandate - Strategy and Implementation, internal presentation of 27 January 2020 and ESM functional model

The Enhanced Mandate Project allowed the ESM to acquire and develop the human resources that ensured the necessary organisational and analytical milestones in a process of gradual transformation. Staff budgeting nevertheless took longer than initially planned and the increase in headcount was more limited than originally proposed by management. Upon recommendation by the Group of External Experts, the Board of Directors implemented the vote of the Budget Review and Compensation Committee, agreeing to the recruitment over three years of 36 full-time equivalent employees, instead of 43.⁶ The Group of External Experts found that the overall headcount need was smaller than proposed by the ESM because the institution should reassign staff from other functions in times of crisis. Experienced and well-trained staff would step up to the challenge of an emergency, and prioritisation would lead to interrupting certain monitoring and support activities. Based on experience from other institutions, the evaluation's findings point to a preference for sourcing market intelligence particularly through banking and economic functions rather than market-facing functions.

The smaller than envisaged increase in headcount prompted changes to the planned operating model, increasing reliance on teams conducting market analysis in the CE department.⁷ The 2020 administrative budget states: "Broadened country monitoring will be implemented in a risk-based manner, focused on the assessment of macroeconomic and financial risks, and with the number of resources devoted to each country calibrated to the potential risks to financial stability and possible spillovers to other euro area member states."⁸

Workforce constraints were also addressed by establishing several horizontal working groups to form a matrix of team linkages across departments and divisions. These groups include thematic teams, such as the Market Data Working Group (Data Steward Group), the Informal Market Forum, the Modelling Team, and the Risk Group, and area and country teams, such as the Euro Area Monitoring Team, the Early Warning System (EWS) Coordination Team, and the Macrofinancial Framework Coordination Team.

The Management Plan developed the necessary analytical capability in terms of tools, processes, and products to implement sufficiently the enhanced mandate with the follow-up work plans. The implementation of the core elements is very advanced and broadly in line with the 2019-2020 planning. Management considers most analytical tools to be in place and operational for the monitoring of macrofinancial risks, but some work is still needed if the ESM is to be prepared for programme engagement. Implementation of the Management Plan is a process of constant improvement and transformation with follow-up defined in each division's annual objectives. The key elements of the Management Plan are shown in Table 2.2.⁹ The latest elements in the third column also reflect objectives for continued capacity building and efficiency improvement.

Table 2.2
Management Plan for the enhanced mandate

Workstream	Milestones/achievements	2024 objectives
Core element		Enhanced economic and financial risk monitoring
Preparation for programme role	<ul style="list-style-type: none">Objective of regular dry runs or simulations setIMF financial programming training	<ul style="list-style-type: none">Further improve operational readiness for potential ESM programme by enhancing staff programming skills (core objectives, policies, monitoring/conditionality, financing, and lending) and conducting a dry run exercise.Develop and optimise lending models to ensure suitability for both programme loans and SRB backstop.Establish a structured and documented framework that is designed to be subject to audit or examination for the lending models, ensuring transparency and reliability.Dry run follow-ups.^{a)}
Effective precautionary instruments	<ul style="list-style-type: none">Design and operationalisation of Pandemic Credit Line as an additional response instrument to Covid-19Dry run on Enhanced Conditions Credit Line (ECCL)^{b)} instrument (postmortem report)	Overall instrument review for discussion by Board of Governors at the Annual Meeting.
Risk-based approach for country monitoring	Adoption of risk-based approach for country monitoring and in-depth analysis of issues relevant for financial stability	<ul style="list-style-type: none">Further improvement of the country analytical toolkit and more dry runs.Roll out DSA for countries based on Dynamic Stochastic General Equilibrium model and development of risk thresholds.Integrate climate change risk assessment in the country monitoring framework.Full implementation and inclusion in regular country work of Capacity Assessment Tool.Strengthen collaboration between euro area team and country teams following the four largest Members, optimising the use of common tools.

Workstream	Milestones/achievements	2024 objectives
Integration of macrofinancial risk assessment	<ul style="list-style-type: none"> Macrofinancial linkages framework for euro area analysis EFRR Market Data Working Group (DataLayer) transformed into Data Steward Group Risk Group (to be formalised) Informal Market Forum Designated teams (Market Analysis team in Economic and Market Analysis division, Lending team in the Economic Risk Analysis division) 	<ul style="list-style-type: none"> Further enhance the CE department macrofinancial linkages framework (complementarities between Economic and Market Analysis and Financial Sector and Market Analysis divisions' tools; consolidation of euro area macrofinancial risk assessment toolkit and reporting; guidance note and a smart catalogue on euro area risk tools; develop growth-at-risk project; develop firms' level database Orbis). Consolidate the euro area risk assessment framework and further develop an integrated, CE department-wide approach. Provide a timely view on global and euro area economic and financial markets developments and outlook, identifying key risks and emerging trends. EFRR dry run. Deepen engagement with peer institutions on risk assessment (CE department).
Analytical tools and indicators (e.g. Debt Sustainability Analysis (DSA), Repayment Capacity Assessment, Bank Viability Indicator (BVI), Sovereign Vulnerability Indicator (SVI))	See Chapter 3 for details	<ul style="list-style-type: none"> Consolidate and extend existing analytical toolkit (e.g. risk-free rate, spread scenario infrastructure, euro area fiscal monitoring framework, Dynamic Stochastic General Equilibrium model development). Enhance DSA framework. Macro, interest rate, and scenarios of sovereign yields developments within EWS. Design, develop, and operationalise a euro area-wide risk skewness measure. Enhance monitoring of the United States, with special focus on fiscal.
Processes (internal)	<ul style="list-style-type: none"> EWS process including Internal Control Framework reviewed Horizontal coordination for DSA assumptions established EFRR process established and formalised Review function's quality assurance steps integrated in the reporting process Mission preparation (policy note) - Back to Office Report - debrief process for country teams through Economic and Financial Monitoring Committee 	<ul style="list-style-type: none"> Improve efficiency and strengthen internal processes. Improve coordination across divisions, leveraging new technologies available to the ESM. Establish process with identifying and following up with key messages/common themes from the EWS reports. Conduct periodic reviews for reprioritisation to reduce individual workloads. Review and document existing processes, guarantee that all critical processes have backup.

Workstream	Milestones/achievements	2024 objectives
Review function	<ul style="list-style-type: none">Policy framework in place (note and self-review after one year)Process connecting the Review function to EWS and EFRR in place and activeAnnual Policy Review Agenda	Further develop the review process by enhancing the underlying analytical framework.
Senior level committee	<ul style="list-style-type: none">Terms of Reference approvedEconomic and Financial Monitoring Committee set up and active	
Collaborations (external) with European Commission, ECB, and others (on debt sustainability, forecasts, risks)	Memorandum of Cooperation with the European Commission agreed	<ul style="list-style-type: none">Operationalisation of the cooperation with the European Commission at staff level.Explore possible cooperation agreement with the ECB, improve semi-annual meetings with the ECB.Engage and cooperate with IMF staff to benefit from their expertise on programme work and DSA.Maintain good collaboration with the SRB.
Core element	Backstop for the SRF	
Methodology to assess SRB repayment capacity	<ul style="list-style-type: none">Common Backstop Repayment Capacity Assessment Methodology jointly developed by ESM and SRB, conditional on treaty ratification^{a)}External model validation completed (positive technical opinion)Process dry run	<ul style="list-style-type: none">Re-test models and discuss results with the SRB once access granted to the data room (pending treaty ratification).Implementation of model refinements, enhancement of the methodological note, code governance, and IT infrastructure.
Preparation and operationalisation of the backstop ^{c)}	<ul style="list-style-type: none">Collaboration agreement with the SRB signed, to take effect after treaty ratifiedInternal Control Framework documentation in place	<ul style="list-style-type: none">Complete operational agreement and data room rules in 2024.Complete liquidity loan dry run with all stakeholders.Pre-disbursement monitoring.Finalise tools after treaty ratification.

Notes: Data as at end-2023.

a) The CE department divisions identified four key areas for improvement with concrete actions: rationalise the format of existing tools; data/IT-related issues; new tools to be developed. See the internal ECCL Dry Run Postmortem Report 2024, section 3.2.1 of the CE department's analytical toolkit.

b) Precautionary financial assistance may be provided via a Precautionary Conditioned Credit Line (PCCCL) or via an ECCL. A PCCCL and an ECCL credit line can be drawn via a loan or a primary market purchase. Both types of credit line shall have an initial availability period of one year and shall be renewable twice, each time for six months.

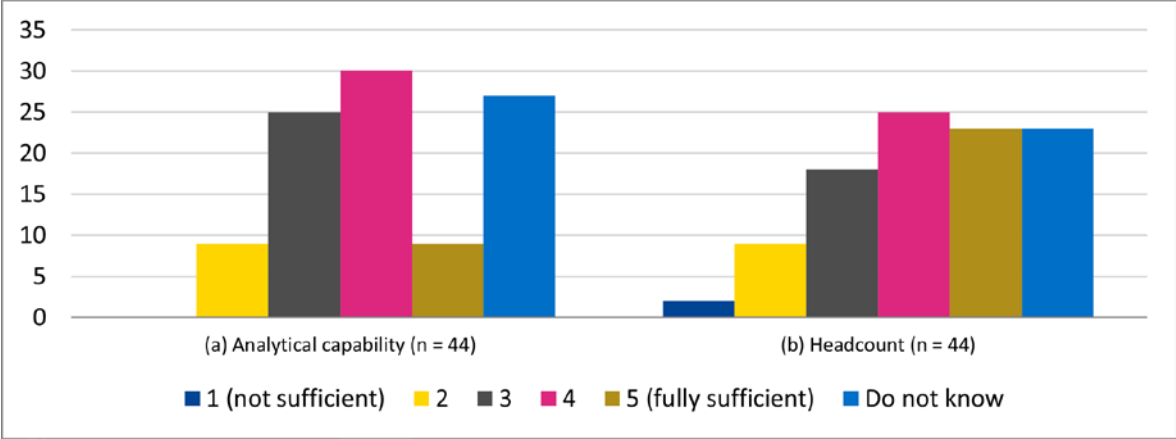
c) Operationalisation of the backstop is not considered within the scope of the evaluation.

Sources: ESM Enhanced Mandate – Strategy and Implementation, internal presentations of 10 December 2019 and 27 January 2020; Enhanced Mandate Project – Project Closure Report, internal note (2021); Economic Risk Analysis Objectives 2024, internal presentation; Economic and Market Analysis Divisional Objectives 2024 (Final), internal presentation

ESM staff who responded to a survey view the Management Plan as broadly sufficient to meet the challenges of the enhanced mandate in terms of analytical capability and headcount (Figure 2.1). The analytical agenda of previous years and projects now in the making broadly focus on the institution’s strategic policy objectives and the enhanced role.¹¹ Staff consider progress to be sufficient in terms of the overall organisational structure, the analytical system (e.g. the Monitoring Framework, EWS, DSA, bank viability indicators), the Review function, and the operation of the senior-level oversight committee (the Economic and Financial Monitoring Committee or EFMC). While Management’s ability to mobilise employees’ analytical talents, skills, and capacities to fulfil the enhanced mandate is considered broadly good (Figure 5.3), progress in process efficiency is viewed as less advanced due to too many processes overlapping (Figure 2.2). Individual staff comments deemed insufficient resources, insufficient prioritisation by management, and inadequate internal communication as potential constraints to meeting fully the objectives of the Management Plan.

The EFMC’s preparedness to perform its tasks under the enhanced mandate is rated overall positively by staff, although guidance on pre-programme, programme, and post-programme interactions with stakeholders is seen as somewhat less well prepared.¹²

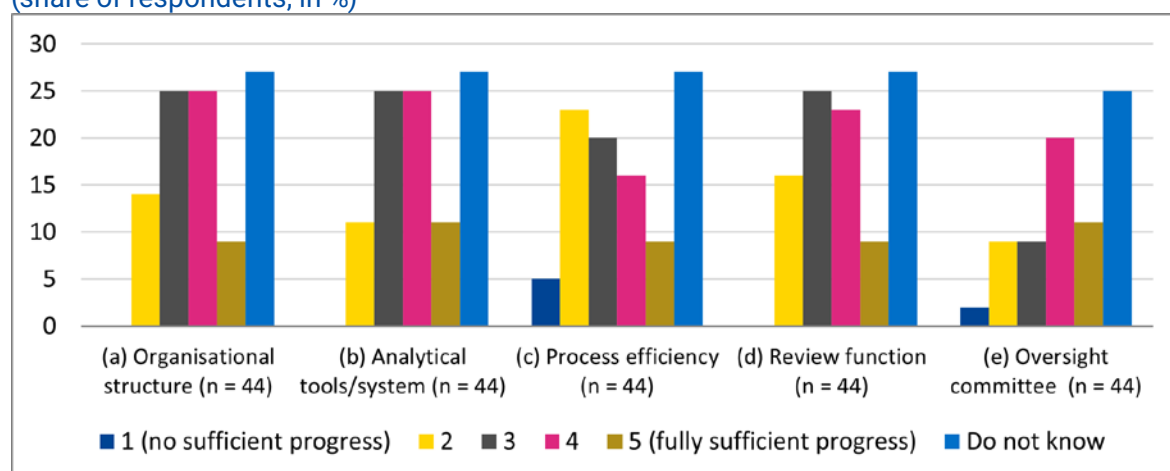
Figure 2.1
Management Plan: staff views on analytical capability, headcount
(share of respondents, in %)



Notes: Based on 44 responses to the question: "Do you deem the ESM Management Plan – once completely implemented – sufficient to meet the challenges of the ESM's enhanced mandate regarding (a) analytical capability and (b) headcount (personnel capacity)?" For details, see technical annex.

Source: ESM staff survey (2023)

Figure 2.2
Management Plan: staff views on progress of implementation
 (share of respondents, in %)



Note: Based on 44 responses to the question: "How do you rate progress made in implementing the ESM Management Plan regarding (a) overall Organisational Structure (e.g. CE department structure, SG department Review function, EFMC, Macro-Market Discussion Forum, Market Data Working Group), (b) Analytical Tools and System (e.g. Monitoring Framework, EWS, DSA, Vulnerability Indicators), (c) Efficient processes, (d) launch of the Review function and (e) operation of the overseeing committee (EFMC)?"

Source: ESM staff survey (2023)

Most significant change

The change narrative drawn from a fact-finding exercise (Table 2.3) with CE department management emphasises that the adequate addition of highly skilled staff resources, through a selective recruitment process and budget planning, was of vital importance in the achievement of the Management Plan and the continuing transformation in capability. Having established a formal country monitoring framework and the supporting toolkit, management sees that process development facilitated deeper risk analysis and scenario work. Establishing a macrofinancial linkages framework and an efficient data infrastructure also advanced the underlying capability. Progress benefitted from interaction with peer institutions and their advice.

Table 2.3
Management Plan achievements: CE department management's top 10

Rank	Most significant changes to analytical capability
1	Improved ability to dedicate skilled resources to analytics thanks to an increase in headcount by over 30 experts.
2	Establishing a formal country monitoring framework supported by a toolkit to be applied to different countries.
3	Process development with deeper underpinning of risk analysis and scenario work.
4	Technical progress made in developing DSA methodology.
5	Introduction of the regular EFRR and other products to channel analytical output.
6	Introduction of a macrofinancial linkages framework for euro area analysis.
7	The ESM constructed a data environment that can be used across the CE department and possibly beyond.
8	Strengthening internal review processes by setting up the Review function in Policy Strategy and Institutional Relations and introducing the EFMC as an oversight body.
9	Documented and regular use of structured brainstorming to identify key analytical priorities.
10	Nurturing culture of awareness of the necessity to maintain crisis preparedness even in non-crisis periods.

Source: Management survey conducted by evaluation team (2024)

Implementation of the Management Plan benefitted most from internal drivers. From management's perspective, the regular reporting on analyses and consolidation of work determines outcomes and encourages a continuously developing conceptual framework and reporting process. The EFMC and the Review function operate as vehicles to process this information and the learning objectives. This is in line with good practice in sustainable capability building. The staggered recruitment process, however, acted as a bottleneck in the early stages, for example for the implementation of the formal country monitoring framework and toolkit development.

Management underscored the boost from externally supported dry runs for tool development. Later, delay in ratification of the amended ESM Treaty resulted in some loss of drive for the transformation and made the institution less attractive as a recruiter. Due to limited interaction with the governing bodies on the substance, their expectations for institutional preparedness remain vague.

Although ESM staff see a need to continue the transformation, they are substantially more confident than before about their capacity to tackle future crises and fulfil the ESM's crisis resolution role. Respondents to the staff survey rated model-based risk assessment in the EWS and euro area monitoring framework as the greatest achievements of the Management Plan, along with the workforce skills upgrade. They were generally of the view that more extensive priority-setting, and notably a stronger focus on early risk detection and the analysis of respective policy implications, are required to better prepare the ESM for its future crisis role. Nonetheless, a large majority of respondents were significantly more confident in their preparation for such an event, in comparison to the situation in 2019.

Conclusions

- The Enhanced Mandate Project established the formal preconditions to acquire and develop the human resources needed for the organisational and analytical changes required by the enhanced mandate.
- The Management Plan provided the framework to motivate staff with concrete objectives and timelines from 2020 to 2022. Efforts to integrate the various strands of analysis were key, particularly the ramping up and integration of macrofinancial and market analysis.
- The Enhanced Mandate Project structure enabled completion of the ESM Reform deliverables but intervening shocks in the form of the Covid-19 pandemic and the energy crisis created some delays on specific parts of the Management Plan. Delays in ratifying the amended ESM Treaty later dampened staff motivation.

3. Robustness of analytical system

The analytical system must respond to the needs of the mandate. Previous crises, and particularly the global financial crisis and the euro area sovereign debt crisis, revealed, however, that institutions involved did not always have tools commensurate with their mandates (Claessens et al. 2020; Box 1.1). To assess the ESM's analytical capabilities in the context of the institution's broader objectives, the evaluation team looked at four main types of process, according to what they yield: analytical products, data, tools, or staff capabilities. The overall analytical process is directed by high-level priorities set by the mandate and operational priorities defined by management. Analytical capability is further affected by the European and international institutional context in which the ESM operates.

This chapter was guided by the following questions:

- To what extent has the ESM implemented the macrofinancial monitoring plan devised in 2020?
- Were activities implemented as intended? How are these activities prioritised? Were internal roles and responsibilities clearly defined and implemented as planned?
- How well integrated are the various analytical activities? What are the arrangements to ensure useful integration of market analysis and intelligence with macrofinancial analysis?
- How appropriate is the intended scope of ESM analytical capabilities and activities for the enhanced mandate? How appropriate is the staggered approach for country assessment? What is the capacity to produce timely analyses?
- How well do staff profiles match with the analytical needs? Is there a good balance between specialists providing depth and generalists, including those with management skills? How are needs identified and articulated? How have the capabilities sought through recruitment evolved since 2019?
- How well is the ESM prepared to alert members about identified economic and financial vulnerabilities and risks?
- Implementation of the Review function: How is its conceptual framework defined? To what extent is guidance available for the implementation of the Review function? What synergies have been created within the ESM?
- Are ESM work processes well suited to their purpose?

Overall framework and priorities

In line with the Management Plan, the enhanced monitoring activity is rooted in four functions managed by the CE and Chief Financial Officer (CFO) departments, while the Review function anchored in the SG department provides quality assurance. All teams involved collaborate to develop the analytical system and prepare analysis. This feeds into key products that assess vulnerabilities for discussion by the Economic and Financial Risk Committee, the senior oversight body. Additional products inform other internal committees, such as the Finance Committee, the Investment Management Committee, or the Internal Risk Committee, as well as going into preparations for ESM engagement in international fora (Figure 3.1, Table 2.2).

Box 3.1 Assumptions underlying the expansion of analytical capacity

Previous ex-post evaluations at the ESM have been based on a Theory of Change or Intervention Logic. Knowing what assumptions underlie an institution's choice of certain actions – i.e. how precisely it thinks those actions can help it achieve its goals – is particularly valuable for evaluators because identifying those assumptions permits more detailed assessment of whether and how the actions under review have worked in practice. Yet assumptions are often tacit, making them hard to identify.

The ESM does not clearly spell out underlying assumptions. These tend to be taken for granted by those closely involved, as independent evaluations also found in 2017 and 2020. This form of tacit knowledge is seldom shared equally by all staff or understood by other stakeholders. This often leads to evaluators navigating diverging, even conflicting, expectations of what plans aimed to achieve.

Following advice from the Evaluation Reference Group, no intervention logic was produced for the current evaluation. One assumption underlying the Management Plan does emerge from the evaluation findings – namely that analytical work by the ESM bears a direct relevance to its mandate of safeguarding financial stability in the euro area.

However, a significant number of respondents and interviewees questioned whether this is always or necessarily the case. Some said that analytical work often relates to specific deliverables deemed less central to the mandate, or that analysis is conducted in response to ad hoc questions or to discussions in EU meetings pertaining to economic or fiscal policy coordination. For some respondents, ESM analysis lacks a sufficiently holistic approach to the institution's core concern of financial stability.

Some interviewees felt that, for the purpose of analytical work, the very notion of financial stability is insufficiently defined at the ESM, covers too wide a range of topics, or lacks focus. A number pointed to peer institutions organising work on these fundamental concepts around agreed defining principles, an approach they believed was missing at the ESM.

In light of these findings, management, possibly in consultation with analytical staff, could reflect on the extent to which the analytical work being done is actually relevant to the ESM's mandate.¹³

Since the Management Plan was implemented, staff have prioritised improvements in monitoring processes and products. The Economic and Financial Risk Committee as a supervisory body assumed a core coordination role. Submission to the EFMC of policy notes serving mission preparation and back-to-office mission debriefs bolstered the monitoring of beneficiary Member States. In addition, the ESM's EWS assessing beneficiary Member States' repayment capacity has been updated. The preparation process underpinning the internal EFRR started to serve as an outlet for monitoring workstreams established by the Management Plan. It encompasses aggregate euro area risk analysis, monitoring of non-beneficiary Member States, and topical analysis relevant to functional monitoring.¹⁴ Where relevant, analysis also covers market-related aspects. The main processes benefit from input provided by the Review function of the SG department.

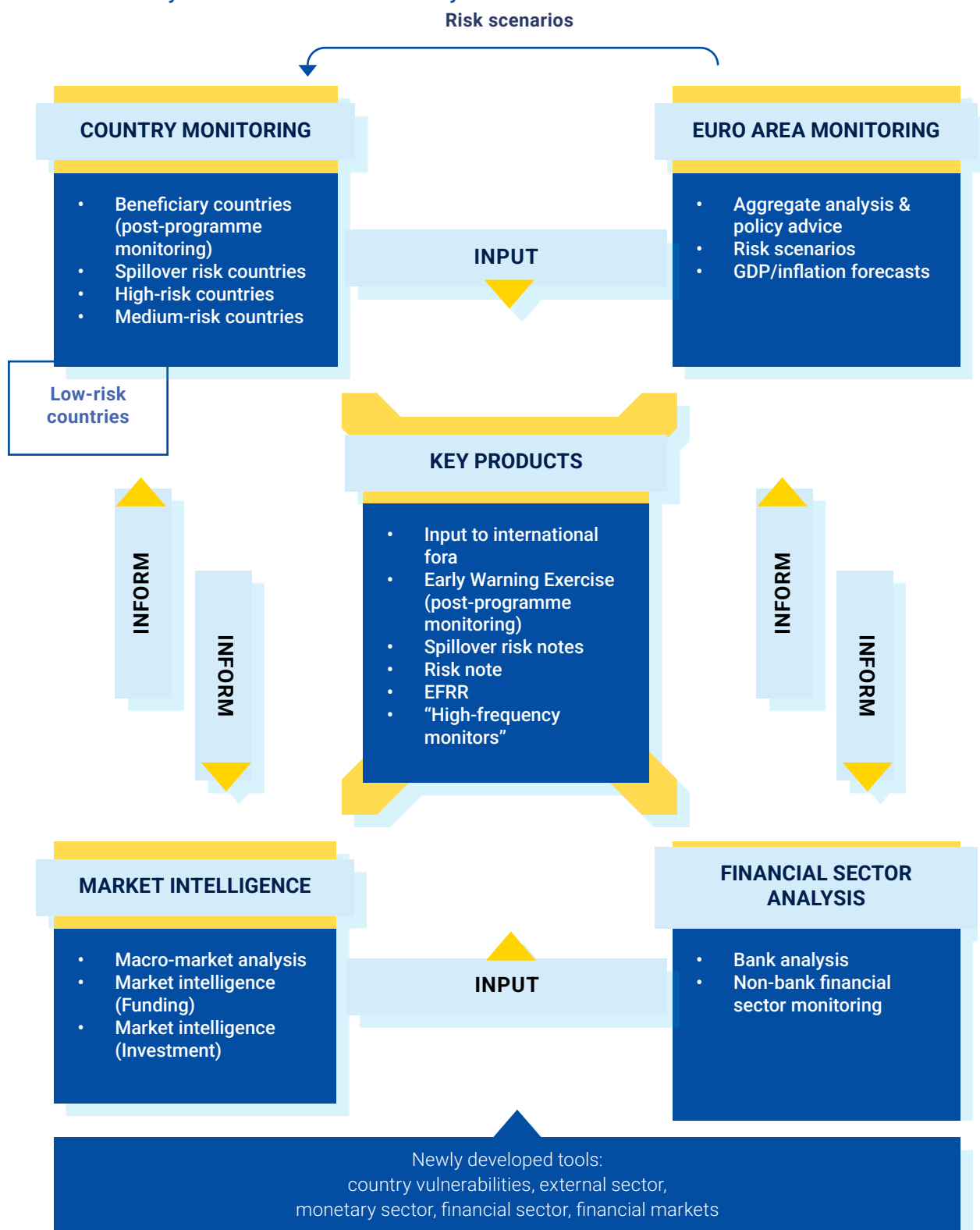
Annual strategic planning has distilled divisional objectives to deliver tools and products underpinning analytical and monitoring activities. The selected priorities have fed into research activities, as well as aggregate, functional, and country monitoring. Management paid special attention to the operationalisation of market monitoring and its interaction with other workstreams. While research was acknowledged as a separately coordinated workstream, only selected projects are recognised as priorities. Despite involving detailed annual plans, objectives include neither time allocation for the activities envisaged, nor any time buffer for later, ad hoc requests related to external engagement.

