European Stability Mechanism

2019 Annual Report

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2019

2019

Annual Report

Letter of Transmittal to the Board of Governors

11 June 2020

Dear Chairperson,

I have the honour of presenting to the Board of Governors (BoG) the annual report in respect of the financial year 2019, in accordance with Article 23(2) of the By-Laws of the European Stability Mechanism (By-Laws).

The annual report includes a description of the policies and activities of the European Stability Mechanism (ESM) during 2019. It also contains the audited financial statements as at 31 December 2019, as drawn up by the Board of Directors (BoD) on 30 March 2020 pursuant to Article 21 of the By-Laws, which are presented in Chapter 4. Furthermore, the report of the external auditor in respect of the financial statements is presented in Chapter 5 and the report of the Board of Auditors (BoA) in respect of the financial statements in Chapter 6. The independent external audit was monitored and reviewed by the BoA as required by Article 24(4) of the By-Laws.

Klaus Regling
Managing Director

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"After a successful first 10 years, the rescue fund is adapting its lending tools to respond effectively to the corona pandemic."

KLAUS REGLING
Managing Director
European Stability Mechanism

Message from the Managing Director

Since the coronavirus struck Europe in March 2020, we have been living in a different world. The eruption of the global pandemic quickly developed into a multidimensional crisis that disrupted all areas of life. To slow the spread of the virus and avoid the breakdown of healthcare systems, governments in Europe and beyond were forced to organise unprecedented lockdowns. Public life came to a standstill, economies slowed dramatically, and gross domestic product plummeted.

In the short-term, European governments responded with large-scale fiscal and liquidity measures to safeguard jobs, social safety nets, and companies. This extraordinary expenditure is prompting a steep rise in deficit and debt levels in all Member States. Three European safety nets offering €540 billion in assistance complement national crisis responses. These involve the European Commission, the European Investment Bank, and the ESM.

The ESM's contribution to the European crisis response is the Pandemic Crisis Support credit line, based on its existing precautionary credit line, available to all euro area member states at a volume of 2% of each country's gross domestic product as a benchmark. The European measures will particularly benefit countries with less budgetary room to manoeuvre. For the medium-term, the European Council decided to establish a recovery fund that will be set up to finance the repair of the economic damage the pandemic caused in member states.

The rescue fund was created 10 years ago to address a very different type of crisis, in which the survival of the currency union was at stake. Some member states faced the loss of market access, while others began to feel spillover effects. At that time, the euro area had no institutionalised response, but policymakers moved swiftly to fill the gap and decided to erect a potent financial firewall that could reassure markets and alleviate the crisis. The June 2010 creation of the temporary European Financial Stability Facility (EFSF) served that purpose.

But as that crisis gathered steam, it became clear that a permanent response was needed. So, the Eurogroup agreed to create the ESM, with the mandate to safeguard financial stability for the euro area as a whole and its member states. Endowed with a solid financial base of €80 billion in paid-in capital, €620 billion in callable capital, €500 billion in lending capacity, and the ability to raise money cheaply on the markets, the ESM and its loans-for-reforms approach provided a convincing answer to the crisis that markets had been looking for.

Together with its temporary predecessor, the ESM financed six assistance programmes in five countries: Ireland, Greece, Spain, Cyprus, and Portugal. Greece, the most troubled of the five programme countries with long-accumulated problems, received a combined €203.8 billion in support from the EFSF and the ESM's two programmes, on top of a first €73 billion programme from the Greek Loan Facility and the IMF, enabling the country to reduce imbalances and restore competitiveness.

The rescue funds' very low interest rates on their loans and their exceptionally long maturities saved Greece €14.1 billion in debt service payments or 7.5% of its GDP in its 2019 budget alone. Greece enjoyed similarly large budgetary savings in past years. This impressive display of euro area solidarity created budgetary breathing space for Greece and, along with our short- and medium-term debt relief measures, contributed to ensuring the country's debt sustainability.

To ensure continued positive developments, the ESM monitors Greece and the other former programme countries regularly in the context of its Early Warning System and will continue to do so until all country loans are fully repaid.

Ten years on, the ESM and its partners – the European Commission, the European Central Bank, and the International Monetary Fund – look upon the five programme countries as five success stories. Thanks to almost €300 billion in disbursed loans with long maturities and favourable rates and the countries determined reform implementation, all five overcame their problems and regained investor trust.