Overall, the ESM's analytical system rests on the following principles:

- Analytical processes run in various cycles depending on the product prepared.
- Tool development is a bottom-up and top-down effort, on the basis of the 2020 macrofinancial monitoring plan.

- Delivery on tasks is arranged under several horizontal workstreams, of varying degrees of formality, shared among units to ensure broad use of talent and resulting in a matrix structure.
- Tool development and recurrent monitoring are organised under three monitoring strands: country monitoring; enhanced aggregate euro area monitoring; and functional monitoring of the financial sector and markets.
- Country monitoring intensity reflects the country risk category. While beneficiary Member States constitute a special category, other countries are assessed according to the ESM's risk categorisation methodology.

Figure 3.1
Interaction of key elements in the ESM's analytical framework



Monitoring products and processes

Practical cases in risk monitoring: shock event studies

The evaluation team reviewed the ESM's analytical capability around five shock events to the euro area: Brexit, Covid-19, the energy price hike, rapid monetary policy tightening, and the failure of Credit Suisse. The purpose was to assess the timeliness, clarity, and rigour of ESM analysis and policy advice, benchmarked against publicly available material from peer institutions and other analysts, such as investment banks. Individual time windows before and after the shock were defined for each study, but documents outside this window were also considered. Table 3.1 summarises results of the five studies.¹⁵ Chapter 5 of the technical annex expands on the details. Conclusions from the shock event studies are reflected throughout this chapter.

While the studies identified notable strengths in the pre-emptive identification of risks, the shocks revealed that weaknesses remained in analytical capability. The delivery of economic analysis lagged market intelligence signals. Although some lag is inherent, gaps that were identified could hinder effective crisis management or the ability to provide actionable policy advice to preserve financial stability.

The studies show there is room to improve the link between market and macro analysis. The general implications can be summarised as follows:

- Incomplete integration of macrofinancial and market analysis: While the staff survey shows strong progress in integrating macrofinancial and market analysis (see Figure 6.2 in the technical annex), shock event studies point to the sometimes fragmented, siloed nature of the ESM's risk monitoring. This calls for more active internal collaboration and stronger processes. The ESM's analysis was often conducted on separate tracks (e.g. only partial interaction between market, macro, and financial monitoring in Brexit analysis).¹⁶ This limited interaction between different analytical strands, causing delays in exploiting early market intelligence signals.
- Timeliness of policy advice: While market analysis identified risks early, delivery of macro analysis by nature required more time. Limited and quantitatively-oriented resources prevented macrofinancial analysis from anticipating or deviating from the conclusions already drawn by peer institutions. The ESM did not go beyond mainstream views. Clear, timely policy recommendations remained scarce. The shock event studies provide only limited evidence that the ESM engaged in discussions beyond EU fora on policy solutions or shock mitigation options. All the studies underscore the importance of timely identification of interconnected risks to enhance the relevance and effectiveness of future policy recommendations.
- Focus on fiduciary responsibilities and general macro risks: The ESM's rather narrow focus on fiscal and macroeconomic developments may have hampered analysis of potential spillover effects and the broader implications of identified risks (e.g. spotting contingent liabilities for governments arising from energy companies' funding liquidity crisis in derivatives markets), highlighting a degree of disconnect in understanding such interdependencies. A strong focus on the repayment capacity of the beneficiary Member States as a fiduciary responsibility overshadowed analysis of euro area financial stability risks and growth prospects, suggesting limits to the ESM's ability to adequately address systemic risks in a timely manner. The ESM's limited communication of comprehensive policy recommendations indicates room for a broader analytical perspective.
- Knowledge gaps and insourcing: Gaining a broader analytical perspective requires specialised sectoral knowledge and useful external networks could help the ESM to source timely insights. The studies provide evidence that there has been limited use of analysis from national authorities, except for some beneficiary Member States.

- Scenario analysis and interconnected risks: The studies illustrate some capability shortcomings in developing consistent macrofinancial scenarios or in identifying spillover effects from broader market dynamics. Internal analysis often prioritised short-term market moves crucial for ESM funding and investment activities. While swift identification of risks is a clear strength of the ESM, some gaps appear in recognising the interconnectedness of risks, potentially resulting in longer-term threats to financial stability (e.g. risks related to inflation, monetary policy tightening, or political upheaval). These gaps hindered the ability to inform decision-makers or develop recommendations based on the unique context of the ESM's market operations.
- Deficiencies in the enabling environment: Regulatory limitations on access to granular supervisory financial data and the requirement to use European Commission macroeconomic assumptions in forecasts have inhibited the ESM's ability to produce timely, independent warnings on risks. While collaboration with peer institutions generally enhances credibility, the ESM's dependence on external data sources for analysis and decision-making poses significant challenges to the institution's operational effectiveness. Unlike the IMF's Financial Sector Assessment Program consultations, the ESM has not attempted to compensate for its unsuccessful data exchanges with EU institutions by directly reaching out to national authorities.

Table 3.1
Shock event studies: summary

Assessment criteria	Brexit (2015–2016)	Covid-19 2020	Monetary policy tightening (2021–2022)	Energy crisis (2021–2022)	Credit Suisse failure (2022–2023)
Timeliness of the analysis	<p>The ESM was aware of the Brexit referendum from 2015 and prepared for possible repercussions from early 2016. The analysis was triggered by ESM market monitoring.</p>	<p>ESM market staff swiftly identified the risks emanating from the virus, leveraging their role in financial markets, and provided regular updates on the shock spillovers from China. Macro teams employed a multi-scenario approach initially. Later stage timeliness was hampered by limited own forecasting capability.</p>	<p>The ESM's internal analysis did not systematically flag a risk of a persistent and significant rise in inflation and subsequent tightening of monetary policy until spring 2022.</p>	<p>ESM analysis covered the energy price shock impacts and potential risks in line with most peer institutions, mainly from early September 2021.</p>	<p>The ESM's monitoring was timely. The rescue merger was reported on the day of intervention and the ensuing events were followed daily.</p>
Clarity on context, history, and connections across policy areas	<p>The ESM did not conduct an analysis interacting with different economic policy areas in the run-up to the referendum. The analysis was conducted on separate tracks.</p>	<p>Evidence from meeting notes and reports on EU meetings indicate that ESM analysis on market consensus and evidence of macrofinancial linkages were appreciated by stakeholders. Systematic country analysis started in the second quarter of 2020, focused on the consequences of the pandemic in the broader context of repayment capacity.</p>	<p>The ESM's country risk analysis assessed risks to growth, inflation, fiscal position, and the resulting debt dynamics quantitatively, via at least two different scenarios.</p>	<p>The analyses were contextualised. The direct consequences of the energy price shock were followed from a fiscal and macroeconomic perspective. But there is no evidence that the energy price formation mechanisms and market microstructures were studied. The criticality of stable energy supply for politics was underestimated, despite the broad introduction of retail subsidies in Europe.</p>	<p>The ESM analysed non-euro area Credit Suisse as part of its monitoring of the financial sector, because it was a global systemically important bank.</p>

Assessment criteria	Brexit (2015–2016)	Covid-19 2020	Monetary policy tightening (2021–2022)	Energy crisis (2021–2022)	Credit Suisse failure (2022–2023)
Draws on relevant sources and compares scenarios or pathways	The ESM's analysis reflected findings of other institutions and was structured along various timeframes: short-, medium-, and long-term.	The macroeconomic analysis primarily relied on the work of the European Commission, IMF, ECB, and OECD. Limited evidence was found of use of analysis from national authorities, except for some beneficiary Member States. Academic research was used broadly. As the pandemic progressed, staff analysis, aligning with peers, focused on identifying key transmission channels.	The ESM's country risk analysis was based on the European Commission's forecast and methodology, the adverse scenarios were model-based and accompanied by a cross-sectoral narrative informed by recent euro area-wide macro and market developments.	Analysis drew on relevant sources and tried to put events in perspective. Policy relevance was understood, but it did not provide scenario analyses until Q2 2022 and showed little own concrete pathways ahead. While scope for substitutability was noted, the risk of a supply-constrained recession was flagged and quantified.	Besides news reports and Credit Suisse's financial statements, the ESM analysis also relied heavily on market data on credit default swaps, bonds, and equities. After the forced merger with UBS, the resolution framework, its actual implementation, and the implications for the market in junior subordinate bank bonds were the focus.
Uses relevant analytical frameworks/ methods, clarity on limitations provided	The ESM used metrics similar to other institutions. It focused on the impact on growth, trade, fiscal policy, and banking.	Staff assessed the impact and volatility in international financial markets, the outlook for the euro area (shape of recovery), and developments in trade and global value chains. The ESM took on a role to chart market consensus.	The internal country risk analysis was performed via scenario analysis, similarly to peer institutions.	While the market analysis took the form of well consolidated overviews, it lacked an own analytical framework, process, or deliverable comparable to peers. Reporting focused on inflation, terms of trade, and dampened growth. Q2 2022 economic analysis underscored the limitations of simulations.	The ESM had no direct credit exposure to the banks concerned nor were they a derivative counterparty. Bank analysis is based on the CAMELS supervisory rating system, like those of rating agencies. For event analysis no consistent framework was in place. Lack of supervisory data was acknowledged.

Assessment criteria	Brexit (2015–2016)	Covid-19 2020	Monetary policy tightening (2021–2022)	Energy crisis (2021–2022)	Credit Suisse failure (2022–2023)
Analysis/advice reflects relevant sectoral perspectives and spillovers	<p>The post-referendum analysis reflected various sectoral perspectives and analysed risks to euro area growth and to the repayment capacity of the beneficiary Member States.</p>	<p>Covid-19 analysis was structured along short-, medium-, and long-term lines. Macroeconomic analysis reflected the situation in a timely manner. Interactions with the European Commission were crucial for assessing fiscal policy and the macroeconomic outlook, given the absence of an independent forecast framework. Coverage was adequate in the macro, fiscal, and financial sector. Study of financial flows was deployed as scenario analysis.</p>	<p>While most sectors were adequately covered, any formal analysis of external sector risks using risk scenarios was missing. Analysis was more focused on the short term due to increased market pressure.</p>	<p>Mounting contingent sovereign funding needs resulting from volatility-induced margin calls in the energy derivatives markets for non-bank participants were not spotted. Analytical focus was on macroeconomic consequences, but connection with Too-Interconnected-to-Fail energy companies and their political sensitivities were not adequately noted to have traction on analysis.</p>	<p>The ESM covered the Credit Suisse failure through various notes. But the analysis did not include risks to euro area growth, financial flows, or risks to the repayment capacity of the beneficiary Members. It focused mainly on market analysis and the banking sector.</p>
Proposes potential engagement approaches/action to take/policy solutions/mitigation options	<p>The ESM's analysis focused on its fiduciary responsibility, while the analytical toolkit for euro area financial stability and analytical processes were yet to be developed. In spring 2016, a risk function coordinated an internal impact assessment of the referendum on ESM own operations. It was escalated to the Board Risk Committee.</p>	<p>The ESM set up the Pandemic Crisis Support instrument that made temporarily available financial assistance to Members, to recover costs related to direct and indirect healthcare, cure, and prevention. Internal collaboration was found to be a strength in formulating proposals.</p>	<p>Over the study window, internal analysis tackled broadly the same questions as peer policy institutions and adapted the risk narrative to the evolving situation.</p>	<p>The contributions offered mainly summaries from other sources, raising potential risks and questions but lacking clear and consequential action steps. The first staff simulations in September 2021 estimated a minor impact on GDP in 2022, noting disposable income pressures for households that might not have excess savings, but suggested no action.</p>	<p>Staff highlighted the exceptional treatment of some debt holders' ranking with reference to EU law. Risk Management, with a mandate over ESM fiduciary risks, told the Board Risk Committee the day after the bank failure that it would monitor potential spillovers and market reaction.</p>

Notes: Assessment framework drawn from the New Zealand Government Policy Project: Policy Quality Framework <https://www.dpmc.govt.nz/publications/full-policy-quality-framework>. For further details of the shock event studies, see the technical annex.

Source: Evaluation team

Country monitoring

Implementation of the Management Plan reinforced cross-country coordination. This is now underpinned by horizontal guidance. Since 2014, country monitoring had been structured around the EWS assessments of the repayment capacity of the five beneficiary Member States. The EWS is a quarterly process that reflects a variety of internal tools and reports prepared by other institutions. According to the internal survey, staff perceive the EWS as a clear and well-defined process for flagging macroeconomic, financial, fiscal, and liquidity risks. Some survey respondents suggested giving greater prominence to long-term risks, as there is no other outlet where such concerns may be flagged.

A lack of documentation, as well as of ESM definitions of key terms such as for vulnerabilities and risks, clouds the transparency of ESM analysis for external stakeholders and undermines guidance given to staff focusing on country work. The Management Plan also expanded the coverage of the ESM's country risk monitoring framework (Box 3.2). This applies a new risk categorisation and assesses risks across all euro area member states (Figure 3.2). The ESM's updated risk categorisation builds on an initial quantitative scoring based on the SVI.¹⁷ However, the overall risk categorisation framework suffers from serious weaknesses in documentation. The shock event studies suggest one consequence was an uneven approach to country risk analysis. In a fast-paced environment, where risks can evolve quickly, a well-documented framework can alleviate pressure on ad hoc guidance and foster common understanding, even-handed assessments, and credible external communication.

Box 3.2 ESM country risk monitoring

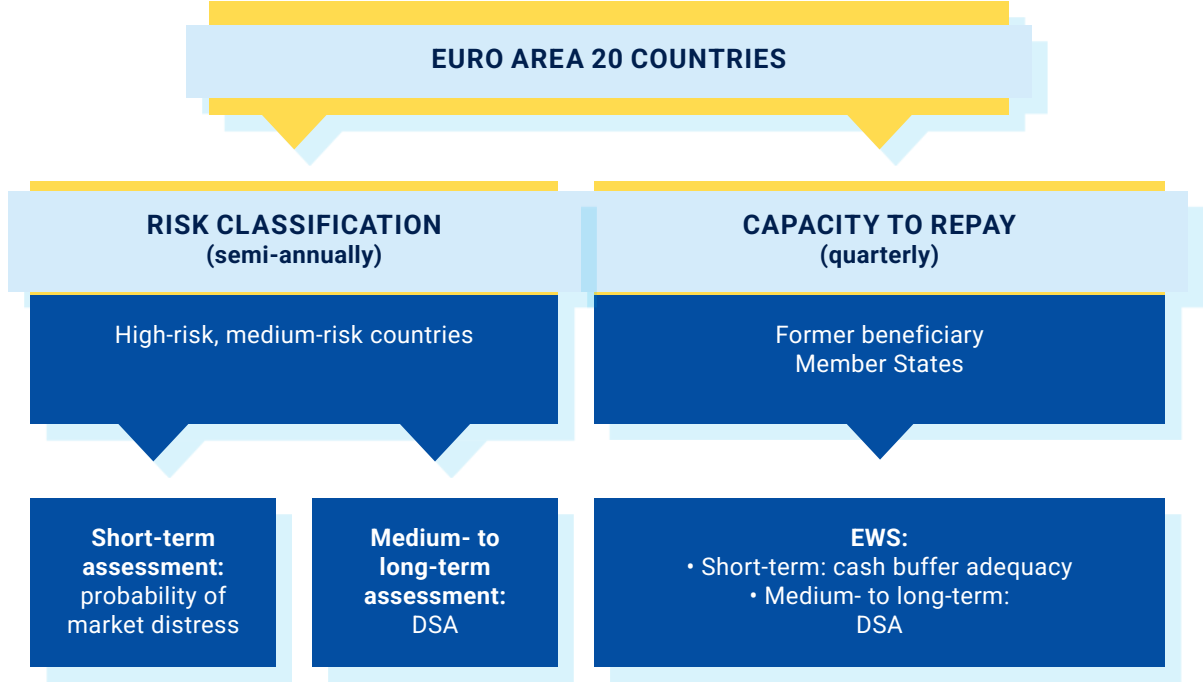
The ESM operationalised its new risk categorisation framework in 2021 with further adjustments in 2022. The framework assesses risks across all euro area member states. As of spring 2024, in addition to beneficiary Member States, country teams monitor one high-risk country and five medium-risk countries. Country monitoring has, therefore, expanded beyond the five former programme countries; to cover other Members, classed in three categories: high-risk countries; medium-risk countries, and low-risk countries. The risk developments and country categorisation are reviewed twice a year within the EFRR cycle.

The ESM's risk classification methodology relies on in-house and European Commission methodology. The ESM's approach builds on the European Commission's Macroeconomic Imbalance Procedure and the in-house SVI. The methodology further takes into account short-term market indicators and a debt sustainability assessment (Figure 3.2). Further details can be found in the technical annex.

Since 2020, the EFMC ensures consistent policy messaging on various country risk categories and prepares missions to the beneficiary Member States. All regular country-related monitoring input is submitted to the oversight committee.

- The EFMC receives semi-annual notes on the medium-risk systemically important economies and high-risk countries. The quantification of spillovers from selected euro area countries relies on qualitative judgement. Except for a specific attempt involving the largest Member, efforts to quantify spillover risks have so far not produced a sound and stable framework.
- The country section in the EFRR includes a risk matrix summarising risks identified across those countries in the three categories not covered in the EWS for beneficiary Member States.
- In the case of beneficiary Member States, the country teams submit quarterly EWS reports, pre-mission notes, and back-to-office reports. The EWS is further discussed by the Internal Risk Committee, and shared with the Board Risk Committee (Figure 4.1 in the technical annex).

Figure 3.2
Risk classification



Source: ESM

More rigorous guidance and documentation would enhance robustness and address internal accountability issues that arise in country risk monitoring. The current approach respects the risk-based country assessment initially envisaged.¹⁸ However, there is no single, overarching guidance document on country monitoring nor any outline of minimum requirements across different country categories. This leaves country team coordinators solely accountable for their teams’ work. The risk categorisation methodology is only vaguely defined and its application fully entrusted to a single division, which raises additional questions on accountability.¹⁹ Similar to practices at the IMF²⁰ and World Bank (Box 3.3), guidance documentation could clarify the analytical process at the ESM and where the margins lie between the tools used and judgement applied (Chapter 4 of the technical annex offers more detail).

Box 3.3 World Bank country risk rating process

The World Bank’s country risk analysis team consists of around 20 people who together assess 130 countries every year. This assessment feeds into country strategies, project documents, and financing decisions.

Data analysis and continuous short-term risk monitoring from various sources inform the rating process. Each assessment is conducted based on country analysis at regular rating meetings and audited to ensure rigour. The World Bank strives to build a comprehensive picture, encompassing economics and politics, as well as potential conflicts and the impact of global macroeconomic developments. Ratings also consider environmental and social variables. The process is further informed by international fora such as the Paris Club.

A typical country risk discussion among the analysis team lasts at least an hour. The initial recommendation is provided beforehand to those participants not involved in its preparation so that they can prepare questions for the lead country analyst. The country analyst is backed up by a colleague acting as discussant – offering input during the preparation of the analysis and helping with the presentation to the meeting. Finally, ratings are determined by a vote.

To avoid political pressure from national representatives on the World Bank Boards, ratings are disclosed only to management and to the wider country team for comments. Year-end checks are used to validate the findings.

Short-term monitoring builds on a monthly internal risk survey, engagements with other country teams, and a peer review with other World Bank Group entities. This helps to gather short-term signals and develop views on more immediate risks.

The establishment of similar procedures was discussed within the ESM, when the EFMC and Financial Monitoring Committee were being set up in 2020. There was a view that the EFMC should play a similar role in attributing country risk scores. However, in the context of the pandemic and staff departures, the proposal was not followed through. The absence of a written operational manual and a well-elaborated monitoring framework renders the ESM's risk-based approach susceptible to inconsistencies across countries. The ESM's risk-based monitoring gives country teams leeway to focus on what they see as the most salient issues and limits resourcing inefficiencies. But this approach leaves the implementation prone to inconsistency. Incomplete guidance and unspecified expectations translate into uneven coverage of euro area aggregate risks as well as of non-core issues. The shock event studies showed the need to better integrate aggregate, functional, and country-specific monitoring. During the energy crisis, none of the monitoring streams flagged possible contingent sovereign funding needs resulting from volatility-induced margin calls for non-bank participants in the energy derivatives markets. While country monitoring teams were closest to these potentially adverse developments, they did not escalate evidence of mounting vulnerabilities. Market analysis, feedback loops between banks and sovereigns, financial flows, debt composition, and external sustainability are not covered consistently in the country monitoring products. A focus on cross-border financial flows at country level has not been translated into the ESM's monitoring framework, nor into the supporting tools (Tables 4.1 and 4.2 in the technical annex). A refined, iterative process between macro and financial analysis and deeper analysis of macroeconomic imbalances would allow the ESM to provide contingent policy advice and better assess a range of potential outcomes.

Aggregate euro area monitoring

As envisaged in the Management Plan, monitoring of the euro area in aggregate covers economic and financial developments and risks across the common currency area. In line with the initial plans, the euro area team is responsible for the surveillance and assessment of macroeconomic and financial developments and risks at the euro area aggregate level. This team's activities complement the work of country teams and provide a regional perspective on macroeconomic developments, outlook, risks, and policy issues. The shock event studies confirm that this monitoring accentuates the impact of economic shocks and market events on economic growth and lacks considerations of broader financial stability.

Management and internal committee decisions benefit from regular and ad hoc briefings on the euro area economy, while unstable processes and imperfect documentation make it hard to assess what impact the analysis that went into it has had over the longer term. Regular euro area products inform management interventions at external meetings. In addition, the assessment of euro area aggregate developments informs decisions of internal committees, notably the Investment Management Committee. They also feed into internal assessments within the EWS and DSA processes. While most of the analysis that is prepared on a regular basis follows recurrent processes, those notes and updates that are prepared ad hoc are difficult to retrieve as there is no explicit mechanism for sharing and archiving such information. The framework could define how the analysis delivered relates to the ESM's financial stability mandate and how it takes account of broader developments in the financial sector.

An internal monitoring report has not sufficiently explored synergies between aggregate euro area and country-specific risk analysis. To structure the expanded risk monitoring system, the Management Plan established the EFRR. This has become a core instrument for implementing the ESM's new mandate as it integrates country, euro area-wide, and functional monitoring. An originally planned division of the EFRR into recurring, standardised chapters has evolved: those parts of the report focused on monitoring have been curtailed in favour of one-off, topical chapters that showcase staff analysis. In no edition of the EFRR,²¹ since it was first compiled in September 2020, has there been a full exploration of synergies between country-specific analysis and euro area aggregate monitoring. While euro area aggregate analysis identifies relevant, rapidly evolving risks, the country-specific chapter runs on a separate track. The country teams do not fully translate the analysis and conclusions on aggregate risks or material from the topical chapters into their analysis. Better integration between the country analysis and the rest of the report could

improve overall consistency and coherence. However, intensifying cooperation among the teams during the period dedicated to preparing the EFRR would entail significant operational challenges. The benefits of having a single major report prepared over a short period of time must be weighed against increased costs of coordination. Separating these two analytical strands would be another avenue to explore.²²

Closer cooperation between the euro area risk monitoring function and the Review function could help develop the ESM's capacity to provide policy advice and achieve the goals originally set. Although the initial EFRR documentation envisaged elaborating on the implications of various risks for the ESM, the latest versions do not do so. As shown in the shock event studies, the ESM's economic analysis lacks policy perspective; its policy recommendations do not go beyond those of peer institutions. The EFRR would benefit from closer cooperation with EU policy and institutional experts to deliver on the initial promise of describing the implications of analyses for the ESM and including analysis that would inform the taking of key policy positions, the setting of work priorities, and an appreciation of implications for ESM resources.

To leverage fully the knowledge that has accumulated within the institution, the ESM should implement a more structured approach to monitoring and to sharing information. Topical notes and ad hoc presentations that provide deep insight into recent developments, such as the war in Ukraine or comparisons of the euro area with the United States, could be better embedded in the ESM's analytical processes and shared across the institution. Euro area aggregate monitoring could also be better anchored in the internal framework. Some 80% of respondents to the staff survey had had some involvement in preparing the EFRR. Being drafted in ad hoc, according to their expertise, to supplement the core EFRR team makes for an unpredictable workload, staff said. It also seems to undermine information-sharing on EFRR findings among staff, as there is no formal process for sharing information.

Functional monitoring

The ESM's financial sector analysis supports institutional crisis preparedness and delivers financial sector expertise to programme and post-programme activities. The objective of the ESM's financial sector analysis is to monitor and assess developments in the euro area banking system and broader financial sector. It provides risk analysis and technical advice on regulatory and policy matters related to the financial sector and the market activity of bank and non-bank financial institutions, including their bond issuance.

The Management Plan broadened the ESM's financial sector monitoring. Initially, the ESM focused on euro area banks, banking union policies, and deploying the direct recapitalisation instrument, scheduled to be replaced by the introduction of the common backstop facility for the SRF. The scope has broadened to the non-bank financial sector, such as insurers, pension funds, and exchanges, and to topics related to market structures, including capital markets union and securitisation. The team provides expertise for horizontal workstreams such as Markets and Country Monitoring and products such as the EFRR. Since 2023, the EWS has integrated a macro scenario assessment on banking sectors, drawing on spin-offs from repayment capacity assessment modelling for the common backstop. Structural aspects and transmission channels for systemic risk stemming from non-bank financial institutions, particularly the insurance and investment fund sectors, are assessed semi-annually in the non-bank financial institution monitor, with that report updated quarterly when developments require a review or deeper analysis. The financial sector team also contributes to an internal fortnightly newsletter.

Table 3.2
Main analytical tools for financial sector assessment

Tool	Description
BVI	<p>A synthetic, forward-looking indicator to assess and rank banks' viability seeks to yield business intelligence on possible vulnerabilities within a particular euro area bank or sector. It consists of an automated score, generated by an algorithm that follows a CAMELS approach based on bank-level data and complemented by an expert scoring process, vetted by internal scoring committees.</p> <p>For the Credit Suisse shock event, the BVI identified a loss of market confidence and heightened investor nervousness as high-risk; it further elaborated on AT1 price volatility and associated risks.</p>
Non-performing loan tool	Based on a key satellite model of the common backstop modelling framework, the tool produces conditional forecasts of the non-performing loan ratio, under a baseline and an adverse macrofinancial scenario, for beneficiary Member States.

Note: For the repayment capacity assessment methodology, see Box 4.1 of the technical annex.

Sectoral monitoring was timely. The Credit Suisse case study highlighted the timeliness of the ESM's monitoring and risk analysis. Despite not concerning a euro area country, the government-sponsored merger of the two Swiss banks was reported on the day of intervention. The related risks and potential spillovers were followed daily and management was updated regularly.

Regular market monitoring results in numerous briefings circulated by various teams with varying frequency. More structured cooperation could alleviate staff workload. Market feedback and analysis produced in the CE department complements market intelligence gathered by CFO department traders. The ESM's expertise is derived from CFO divisions collecting market intelligence from traders and CE department teams collecting market views on the economic outlook and their conduct of quantitative market analysis and research. A weekly analytical roundup of market movements, the Market Watch, is geared to informing CFO operations about economic and financial risks and their operational implications and which integrates presentations from all the analytical functions. As demonstrated in the energy crisis case, market analysis took the form of well-consolidated overviews, but the ESM did not have its own analytical framework and lacked a process and deliverables that were comparable to those of its peers. To enhance internal thinking and foster transparency, the ESM could follow practice at other institutions and set down in writing its unique approach to market analysis. To further structure their exchanges with market participants, some institutions share high-level orientations of their market intelligence (see De Nederlandsche Bank, 2015). In the context of an evolving market microstructure and the emergence of new participants, asset classes, and risks, such documents clarify institutions' market intelligence objectives and practices. As an official body, the ESM, and specifically the CFO department, could align with this practice to ensure an adequate accountability and transparency framework in this area (see Bank for International Settlements, 2016 and 2023).

Overall processes

The ESM deserves praise for quickly flagging mounting risks; however, gaps in existing processes could lead to it repeating past mistakes and hamper its capacity to provide well-founded policy advice. External interviewees generally praised the ESM for quickly spotting market risks and reporting on market developments. However, as demonstrated by the shock event studies and external views, the lack of a clear framework and established accountability could prevent the ESM from spotting hidden pockets of vulnerabilities and developing independent and well-founded policy advice (see Chapter 5 of the technical annex).

The shock event studies confirmed that short-term market risk monitoring is the ESM's strength but that its market, economic, and policy analysis are not sufficiently integrated. Across all five studies, the evaluation team deemed monitoring of short-term market risks timely and overall a strength of the ESM's analysis. However, current processes do not allow full reconciliation and

interaction among market, economic, and policy analysis. For example, the energy shock case study highlights that the current arrangement does not fully capture synergies between market intelligence and macroeconomic analysis. Processes built up gradually have failed to break down silos and have not yet fostered sufficient cooperation across teams. The Brexit and Credit Suisse studies corroborated this finding and lead to the conclusion that insufficient collaboration across teams might lead to a failure to identify important risks or to superficial analysis.

The shock event studies also highlighted how fluid processes allow for flexibility, but blurred lines of responsibility and accountability undermine analytical output. Flexible processes allowed the ESM to reprioritise quickly and adjust assignments when faced with economic shocks such as the pandemic or the energy shock. But the studies revealed several challenges. ESM analysis around the Covid-19 crisis, the energy shock, and monetary policy tightening incorporated multiple macrofiscal scenarios, but modelling of these shocks' impact on the external sector was not systematic and was missing from the scenario analysis, as was any tailoring of euro area risk narratives to specific countries. The most recent shock, the Credit Suisse failure, was assumed to be peripheral to the euro area. However, the analytical approach around this shock did not use scenarios to quantify systematically any possible impacts on growth and the broader economy in ESM Members, but rather drew on ad hoc reporting and analysts' previous experience.

Uneven documentation of processes could hamper established workflows and delivery on key tasks, especially in the event that work on a programme draws off key staff. While the EWS report and related processes are well embedded in internal policies, the documented process around the EFRR is not yet anchored in any internal policy and the required analytical inputs and outputs are not clearly specified. These two key processes require considerable resources and these might not be available if a Member were to request a programme; the most experienced staff, likely to take charge of any programme, normally coordinate the EFRR and EWS processes. Although the current approach offers flexibility, it could pose challenges in a crisis and be prone to key person risk. It would be helpful if the modalities of the EFRR were more precisely embedded in a formal document, such as the EFMC Terms of Reference.

The evaluation findings indicate that clarifying responsibilities for the delivery of various analytical inputs and outputs could increase transparency and help enforce accountability. Internal documents do not clearly specify the intended interaction and allocation of responsibilities to ensure consistency among the analyses of individual countries and the euro area aggregate. Initial documents suggested that the euro area team would ensure cross-country consistency.

The strengths and weaknesses of the matrix organisational structure could be better balanced. While the new structure allows the sharing of resources and specialised talent across the divisions, it comes with well-documented risks (Davis and Lawrence, 1978). Staff face an increase in reporting upward and slow decision-making. The need to deliver on multiple projects at peak times increases pressure on both management and staff. The absence of well-established processes on sign-offs and information-sharing, together with blurred accountability, increases demands for day-to-day guidance and increases pressure on management. Some staff survey respondents and interviewees expressed special concern about silo thinking, a lack of synergies, unclear incentives, and limited information-sharing.

Information flows towards technical experts are not well established, which hampers staff's analytical capability. According to the staff survey and interviews, information-sharing processes do not ensure an adequate flow of information towards technical experts. Management previously shared information on a need-to-know basis but increased headcount at technical level has not been matched by appropriate changes in policy on sharing information. Access to information is often restricted to heads of division or team leads and the availability of archives and committee documents is not consistent across the institution. While Management Board meeting summaries are shared across the ESM, committee documentation remains difficult to retrieve for technical

staff. This in turn has an impact on how familiar staff are with the overall functioning of the ESM, a feature confirmed by the results of the self-evaluation study.

Briefing notes supporting external engagements as drivers of analytical and policy work could be better reflected in strategic planning. Management's external engagements in EU and international policy meetings are key interactions with ESM stakeholders. They enrich the ESM's analytical agenda but also significantly increase the workload on analytical staff. More coordination could help reconcile the external policy agenda with analytical work related to the core mandate, including resource planning.

Enhanced ESM tools and data

Tools

Management phased in the new framework for country, regional, and functional monitoring by implementing an internally developed plan. The plans for an updated toolkit were developed gradually and finalised in Q2 2020 without extensive consultation within the ESM or with external stakeholders. The plan envisaged three batches of tools to be delivered gradually (see Chapter 4 of the technical annex).

Progressive implementation of the framework was intended to align practices and tools deployed across country teams. Two crises – the pandemic and the energy price spike – interrupted the rollout of these tools. Lessons learned during the crisis period allowed staff to refine the toolkit.²³

Figure 3.3
Tools development



Note: Tools in yellow not originally foreseen in Management Plan.

Source: Evaluation team

While the Management Plan envisaged all-encompassing monitoring, the approach adopted focuses on selected priority areas and can give rise to inconsistencies. The plan for detailed country monitoring tools yielded spreadsheets for fiscal, macro, and external sectors at country level. These were further developed into forward-looking fiscal and macro scenario tools. External sector monitoring and risk analysis have so far been rather ad hoc, with a more structured approach still under preparation. Both external sector and monetary monitoring spreadsheets exist and are regularly used at the aggregate euro area level. The debt sustainability framework and especially the development of a cutting-edge stochastic debt sustainability analysis have been prioritised. However, they have yet to be documented.

The previously agreed priority tools were complemented by a battery of more than 20 models and analytical tools used with varying frequency. Models based on value at risk complement the euro area macroeconomic workhorse model. The value at risk measures are based on empirical time series and relate mostly to the analysis of specific macroeconomic developments, in areas such as the energy market and financial and sovereign bond markets. The divisions do not keep track of how frequently tools are used and this hampers an assessment of their relevance.

Analytical, mostly model-based, tool development for economics is organisationally concentrated. Most of these tools are owned and maintained by the Economic and Market Analysis division, with its market team focusing on sophisticated market analysis. An additional, complex analytical framework is maintained by the Financial Sector and Market Analysis division to operationalise the backstop for the SRF. The Financial Sector and Market Analysis team also regularly updates financial sector indices. The team managing assets and liabilities has set up various tools for projections, optimisation, and control of ESM and EFSF portfolios. Market intelligence staff (Box 3.5) maintain several tools for monitoring sovereign bond markets and managing ESM and EFSF issuances. The Risk Management team maintains several risk exposure monitoring tools.

Following the direction set in the Management Plan, the newly deployed tools focus mostly on risk monitoring rather than on crisis resolution and are not explicitly linked to the ESM's lending toolkit. The new division-specific arrangement is geared largely towards monitoring risk during non-crisis periods of calm and to the early detection of emerging risks. Following the first dry runs, a few staff survey respondents suggested that some tools might be too complex to use in a programme context. Up to end-2023, there was no written evidence that teams dedicated to the maintenance of tools had supported other staff in their daily implementation. The complex framework backing the operationalisation of the ESM backstop for the SRF represents a notable exception.

Consolidating and better documenting existing tools could alleviate pressure on staff and mitigate risks stemming from staff turnover. Since the Management Plan was approved, the ESM has implemented a much larger battery of tools than originally envisaged. To fully explore their added value, the ESM could review the solutions being implemented and choose the most efficient ways to maintain them. The most relevant tools should be properly documented and embedded in the monitoring toolkit as part of the agreed framework for regular monitoring. A well-structured framework linked to easily traceable records would help maintain capability and mitigate key person risk.

An enhanced and well-documented operational framework clarifying key definitions could help to align the ESM's analytical framework with its mandate. The staff survey and internal interviews highlighted a lack of common understanding of the ESM's mandate, the division of competences, and its analytical and research priorities. Following the practice of other international institutions,²⁴ an explicit written and well-articulated operational framework could help define priorities and foster a better common understanding of the ESM's mandate among staff. Management considers establishing a country monitoring framework as a Most Significant Change. It also recognised that establishing cooperation across divisions turned out to be more challenging than expected.

Supporting data system

Despite considerable investment in data infrastructure, further improvements are necessary, including an increase in the number of data scientists, according to survey respondents and interviewees. The ESM has created a cutting-edge data infrastructure and benefits from access to multiple databases necessary for macrofinancial and market monitoring. Unlike other institutions, the ESM mandate does not include data collection or management. As a small organisation with a specific mandate focused on other matters, it employs few data experts.²⁵ To avoid inefficiencies and potential missteps, the ESM needs to invest continuously in effective and reliable data solutions. Management noted that limited headcount does not allow it to fully leverage the market data available to it.

A lack of formalised data exchange puts the ESM at a disadvantage compared to other institutions. To date, the ESM has no original and unique datasets of its own. Its narrow mandate offers few opportunities to collect such data. Unlike central banks or national ministries, the ESM also lacks opportunities to establish cooperation agreements based on mutual data exchange, nor does it benefit from direct data exchange with national or European authorities. Individual comments suggest that the lack of detailed data on bank and financial institutions' balance sheets may prove a disadvantage when assessing financial risks (Box 3.4). To alleviate data limitations, stakeholders recommend that the ESM participate in joint projects and enter into data access agreements with peer institutions.

The data governance system could be developed further and regularly reviewed to ensure continuity and mitigate emerging operational risks. Since the rollout of the Management Plan, the ESM has put in place advanced data solutions. The progress made has allowed it to acquire restricted datasets, including those that are part of Eurostat's EU statistics on income and living conditions (SILC). To deliver on its crisis resolution role, the ESM will need continuously to develop infrastructure and data governance that follows best practice among international institutions (IMF Independent Evaluation Office, 2016). It might also consider a deeper review of data adequacy in the monitoring and programme context (for comparison see [IMF, 2024](#)).

Box 3.4 Financial sector data

Banking analysis is largely concentrated on euro area banks' financial performance and viability. The BVI process serves to form a view on: banks that may require action by the SRB, and possibly the ESM through the backstop for the SRF; and potential fault lines between a bank and possible need for sovereign intervention. Close attention is warranted where a weak bank could jeopardise the finances of a Member. Output from the non-performing loan tool helps develop a forward-looking analysis of asset quality deterioration and loss absorption capacity coming from the macrofinancial environment. This is integrated in the EWS to improve country monitoring and discussions with national authorities during missions.

Data limitations

The ESM does not receive non-public data from banks and lacks data-sharing mechanisms with peer institutions or national central banks that do have access to such data. It therefore relies on public disclosures. Even once the SRF backstop is activated, the ESM will have access to mainly anonymised bank-specific data or to aggregated descriptive statistics, and even this will not be automatic. A data room is to be made accessible on SRB premises.

Although publicly available data is accurate and is often available in a timely manner, it is harder to assess systemic risks in a pre-emptive fashion using only such information than it would be with access to data available to supervisors under the Common Reporting Standard for credit institutions' financial reports based on European Banking Authority Financial Reporting and Common Reporting standards. As a simple example, supervisors obtain reports quarterly while some banks report publicly only once or twice a year. Moreover, reports to supervisors, including small national central banks, are generally more granular and contain more relevant data than public reports, offering greater transparency. This can be crucial to identifying risk in a bank's asset quality or capital.²⁶ Supervisors can also check borrower information (AnaCredit) to assess risk to banks before it materialises.²⁷

Information sources

As the ESM is a large bond issuer, management and staff attend market fora and engage with chief executives and other senior managers of banks. From such interactions, the ESM obtains insight into euro area banks, markets, and investor interest.

A comparison with central banks' published bank monitoring indicators shows that the ESM broadly assesses banks against the same datasets. However, for the ESM's regular non-bank financial institution monitoring some deficiencies still exist in the scope of indicators.

Varied approaches

Data limitations and changing conditions challenge the reliability of forward-looking assessments. For beneficiary Member States, the ESM conducts deeper bank analysis and is able to rely on non-public information from national authorities. For countries that have had a programme, it also looks at smaller, not systemically important banks and examines local regulations that could impact the banking system and wider economy. Analysis of the financial sector of such countries is deeper and more robust than for others, though still limited in terms of resources allocated relative to the large, outstanding financial exposure of the ESM to these Members.

For other euro area member states, the analysis approach resembles that of a credit rating agency, or institutional investor with lesser coverage of sector dynamics. This may leave the ESM unable to foresee risk triggers in the banking system in a timely manner.

The EFRR and non-bank financial institution monitor products are geared towards charting a more comprehensive view of the broader euro area financial system and financial stability. Market analysis also helps in detecting bouts of volatility or stress in the markets that could signal a crisis.

Box 3.5 What is market intelligence?

Market intelligence is the gathering of qualitative information from market participants in addition to the use of quantitative analysis. The intelligence role has a long history – the Bank of England formalised its traditional market intelligence work in the 18th century, seeing its market presence as a unique opportunity to collect information (Bank of England, 2017). The outcomes enhance findings from quantitative analysis and published research. Adding market intelligence into market analysis entails collecting, connecting, analysing, and interpreting internal and external datasets to deliver added value in decision-making.

The ESM interacts with a diversified group of banks, both as an investor and an issuer in the debt markets. It introduced a market intelligence function in a decentralised fashion, with various teams contributing to financial market analysis within their focus areas. Gathering market intelligence is conducted through regular market discussions with various types of market participants. The insights are combined with market data into internal deliverables, such as presentations, technical notes, and, especially, market briefings. These are prepared jointly with market analysis teams. For example, the Funding and Investor Relations division regularly updates the Finance Committee on issuance conditions. This is part of ensuring that the ESM can raise funding, whatever the market conditions.

Market intelligence also feeds into country and euro area monitoring. Regular internal Market Watch calls benefit from market intelligence work in combination with economic analysis and other topical analytical input. Intelligence helps identify and analyse emerging or hidden risks and trends in markets – in investor behaviour and asset classes.

While peer institutions often provide financial market analyses via policy or theoretical reports, the ESM benefits from the fact that it is a regular participant in bond, bill, and derivatives markets. Along with a diverse staff that can draw on private sector trading experience as well as econometric and other analytical expertise, this hands-on presence helps the ESM measure and interpret financial markets to a greater degree than some peer institutions. However, even after the implementation of the Management Plan, challenges remain in gathering, analysing, and effectively interpreting this market intelligence. For example, some data availability issues persist.

The ESM sees its market intelligence work as giving the institution an edge in contributing relevant and unique input to European fora. Central banks also consider market intelligence an important element not only in their financial market analysis but also in work on monetary policy and reserve and debt management (Bank for International Settlements, 2016; De Nederlandsche Bank, 2015).

Staffing

No consolidated capability assessments of staff skills exist for the period before the ESM reform. Human Resource processes include a semi-annual performance development assessment, but its outcomes are not aggregated. However, strategy and budget documents do provide some indications of management views of key skill needs.

The 2017 ESM strategy set objectives reflecting management's view on development requirements. This aimed to improve managerial skills, develop human resource policies, enhance economic research capacity, and strengthen external links for the global financial safety net. It also advised extending country monitoring beyond programme and shareholder interests, to focus on economic and financial developments. Many initiatives had a control or risk management perspective, calling for better quantitative financial analysis and data quality assurance, with internal committees, procedures, and Members as key focus areas.²⁸

The 2019 budget discussions identified a need for increased headcount. This was especially the case for data management, market intelligence, macroeconomic analysis of major euro area countries, policy work related to ESM mandate reform, and policy communication support. In 2019, an internal staff working group assessed capability constraints, highlighting issues such as headcount, competing interests, unclear or irregular outputs, a diffuse data landscape, and limited data leverage, while recognising diverse in-house expertise as an asset. A mechanism to foster institution-wide alignment was missing.

Capabilities needed

Interviewees indicate that staff skills and experience are important for stakeholder trust in the institution. They said that the role of institutions like the ESM requires diverse staff profiles; strong analytical skills are needed to conduct in-depth analysis to assess risks and provide evidence-based policy recommendations that reflect the unique features of Economic and Monetary Union.²⁹ Market-facing functions require a strong understanding of market dynamics. Member representatives and academics stressed that the ESM required deep knowledge of each country to ensure a proper understanding of national specificities and political dynamics.

The ESM's responsibilities require a range of skills relevant to various sectors as well as continuous learning. The shock event studies demonstrate that recent shocks involved trade, the financial sector, health, labour, monetary policy, and general macroeconomics. Staff, therefore, should constantly improve their abilities to remain responsive in proposing relevant solutions.

Staff capabilities sought in recruitment³⁰

The ESM has raised its criteria for recruiting experts. Post description criteria from 2019 to 2023 suggest that the ESM values candidates who can effectively analyse complex economic and financial issues and propose creative solutions. From 2019 on, requirements posted became more demanding in terms of skills, experience, and knowledge of tools, with an emphasis on technical skills in modelling and quantitative analysis, macrofinancial and bank viability analysis, as well as programming skills to support system development.³¹

Staff capabilities recruited

Based on diverse evidence, staff analytical capability has increased considerably, with a strong technical element. External stakeholders believe that the ESM, thanks to the relevant and varied roles it plays, has attracted talent among economists and has recruited experts of a quality on par with peer institutions.

The staff self-evaluation³² indicates that ESM employees feel that they are highly skilled for analytical roles and have the capabilities to respond to change, to identify the need for reasonable trade-offs imposed by circumstances, and to adopt new information. Staff are confident in their technical skills at applying analytical frameworks and at gathering evidence to support analysis, as well as in their knowledge of their own domain. They reported considerably weaker confidence in their capabilities to design policies and programmes.

Those recruited after 2019 show an improved match to the analytical skill requirements, compared to their predecessors.³³ An emphasis on technical skills has left some gaps, particularly in the depth of CE department recruits' understanding of the EU institutional setting, decision-making and policy priorities, and country knowledge. Those joining the CFO department lacked clarity on EU and ESM priorities. The recruitment requirements did not place sufficient value on knowledge of EU institutional systems and processes or economist candidates' previous experience from national administrations.

Close collaboration with EU institutions has exposed gaps in staff knowledge of those organisations, and their procedures and objectives. This is knowledge that rarely features in ESM recruitment criteria. Management's view is that the ESM's operating model is based on a division of tasks in which collaboration with peer institutions is handled by specific experts with diplomatic skills.³⁴ Many others view this approach as problematic even in non-crisis periods, with external stakeholders flagging this as a particular issue in the event of new programme negotiations. A lack of opportunities to engage with peer institutions means that ESM experts lack external visibility and respect as technical or policy specialists. Focus groups and the staff survey show a reluctance among experts to take on leadership roles. A view emerges that crisis management strategies would require the institution to have more senior experts available.

A tendency to promote conformity in practice is at odds with the ESM's stated recruitment objectives, which encourage critical thinking and problem-solving skills. A very large majority of staff surveyed feel skilled in experimentation, innovation, and seeking opportunities to add value. However, a minority contend that the organisational culture is not unequivocally supportive of such creativity. A culture of innovation is not seen as sufficiently embedded at management level, or adequately reflected in agenda-setting. Prioritisation and more open interaction between staff and management could yield sharper ideas.

Views differ on whether the ESM has enough staff. Interviewees from other international financial institutions stress that economic surveillance is a labour-intensive activity. Many see the ESM's small size as a particular challenge for certain surveillance functions, such as modelling. The shock event studies and survey results point to gaps in some areas.³⁵ Still, ESM staff and managers – especially economists – judge their numbers to be broadly adequate for the current form of risk-based approach.

Headcount adequacy demands strict prioritisation and an ability to mobilise qualified staff appropriately when moving into crisis mode. This in turn calls for extraordinary managerial skills and leadership. A stable core team and use of technological solutions could facilitate the task. Staff turnover has been high at some expert levels. There is some evidence of gaps in the ESM's ability to cover all relevant topics in depth when under stress. The shock event studies highlight such limitations. During the energy crisis, staff missed the buildup of contingent liabilities for public finances by concentrating on the price effects on growth and the terms of trade. During the pandemic and later rise in interest rates, country analysis did not systematically incorporate the external sector and tended to focus initially on the ESM's fiduciary obligations.

Quality assurance

Validation of models and tools

The ESM's risk policies cover model validation but do not automatically apply to all models³⁶ and analytical tools. Definitions in the ESM's internal risk documents continue to reflect the initial mandate, focusing on risks associated with financial operations. This was reflected in the submission to validation of the model for the Common Backstop Repayment Capacity Assessment Methodology.³⁷ Updating definitions, processes, and the division of responsibilities among ESM subject-matter divisions and the Risk Management team could help expand internal controls on the analytical tools, models, and country risk categorisation. A modified framework backed by sufficient resources could curb operational and reputational risks under the extended mandate that could arise from the use of insufficiently reliable tools, as occurred during previous programmes (Almunia, 2020).

External vetting could further increase robustness and offset the effects of the ESM's limited staff numbers. Headcount constrains expertise and the ability to deliver cutting-edge research. Management cannot realistically cover and provide substantive comments on all financial stability issues. Interviewees at international institutions such as the World Bank highlighted the benefits of external consultations. The ESM's analytical rigour and output would benefit from a robust process for external consultation for its papers, models, and tools. Such consultations could take the form of an external advisory committee. External interviewees referred to practices at large institutions and recommended closed-door discussions with outside experts to ensure that exchanges are frank and open. An internal ESM group tasked with the strategic expansion of analytical horizons could prepare material for such discussions.

Review function

The ESM Review function, created within the SG department to strengthen internal review processes and enhance quality assurance, embodies the principles of self-assessment and peer review, but its ultimate authority is ambiguous. Horizontal review of reports and policies provides quality assurance. It supports analytical robustness through internal consultations and aims to ensure adherence to ESM policy norms and even-handed treatment of countries concerned. Unlike at the IMF, the ESM's Review function does not typically take part in missions to beneficiary Member States and does not co-sign related policy documents. This arrangement at the ESM guarantees greater independence for the Review function but also diminishes the formal weight of its input. Stronger reporting lines to management and the EFMC could reinforce the role of the Review team.

The enhanced review framework has improved analysis featuring in regular reports, country surveillance, and policy design. A formal document review helps country teams sharpen their policy and economic analysis. After a period of relatively high staff turnover, the Review team has become an integral part of the ESM, and its country work and its staff have the highest level of workstream memberships among those involved in relevant activities (see Chapter 3 of the technical annex).

On establishment, the Review function was intended to be a strategic asset for the ESM, but underlying processes and policies prevent it from delivering fully on its potential. The formal processes ensure input from the Review team. However, the extent of informal review is at the discretion of the country team coordinators. Consequently, the participation of the Review function in country work remains inconsistent.³⁸ More intensive collaboration among technical staff could allow for a deeper and more structured knowledge exchange. Early informal involvement could also render the formal review process more efficient.

Clearly written guidance notes would further facilitate the review process. The experience of peer institutions such as AMRO suggests that strategic documentation can help build institutional

capacity and memory. This is not necessarily hampered by an institution's size. In the ESM's case, spelling out the main elements of monitoring would allow the Review function to provide input beyond the narrow scope of country monitoring, and extend its role to euro area aggregate analysis and providing input to internal committees other than the EFMC.

Despite not being consistently included in country, aggregate, or functional monitoring, experienced Review staff provide valuable horizontal input. Underlying processes and policies as currently implemented do not let Review staff play the kind of role taken by review teams at peer institutions (external interviews; AMRO, 2023). The IMF draws on a well-established consultation approach and its Strategy, Policy, and Review department plays a crucial role. Similarly, the World Bank draws on an established process of internal consultation.

Conclusions

- An increase in expert resources allowed the ESM to build an analytical system almost from scratch. The ESM has considerably increased its ability to dedicate skilled resources to analysis. New headcount allowed the institution to develop a country, functional, and euro area aggregate monitoring framework and make progress on analytical tools. However, the absence of a common understanding of the ESM's purpose hinders the clear identification of institutional priorities.
- Management has enabled the gradual construction of a new analytical framework, identifying relevant underlying vulnerabilities and emerging risks. Market and aggregate euro area analysis have successfully identified newly arising risks. However, practice still tends to focus on the institution's own financial risks, notably exposure to beneficiary Member States. An anticipatory role would require a focus on the financial stability of the euro area as a whole and of individual member countries.
- The newly developed tools focus predominantly on risk monitoring rather than on programme design. While the ESM's macrofinancial analysis has been considerably enhanced, this analysis does not always offer policy advice of a standard comparable to that of its peers. This underdeveloped policy angle could pose challenges during programme periods. There are delays in the development of programme design tools, such as a way to measure spillovers.
- Unlike other international financial institutions, the ESM has not adopted a systematic and documented approach to risk monitoring. Demarcation lines between ESM activities remain unclear as they are only roughly documented. This affects several key aspects of its monitoring strategy. These include the risk categorisation framework, quantification of spillovers, scoping the field of market intelligence, and monitoring of the non-bank financial sector, countries, and the euro area as a whole. More structure could yield further synergies.
- Quality assurance mechanisms such as the Review function and model validation are yet to match the standards of peer institutions, and they are not fully institutionalised. Although the Review function is central to the ESM's country analysis, it is not fully integrated in the overall risk monitoring framework. Uneven engagement from divisions limits the Review team's ability to ensure consistent quality in its output. Similarly, external vetting has not been common practice in the model validation process.
- A focus on delivering new tools and frameworks overshadowed the need to document progress. Urgent efforts to operationalise processes and tools underpinning the new mandate resulted in a focus on operations rather than on building knowledge. As a result, important elements such as a risk assessment framework and key terms related to the ESM mandate remain undocumented. Differences in the understanding of definitions weaken operational efficiency. Missing documentation, including guidance notes on procedures, raises questions about the quality of the tools and discourages external vetting.

- A lack of documentation leads to operational risks and undermines accountability. A general lack of traceability undermines accountability for the analytical results delivered.
- Despite considerable investment in data infrastructure, the ESM's operational effectiveness suffers from a lack of data exchange with external stakeholders. The ESM has successfully enhanced its data infrastructure. However, effective risk detection remains limited to some extent by the reliance on external data input and a lack of granular bank data from supervisors.
- The ESM lacks the kind of strategic approach to human resource management observed at peer institutions, which regularly assess staffing needs and policies to ensure continuous adaptation to changing circumstances. The ESM is not aligned with international standards on the comprehensive reporting of human capital. This affects its future institutional capability. The current organisational pyramid structure may not be wholly adapted to the challenge of the ESM's tasks in monitoring and policy design. These require experience and depth of expertise, especially in the area of policy advice, which is underdeveloped at the ESM.

4. Effective use of analytical capability

This chapter evaluates how effectively the ESM's analytical capability is put to use. It considers the following questions:

- How prepared is the ESM to fulfil its core mandate of detecting vulnerabilities and flagging risks to financial stability in the euro area?
- How prepared is the ESM to design and implement financial assistance programmes in the event of a crisis?
- To what extent does the ESM make effective use of external networks and collaborations to gather knowledge and influence the policy debate?
- How effectively does the ESM's research and publication activity enhance the institution's analytical capability and the credibility of its analytical framework? To what extent do these activities raise the institution's profile under the enhanced mandate?

Preparedness

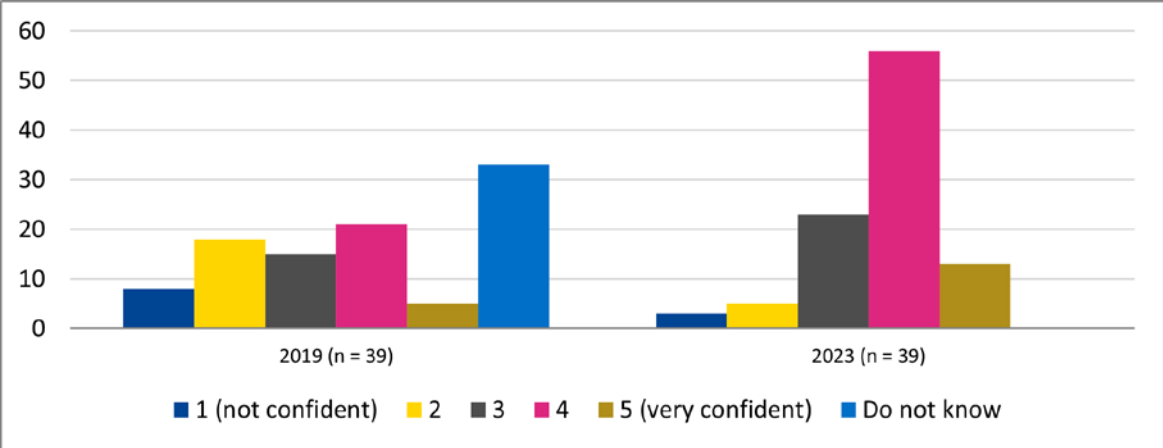
In crisis management, preparedness generally refers to established procedures of analysing and addressing risks that are not apparent in the operational environment through activities such as developing security strategies, collaborations, training, and the pooling of resources.³⁹ In times of increasingly systemic, simultaneous, and interconnected shocks – including accelerating climate change – crisis preparedness also needs to be addressed in the broader context of reorganising societal structures and institutions. On an institutional level, crisis preparedness is often hampered by tensions between short-term and long-term time horizons in analysis, between operational and strategic levels of preparedness, or between dry runs that seek to turn crisis response into routine and dry runs that facilitate the exploration of uncertainty. The diverse aspects of crises that go beyond the political, functional, and temporal boundaries of management cannot effectively be dealt with in siloed administrations.^{40,41} In this evaluation, preparedness is assessed against the backdrop of the ESM's core mandate, namely regarding the institution's capability to detect vulnerabilities and flag risks to financial stability in a timely manner, as well as the institution's preparedness to design, negotiate, and implement financial assistance programmes.

The ESM's analytical approach is generally capable of identifying risks in a timely manner. Staff respondents and interviewees consider the ESM's analytical capabilities, both at the institutional and at the individual level, as well advanced and able to identify risks early in order to preserve financial stability in the euro area (Figures 4.1 and 4.2).⁴² Progress made on integrating operational market intelligence with economic and macrofinancial analysis under the Management Plan broadly contributes to the ESM's capability to flag financial stability risks (Figure 6.2 in the technical annex). However, the shock event studies (Table 3.1) reveal some fragmentation of risk monitoring, causing lags between early market intelligence signals and macrofinancial analysis. This suggests a need for more active internal collaboration and stronger processes.

Staff are confident in their individual abilities to apply the analytical frameworks for identifying risks, collecting evidence, and informing ESM decision-makers. Staff respondents also voiced confidence in the ESM as an institution being able to flag acute risks, with a clear upward trend in the level of confidence from 2019 to 2023. They see the ESM's analytical products, such as the EFRR, EWS, BVI, SVI, and DSA, as useful for detecting risks early with the aim of preserving financial

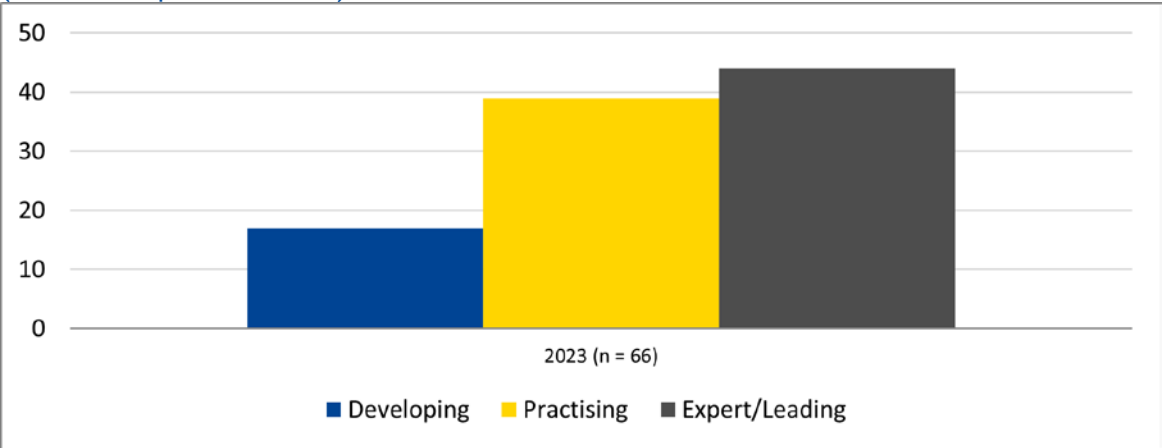
stability.⁴³ However, the lack of an externally validated methodology – other than for the backstop modelling framework – hampers accountability. Today, individual professionalism, rigour, and team commitment are important underpinnings of capability. Broadening participation in IMF financial programming training can be expected to further strengthen these foundations, particularly by providing a basis for a common understanding of certain elements that will be required in future programme work. It is worth noting, however, that the ESM’s predictive capability has so far been rarely tested and so the evidence can only be considered as partial.

Figure 4.1
Institutional capability to detect risks
(share of respondents, in %)



Note: Based on 39 responses to the question: “How confident are you about the ESM flagging acute risks (e.g. risks to financial stability)?”
Source: ESM staff survey (2023)

Figure 4.2
Individual capability to detect risks
(share of respondents, in %)



Note: Based on 66 responses to the question: “How do you assess your capability to apply analytical frameworks and methods to flag risks and assess their implications?”
Source: ESM staff self-evaluation (2023)

Staff survey responses indicate that the EWS process is very capable of identifying and reporting risks in the countries concerned in a timely manner. Macroeconomic, financial, and liquidity and market risks are broadly captured in the EWS reporting. The EFRR process’s ability to identify and report risks in the euro area in a timely manner is assessed as broadly sufficient. The EFRR is deemed to cover adequately macroeconomic, financial, and liquidity and market risks. Other key products, such as the DSA, SVI, or BVI, are regarded as useful for monitoring vulnerabilities and detecting risks early and so they contribute to preserving financial stability. Management also saw these regular products as effective ways to channel analysis.⁴⁴ An analytical framework for the external sector is still in the making, having received only occasional attention so far.

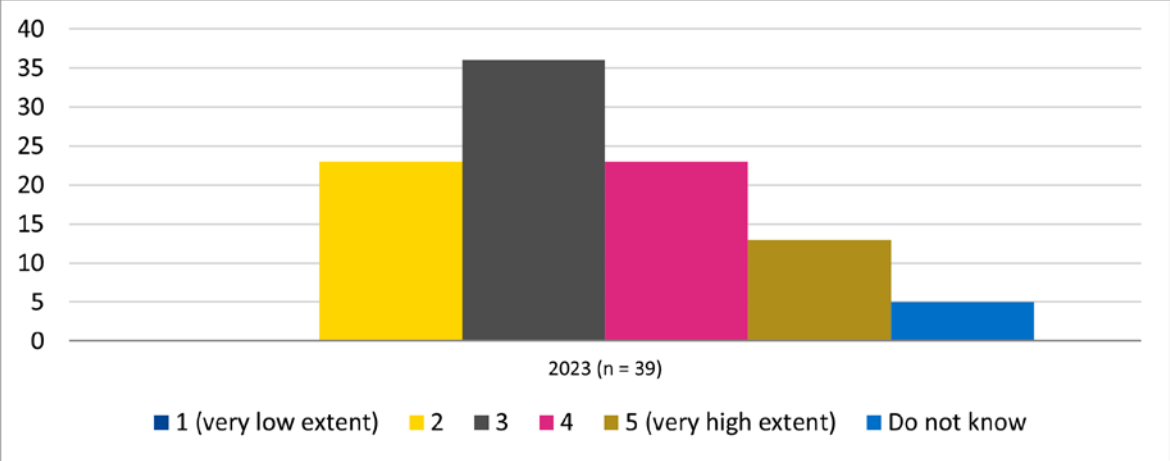
Effective risk detection is limited to some extent by a reliance on external data input.⁴⁵ However, creating a full, in-house forecasting function would probably demand considerable investment. As Members seek to avoid overlapping functions among European partner institutions, promoting more timely and open collaboration among these institutions would be of mutual benefit.

Stakeholders are of the view that, given resource constraints, the ESM should continue to concentrate on its comparative advantage vis-a-vis its peers in identifying macrofinancial risks. Such focus sharpens the ESM's profile within the European institutional setting and underlines its complementary role in risk detection. This might require a framework that uses feedback to make continuous refinements. External interviewees point out that investments in further analytical capacity to detect risks could include the DSA and the repayment capacity framework for the common backstop. Internal stakeholders point to the operationalisation of the Risk group as a means to enhance risk detection.⁴⁶

The ESM is well advanced, but not yet fully prepared to design, negotiate, and implement financial assistance programmes, despite its strong experience in collaborative post-programme monitoring activities following the euro area crisis.⁴⁷ For preventive country monitoring, the ESM's analytical framework appears broadly robust. Most of the tools recently developed focus on crisis prevention and early warning, while the ramping up of crisis resolution tools and contingency planning has been postponed. A conceptual framework for programme design has yet to be adopted consistently in country work, despite co-production projects facilitated by the follow-up to the Greek programme evaluation. This requires management action. Furthermore, unlike the IMF, the ESM's current approach seems to imply that country teams would cover both ongoing monitoring and potential preparation for financial assistance. A fully embedded analytical framework would help untangle the complexity of these tasks. According to the Most Significant Change study (Table 2.3), CE department management is confident that the Management Plan contributes to a culture of crisis preparedness even when there are no ongoing programmes.

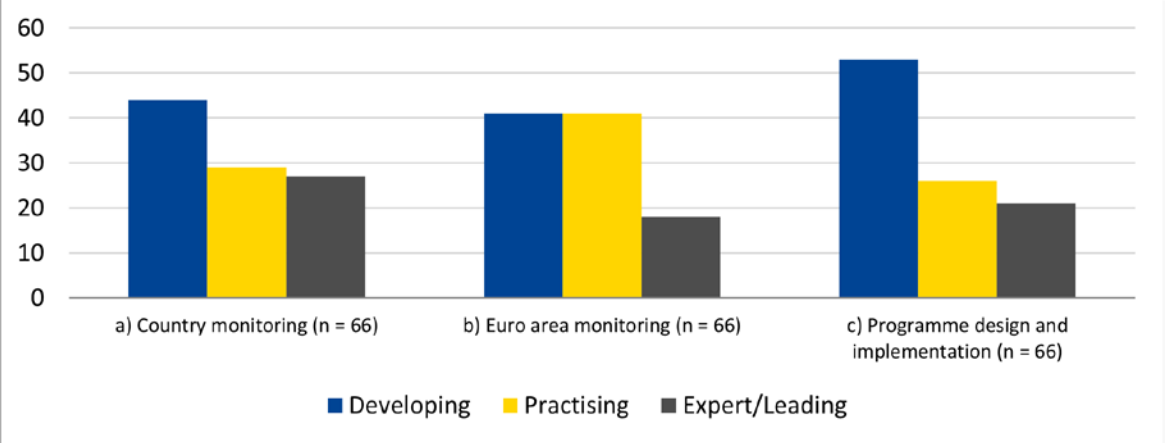
Programme negotiation would pose a new challenge. Staff survey respondents consider the institution broadly prepared to produce timely and relevant analytics in the event of a request for a stability support programme. However, while progress has been made, the existing analytical system for country monitoring does not let the ESM collaborate effectively in programme negotiation and design with the European Commission (Figure 4.3).⁴⁸ Staff respondents assess their individual capabilities to design policy proposals for programme design and implementation in need of improvement (Figure 4.4).⁴⁹ Additionally, following changes to the management structure, no operational arrangement exists for running the back table during negotiations, while the Terms of Reference of the EFMC ambitiously stipulate that it should be "kept informed and consulted as need arises in the course of the negotiation process". This would at least require an institutional support with standing response capacity for the negotiators.

Figure 4.3
Preparedness for programme negotiation
(share of respondents, in %)



Note: Based on 39 responses to the question: “To what extent do ESM’s analytical products prepare the ESM for effective collaboration in programme negotiation and design with the European Commission?”
Source: ESM staff survey (2023)

Figure 4.4
Staff capability for monitoring and programme design
(share of respondents, in %)



Note: Based on 66 responses to the question: “How do you assess your capability to design policy proposals for (a) country monitoring, (b) euro area monitoring, and (c) programme design and implementation?”
Source: ESM staff self-evaluation (2023)

While progress has been made, the country Capacity Assessment Tool is still not integrated consistently into the ESM’s country analysis.⁵⁰ Though a majority of respondents to the staff survey consider that the Capacity Assessment Tool adds some value to their country work, its practical role is still rated as limited. Individual respondents say that lessons learned from the Greek programmes have not effectively improved the way the Capacity Assessment Tool is used. While a regular implementation capacity report is viewed positively, staff suggest more active involvement of country teams and integration of their practical knowledge in the report’s preparation. Individual respondents recommend more testing of the tool and explicit discussion of its outcomes at the EFMC. Furthermore, several stakeholders recommend it as a tool for onboarding new country team members to gain a better understanding of a country’s fundamental problems. Given the more quantitative background of analytical staff after the latest increase in headcount, the mainly qualitative approach required for reform implementation capacity assessment in the Capacity Assessment Tool appears challenging. While external stakeholders stress that the ESM’s capability needs should include in-depth, qualitative country knowledge, the internal staff survey responses suggest instead linking the framework to the indicator dashboard that establishes the initial step of the analysis. The Capacity Assessment Tool process could serve as a premortem of a country

programme to elevate staff readiness and ensure an open-minded and unbiased assessment of the prospects.⁵¹

Departures of senior staff with programme experience and recruitment of more junior staff have led to limited individual capability in dealing with the specific challenges of practical programme implementation; staff would be challenged for time in the event of a crisis. Staff respondents consider the knowledge base on programme design and implementation rather theoretical; applied skills are scarce. This gap will not close soon given the limited number of dry runs, such as on the precautionary credit line and the backstop, and rather few practical training opportunities for staff, such as secondments to programme-experienced peer institutions (see more on secondments in Chapter 5). The IMF financial programming framework training is being gradually rolled out among ESM analytical staff. Some staff argue that the current skill level is adequate for the role that the ESM played in past programmes. No clear evidence was found on whether the ESM could excel in the envisaged broader role without further training or increased headcount.

ESM management is confident of the institution's ability to prioritise and scale up in a crisis – even one involving several countries. Oversight committee discussions do not regularly conclude on ESM priorities for eventual programmes. These would instead require staff to prioritise agendas. Staff could benefit from more open debate in this context. According to management, programme preparedness would be ensured through internal transfers of staff resources.⁵² However, no concrete contingency plan exists for such a reshuffle of priorities, nor have reserve experts been identified. There are as yet no arrangements with peer institutions to bring in staff to support the setting up of a stability support programme at short notice. However, management confirmed that efforts have been made in the past to build a network of experts at other supervisory institutions, the European Commission, ECB, and IMF, which could be called upon in times of crisis. Management considers a crisis unlikely in the near future. The ESM does, however, have standing arrangements in place for bringing on board seconded personnel.

Interviewees suggested refocusing the ESM's efforts on crisis resolution. Several interviewees commended the ESM's activities in risk monitoring and early warning, but suggested it should further develop its crisis resolution tools. They highlighted a view that, while early warning and crisis detection remain challenging, failure on crisis resolution would not go unnoticed and would carry substantial reputational risk for the institution. Others cautioned, however, against over-emphasising the utility of pre-established models when crises erupt. Management believes that fostering a sense of capabilities among staff is essential for enhancing their readiness for such situations.⁵³

External collaboration

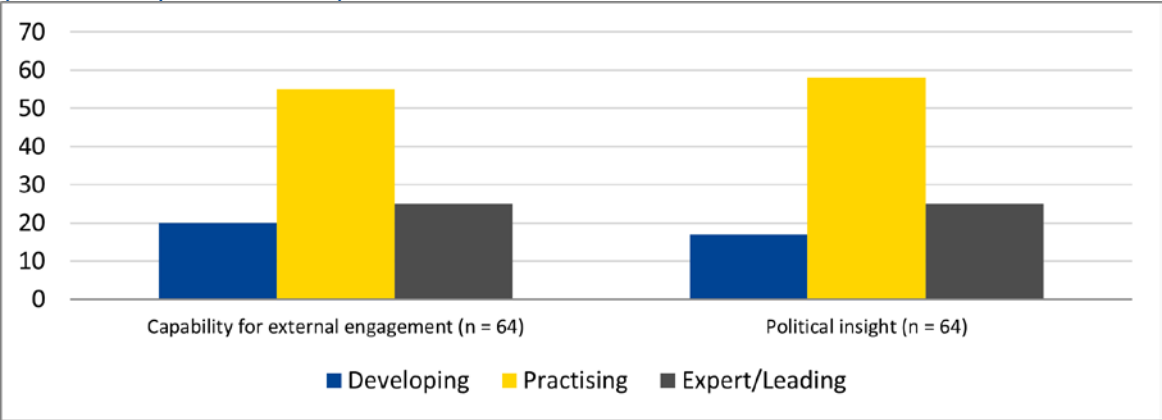
The collaborative capability of an institution is a core element of problem-oriented governance. Collaborative capability stems from the breadth (increasing alignment between a range of participating actors and scope of problem) as well as the depth (increasing alignment of actors regarding goals, means, and working processes) of the cross-silo, cross-sector, and state-society relationships which institutions cultivate and leverage to address public problems.⁵⁴

Collaborative capability plays a fundamental role in deepening understanding and enhancing the quality of strategies developed and implemented.⁵⁵ Building collaborations and shared responsibilities stimulates innovation, increases operational capacity, and strengthens the legitimacy of and support for strategic goals. Collaborative capability requires technical, managerial, and political skills and dispositions to work across internal and external organisational boundaries and develop the structures and processes that enable, incentivise, and compel silo-busting activities.⁵⁶

Collaboration under the new mandate with the European Commission (and SRB) has broadly already been negotiated but will only be finalised after ratification of the amended ESM Treaty. The ESM and European Commission have agreed a Memorandum of Cooperation regarding the setting up of stability support programmes. This will become effective after ratification of the amended ESM Treaty.⁵⁷ However, a detailed definition of each institution’s roles and the operationalisation of staff-level collaboration still need to be developed. Leaving aside the potential benefits of inter-institutional competition, there is a practical need for a clear division of labour to avoid overlaps and the duplication of work. At the same time, research shows that institutional collaboration can benefit from a certain level of flexibility and innate expert-level leadership, particularly during crises.⁵⁸ The ESM and SRB agreed on a collaboration agreement regarding the implementation of the common backstop and jointly developed the CBRCAM⁵⁹ – both are conditional on treaty ratification. This includes operational details and supervised data room procedures applicable to ESM, ECB, and European Commission staff, subject to testing.⁶⁰

Research collaboration and memberships as well as various forms of cooperation with other Regional Financing Arrangements (RFAs) are well established and already benefit the ESM’s analytical capability to some extent.⁶¹ Research collaborations are vital for enhancing transparency and building trust in the ESM’s analytical framework as well as for gathering information from experts outside the institution – a process described as insourcing knowledge. The ESM has also introduced close cooperation, including an annual policy dialogue and annual research seminar, with other RFAs.⁶² This cooperation enables a close exchange of best practice to further strengthen the global financial safety net, reflecting the ESM’s core mandate. These connections could be used further to develop tools and practices, and to inform analysis of the financial sector outside the EU.

Figure 4.5
Staff capability for external engagement and political insight
(share of respondents, in %)



Note: Based on 64 responses to the questions: “How do you assess your capability to engage stakeholders and the community, and build relationship capital to understand diverse expectations, co-create solutions and support implementation?” and “How do you assess your capability to navigate issues, relationships, and situations of sensitivity to the political context?”
Source: ESM staff self-evaluation (2023)

Building long-standing relationship capital requires continuity and credibility of collaboration, and overcoming the limitations commonly set on activities between organisations, such as perceptions of duplication of work, territorial rivalries, or barriers to sharing sensitive data. ESM staff respondents mostly rate themselves as competent in engaging with stakeholders and building collaboration or networks with institutional counterparts (Figure 4.5), and they see a great need for such cooperation. Some individuals noted institutional limitations on efficient collaboration, including a lack of support from management and only rare opportunities for staff to build external networks. Accordingly, staff respondents also assessed as only moderate their capability to anticipate EU peer institutions’ priorities and to integrate EU decision-making mechanisms and policy priorities into their own tasks (Figure 4.10). The IMF explicitly encourages staff to engage with national authorities to gain their trust.^{63,64}

Influencing

Evidence from interviews and surveys shows that the ESM successfully influences the policy debate, though the impact of different channels for policy messaging is not uniformly advanced; some channels, including at staff level, need improvement. Interventions by ESM senior management at high-level political meetings such as the EU Economic and Financial Affairs Council, the Eurogroup, or the Economic and Financial Committee as well as in various academic fora were praised by external interlocutors. The macrofinancial perspective of the institution presented by management is a highly valued contribution to the policy debate and underscores the ESM's core competences centring around market expertise and profile.⁶⁵ The number of media interviews with ESM management has declined slightly in recent years but an annual average of 27 interviews is evidence of some media interest in the institution.⁶⁶

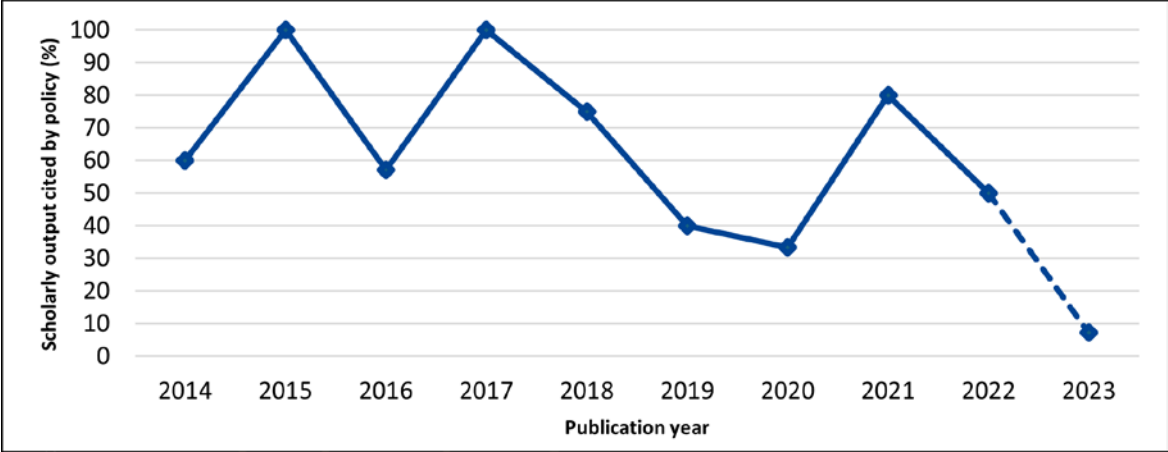
A high-level analysis nevertheless shows that most interventions were formulated as complementary market intelligence or messages broadly supporting other EU institutions' views. Evidence of communication lines departing from such alignment is scarce, reflecting a certain prudence. ESM representatives regularly speak after European Commission and ECB colleagues in EU committees, presenting a risk of repeating messages. Some stakeholders expected the ESM to influence the committee agenda more directly with topics relevant to the institution's core concerns. However, there may be limited scope for the ESM to include its own agenda items in EU coordination meetings, particularly in the Eurogroup Working Group. The shock event studies suggest that persistent gaps in analysing the interconnectedness of risks to financial stability hindered the ESM's ability in a timely manner to inform decision-makers or to develop recommendations based on the unique context of the ESM's market intelligence. This limits the institution's potential for raising its profile and exerting influence in policy debates.

The ESM exerts limited influence through staff-level and expert networks. Staff respondents consider their own impact on EU policymaking to be limited, playing largely an observer role. The role allocated to the ESM within the European institutional setting places certain constraints on staff in voicing positions on, for example, monetary policy or short-term fiscal positions.⁶⁷ Staff-level representation of the ESM at external events such as conferences is still rare compared to ECB and European Commission staff. Informal networks should be further extended to enhance the credibility of the ESM's analytical framework and so strengthen the institution's reputation and its role in programme negotiations. Staff surveyed cited a lack of opportunities to interact with the ESM's external stakeholders in describing their understanding of EU and national decision-making mechanisms and priorities as not highly developed, and their ability to navigate political sensibilities as only moderate (Figure 4.5).

Compared to peer institutions, the ESM's research and publication output contributes relatively little to policy debates and decision-making. ESM blog posts have had good reception, particularly in EU circles, since their launch in 2020, due to their concise and timely analysis of economic and policy developments. However, the influence of other ESM publications such as working papers and journal articles is relatively low and stagnating in terms of references in policy-related documents (Figure 4.6; Chapter 7 of the technical annex). Interviewees suggest that research and publication priorities will need to focus more on mandate-related topics to sharpen the ESM's profile and enhance the policy impact of the institution. High potential gains from research and publication output for the ESM's credibility and reputation appear underrated by management at the current

juncture where resources continue to be concentrated on ongoing surveillance and development projects.

Figure 4.6
ESM publications cited in policy documents
(share of ESM publications, in %)



Notes: Share of ESM journal articles, books, and conference proceedings cited once or more in policy-related documents as defined in the Overton database. The Overton database indexes online policy and policy-related documents, as well as the citations towards peer-reviewed publications therein. Top sources of policy-related economics documents covered by Overton include working papers by the Institute of Labor Economics, the National Bureau of Economic Research, or reports by the World Bank. English is the working language of the ESM and Overton's coverage is biased towards English-language documents and documents from the US, the UK, and, to a lesser extent, Western Europe. Results must be interpreted with caution, as scores for each year are based on less than 30 observations, which considerably limits the robustness of the results. See Elsevier Report (2024) and Bibliometric Study (2024).

Source: Elsevier Report (2024)

The ESM as an institution has considerable media impact but the visibility and media coverage of staff analysis and reports are low.⁶⁸ To build trust in the institution's analytical capability and therefore effectively to influence the policy debate and decision-making, ESM communication should enhance the transparency and understanding of its work, including by actively sharing analysis and publications with stakeholders and peer institutions. Several stakeholders call for a more comprehensive sharing of country analysis. The ESM's monitoring reports fail to match the transparency of those from peer institutions. At present, country monitoring products⁶⁹ are not shared externally, nor with Board members or even with the national authorities concerned. For comparison, Table 4.1 summarises the IMF's disclosure policy, showing how the IMF product palette is disseminated according to different disclosure levels, with much of its output made public. IMF staff may even publish preliminary surveillance findings through its mission concluding statements, with the consent of country authorities.⁷⁰

Table 4.1
Disclosure of IMF documents

Disclosure level	Examples	Shared
Internal use only by management and staff	Vulnerability exercise, mission policy note	None
Restricted to the Board	Briefings by senior management, mission chiefs; Main Financial Sector Assessment Program report	None
Highly confidential (International Monetary and Financial Committee only)	Early Warning Exercise	None
Public disclosure	Flagship multilateral surveillance reports (World Economic Outlook, Global Financial Stability Report); External Sector Report; Member's financial data Assumed publication: Bilateral surveillance reports (Article IV reports, Financial System Stability Assessments) and Use of funds reports (programme reviews).	98%-100%

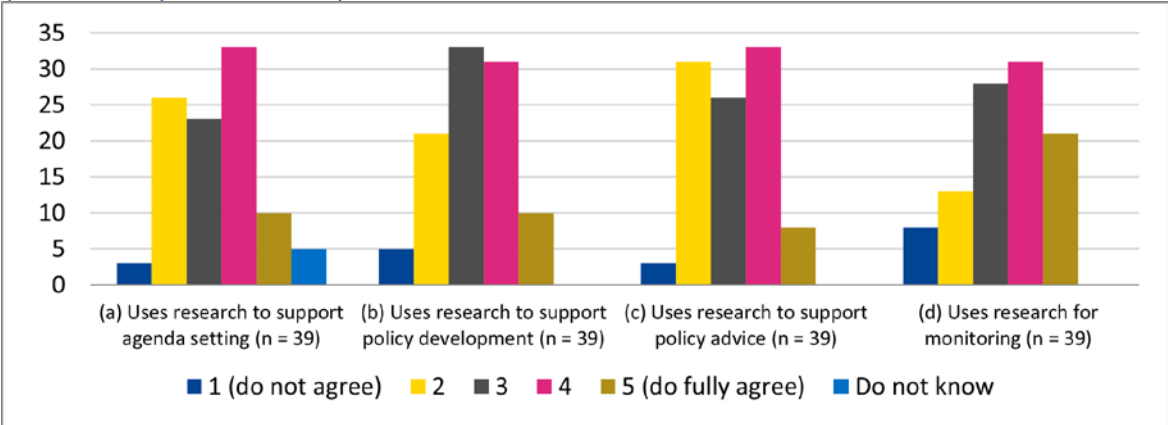
Sources: IMF Independent Evaluation Office (2014), pp. 14-15; IMF [website](#)

Interviewees suggest the ESM should take a more active approach to influencing the policy debate through bilateral dialogues, such as with stakeholders and public and private sector experts, as well as through multilateral communication channels. This would also include using publication of key ESM analytical work and findings to strategically set the policy agenda. Messages need to be adapted to different audiences, from technical to political, and timed to have the greatest possible influence. Sensitivities around certain topics could mean restricting the audience. Peer institutions recommended Eurogroup Working Group dinners or supervisory committees of the European Systemic Risk Board as suitable fora for market-sensitive discussions. Some interviewees felt that awareness of the ESM had fallen off somewhat compared to a decade ago, when it featured in extensive media coverage of its stability support programmes.

Research, publishing, and communication

Research activities are considered a fundamental element of a learning institution. Research⁷¹ and publication output make a strong contribution to further developing the ESM's analytical capability to implement its mandate effectively, as well as its reputation (Figures 4.8 and 4.9), and its ability to collaborate on equal terms with peer institutions (Figure 4.9).⁷² Staff respondents also say that ESM research is actively used to influence the institution's agenda setting, policy advice, and monitoring (Figure 4.7). However, as discussed above, the Elsevier Report (2024) and ESM staff survey (2023) show only a limited external media and policy impact from ESM research and publication engagement compared to peer institutions (Figure 4.6). Makkar et al. (2016) conceptualise the use of research engagement to influence policymaking. Strong research engagement can strengthen an institution's zone of indirect influence and flag up issues of interest.

Figure 4.7
Uses for ESM research
(share of respondents, in %)



Note: Based on 39 responses to the question: "To what extent do you agree with the following statement: My department (a) uses research to support agenda setting, (b) uses research to support policy development, (c) uses research to support policy advice, and (d) uses research for monitoring."
Source: ESM staff self-evaluation (2023)

The ESM's publication track record is mixed, with the institution losing some ground through focusing on core competences. This can probably be considered natural for a small institution. The quantitative publication output of ESM staff has been broadly sustained, on a slight upward path with a dip in 2021 related to the pandemic. The output mix has shifted in recent years from working papers and journal articles towards blog posts, opening an additional channel of external communication. While blogging offers the opportunity to react in a more flexible and timely manner to economic or political developments or shocks, reduced output of high-level journal articles may have a reputational cost. The ESM has also recently lost some ground in publishing on the institution's core topics such as financial stability and systemic risk or fiscal policy and sovereign debt.⁷³ The much larger IMF has also, it should be noted, seen a decline in these core research clusters in recent years.

Interviewees said the ESM should publish its analytical framework (models, tools, and indicators) to build trust in the institution's capability to execute its mandate effectively and conduct consistent analysis. Even though the ESM's mandate is clearly defined within the EU's regulatory context, effective collaboration with peer institutions is ultimately based on trust in the analytical capability of the institution and the proven skillset of its experts. Outsiders are unable fully to see or understand an abstract system.⁷⁴ They need to rely on experts from within the system. Specific actors representing the system can act as mediators or access points, so that trust in the actor is equated with trust in the system. Transparency of the ESM's analytical system is, therefore, a condition for the effective implementation of the mandate.

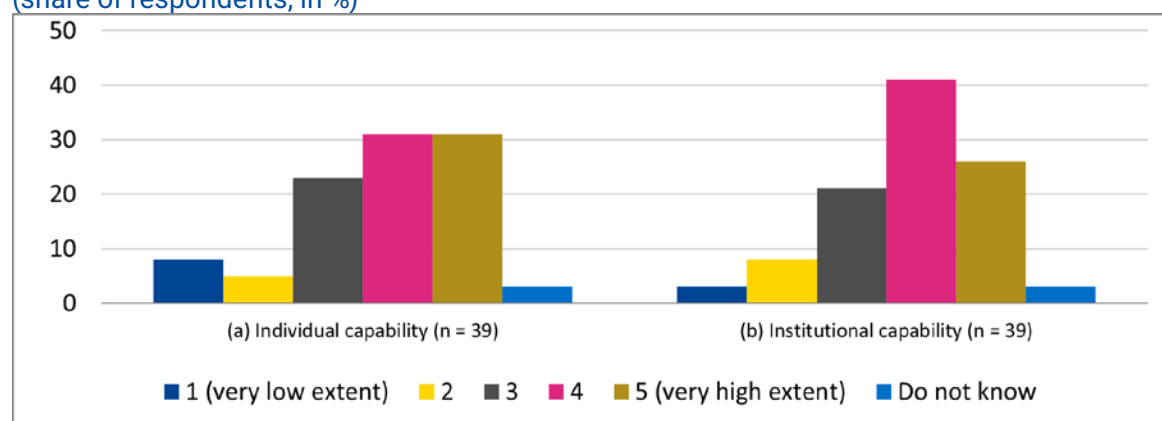
Table 4.2
ESM publication output by type

Year	Blogs	Annual reports	Working papers	Discussion papers	Articles and op-eds	Other publications	Total
2013	0	1	0	0	2	2	5
2014	0	1	0	0	0	4	5
2015	0	1	9	0	0	4	14
2016	0	1	12	2	1	3	19
2017	0	1	4	0	5	1	11
2018	0	1	8	3	3	0	15
2019	0	1	8	2	1	1	13
2020	28	1	6	7	1	1	44
2021	13	1	3	4	2	0	23
2022	14	1	5	2	9	0	31
2023	15	1	3	2	5	0	26
TOTAL	70	11	58	22	29	16	206

Notes: The systematisation of publication types reflects the systematisation used by the ESM until the end of 2023 (end of the evaluation period), before changes in 2024. "Other publications" include working papers co-authored by ESM staff but published by other institutions (e.g. by the ECB or the Bank of Spain), journal articles, books, and reports (e.g. ESM evaluation reports). Articles referred to in "Articles and op-eds" are mainly newspaper articles. The ESM was established on 27 September 2012, no publications are listed on the ESM homepage until 31 December 2012. 2013 was the institution's first full calendar year.

Source: ESM website

Figure 4.8
Research contribution to analytical capability
(share of respondents, in %)



Note: Based on 39 responses to the question: "To what extent does ESM staff research and publication output (a) support you developing your analytical capability at ESM (e.g. expertise, quality of informing management) or (b) boost ESM's analytical capability as an institution?"

Source: ESM staff survey (2023)

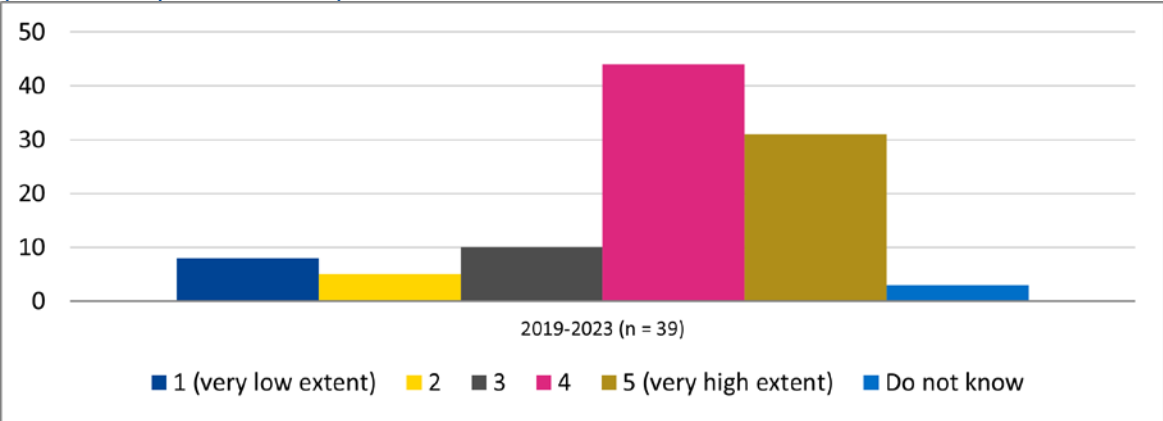
Research and publication output considerably strengthened both the individual analytical capability of staff as well as the analytical capability of the institution (Figure 4.8). To raise the ESM's profile and further enhance the positive impact of research on its analytical capability and reputation, research priorities could be refocused.⁷⁵ Staff respondents and interviewees think the ESM's research and publications aid collaboration with peer institutions. Interviewees from EU institutions said the ESM should be less timid about speaking up on issues, even those that more directly concern their own institutions – though they acknowledged a general tendency among European institutions to become entrapped in political sensitivities.

The ESM has established internal processes to advance the institution’s research agenda embedded in seminars and a widespread collaboration network, but it lacks an overarching research and incentive framework. Staff say incentives to conduct research and publish have improved but could be further strengthened.⁷⁶ To boost influence through the academic and research community, clear research priorities set out in a multi-annual agenda would be useful. A Board consultation on priority topics could boost relevance and influence. One interviewee suggested the Board of Directors select one research topic for the institution on a regular basis for eventual seminar engagement with it. More formal arrangements, including an organisational structure such as a cross-divisional research unit,⁷⁷ could be considered to coordinate and enable increased research and publication activity in future.

Publications and targeted communication of research can build up visibility, trust, and reputation, thus supporting effective mandate implementation. The external policy and media impact of the ESM’s research and publication output should be seen in the light of a young crisis resolution mechanism rather than a policy or research institution. However, alongside some loss of scientific competitiveness benchmarked vis-a-vis peer institutions, the policy and media impact of the ESM’s research and publication output also lost some ground recently. Management considers blogging an important new element of the ESM’s external communication strategy to enhance trust and raise the institution’s profile. Some interviewees, notably academics, said they were unfamiliar with ESM research products, but it was also noted that larger institutions also managed to get more attention by getting “big names” to lead research.

Though it has a positive impact on its reputation (Figure 4.9), ESM research and publication output under the monitoring mandate has not raised the institution’s profile through its impact on policy or in the media. More strategic communication aimed at policy-oriented academics, focusing on specific, mandate-related research, could raise the ESM’s profile and increase media coverage over and above the media attention the ESM already receives.

Figure 4.9
Research contribution to the ESM’s reputation
(share of respondents, in %)



Note: Based on 39 responses to the question: “To what extent does ESM staff research and publication output contribute to ESM’s reputation (benefitting e.g. ESM’s influence in future collaboration with EU institutions under the enhanced mandate)?”
Source: ESM staff survey (2023)

Role of networks

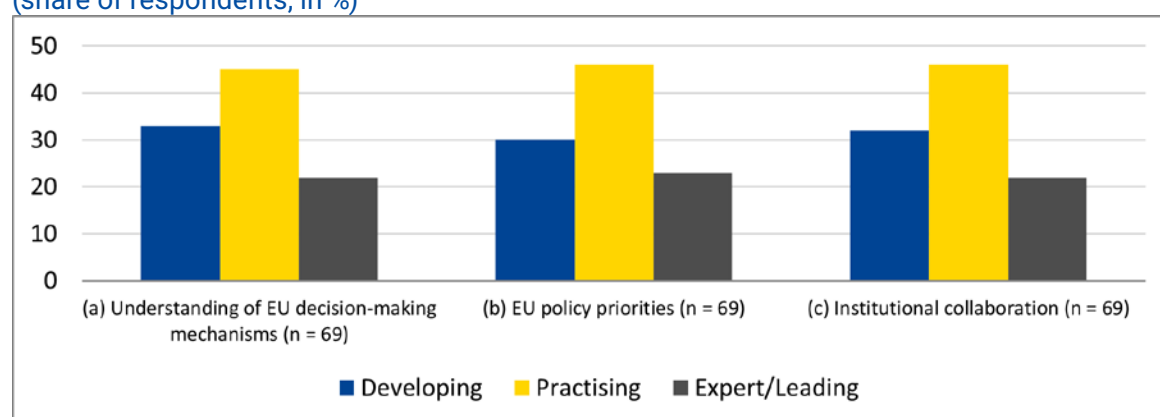
Beyond acting as vectors of influence, external networks and collaborations are crucial for garnering up-to-date knowledge from stakeholders, peer institutions, and the scientific community.⁷⁸ Findings from the staff survey show that ESM analytical products incorporate a large amount of analytical output from other institutions and the academic community. External knowledge transfer has been organised increasingly efficiently since 2019, with particularly good knowledge insourcing

from peer institutions and universities. Insourcing from the private sector can, however, still be improved. While evidence from the staff self-evaluation shows that employees largely rate their capability to engage with external stakeholders to build relationship capital in support of mandate implementation as competent (Figure 4.5), staff assess their capability to incorporate institutional collaboration into their work assignments as less advanced. A majority of respondents say they have only a moderate understanding of the external context in which the ESM is operating (e.g. understanding of government systems, processes, and priorities, and anticipation of EU partner institutions' priorities). This weakens their capability to integrate EU decision-making and policy priorities into their work assignments (Figure 4.10). At the same time, most respondents deem this external knowledge broadly relevant to their job. Individual staff comments suggest that they miss active management efforts to develop institutional collaboration that would enable broader staff engagement and knowledge accumulation. Overall, staff respondents assess their opportunities to build networks as rather limited.

Interviewees recommend using external advisory groups as best practice to keep analytical knowledge and tools current. There are varying approaches to this. One interviewee stressed that outside experts should have a purely advisory role. One option would be iterative co-production arrangements with selected stakeholders, particularly when developing solutions that require a multidisciplinary approach. Joining peer advisory groups could ease administrative burdens. Although this evaluation did not comprehensively study past and ongoing collaborations, it is noted that ESM lending tool development has been vetted by Member representatives at the technical level. The ESM also uses outside consultants to support the development of analytical tools, including dry run exercises, and runs or takes part in research seminars to benefit from external expertise on methodological issues.

The ESM may also rely on stakeholders' analysis. Staff interviews provide some evidence of cases where country teams' questions triggered specific analysis by relevant authorities. Where work scheduling is well organised, networks and collaborative production may provide for improvements in efficiency and relevance. However, to engage in this way, staff need clear and well-communicated authorisation, preferably embedded in a policy.

Figure 4.10
Staff capability to integrate EU context
(share of respondents, in %)



Note: Based on 69 responses to the question: "How do you assess your capability to integrate the following in your work assignments: (a) EU decision-making mechanisms, (b) EU policy priorities and, (c) institutional collaboration/coordination?"

Source: ESM staff self-evaluation (2023)

The strategic use of networks to discuss the ESM's analytical framework or to share assessments on issues such as early risk detection bolsters the credibility of the ESM and sharpens the institution's profile. Such networks are well established at managerial level and highly appreciated by interviewees, but staff-level opportunities to build networks are still rare and not effectively supported by the organisation. Interlocutors suggest that additional formal and informal channels

of knowledge insourcing could be developed. Shock event studies (Table 3.1) suggest that timely insourcing of external knowledge via collaboration or networks can be useful for overcoming a certain lack of specialised sectoral expertise at the ESM, enabling a broader analytical perspective in risk monitoring and actionable policy advice.

There is a need for the ESM to further promote research networks and enhance incentives for external collaboration. Staff survey findings show that the ESM as an institution has the tools and systems to support external research collaboration with academics or peer institutions, and to support the institution's use of external research. Individual staff respondents assessed themselves as possessing the knowledge and skills to support external research collaboration. Staff respondents value the use of external research and the ability to cooperate actively with researchers. They also assessed that the ESM's research output has largely benefitted the institution's analytical system, as well as external committee work and collaboration with peer institutions (Figure 4.8).

Like some peer institutions, the ESM would benefit from developing more effective external networks. Interviewees recognise that senior management is strongly engaged in stakeholder management and is successfully building relationship capital from active networks. Suggested additional channels to build up networks for successful knowledge insourcing are:

- **Recruiting:** Hiring senior executives and experienced, internationally mobile staff to overcome potential internal knowledge constraints. Commissioning reputed external advisors with high visibility or external contractors who work, say, with universities. This would give the ESM access to a pool of experts.
- **Training:** Setting up workshops or in-house training with external advisors or contractors. Training helps retain staff. Internal transfers of skilled people allow them to train others. Secondments to other institutions or swaps of staff enhance staff skills.
- **Stakeholder engagement:** Frequent exchanges with key stakeholders, such as with ministries of finance for private discussion of crisis risks, enhance knowledge transfer and improve limited data access for country monitoring. Memorandums of Understanding with peer institutions facilitate the exchange of data and confidential information.
- **Dialogues:** Bilateral discussions with stakeholders on the ESM's analytical framework. Presentation of research output and key reports in national ministries. Active practice of market participant consultations on financial market topics is in place, involving funding and investment experts, and economists, particularly from the Economic Risk Analysis division.
- **Research networks:** Expertise from collaboration and partnerships with independent research institutions leverages the ESM's internal knowledge. Commissioning of scientific input from research institutions and external experts.
- **Alumni network:** An alumni network of former ESM employees could, as a knowledge bank and workforce reserve, contribute to the development of effective networks.

The benefits of external knowledge insourcing need to be reinforced by internal knowledge transfer including through staff networks.⁷⁹ Staff survey results indicate that internal knowledge transfer at the ESM has improved significantly since 2019, though institutional memory still requires safeguarding and time should be reserved for updating knowledge through experimentation and reflection. While responding to the Review function and seeking external review or feedback have strengthened formal efforts to avoid silo thinking, there is scope for more cross-departmental analysis, as well as knowledge-sharing and data transfer beyond a need-to-know basis. Interviewees stress the importance of internal databases, knowledge management, co-working, and strong communication to enhance internal knowledge transfer.

Conclusions

- The ESM's analytical approach is generally capable of identifying risks in a timely manner. While considerable progress has been made, the integration of operational market intelligence with economic and macrofinancial analysis still leaves room for improvement, and risk monitoring would benefit from more active internal collaboration and stronger processes. The reliance on external data input underscores the importance of external collaborations with EU institutions to improve effective risk identification.
- The institution is not yet prepared for its broader role in designing, negotiating, and implementing stability support programmes. Departures of senior staff with programme experience have reduced individual capabilities for dealing with the specific challenges of practical programme engagement; this has yet to be offset by the more junior staff hired in recent years. So far, contingency planning does not guarantee that programme teams can be scaled up.
- The ESM has developed a collaboration framework with the IMF and peer RFAs, but a similar arrangement with the European institutions remains incomplete. New collaboration with the European Commission and the SRB, related to the new mandate, has been formalised in an agreement, but finalisation is subject to ratification of the amended ESM Treaty. The institutional cooperation with the IMF and RFAs is less formal but follows established practice. Research collaboration and academic memberships are well established and already benefit the ESM's analytical capability.
- The ESM successfully influences the policy debate, though not all channels have been used or proved impactful. Interventions by ESM senior management at high-level political meetings or in various academic fora were praised by interviewees. However, influence through staff-level and expert networks appears limited and is not effectively supported by management. Compared to peer institutions, the ESM's research and publication output contributes relatively little to the policy debate. While there is significant media coverage of the ESM as an institution, visibility and media attention to staff analysis and reports are low.
- The ESM's research and publication track record is mixed, with the institution losing some ground in mandate-related output. While the ESM has established internal processes to advance its research agenda, no overarching research framework is in place. Management does not provide sufficient incentives for staff to scale up research activity. Stakeholders suggest that the ESM should publish its analytical frameworks to sharpen the institution's profile and enhance credibility.

5. Continuity

This chapter centres around the evaluation criterion of continuity, or sustainability, of the ESM's analytical work. The concept of sustainability examines the degree to which capability has been built and institutionalised, and how well the capabilities are grounded in the organisation compared to best practice. In this evaluation, the focus is on the capability of the institution to maintain operations when staff rotate or leave the organisation, and to develop its capabilities on a continuous basis. This entails examining guidance and accessibility, or sourcing, aspects of data, knowledge, and tools, which are also relevant for the efficiency aspect. There is also an assessment of the potential for scaling up and of the ownership of the results.

The following questions guide this chapter:

- How well do the analytical teams ensure they have the skills to achieve their purpose, including the right mix of experience?
- What is the capability to develop, implement, and review analytical/assessment tools? What mechanisms exist to incorporate findings and lessons from them into operational work? How is this monitored?
- What systems are in place to draw conclusions and lessons from past analyses' performance that can be used to improve future work and maintain continuous improvement?
- How does the ESM source the necessary capabilities? Would there be alternative ways?
- How well do arrangements in place support the ESM's role in the European institutional structure in terms of future crisis prevention or resolution?
- How well is the analytical capability grounded in the ESM as an institution?
- How is institutional knowledge maintained and built? What systems are in place for recording and accessing information relevant to achieving excellence in mandated responsibilities?
- In view of staff attrition or rotation, what mechanisms exist for transmitting accumulated knowledge of a country or specialist role from a departing expert to an incoming staff member?
- How adequate are the systems supporting continuous institutional learning and improvement, as well as staff development?
- How are staff encouraged and enabled to have good external connections – including with other agencies, stakeholders, academia, and international counterparts – and to keep up with the latest thinking?

Maintaining capability

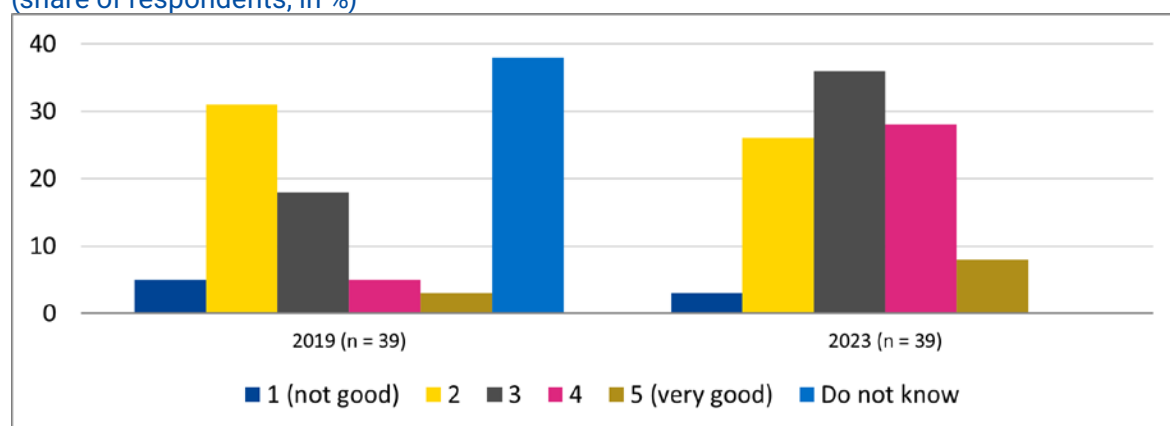
Management recognised the importance of continuity in its operations and capabilities as early as 2017⁸⁰ when capacity development and ensuring a pool of talented and motivated staff were focal points of its strategic plan. From 2019, management articulated a specific target for the 2020–2022 period to implement the expanded mandate and develop the new capabilities necessary.⁸¹ This relied on identifying missing capabilities (see Chapter 3).

Since that period, findings from surveys and interviews show that the ESM has made substantial progress in structuring and harmonising its data infrastructure, while ensuring its adaptability. In this, it is now at the level of, or indeed surpasses, peer institutions. This is largely thanks to diligent efforts by data scientists and analysts, supported by management, over a sustained period.

The rapid development and implementation of analytical tools in recent years led to a certain proliferation. Tools are accorded varying degrees of importance. Some are rarely used or maintained, with some overlooked when staffing turns over. Given the need for continuous tool maintenance and the existence of key person risks, continuity would be better ensured by clarifying how tools relate to the ESM's mandate to safeguard financial stability in the euro area, and consolidating them accordingly, while also ensuring adequate documentation and clearly designated maintenance teams. While the ESM is less able than larger institutions to offer broad support functions and services for analytical staff,⁸² it could benefit from developing communities of practice where key experts are identified for each tool to advise colleagues on their use. The ESM should attempt to codify and consolidate the analytical toolkit. This was also identified as a priority by management in the Most Significant Change exercise. Interviewees from peer institutions stressed that, for them, knowledge management comes down in practice to frequent use of analytical tools by multiple staff members; this has the added value of ensuring proper maintenance.

Interviewees and staff survey respondents said that further improvements may be obtained by institutionalising analytical processes, enhancing knowledge management practices, and reducing key person risk. This in turn would require active management of the interplay of horizontal workstreams, an increased degree of cross-departmental work, a looser application of the currently strict need-to-know basis, and breaking down silos. Survey respondents and interviewees said that, in their organisations, onboarding and handover practices as well as staff succession planning have proven successful strategies to reduce key person risk (Figure 5.1). Several interviewees also mentioned using internal staff rotation for that purpose. Management should review current knowledge transfer practice against best practice.

Figure 5.1
Quality of internal knowledge transfer
(share of respondents, in %)



Note: Based on 39 responses to the question: "How do you rate your department's mechanisms for transferring knowledge e.g. in view of task rotation, training a successor - Think e.g. of onboarding sessions, handover protocols, manuals or trainings."

Source: ESM staff survey (2023)

To ensure institutional continuity in crisis response, the ESM needs to have certain frameworks in place that are sufficiently robust. As mentioned in Chapter 4, a conceptual framework for programme design has not yet been adopted consistently in country work, and no operational arrangement with the programme partners exists for programme negotiations.⁸³ Reference was also made to the methodology underlying the ESM's analytical products and that this could be vetted externally, for example through peer-reviewed papers, to contribute to better accountability and credibility – a point stressed by many external interlocutors. This approach could be adopted in the analytical framework that is in the making for the external sector.

While it is clear what analytical deliverables are expected, the processes through which analysts should respond to a set of relatively standard country risks remain undefined. Management regarded the objective of increased expert autonomy as one of the key success factors for producing standard analytical responses to country risks, but it was not evident how this objective was to be achieved. It could be through, among other things, collective discussions, establishing written guidance, or active objective-setting for each expert in accordance with analysts' roles. A medium-term self-evaluation objective for the CE department would also be appropriate.

Management has a declared ambition of installing a culture of preparedness that is guided by a structured process for the identification of analytical priorities. This includes: a further consolidation and refinement of the analytical toolkit and reports; strengthening of the policy advisory role and developing a standard analytical response to country risks; launching an external flagship report on euro area financial stability; and full deployment of the data infrastructure to ensure efficiencies that allow excellence in analysis.⁸⁴ Survey results demonstrate that these changes would support the improvements required. In the view of many respondents, a transformation towards a stronger focus on early risk detection and analysis of the respective policy implications would better prepare the ESM for a future crisis role.

Interviewees and survey respondents saw scope to optimise processes that lead to analytical outputs, and to streamline internal governance. Some suggested better integration of the Capacity Assessment Tool in country work. Many mentioned that the ESM has a plethora of internal committees, with some overlapping and others lacking clear purpose. Management should consider consolidating the committee structure to allow for sound decision-making on the basis of rigorous analysis.⁸⁵ One possibility could be to establish a single committee comprising different compositions, which could act as a portal to the ESM Management Board.

While it is clear that, within the building, processes should be in place to flag, escalate, and assess identified vulnerabilities or risks, a number of respondents and interviewees insisted that these should also be flagged to the Board of Directors or to Members concerned. While many survey respondents and interviewees acknowledged that this may involve sensitivities that are best not discussed publicly, they expressed an expectation that the ESM would raise these issues in appropriate formats. Others underlined the need for transparency, to increase accountability and engage in academic or public debate, but also to subject analytical work to quality controls. Some interviewees warned against being overly cautious about possible market reactions to public statements on risks. They argued that many risks to financial stability that are viewed as sensitive within the ESM are already very familiar to market participants.

Flagging vulnerabilities and risks is crucial for the continuity of the ESM's monitoring mandate. Some interviewees mentioned that they considered the ESM's monitoring mandate to be preventive, in the sense that its purpose is to flag risks before they materialise so that they can be addressed, and the need for stability support avoided. On this reasoning, the ESM's key performance indicator would be to have zero programmes. This in turn requires a consistent policy on how identified vulnerabilities are communicated, discussed, and potentially addressed. Survey respondents and interviewees were divided on whether the ESM should have access to confidential information or not for conducting vulnerability assessments. Some external representatives expressed reluctance while others expressed varying degrees of openness. One noted that privately owned rating agencies have access to information that is not publicly available, so Members could be even more open to sharing that information with a public institution of which they are a shareholder. Others stated that their national entities would benefit greatly from an ongoing discussion or dry runs with ESM staff.

Together with its capital, the ESM's staff is key to ensuring continuous delivery of the institution's mandate. The ESM has attracted analytical staff with strong academic backgrounds, who are recognised as very competent and able by a wide variety of stakeholders. This success is the result of an attractive combination of the ESM's mission, competitive packages, and opportunities to

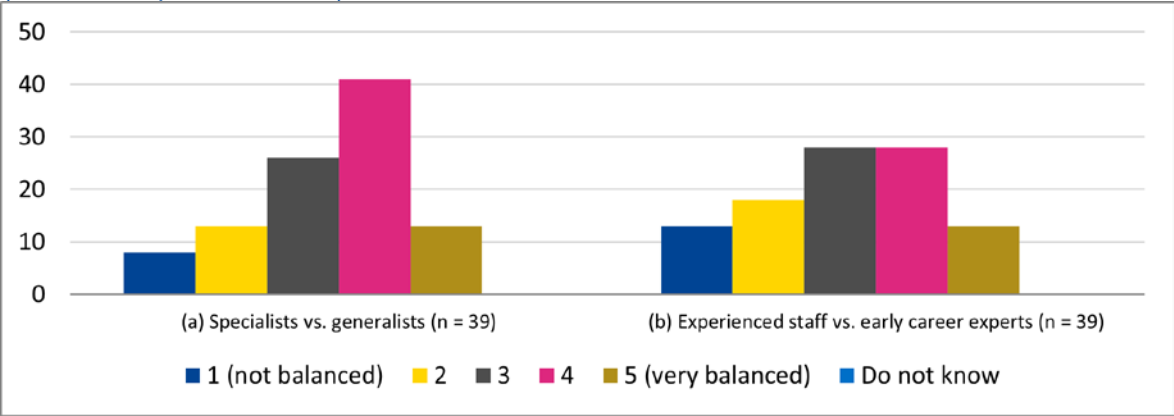
contribute to the financial stability of the euro area. Many interviewees expressed a wish to second ESM analytical staff to their own organisation, or to have more opportunities to engage with ESM staff in joint work or research projects (Box 5.1).

Compared to institutions whose mandates impose clearer daily pressures of work, the ESM faces greater challenges to motivate and retain staff due to periods of crisis alternating with long non-crisis periods. Some stakeholders mentioned that this is making it more difficult to hire talent in some areas. Some interviewees said that the ESM's location, in Luxembourg, was hampering recruitment, while other factors cited included that some of its relatively strict remote working practices compared to practice at peer institutions put the ESM at a disadvantage.

Many survey respondents and interviewees highlighted the challenges of making optimal use of staff skills during long non-crisis periods, as well as concerns that staff lacked external visibility and could feel at times that their work lacked purpose. There was a consensus that ESM staff should be immediately and fully available for crisis resolution, including for regular dry runs. Some noted that other institutions face similar cycles of crisis and preparation. Interviewees from organisations that experienced similar staff retention and motivation issues proposed various practices for dealing with them. Survey responses show that ESM policies to motivate staff by offering long-term development perspectives in line with individual preferences have made progress, but still leave room for improvement. For example, research and publication efforts could be better rewarded. Dozens of interviewees stressed it was vitally important that analysts' regular work should be truly relevant to the institutional mandate, that it should not be too focused on routine tasks like standard reporting but should provide opportunities for "deep dive" assignments and scenario exercises representing real threats.⁸⁶ Many also argued that external visibility and engagement are powerful motivators for this category of staff. One interviewee suggested that analytical staff should be given time and encouragement to follow their natural curiosity on relevant topics, this being beneficial for staff motivation as well as for helping the institution maintain a broad perspective.

Some interviewees suggested that the ESM should hire more diversely beyond economists; in particular, social scientists, sociologists, and behavioural economists were mentioned as potentially valuable recruits. Such skills could help safeguard support and traction for programmes, and hence their effectiveness. They could also help guard against tunnel vision, enhance quality control, and strengthen the sustainability of the ESM's analytical capabilities. This suggests a more balanced view of the relative utility of qualitative and quantitative approaches to analysis and raises the possibility of benefits deriving from a diverse experience base among staff in creating a working environment that encourages constructive criticism. On the other hand, survey respondents (Figure 5.2) generally felt that there is already a broad balance in the ESM staff between specialists and generalists and between experienced experts and those early in their career.

Figure 5.2
Staff balance
(share of respondents, in %)

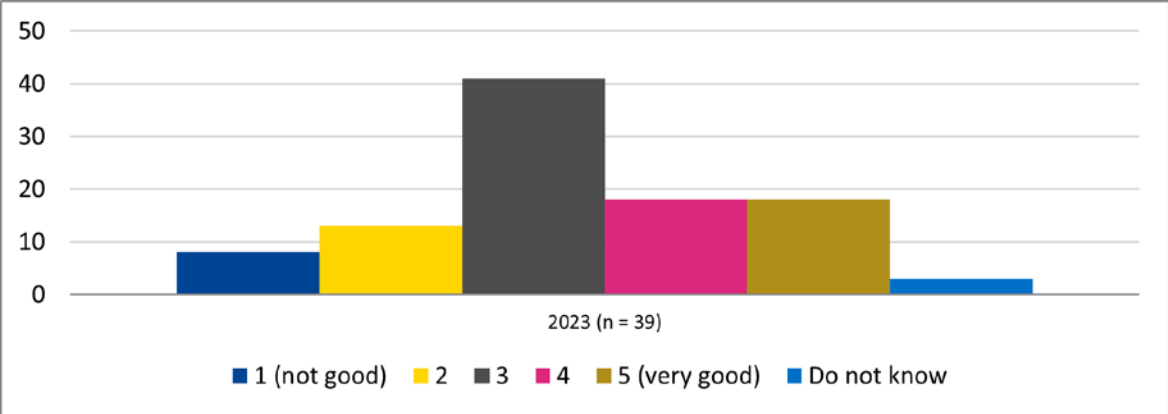


Note: Based on 39 responses to the question: “How balanced is staff composition (a) between specialists providing depth and the generalists and (b) between the experienced staff members who provide institutional knowledge and early career experts who typically know the latest tools?”

Source: ESM staff survey (2023)

For a crisis institution to be prepared to deliver on its mandate, its staff needs to be trained, ready, and alert.^{87,88} Staff survey responses show that management has generally been successful in mobilising employees’ analytical talents, skills, and capacities to meet the ESM’s enhanced mandate (Figures 5.3 and 5.4). Many stakeholders and interviewees stress that staff skills should be maintained through the regular use of analytical tools, through conducting regular dry runs, and through research conducted in house and jointly with academics. Surveys and interviews suggest that the ESM offers relatively few relevant training opportunities⁸⁹ to analytical staff, with a positive outlier being the IMF Financial Programming course. Against that, however, there is evidence that a wide range of training is actually on offer; this could perhaps be better advertised. Individual external training for the CE and CFO departments focuses on quantitative analytical methods, banking, and regulation, as well as professionalisation in capital markets techniques. Particularly for economists, the use of methods training has increased considerably. The standard training offering has been harnessed to promote productivity, self-confidence, collaboration, and communication skills (Chapter 8 of the technical annex).

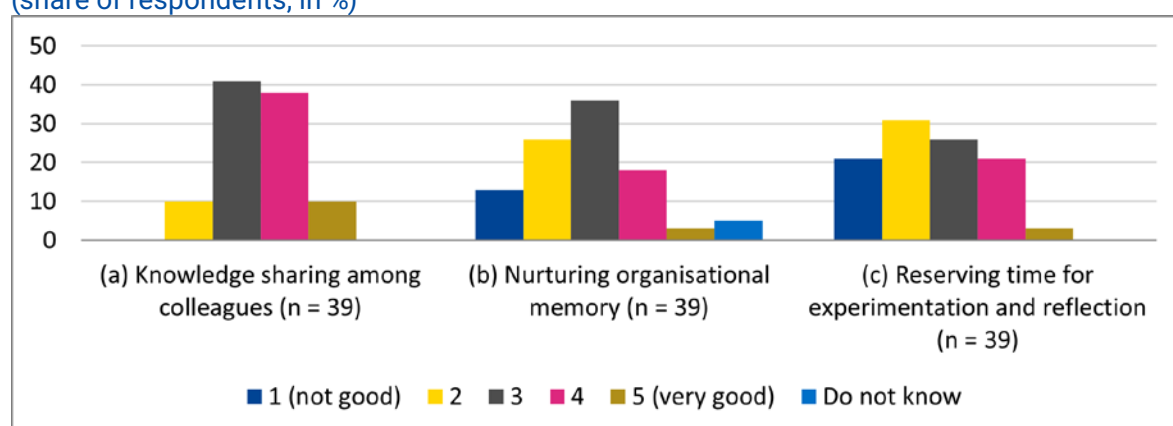
Figure 5.3
Mobilisation of staff analytical capabilities
(share of respondents, in %)



Note: Based on 39 responses to the question: “How well does Management mobilise staff’s analytical talents, skills, and capacities to meet the ESM’s enhanced mandate?”

Source: ESM staff survey (2023)

Figure 5.4
Opportunities to update knowledge
 (share of respondents, in %)



Note: Based on 39 responses to the question: "How well does ESM organise internal knowledge-transfer or opportunities to update your knowledge by: (a) knowledge sharing among colleagues, (b) nurturing institutional memory, and (c) reserving time for experimentation and reflection?"

Source: ESM staff survey (2023)

Staff would benefit from opportunities to apply newly acquired skills in dry runs, more ambitious monitoring objectives for the EFRR, suitable research assignments, or secondments. Simply providing training will not be effective in terms of changing practice, even if it succeeds in boosting skills and knowledge, if there are barriers in terms of motivation or opportunities to practise those skills and tools (Rogers and Woolcock, 2023; Bridoux et al., 2017). Typically, barriers may come from management action, a lack of their support, or from practical scheduling constraints. For example, the financial programming course taken by many economists provides insight and skills that constitute a basis for a new process and practice. However, staff need opportunities to practise those skills so that they develop into a real capability. In theory, the training may support deeper reflection on the ESM's post-programme monitoring, but in practice the institutional set-up of this monitoring remains backward-looking, limiting the practical opportunities.

Towards anticipatory governance

Many stakeholders observed that the ESM typically reacts to input from other institutions rather than actively monitoring risks. They argue that to improve its crisis response capabilities at the institutional level, the ESM needs to become more proactive on risks to financial stability and more selective in reacting to external events and actors. A similar finding is reflected in the summary of the shock event studies in Chapter 3. A few interviewees pointed out that the IMF has a large team at its disposal which is specifically tasked with monitoring global economic and geopolitical events on a 12- to 24-month rolling basis, and with reporting on their implications for the IMF's institutional mandate. As the ESM would be unable to mobilise similar resources, management might leverage this peer capability given the ESM's role in the global financial safety net, to further enhance its preparedness to safeguard financial stability.⁹⁰ Other interviewees suggested that the ESM should join closed-door meetings at the European Systemic Risk Board to share and discuss the results of its analytical work and that of relevant stakeholders.

Exploring and engaging on emerging issues that might shape future commitments or priorities is a mark of institutions that apply anticipatory approaches. The shock event studies show that the ESM is particularly vigilant on the institution's own risks, notably fiduciary and reputational risks.⁹¹

The publication of research, joint research projects, and staff-level external engagement are important drivers for staff motivation and retention, according to a large majority of respondents and interviewees. Some emphasised that external exposure also acts as a quality control; if analytical work is published on the institution's website or in a journal under the author's name, this acts as a powerful incentive to deliver top-quality work.⁹² This in turn ensures that skills are

maintained. Furthermore, external engagement would enable staff to deepen their knowledge, and opportunities to present one's work would address a perceived lack of staff visibility outside the ESM. While some interviewees pointed to risks in discussing sensitive topics, others stressed that staff research publications were unlikely to rock global markets.⁹³ Moreover, research and publication priorities need a greater focus on mandate-related topics to sharpen the ESM's profile and enhance its policy impact.

While research activities are considered fundamental to being a learning institution, the ESM makes limited or no public disclosure of its analytical toolkit. Staff believe that the ESM's research and publication output makes a positive contribution to collaboration with peer institutions but said that further efforts could be made by establishing an overarching research framework and encouraging staff to publish. Furthermore, a more strategic approach to communicating on ESM research output to the policy-oriented academic community, including a stronger focus on individual, mandate-related research, could increase its media impact. In parallel, management could step up efforts to develop institutional collaboration arrangements, which enable broader staff engagement and knowledge accumulation. Analytical staff feel that they have limited opportunities to build networks and that the institution does not actively support this.

For a crisis institution like the ESM to be prepared to deliver on its mandate, it needs to be able to scale up its capabilities rapidly. The evaluation team found that formal arrangements with peer institutions to scale up operations in the event of a crisis are no longer in place. To allow selected former staff to be brought back temporarily, the ESM could set up an alumni network, as peer institutions have done. The ESM could also develop a concrete contingency plan for the reprioritisation of staff agendas and the identification of reserve experts, as well as prepare external arrangements with peer institutions to second their staff to support ESM programme work. While the ESM has developed a collaboration framework with the IMF and RFAs, a similar arrangement with the European partner institutions remains incomplete. As their involvement is indispensable for any ESM programme operations, management could consider setting up frameworks or protocols for joint work, staff exchange, or technical assistance. Uvin and Miller (1996) provide background on the basic forms and strategies for institutions to scale up (Box 8.1 in the technical annex).

Box 5.1 Routes to external engagement

When asked about staff retention and motivation during non-crisis periods, a large number of interviewees mentioned or advocated for ESM analytical staff to be seconded or allowed to participate in joint research work. A significant number of external interviewees expressed a strong desire to have ESM analysts seconded to their own organisation. Advantages mentioned were their excellent reputation and skills which would benefit other organisations, increase the ESM's intellectual footprint, permit useful and meaningful work, support staff motivation, and help keep analysts' skills.

The evaluation team found ample scope for mutual benefit from such external engagement, but some interviewees warned against a drain on ESM resources if the work to be done lacked a meaningful connection to the ESM's mandate of financial stability, structural reforms, sovereign risks, programme execution, fiscal policy, contingent liabilities, and so on. This link would need to be made explicit for each business case.

To the extent that secondments would not be feasible, reference was made to other forms of engagement, such as offering technical assistance through the IMF, the European Commission's Structural Reform Support Programme, or the Vienna Institute, and joint research.

At the request of management, the evaluation team includes concrete examples of relevant institutions in this context. These would be, firstly, the ESM's partner institutions: the IMF (country work, risk work, financial stability), the European Commission (involvement in Recovery and Resilience Facility programmes), the ECB or SRB (financial sector analysis), and the European Systemic Risk Board (sovereign risks).

Secondly, excellent opportunities would also be found in country rating or risk work at other international organisations, such as the World Bank and the European Bank for Reconstruction and Development, or at other RFAs, and in joint research with the Bank for International Settlements.

Thirdly, the mutual benefit of engagement with ESM Member authorities could be even stronger. Representatives from a number of countries expressed great interest in benefitting from the knowledge and skills of ESM staff. This could, for example, strengthen their fiscal framework, develop a debt sustainability framework inspired by that of the ESM, map sovereign contingent liabilities, assess the effectiveness of fiscal policies, or optimise their public debt management. These institutions include finance ministries and debt management offices. National fiscal councils and central banks would also be natural candidates, and of particular interest to the ESM as engagement with them would enable deeper country knowledge.

Finally, national research institutes and academia would be valuable partners in joint research projects.

Issues in organisational culture

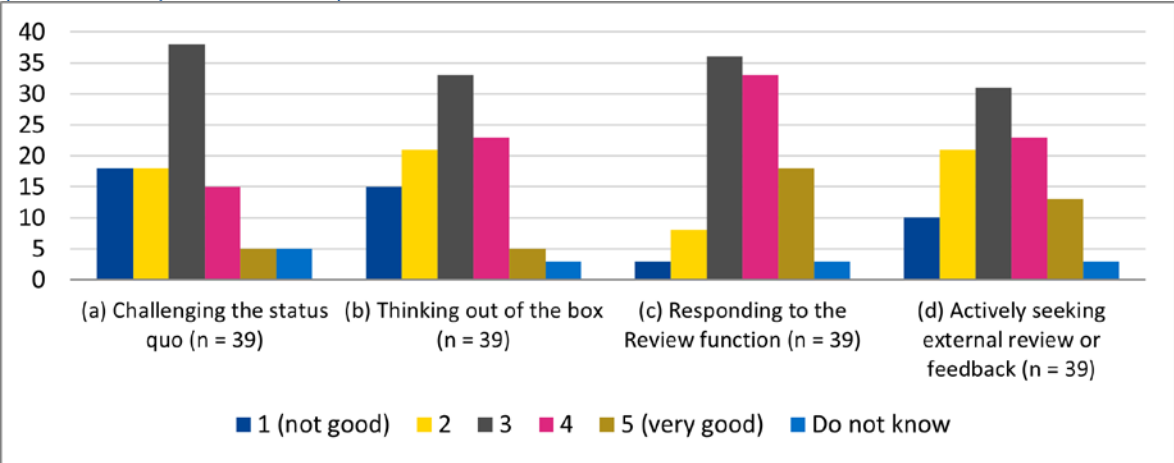
Practice at peer institutions shows that internal discussion can improve products and outcomes and help an institution develop its distinctive voice. Survey respondents and interviewees point to a tendency among ESM managers and senior staff to suppress critical or dissenting views and discourage speaking truth to power. This contributes to a general tendency of conformity.⁹⁴ Reference is also made to exaggerated concern around political sensitivities. This creates a risk that the institution fails to detect risks in a timely manner and lowers the overall quality of work.

Several staff respondents said that restrictions on access to documents were excessive and that they received limited feedback on their input to reports that were confidential under the ESM's "need-to-know" basis for access to information. Staff also experienced poorly prepared discussions and approval processes in opaque and overlapping internal committees. Some managers countered that good efforts had been made to circulate internal committee minutes or summaries more widely. The internal distribution lists of four relevant committees contain 112 experts and managers – half of all ESM staff – and Management Board meeting summaries are consistently shared internally online.⁹⁵

Management should promote better incremental learning by integrating insights and general lessons from analytical processes or committee outcomes into other experts' assignments. Many analytical reports are not shared between divisions or across departments. At best, further insights emerge during review and approval processes, placing an additional burden on managers, and creating frustrations for those holding the pen. No repository of analyses or policy lines is openly available to staff, limiting incremental learning and the ability to connect the dots between sectors and knowledge domains. This leads to a risk of problems with consistency and efficiency.

Survey respondents have mixed views on efforts to avoid silo thinking. Efforts at the ESM to encourage challenges to the status quo or to promote thinking out of the box are rated rather poorly, but progress made under the newly established Review function and efforts to seek external review and feedback are broadly appreciated by staff (Figure 5.5). To further strengthen a culture of preparedness, various stakeholders identified potential solutions. These include fostering genuine and frank discussion, breaking down silos, consolidating internal committees, and a clearer delegation of decision-making on the basis of sound, bottom-up information shared among internal stakeholders. These are characteristics of a learning organisation.⁹⁶

Figure 5.5
Efforts to avoid silo thinking
(share of respondents, in %)



Note: Based on 39 responses to the question: “How well does the ESM make efforts to avoid silo thinking by: (a) making efforts to seize opportunities for challenging status quo, (b) thinking out of the box / challenging one’s world view, (c) responding to the Review function’s feedback, and (d) actively seeking external review or feedback?”

Source: ESM staff survey (2023)

Box 5.2 Sustainability criteria

Schröter (2015) lists a number of criteria of merit to define good sustainability. Management may use these to determine whether the ESM has the capacity to address sustainability needs for its new monitoring mandate, and which tools and processes from the Management Plan will be maintained once the initial drive is completed (see Most Significant Change, Chapter 2).

Some of the relevant aspects are:

- **Organisational characteristics:** replicability of sustainable actions and/or impacts; relevant knowledge, skills, and abilities of staff; staff engagement at all levels; institutionalisation efforts in place.
- **Leadership competences:** championing and promoting sustainability and continuity, while preventing or mitigating negative impact of measures taken; strategic plans for sustainability are frequently revised to adjust for changes in context; consensus and long-term vision about objectives; shared strategic and pragmatic vision; realistic targets; succession planning; strong political commitment and external support obtained.
- **Use of evidence from research, monitoring, and evaluation:** activities or outcomes to be sustained are adequate to allow for the continuation of the monitoring mandate; findings from monitoring and evaluation are used proactively for continuous improvement of the evaluation object (learning organisation); activities that are detrimental or insufficient are discontinued (setting negative priorities).
- **External collaboration and engagement:** inclusion of relevant stakeholders and impactees; clear communication and transparency, for example sharing vision, sharing analytical frameworks and models; linkages to other programme partners and stakeholders.

Individual management comments reveal that the ESM has had recurrent difficulties in identifying negative priorities – stopping unnecessary tasks to give more time to focus on the most essential. This is due to the predominant ESM organisational culture which emphasises agility in a context of constantly shifting priorities and ad hoc demands. As a result, the prioritisation challenge ends up on analysts’ desks.⁹⁷

Conclusions

- The ESM's analytical tools support the monitoring of macrofinancial risks. However, the current quantitative approach is not geared towards assessing the trade-offs required in policy design. The Capacity Assessment Tool provides a basis for staff to develop relevant input for future programme negotiations. The ESM needs a policy on how vulnerabilities that are identified are then communicated, discussed, and potentially addressed.
- The ESM's analytical frameworks are incomplete and could be better geared to its mandate. There is room for improvement to align with best practice in institutionalising (and hence sustaining) analytical processes and knowledge management procedures, as well as in managing key person risk. Management's ambition to instil a culture of preparedness guided by a structured process for the identification of analytical priorities has not yet been put into operation.
- The ESM has managed to attract talented experts on a par with peer institutions, but it faces challenges to motivate and retain them.
- The ESM follows best practice by conducting dry runs, but the scenarios adopted do not reflect the criticality expected by external interviewees.
- The ESM reacts too much to external events and actors rather than actively setting its own agenda based on its own monitoring. It also does not sufficiently de-prioritise non-essential work. Staff would benefit from efforts to identify negative priorities and focus on the most essential, lightening the burden of frequent shifts in priorities and ad hoc demands. With this in mind, management could further articulate a strategic vision and re-examine assumptions underlying the ESM's distinctive competences. During non-crisis periods, analytical staff lack opportunities to put their skills to work in practice. Furthermore, compared to larger peer institutions, there is little in-house and joint academic research. Compared to these institutions, management's regular policy and media engagement places a disproportionate burden on ESM analysts.
- The ESM is not sufficiently prepared for rapidly scaling up its crisis response capabilities as it lacks formal arrangements with peer institutions to bring in staff to support programme work. Furthermore, internal contingency plans to transfer people to programme teams are missing. There are limited opportunities for analytical staff to be seconded, take part in joint research, provide technical assistance, or engage in other staff-level external engagement. The offer on training in analytical methods has increased considerably since 2021. However, the ESM can do more to foster an environment of continuous learning and knowledge accumulation.
- Aspects of the ESM's organisational culture act as a barrier to using its analytical capabilities effectively. There is scope for better incremental learning and knowledge-sharing and transfer within the institution to ground the capabilities in the organisation.

Conclusions and recommendations

Conclusions

While considerable progress has been made, the deep transformation required to deploy the new capabilities successfully needs continuous planning efforts and a focus on priorities. The progress achieved in the ESM's efforts to ramp up quantitative capabilities in macroeconomic and macrofinancial analytics deserves credit. To fully match stakeholder interests under the new mandate, a number of issues should continue to be addressed given various remaining limitations.

Management Plan

Management has largely completed implementation of the multi-annual Management Plan and is now working on complementary follow-up tasks. Strong Board member support created the necessary enabling environment by permitting the hiring of highly capable staff resources. Key objectives such as toolkit consolidation, developing policy advisory capacity, and a full deployment of the data infrastructure would be appropriate responses to many of the remaining gaps and stakeholder concerns in the next phase of development. However, the institution must better manage its priorities and develop a more anticipatory approach, focused on crisis prevention.

Resource constraints prompted the establishment of several horizontal workstreams that have evolved into primary organisational structures for analytical work and are key elements in fostering a collaborative workplace. Management of such horizontal workstreams, however, suffers from weaknesses that must be addressed. Actions required include clarifying roles and task allocations, ensuring responsibility for maintaining engagement among workstream members, and recognising that communication among workstreams is a cornerstone of effective overall collaboration and alignment.

Analytical system

Management rightly identified codification and consolidation of the analytical toolkit as a priority in the Most Significant Change exercise. Poor documentation practices and a lack of common understanding of key definitions affect the robustness of the analytical system and the ability to develop it further. The ESM falls short of peer institution practices in defining the expectations for analytical processes (e.g. how-to-do and guidance notes). To ensure robust and consistent processes, the EFMC should endorse a risk monitoring framework that includes a country risk categorisation methodology, along with staff guidance for conducting key tasks in times of crisis and of preparation. This would further management's commendable goal of giving analysts autonomy in addressing financial stability vulnerabilities.

The incomplete integration of market intelligence and financial and macroeconomic monitoring hinders effective crisis management and the ability to provide actionable policy advice to preserve financial stability. There is a niche for this kind of integrated analysis and advisory role that stakeholders expect the ESM to fill. This in turn requires developing staff capabilities, such as deep country and sectoral knowledge, that will permit the ESM to turn diagnostics into relevant policy advice and foster synergies in the analytical processes.

The standard pyramid-shaped organisational structure may not be entirely appropriate for new monitoring and policy design tasks, due to the considerable experience and expertise required and

the concentration of demands the current hierarchy places on senior staff. Instead, a diamond-shaped organisation with more analysts in senior expert roles could be more suitable. Compared to peer institutions, the ESM lacks strategic human resource management to regularly assess its staffing needs and adapt recruitment to ensure that it has the necessary expertise to carry out its sophisticated analytical activities effectively.

Putting capabilities to effective use

The progress made in integrating market intelligence and financial and macroeconomic monitoring contributes to the ESM's capability to flag risks to financial stability. However, the focus has tended to remain on the institution's fiduciary responsibilities rather than on enabling the ESM to propose clear actionable steps and policy solutions to mitigate the impacts of economic shocks. There is a need for stronger internal coordination and independent analytical capabilities. Stakeholders are strongly of the view that the ESM should share its assessments with those concerned through confidential channels.

The ESM could make more effective use of its analytical capabilities by using shock events to develop relevant scenarios that improve understanding of the implications at country and euro area level. It should also more systematically quantify their possible economic and financial impacts. The absence of the ESM's own forecasting framework requires it to base its scenario analysis on external forecasts. Access to national authorities' resources and to their deep country and sectoral knowledge would strengthen the relevance of the ESM's analysis.

Despite progress made, the ESM has yet to build the full capacity to assume its broader role in programme negotiation and design; further contingency planning is needed. A drain of senior staff with programme experience and the hiring of more junior recruits who lack policy experience has reduced individual staff capabilities to deal with the specific challenges of practical programme engagement, notably considering the time pressure exerted during periods of crisis.

Management's ability to influence the policy debate is recognised, though not all channels are uniformly impactful. While the ESM as an institution has a significant media impact, the visibility of and media attention to staff analysis and reports are low. Compared to peer institutions, the ESM's research and publication output contributes relatively little, both in volume and impact, to the policy debate and decision-making by, among others, ESM stakeholders.

Continuity

To sustain the progress achieved and further enhance analytical capability, there is scope for the ESM to institutionalise internal and analytical processes. The ESM could clarify procedures, simplify internal governance, and optimise processes that lead to analytical outputs. Management should address the cumbersome committee structure to better allow for decision-making based on rigorous analysis and frank discussion, ensuring a level of quality assurance commensurate with the institution's mandate, and clarify accountability for following up – or not – on identified risks.

The ESM faces challenges related to staff retention and motivation as a result of intense periods of crisis being followed by long spells of preparation. Management should investigate how to make optimal use of staff skills during non-crisis times and address the lack of external visibility perceived by staff, as well as their sense that their work is insufficiently connected to supporting the ESM's mandate. This may be partially addressed by strengthening policy advisory practices. This is also seen by management as key to ensuring future preparedness.

Staff analytical skills are best maintained through training, dry runs, and academic research, while always ensuring a clear connection to the ESM's financial stability mandate. The ESM should also pursue more publication of research, joint research projects, and staff-level external engagement, as these are important drivers for staff motivation and retention. More frequent staff-level engagement with these stakeholders would present increased learning opportunities and alleviate some of the capability gaps identified in the staff self-assessment. In this context, the ESM could also explore different forms of staff mobility, such as secondments to other institutions, project collaboration with national authorities, or technical assistance (Box 5.1).

Current ESM arrangements for rapidly scaling up capabilities are inadequate to ensure a timely and well-informed response to a sudden increase in demand. The ESM must take concrete steps rapidly to scale up its capabilities, for example by reinstating formal arrangements with peer institutions to bring in staff on pre-defined terms, by developing a concrete contingency plan for the reprioritisation of staff agendas and the identification of reserve experts, and by setting up an alumni network whose members could also be called upon in a crisis.

Several issues of organisational culture were identified that hinder management's aspiration to strengthen a culture of preparedness. There is a risk of falling into complacency or allowing overconfidence in technical skills during potentially long quiet spells. The ESM could draw inspiration from best practices at peer institutions to foster genuine discussion, encourage cross-departmental cooperation, and increase transparency to produce better products and outcomes. Senior management could consider ways to challenge the general tendency of conformity by encouraging line managers and senior staff to embrace critical and dissenting views and encouraging staff to speak truth to power.

Management should foster an environment of continuous learning to sustain the progress made in developing analytical capabilities. It should promote incremental learning by integrating insights and general lessons from analytical processes or committee outcomes into other experts' assignments, increase knowledge-sharing across departments, and continue efforts to de-silo the institution. Other strategies that may be considered are diversifying staff backgrounds, encouraging open dialogue and constructive dissent, leading by example, adopting review checklists, or implementing double-loop learning, reviewing past experience to modify future goals. Management should also review current knowledge transfer practices against best practice and further promote research networks and enhance incentives for external collaboration.

To ensure long-term benefits from the efforts to build capability, senior management could take specific measures to strengthen accountability across the institution. For example, the EFMC could clarify who is responsible for following up when risks are identified; line managers and senior experts could be held accountable for nurturing a culture of excellence and continuous learning; and the CFO department could improve accountability in market intelligence by issuing an accountability and transparency statement concentrating on the primary objectives of market intelligence and the way it is conducted.

Recommendations

The evaluation team bases its recommendations on the evidence collected and conclusions drawn. Their aim is to prompt improvements in the three core areas evaluated, namely the robustness, effectiveness, and sustainability of the ESM's analytical system.

The recommendations are primarily addressed to ESM senior management and Members. Other stakeholders and peer institutions share some collective responsibility in enabling certain steps that the ESM can take to enhance its capability and so become a more effective partner for them.

The recommendations are made against the background of a great leap forward already made in the analytical system, which has already bridged some of the gap between the ESM and its peers. The evaluation's fact findings also indicate potential development needs in the institutional arrangements and organisational culture if the ESM endeavours to excel in analytical capabilities.

Recommendation 1. Refine the analytical system, data, tools, and processes.

It is difficult for analytical staff to carry out the ESM's mandate without a clearly defined framework and common terminology. The absence of a commonly shared understanding hinders the identification of institutional and analytical priorities. The ESM should therefore address the lack of documentation and lack of agreement on the definitions of key concepts related to the ESM's mandate, such as financial stability.

- **Enhance operational guidance related to the analytical tools to ensure their consistent application.** Management should assign the responsibility to develop documentation of the tools, including on how they fit into the overall analytical framework and how they will be used in crisis and non-crisis periods. This should enable experts to proceed autonomously to a standard underlying analytical response to country risks. The ESM should follow the example of other international financial institutions that have adopted a systematic approach to risk monitoring, documenting crucial aspects of its monitoring strategy and setting clear accountabilities.
- **Consolidate and codify the analytical toolkit.** Senior management should assign this responsibility, possibly to a dedicated cross-departmental task force, to arrive at a single institutional approach on the life cycle of analytical tools. The ESM should subject its tools to broader external scrutiny to ensure their quality, and to reinforce the institution's credibility.
- **Foster further synergies in the analytical process and resolve remaining gaps between finance and economics for improved risk assessment.** Management should unlock incremental learning between the functions and senior and junior staff, and actively discourage tendencies to silo thinking, for example by requiring an increased degree of cross-departmental work and a looser application of the need-to-know principle.

Recommendation 2. Strengthen the impact of the ESM's analytical capability and advisory role by focusing more actively on the identification of vulnerabilities and developing analytical output that has wider external traction.

The dissemination of the ESM's analytical work is largely restricted to closed-door policy fora and market roadshows. As a result, its relevance and impact are limited, unnecessarily restricting the institution's public footprint.

- **Embrace anticipatory governance.** The ESM should react less to events and general EU policy work and avoid excess bias towards its fiduciary responsibilities. Instead, by focusing more actively on the identification of vulnerabilities and assessing the buildup of risks, the ESM may bring about the shift from crisis response to crisis prevention that its new mandate entails. To adopt this more anticipatory role, the ESM should use past shock events to develop relevant scenarios, and conduct premortem exercises and dry runs. The ESM could also attempt to leverage the anticipatory work of peer institutions, such as the IMF's scenario work, or engage with the European Systemic Risk Board.
- **Increase the traction of analytical work.** The ESM should disseminate the output of its analytical work by targeting diverse audiences and using diverse channels. It could, for example, engage bilaterally with authorities in a country concerned, possibly on a confidential basis, as well as

with universities, trade associations, and labour unions. Excess concern over market or political sensitivities acts as a barrier to effective engagement.

- **Increase staff-level external engagement to increase traction.** Management should encourage more staff-level external engagement in technical, academic, and policy domains. Better use by staff of expert and professional networks would disseminate the institutional messages more broadly and foster trust. It would also serve as a quality assurance for analytical work. To respond to stakeholder demand, the ESM should strategically publish the specifications of its analytical framework and its key tools, for example in peer-reviewed papers or by discussing them at academic conferences.
- **Boost the policy advisory role.** To increase the public footprint of the ESM's analytical work and strengthen its crisis prevention capabilities, it should be able to convey the policy implications of its analysis. To this end, the ESM should enhance staff's policy advisory capabilities. This requires specific support from Human Resources and line managers.
- **Develop a flagship publication.** The ESM should develop a flagship publication central to its mandate to ensure effective communication to the professional community and sharpen the institutional profile. In due course, to become a more interesting partner for academia, the ESM could consider publishing its own data series – stakeholders suggested a market survey, a composite social indicator, a reliable predictor for loss of market access, or a database on the quality of public spending or on sovereign contingent liabilities.

Recommendation 3. Strengthen the ESM's analytical capabilities and enhance the influence of its output by making greater use of external networks.

As a relatively small institution, the ESM can ease constraints on its analytical capabilities by judicious use of external networks, which can also be used to boost its influence.

- **Insource external knowledge.** Management should take concrete steps to leverage more on external expertise and partnerships, such as academia, think tanks, professional societies, and peer institutions, to gain access to specialised knowledge and research that it cannot recruit. This would enable the ESM to better deal with headcount constraints and to confront a potentially wide range of future shock events.
- **Address data dependencies.** Management should assess whether reliance on external data input in some areas is commensurate with the criticality of the function in internal processes. It could explore whether more informal arrangements, such as joint research and advisory services, can serve to reduce data dependencies.
- **Increase staff-level external engagement for knowledge insourcing.** Management should encourage more staff-level external engagement in technical, academic, and policy domains to increase learning opportunities and strengthen the ESM's analytical capabilities. While networks at senior management level are well established, management should better support staff-level networks and reinforce the benefits of external knowledge insourcing by better internal knowledge transfer, including through staff networks.
- **Strengthen publication and research activities.** Management should consider incentives for analytical staff to boost the output and impact of academic publications and participate in joint research projects relevant to the institution's mandate.

Recommendation 4. Enhance sustainability and adaptability to evolving circumstances to ensure preparedness.

- **Maintain analytical capabilities.** In non-crisis periods, management should ensure the upkeep of staff capabilities with a view to institutional preparedness by requiring staff to take part in relevant training and by organising regular dry runs and scenario exercises to develop skills into real capabilities. To ensure the relevance of such exercises, management could adopt a thorough process to investigate which kind of exercises to run and adopt a multi-year planning schedule.
- **Ramp up contingency planning.** Senior management should ramp up the ESM's internal contingency plans. Management should identify internal experts to be transferred to support crisis teams in designing, negotiating, and implementing financial assistance programmes. Line managers should establish a training plan to develop and maintain their capabilities. Management should also ramp up external contingency planning by insourcing staff from peer institutions, national authorities, or academia so that additional analytical capabilities may be brought in at short notice on pre-defined terms. To that end, senior management should develop mobility arrangements with relevant peer institutions and national authorities. This would also ensure the upkeep of analytical skills and support staff motivation. Such mobility arrangements may take different forms (Box 5.1). Management should also set up an alumni network similar to those of peer institutions.
- **Encourage continuous learning and institutionalise quality assurance.** To ground the analytical capabilities in the organisation, management should foster a practice of periodic review and self-evaluation, including mechanisms for reviewing its core processes and policies. A learning institution requires looping reflection points to benefit from lessons learned and ensure excellence.

Many of the issues taken up in the above conclusions and recommendations have broader implications, which should be addressed with the Management Board and the Board of Directors. Particularly likely are implications on human resource management. As regards workforce planning, clear contingency planning is crucial to avoid placing unsustainable demands on staff in the event of an impending financial assistance programme. Insufficient anticipation of financial assistance requests could increase pressure not only on a specific country team but also overall work pressure for their back-ups. Members would ideally take note of this risk in the ESM budgeting process. Other issues arising from the evaluation team's interactions include more generally that Members and partner institutions, each for their own part, should foster an enabling environment for the ESM's activities and be aware of the importance of restoring and broadening the effectiveness of European partnerships so that the ESM can add value through its role in the institutional setting and respond to country demands for technical-level engagement.

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Annex: Statement by Management

ESM Management welcomes the evaluation report on the analytical capability of the ESM. The report is rich in argument, rigorous in analysis, and ambitious in its recommendations. It provides valuable insights and comprehensive analyses at a critical time for the ESM and for Europe more generally. The ESM's mandate is to safeguard financial stability in the euro area and in its member states. Successfully delivering on this mandate, both in normal and crisis times, requires a robust analytical framework and excellent skills to identify risks in a timely manner and to draw the right lessons for economic policies. It also requires an effective use of analytical outputs, with the adequate channels to inform decision-making and policy discussions.

The report recognises the significant progress and achievements made in the last few years. The ESM has enhanced its analytical capabilities, particularly in the development of an internal macrofinancial risk-assessment framework, building on the skills and experience of a diverse staff. It has also established horizontal workstreams to foster collaboration and adaptability, reorganised teams, and strengthened the institution's external presence with new publications and collaborations with peers and academics. In addition, the institution has strengthened quality assurance through self-assessment by establishing a dedicated Review function in the Secretary General department.

We are pleased to note that the evaluation report acknowledges the ESM's ability to integrate market intelligence with financial and macroeconomic monitoring and modelling as a key strength. The report highlights this feature as an institutional niche for the ESM in the euro area. By further integrating economic analysis and market intelligence and showing more pragmatism, the ESM can develop a unique voice on financial stability matters.

We acknowledge and take note of the report's conclusion that there are remaining gaps and challenges to address. Further actions are needed to (i) refine the analytical framework and strengthen internal processes, including exploring cross-departmental synergies; (ii) enhance the external impact of analytical activities, and sharpen the ESM advisory role; (iii) develop and leverage external networks to build up expertise and overcome data dependencies and other limitations; and (iv) ensure the sustainability and adaptability of the analytical capabilities for crisis preparedness.

We support the thrust of the report's key recommendations, and the roadmap of key areas that the report lays out. The implementation of several of the recommendations of the evaluation report is already planned or under way. Within the context of the strategic priorities and work agenda for 2025, the institution will: (i) enhance the consolidation and documentation of existing processes and analytical tools for risk assessments, including their external publication; (ii) work on a new publication about staff assessment of risks to increase transparency; and (iii) foster engagement with stakeholders and peer institutions, sharing analytical work and promoting collaborations and joint projects. The ESM also plans to strengthen its crisis preparedness through several real-world crisis simulations which will continue over the coming years, staff exchanges, and other mobility programmes.

At the same time, we recognise the need to prioritise, focusing first on those actions that best address the most relevant needs. The report's recommendations cannot be addressed all at once, considering the limited size of the institution and existing resource constraints. The report serves as a useful benchmark by pointing to best practices in peer institutions that can inspire the ESM's development. This external perspective helps identify opportunities to grow and strengthen the ESM's contribution to the euro area institutional architecture.

We will follow up these recommendations with the preparation of a medium-term implementation plan, prioritising the measures and taking into account progress on the initiatives that were already launched in the 2025 workplan.

Response to the recommendations

The ESM evaluation team makes four key recommendations in the report. Below is a short summary of the management response to them:

Recommendation 1. Refine the analytical system, data, tools, and processes.

- *We acknowledge the importance of a robust analytical system, and emphasise the significant progress made with new workstreams set up to address existing gaps.* The revamp of the Chief Economist department's risk assessment process and the development of a macrofinancial framework to overcome fragmentation and silos has allowed for the integration of macro, fiscal, and financial dimensions into consistent risk scenarios and narratives. Further steps to strengthen the existing framework include the consolidation of the existing risk assessment process and the adoption of the corresponding Terms of Reference. In addition, stronger cooperation could enable further synergies and leverage knowledge existing in all departments including the Risk Management department and the Chief Financial Officer department.
- *We also concur on the importance of having a clear documentation for existing analytical tools and processes and recognise the need for further improvement in this area.* In the Chief Economist department, several initiatives have been implemented to address this need, including the development of an analytical toolkit catalogue and guidance notes on key divisional processes. Additionally, we support the recommendation to allow external scrutiny of our analytical work, which will enhance both credibility and external impact.
- *We have some reservations about the recommendation to have a single institutional approach for all analytical tools in use for economic analysis at the ESM.* In our view, this approach should avoid ending in an impractical and cumbersome process in view of the plethora of existing tools and models. We would prefer to apply a standardised vetting process that focuses on the most relevant tools such as the Debt Sustainability Analysis, already subject to a validation process. For others, we are in favour of a lighter review process for tools created on an ad-hoc or temporary basis.

Recommendation 2. Strengthen the impact of the ESM's analytical capability and advisory role by focusing more actively on the identification of vulnerabilities and developing analytical output that has wider external traction.

- *We agree with the view that broadening the dissemination of the ESM's analytical work will increase its impact and relevance.* We particularly support the idea of launching a new publication to enhance the ESM's institutional profile as a risk-based institution. In addition, the ESM has initiated discussions with Members' authorities to engage them on analytical work at technical level.
- *We consider that any policy advisory role should be explicitly linked to crisis preparedness and financial stability.* The ESM has already moved in this direction. Beyond policy, the provision of technical advisory support to member states in our areas of expertise, including funding and investment activities, could also contribute to enhance the impact of the ESM's analytical capabilities.
- *While we support the notion of embracing anticipatory governance, we also note that the ESM has already established a forward-looking internal risk assessment framework.* This includes the internal Economic and Financial Risk Report and the Economic and Financial Risk Committee. At the same time, scenario analyses have become a regular element of the analytical work, with

significant progress as well in exchanges with peer institutions on risk assessment, and efforts in this direction will continue. Therefore, we consider that no additional steps are needed for the moment.

- *We consider that the finding to establish stronger reporting lines to strengthen the Review function does not warrant a follow-up.* The ESM's experience with the Review function is positive since it contributes to the quality of the assessments and upholds the ESM's self-evaluation and learning culture. It is fully institutionalised and organised independently from the Chief Economist department with the head of Policy Strategy and Institutional Relations, reporting to the Secretary General, in the lead. Its integration in the country risk monitoring framework is regularly discussed and adjusted when needed.

Recommendation 3. Strengthen the ESM's analytical capabilities and enhance the influence of its output by making greater use of external networks.

- *We acknowledge the importance of well-developed external networks to enhance ESM analytical capabilities.* In recent years, collaboration in analytical work with external experts has significantly increased, with several staff members engaged in projects with peer institutions and academics. These efforts have resulted in valuable joint research projects and publications. Further initiatives in this direction can count on our support.
- *We recognise the existing data dependencies' challenges, in particular in the analysis of financial institutions.* ESM management will persist in its efforts to access essential data.
- *Additionally, as a comparatively small institution, we should address human resource limitations to build up analytical capacities.* This implies enhancing collaboration across teams, optimising resource allocation, and improving information-sharing through initiatives like career evolution, horizontal mobility, and on-the-job coaching.

Recommendation 4. Enhance sustainability and adaptability to evolving circumstances to ensure preparedness.

- *The ESM strongly believes in the importance of crisis preparedness—a critical operational priority at the institution.* Accordingly, it has actively enhanced its crisis response capabilities through annual programme dry-runs, trainings, and departmental knowledge-sharing initiatives. This year, the institution put significant resources towards developing credible crisis scenarios for the euro area at this juncture.
- *We recognise the need for a comprehensive staff planning process that includes practical crisis dry-runs, staff exchanges, and other mobility programmes.* A strategy to this purpose is under development.
- *Further progress is also needed in both internal and external contingency planning.* The existing dry-run practices will inform the ESM's resource planning, and the institution will strive for continuous improvement through periodic reviews and self-evaluation, in line with institutional practices.

Acronyms and abbreviations

AMRO	ASEAN+3 Macroeconomic Research Office
BVI	Bank Viability Indicator
CAMELS	Capital adequacy, Assets, Management capability, Earnings, Liquidity, Sensitivity
CE	Chief Economist
CFO	Chief Financial Officer
DSA	Debt Sustainability Analysis
ECB	European Central Bank
ECCL	Enhanced Conditions Credit Line
EFMC	Economic and Financial Monitoring Committee
EFRR	Economic and Financial Risk Report
EU	European Union
EWS	Early Warning System
GDP	Gross domestic product
IMF	International Monetary Fund
PCCL	Precautionary Conditioned Credit Line
OECD	Organisation for Economic Co-operation and Development
RFA	Regional Financing Arrangement
SG	Secretary General
SRB	Single Resolution Board
SRF	Single Resolution Fund
SVI	Sovereign Vulnerability Indicator

Endnotes

- 1 The completion of the ESM reform depends on ratification by all Members of the Agreement Amending the ESM Treaty.
- 2 For the purposes of this evaluation, “the ESM Reform” means the Enhanced Mandate Project, set up to adapt staffing and corporate infrastructure to provide the new business capabilities to be introduced through the Management Plan. There is an overlap between these two elements, the plan and the project, and an interlinked process.
- 3 See IMF Independent Evaluation Office (2006) on the importance and shortcomings (including “silo” structures) of the integration of capital market and macroeconomic analysis at the IMF. See Figure 6.2 in the technical annex on the effectiveness of the integration of macrofinancial analysis and market intelligence at the ESM.
- 4 This evaluation of analytical capability pays particular attention to the Management Plan’s contribution to improving the ESM’s preparedness to detect macrofinancial risks at an early stage and to ensure an effective, rapid response to a crisis, including when compared to peer institutions. This focus also reflects the resource constraints of the evaluation team. While the evaluation examined the contribution of the Management Plan to preparations for the ESM’s programme role, it did not consider the lending instrument reforms. The evaluation touched upon the preparation of the common backstop mainly in relation to the validation of modelling and testing of preparedness.
- 5 The primary results of the Enhanced Mandate Project included the establishing of budget, staff planning, and recruitment, as well as laying ground for the common backstop and a close institutional collaboration with the European Commission, as well as the revision of the lending instrument guidelines.
- 6 The focus of these 36 full-time equivalent posts is as follows: euro area and member countries, 16; financial sector, seven; markets, four; Review function, three; and data and other support roles, six.
- 7 Market intelligence gathered from traders by the Funding and Investor Relations division is combined with market feedback on economic developments and the economic outlook from the markets unit, the Economic and Market Analysis division.
- 8 The ESM and EFSF 2020 Administrative Budget, ESM Confidential, 25 November 2019, pp. 11-12. See Note on ESM Enhanced Mandate – Staffing Needs, 10 March 2020, for a detailed description of the ESM’s risk-based approach to enhanced monitoring.
- 9 See Chapter 3 of the technical annex for a detailed discussion of the Management Plan.
- 10 See Box 4.1 in the technical annex.
- 11 See Figure 3.4 in the technical annex.
- 12 See Figure 3.5 in the technical annex.
- 13 Such a reflection could have the additional benefits of contributing to further clarifying the ESM’s role in euro area institutional development, as recommended by Tumpel-Gugerell (2017, recommendation 6), and of helping to allay concerns on duplication of work among institutions.
- 14 For the purposes of the evaluation report, the text distinguishes three types of monitoring. Functional monitoring refers to specific areas, such as financial sector monitoring and market monitoring. Euro area aggregate monitoring focuses on the biggest economies driving euro area developments and identifies broader trends. Finally, country monitoring refers to the monitoring of ESM beneficiary Member States and selected spillover and high-risk countries. For a comparison of the definitions see AMRO (2024).
- 15 The evaluation team did not discover a clearly documented analytical process for assessing risks during the shock events.
- 16 See Chapter 5 of the technical annex. While the market unit monitored shifts in bond yields and market sentiment, macrofinancial monitoring focused on recent developments and short-term risks to the beneficiary Member States. After the referendum, the country analysis submitted for the purposes of the EWS focused on consequences for economic activity through trade channels and the impact on banks’ shares and profitability.
- 17 Lennkh, Moshhammer, and Valenta (2017), A Comprehensive Scorecard for Assessing Sovereign Vulnerabilities, ESM Working Paper Series. Available at: [wp231.pdf \(europa.eu\)](https://www.europa.eu/press-room/media/33444/1/wp231.pdf).
- 18 Country monitoring was broadened to respect four principles: take a risk-based approach; focus on the assessment of macroeconomic and financial risks; devote resources to each country in line with the potential risks each poses to euro area financial stability; and assess possible spillovers to other member states.

- 19 The approach rests on a combination of the European Commission's Macroeconomic Imbalance Procedure and the ESM's SVI (Figures 3.1 and 3.2). The documentation does not clearly define the margin between judgement and quantitative analysis. The framework has not been shared with the Board of Directors, nor published externally. Unlike the risk categorisation governance structure that is being reworked, the methodology is not considered a priority and is to be published in the course of 2025.
- 20 Guidance Note for Surveillance Under Article IV Consultations, IMF (2022).
- 21 Between September 2020 and June 2024, the euro area team coordinated the preparation of 15 editions of the EFRR. Full reports are published at mid- and end-year, intermediate updates are shared in March and September.
- 22 Preparation of the EFRR is determined by the EFMC's Terms of Reference and set out in a concept note which outlines what the EFRR should contain and a timeline for its preparation. This note does not specify how the topical and risk chapters should inform the country risk section. Countries to be included in this section ought to vary depending on the evolution of risks.
- 23 See the technical annex for details on the gradual approach to tool development.
- 24 IMF, Surveillance Manual; AMRO, Annual Report (2023).
- 25 Unlike rules governing the ECB, IMF, European Commission, or national central banks, the ESM Treaty does not include detailed provisions related to data collection, statistics, or data management. These other institutions often have specialised teams dedicated to data collection and maintenance. The existence of such functions has positive spillovers for overall data management and infrastructure within the institution, including for the analytical functions. In addition, the headcount of analytical functions often includes data scientists supporting subject-matter experts in data analysis. When it comes to ensuring data quality and development of data infrastructure, the ESM is constrained by limited human resources and in turn expertise in the analytical divisions.
- 26 For example, a granular breakdown of credit exposure, how long loan interest rates are fixed for, or the amount of capital accounted for by deferred tax assets.
- 27 For market data, the ESM has access to many data providers used by market participants and is constantly assessing potential new providers. One data source that is largely absent is access to sell-side analysts, which would provide more background and offer insight into how market participants regard banks.
- 28 The 2017 evaluation report on EFSF/ESM financial assistance found that ESM involvement in programmes concentrated on securing financing, programme exit, and financial sector support. Investment in macroeconomic analysis appeared overall as a lower priority given the advantage held in this area by the larger institutions involved.
- 29 They expect staff to understand the dynamics of the common currency area, how economic sectors fit together, including financial interactions, and implications for policymaking.
- 30 Human resources analysis is based on several studies: an evolution of post description criteria, the staff survey, the staff self-evaluation, external and internal interviews, and a focus group with management teams.
- 31 The CE department demanded an academic publication record for experts, but not for manager positions; the CE department also showed growing demand for applied economics, financial sector, and macrofinancial analysis, and knowledge of advanced tools. The CFO department emphasised the ability to communicate complex issues effectively to non-experts and knowledge of capital markets, the financial sector, and European institutions.
- 32 The evaluation team asked CE, CFO, and SG department staff to evaluate their own analytical and policy advice capability using a framework designed and widely tested by the New Zealand government. The technical annex elaborates on the self-evaluation framework, which encompasses professional knowledge, applied skills, and behavioural elements. Self-evaluation is generally understood as an evaluation by those who are entrusted with the design and implementation of an activity, a project, or programme. Here it stands for assessing one's own capability.
- 33 Compared to earlier recruits, analytical recruits hired between 2020 and 2023 describe themselves as more confident in their knowledge of government systems and priorities, country-specific knowledge, applied analytical skills, and in delivering clear and compelling messages. But they feel substantially weaker on stakeholder engagement and institutional collaboration, long-term thinking, and political insight for sensitive situations. Those who joined the ESM before 2020 see comparative strengths in their capability to make improvements, add value, and navigate situations. Overall, the workforce needs to develop greater capabilities in policy and programme design.
- 34 De Jong et al. (2023) argue that strategic thinking, openness, and respect for counterparts and colleagues, as well as group facilitation capabilities, are among the collaborative capabilities required in critical networked positions. The more the organisation embraces collaborative arrangements, the more it needs distributed creative skills to conceive, design, broker, manage, and assess such arrangements.

- 35 Evidence on this includes among other things complexity and second- or third-round effects missed in some analytical processes under stress, the somewhat unstructured scope of market analysis, and limited technical support functions compared to larger institutions.
- 36 Macroeconomic models represent an econometrically estimated set of equations. Conditional on underlying assumptions about the exogenous variables, the models forecast key indicators, such as growth, inflation, and unemployment. Dynamic stochastic general equilibrium models are the main type of “workhorse” models. Complementary, satellite models render forecasting more flexible and efficient. They help describe developments in selected sectors, such energy or housing, where the workhorse models provide only limited coverage. This is crucial especially at times when sectoral developments can spill over to the wider economy. While the workhorse models are deployed consistently across the various policy processes, the satellite models are used rather ad hoc (ECB, 2024).
- 37 See Chapter 4 of the technical annex.
- 38 The Terms of Reference for country team coordinators set a minimum standard for cooperation between the country team and the Review function. Interviews with ESM staff confirmed that in practice the process remains highly uneven for formal and, especially, informal review.
- 39 See World Bank (2021) for a comprehensive list of preparedness dimensions based on literature. Organisational ability: knowledge and thought leadership; staff skills; resources; organisational structure, roles, processes, and decision-making that allow for flexibility; agility, knowledge-sharing and learning, and cross-sectoral coordination and collaboration; ability to identify, adapt, and deploy knowledge on technological developments; and partnerships, global networks, and positioning relative to other actors.
Organisational willingness: leadership, culture, and incentives for innovation; and risk appetite and informed risk-taking.
- 40 See Räisänen (2024).
- 41 The OECD’s Council on the Governance of Critical Risks recommends building preparedness through foresight analysis, risk assessments, and financing frameworks, to better anticipate complex and wide-ranging impacts; see OECD (2018). OECD (2016) recommends a twin approach to crisis preparedness: (a) traditional crisis management (including: risk assessment based on historical events; scenario-based emergency planning; training to test plans and procedures, as well as early warning systems based on monitoring; forecasting, warning messages, communication, and a link with emergency response) and (b) dealing with novelty (including: risk assessment with horizon-scanning, risk radars and forward-looking analysis to detect emerging threats; frequent updates, and different time-scales; international analysis sharing and multi-disciplinary, capability-based planning and network-building; strategic crisis management training to learn agility and adaptability and to create networks and partnerships, as well as strategic engagement from centres of government).
- 42 ESM staff self-evaluation (2023) and ESM staff survey (2023).
- 43 See Figure 6.1 in the technical annex.
- 44 Most Significant Change study.
- 45 See IMF Independent Evaluation Office (2016) for how the IMF addressed long-running and deep-seated external and internal problems with data quality that hampered its effectiveness as a global macroeconomic risk manager. Recognising data as a strategic institutional asset, the IMF reconsidered the role and mandate of its Statistics Department, re-examined staff incentives, and clarified its responsibility for the quality of the data it disseminates.
- 46 The challenge is utilising all opportunities to learn. Robson (2019) warns of outcome bias that tends to lead teams to focus on actual and most salient consequences and close reflection early, when an event or phenomenon provides an opportunity to think about what might happen if the initial circumstances were different.
- 47 Collaboration with the European Commission on programme design and implementation has yet to be described in detail. Potential conflicts in terms of responsibilities cannot be excluded.
- 48 See ESM staff survey (2023).
- 49 Overconfidence would be risky. OECD (2022) highlights the need to align intent with reality on the ground. Overconfidence in results, limited understanding of national context, fragmented governance arrangements, or inadequate forms of collaboration can lead to failure. See OECD (2022), p. 12. Bogetić (2020) highlights additionally the need to focus on the most critical issues and urgent priorities.
- 50 The purpose of the Capacity Assessment Tool and the Country Capacity Assessment is to deepen the ESM’s understanding of strengths and weaknesses of key institutions within a country that may impact effective implementation of a reform programme within a given period. In this context, the assessment of a country’s capacity to implement the actions and conditions agreed as part of a programme is a critical component of assessing the likelihood and risk of achieving programme outcomes. ESM evaluations of country programmes overall (2017) and, specifically, the financial assistance to Greece (2020), have led to an increased focus on the role of a country’s capacity to

implement agreed reforms to satisfy programme conditions, as an important consideration for the design of future country programmes. See Jenkins (2022).

- 51 Robson (2019) discusses various elements of effective learning and wisdom, finding acceptance of the limits of one's judgement (intellectual humility) as a critical determinant of decision-making in leadership positions, together i.a. with deliberate pursuit of alternative viewpoints and avoidance of emotional responses (mindfulness). He defines premortem as deliberately considering the worst-case scenario and its determinants as a de-biasing strategy, before concluding for a decision.
- 52 Batini and Wojnilower (2023) highlight the IMF's ability to scale up rapidly, for example, by rehiring retirees with institutional experience of emergency financing and regional knowledge.
- 53 Focus group discussions with management teams.
- 54 World Bank (2021) refers to collaborations (partnerships) as a means to fill gaps in analytical capability (skills), along with recruitment of new staff or consultants, retraining of existing staff, outsourcing, or secondments.
- 55 IMF Independent Evaluation Office (2022) stresses the importance of collaboration with partners and other providers to leverage the knowledge of other institutions on topics where the IMF may not have expertise.
- 56 See Mayne, de Jong, and Fernandez-Monge (2020).
- 57 A Memorandum of Understanding with the European Commission was signed in April 2018 and is already in force irrespective of ratification of the amended ESM Treaty. This Memorandum of Understanding provides a basis for collaboration, outlining specific tasks; it also contains a provision for ESM staff to join European Semester missions, but the evaluation team has not found evidence that this right has ever been exercised. The Memorandum of Cooperation is to be signed when the revised treaty enters into force. However, management stresses that non-ratification of the amended ESM Treaty does not hamper collaboration.
- 58 See Korhonen, Hinkenhuis et al.
- 59 See Box 4.1 on Common Backstop Repayment Capacity Assessment Methodology in the technical annex.
- 60 The ESM and the European Parliament have signed a Memorandum of Cooperation. This strengthens their collaboration through bilateral meetings and annual exchanges of views between the ESM Managing Director and the ECON Committee. It has the potential to strengthen the legitimacy of the broader monitoring function.
- 61 The ESM has successfully established various formal and informal research collaborations (University of Luxembourg, AMRO Asia, European Bank for Reconstruction and Development, European Investment Bank, etc.) and memberships (the Centre for Economic Policy Research, Société Universitaire Européenne de Recherches Financières (SUERF), CompNet). See bibliometric study (2024) in Chapter 7 of the technical annex.
- 62 Such as the Arab Monetary Fund, AMRO Asia, the Eurasian Fund for Stabilization and Development, FLAR (Fondo Latino Americano de Reservas), and the European Commission Secretariat for Macrofinancial Assistance. See bibliometric study (2024) in Chapter 7 of the technical annex.
- 63 "An open, responsive, and collaborative approach can help staff develop a continuous, two-way policy dialogue and relationship with the authorities. Listening to and striving to understand members' concerns helps build trust and tailor analysis and advice to their needs. Staff is encouraged to engage with member states well ahead of Article IVs and maintain a continuous dialogue, including through staff visits, seminars, and workshops, and making use of new technologies". See IMF (2022), p. 16.
- 64 The OECD notes that in the context of Covid-19 co-creation mechanisms proliferated, with the purpose of bringing together actors to collect expertise, foster research, and develop collective solutions to maintain "an ability to use anticipatory approaches". See OECD (2022).
- 65 Informal networks at senior management level also appear well established and influential in positioning the ESM's political messages. The CFO department is well respected among investors and peer institutions for its engagement through market collaboration groups (e.g. the Economic and Financial Committee's Sub-Committee on EU Sovereign Debt Markets, Capital Market Forum).
- 66 The number of press interviews of senior management was broadly stable over recent years, with a peak in 2018 due to interest in the Greek crisis. Numbers are taken from ESM Communications department: 2023 (19), 2022 (25), 2021 (27), 2020 (32), 2019 (23), and 2018 (39).
- 67 Some external stakeholders argue that public disagreement on issues assigned by regulation to the European Commission are unhelpful. Others explicitly welcome hearing, among experts and policymakers, well founded views from the ESM on issues such as markets, fiscal policy, or debt sustainability.
- 68 Source: Elsevier Report (2024), the bibliometric study (technical annex) and interviewees. ESM blogs are an exception. The ESM as an institution received a total of 1,929 online media mentions between 2014 and 2023.
- 69 Excluding EWS reports with the Board Risk Committee.

- 70 The IMF (2022) stresses the importance of engaging with stakeholders (“constructive dialogue”) on its analysis and advice, in order to build trust and influence policymaking.
- 71 The ESM 2017 Strategy charted an objective to develop capacity to address financial, economic, and political tasks by actively developing economic research capacity, with the goal of becoming a thought leader on topics relevant to the mission and core activities and to the shareholders’ interests. It also planned to link leading academics with ESM economic research and analysis and to apply this knowledge systematically to ESM core activities.
- 72 The IMF Independent Evaluation Office (2011) evaluates the relevance and utilisation of IMF research to member country authorities, IMF staff, and other stakeholders, as well as its technical quality and management. It concludes that research contributes to the development and updating of conceptual models and tools that form the basis for the IMF’s analysis and policy recommendations. IMF research has played an important role in how country authorities think about policymaking, and in furthering global knowledge. High-quality research contributes to the IMF’s reputation and credibility. However, the evaluation finds that there is still significant scope to improve the relevance and quality of IMF research and enhance its utilisation. There is a widespread view among IMF staff that research findings must be aligned with current IMF policies. Member country authorities and other stakeholders perceive IMF research as message driven. To deal with this problem, IMF Management and its Executive Board would need to cultivate an open, independent, and innovative research environment, explicitly encouraging staff to explore differing and alternative views. The evaluation also recommends greater consultation and cooperation with country authorities, and an enhanced quality review process – reforms that would bring greater diversity of research methods and perspectives and ensure that conclusions and recommendations in research papers are better linked. Conducting high-quality, policy-relevant research at the IMF would be essential for its credibility – both in interactions with country authorities and with the international community more generally.
- 73 See Elsevier Report (2024) and bibliometric study (2024) for details and definitions of the research clusters investigated.
- 74 Scharte (2024), p. 5.
- 75 Management sees resource constraints entailing trade-offs between investment in research, policy communication, and increased preparedness for crises.
- 76 Incentives could include measures to enhance authors’ visibility, such as more opportunities to present research at conferences, better opportunities to integrate research into regular staff tasks under the institution’s mandate, or output-linked financial rewards. Such incentives could trigger further research, research collaborations, and publication activity at the ESM, raising its profile and providing benefits for the implementation of its mandate.
- 77 Research coordination is broadly centred at EMA.
- 78 For a theoretical background on the benefits of external knowledge insourcing see Cohen and Levinthal (1990). Lenz (1980) argues that the strategic capability of an organisation derives from its knowledge-technique base for value creation, its capability to internally generate and acquire resources, and from general management technology (knowledge and experience, and the quality of administrative arrangements such as culture, reward structure, and formality). This includes the quality of “support in the task environment”, i.e. the external environment and relevant partners and stakeholders, as well as the market position vis-à-vis ‘competitors’ for relevant resources and other barriers the competition may create.
- 79 Guo et al. (2022) underline the importance of internal knowledge transfer in addition to external knowledge insourcing by institutions. They offer a dynamic perspective on capability (“generative capability”). This is based on three key learning dimensions related to continuous innovation that tackles a changing environment, seizing opportunities (changing one’s world view, challenging status quo, thinking out-of-the-box) and achieving sustained excellence. These are namely knowledge acquisition (customer-, competition-, and collaboration-oriented), knowledge inheritance (knowledge sharing and integration, nurturing organisational memory), and knowledge updating (experimentation, reflection, adaptation to demand, and keeping pace with the market). Guo et al. (2022) see generative capability as particularly important in organisations whose development involves the evolution of its knowledge base and behaviours.
- 80 In its Strategic Plan 2017–2018, management outlined the internal need to “continuously adapt to unexpected priorities; our key priority is to deliver to our shareholders’ expectations while maintaining our agility to respond to change”; to “maintain and develop our pool of talented and motivated staff and ensure that our work reflects our common values, to bring operations to the next level”; and to “maintain and strengthen our trusted relationships with stakeholders, and carefully build our external profile”. These distilled to specific objectives, relevant to the scope of this evaluation, to “ensure a staff body with outstanding technical and institutional knowledge and soft skills, implement projects that increase the diversity of financial operation, and develop capacity to address financial, economic, and political tasks by actively developing economic research capacity, linking leading academics with ESM economic research and analysis; and systematically apply this knowledge to our core activities.”

- 81 Management recognised that this would require: developing and implementing tools, policies, and governance for the new tasks; developing capacity for the effective and efficient future use of assistance instruments; retaining and creating crisis expertise; and reviewing existing structures to prepare for the next crisis and identify negative priorities.
- 82 For example, the IMF's Library maintains a help desk for many analytical tools, and has developed communities of practice, where key experts are identified for each tool to advise colleagues.
- 83 Note is taken that a Memorandum of Cooperation is agreed with the European Commission, contingent on ratification of the amended ESM Treaty; however, it provides more detail on DSA and less on macro-critical programme measures or defining inter-institutional negotiation positions.
- 84 Most Significant Change study.
- 85 As a practical example, the energy shock event study demonstrated that the ESM was able to pick up early signals of a forthcoming shock which later materialised, that this was reported to the relevant committee, but that there was no follow-up as accountability for the follow-up was not clearly defined.
- 86 The ESM has organised some dry runs to test processes and some analytical tools, but the scenarios used fell short of external stakeholders' expectations.
- 87 Staff readiness is a mental, motivational, or cultural disposition for the activities and responsibilities to exercise the capabilities developed for institutional preparedness.
- 88 OECD (2016) recommends that training and exercises for crisis preparedness focus on building the capacities of individuals and testing contingency plans, from staff knowledge of the detailed protocols and procedures to stress testing the plan itself. Tabletop or large-scale exercises can be organised to test a specific response plan and its related coordination mechanisms. Feedback from training can then be used to improve planning.
- 89 The staff self-evaluation pointed to relative weaknesses in the confidence of the latest cohorts of recruits in navigating sensitive situations and applying political insight. However, the ESM does offer numerous training elements that emphasise soft skills.
- 90 Behar and Hlatshwayo (2021) and OECD (2019).
- 91 While larger institutions said they struggled to adapt to the pandemic, for example the IMF's internal crisis management plan of 2013 foresaw such an eventuality. And thanks to their engagements with the World Health Organization, staff had a pandemic scenario to trigger further analysis in 2020. See further IMF Independent Evaluation Office (2023).
- 92 The reverse may also be true for work that the author knows will not be published. Figure 7.4 in the technical annex suggests somewhat improved incentives for research and publication since 2019.
- 93 Other interviewees suggested letting staff use some of their work time to follow their natural curiosity, including to build skills in new practice areas, both for staff motivation purposes and for the institution to benefit from insights that might be missed in a business-as-usual context. Robson (2019) also highlights a need for people working in high-stakes environments to have time to pause and reflect; the process of switching between tasks, known as interleaving, also supports deep learning.
- 94 An example of the difficulty in ensuring fresh and appropriate perspectives on decision-making can be found in an external report on ESM internal committees. It noted that risks in terms of the committees' advisory function emerged due to the committee structure attached to departments. In 2020, three ESM officials had seats in four or more internal committees, four were voting members in three, and six officials in at least two internal committees. Management's response underscored that committee decisions "are taken by consensus reached through open exchange of views", [...] or "if consensus is not reached, by majority of votes cast". The report also noted that the Terms of Reference of the committees required minuting "conclusions on any opinion or recommendation" or providing "summary record of the proceedings".
- 95 Staff also said the information shared often concentrated on generalities about external engagements and that they lacked insights from management consultations with Members. Some staff concerns are more administrative and go beyond the scope of this evaluation.
- 96 Guo et al. (2022), endnote 79.
- 97 Learning agendas have been presented as a tool to support organisational strategic planning, focusing specifically on the generation of relevant knowledge for decision-makers and stakeholders. A higher ambition would be to devise an inter-institutional collaboration with shared priorities (Newcomer et al., 2022).