After a successful first 10 years, we now turn to how the future looks for the rescue fund. In the context of the corona crisis, the ESM can offer a credit line to its member states that is very different from that of the financial support during the crisis, also in terms of conditionality. Before the corona outbreak, European leaders had already considered a number of new tasks for the ESM. A reformed ESM Treaty was agreed by the Eurogroup in principle, in the context of deepening Economic and Monetary Union. Once the reformed ESM treaty is ratified by all member states, we will get additional responsibilities: the ESM will become the backstop to the Single Resolution Fund and can then provide a loan for the resolution of banks in case the Resolution Fund's own resources are depleted. Furthermore, the ESM will participate in the design of future programmes, including conditionality, and monitor adherence together with the European Commission. The cooperation between the ESM and the European Commission has been agreed in a Memorandum of Cooperation. The ESM will follow economic developments in all euro area member states in order to be ready at all times to act in a crisis. Lastly, access to the ESM's precautionary credit lines will be improved.

The ESM remains a major participant in financial markets and is present on both sides of the balance sheet, as an issuer and as an investor of its €80 billion in paid-in capital. The ESM finances its loans to programme countries on the market – not with taxpayers' money – making it one of the largest issuers of euro bills and bonds. Our daily contact with investors and other issuers around the world enables us to bring a market perspective to our work with member states, partner institutions, and the Eurogroup.

In 2019, the EFSF and ESM issued new bonds amounting to nearly €30 billion. In an important move, reflecting Europe's new reality after Brexit, the ESM decided to issue its bonds under Luxembourg instead of English law, with a first such issuance in October.

As a public institution, the ESM is committed to being a responsible institutional citizen of Europe and the world. We have therefore continuously strengthened our environmental, social, and governance efforts (ESG). Throughout this report, you will read my colleagues' thoughts on the work done on ESG and how to drive forward our performance. In February this year, we reached an important milestone in this context: the ESM signed the United Nations Principles on Responsible Investment.

For me, ESG goes to the heart of the ESM's mandate. "Safeguarding financial stability" does not mention programme countries' social welfare explicitly, but by granting loans to troubled countries when no one else is willing, the ESM allows a country to spread the adjustment burden over several years, thereby easing the pain for citizens. Without these loans, the adjustment would have to happen overnight with incomparably more social hardship for the country and its population. Therefore, the ESM brings sizeable social benefits to distressed countries and the euro area when safeguarding financial stability. Our Pandemic Crisis Support credit line demonstrates yet again our commitment to that mandate.

ESM at a glance

The ESM is a crisis resolution mechanism established by the euro area countries. Since its inauguration in October 2012, the Luxembourg-based ESM has provided financial assistance to ESM Members experiencing or threatened by severe financing problems to safeguard the financial stability of the euro area as a whole and of its member states.

On 4 December 2019, the Eurogroup agreed in principle, subject to the conclusion of national procedures, on the reform of the ESM. The scope of the reform, agreed by the euro area finance ministers in their report to the Euro Summit in December 2018, includes the refining of ESM precautionary instruments, enhancing the ESM's role in financial programme management, and setting up a common backstop for the Single Resolution Fund (SRF). The agreed changes will take effect once the Amending Agreement to the ESM Treaty has entered into force. For more information, see ESM reform and treaty change.

The ESM raises funds by issuing debt instruments, which are purchased by institutional investors. The proceeds enable the ESM to provide its Members with the following types of financial assistance:

- loans to cover their financing needs;
- loans and direct equity injections to recapitalise financial institutions;
- primary and secondary debt market purchases of Members' national bonds;
- credit lines to be used as precautionary financial assistance.

For more information about the ESM, visit our website.

Note: The *ESM 2019 Annual Report* contains the audited financial statements as at 31 December 2019, together with the report of the external auditor in respect of their audit concerning these financial statements, and the report of the BoA in respect of these financial statements. The description of ESM policies and activities covers the 2019 financial year, except when stated otherwise. The information related to the composition of the BoG and BoD reflects their composition as of 28 April 2020. The economic development report (Chapter 1) includes certain information available up to 23 April 2020. All historic financial data is limited to the period to 31 December 2019.

2019 year in review

18.02
Joaquín Almunia, a former European Commission Vice President, is appointed High-Level Independent Evaluator of financial assistance to Greece

19.02
ESM adjusts capital contribution keys for 14 Members following end of temporary correction period for Slovenia

02.05
EFSF BoD approves reimbursement and reduction of step-up interest margin for Greece as part of medium-term debt relief measures agreed in November 2018

16.05
ESM co-organises with the Latin American Reserve Fund and the Association of Southeast Asian Nations (ASEAN) +3 Macroeconomic Research Office the 3rd Regional Financing Arrangements Research Seminar, in Luxembourg

13.06
ESM publishes *Safeguarding the euro in times of crisis: the inside story of the ESM* recounting the rescue funds' history against the backdrop of the European sovereign debt crisis

10.07
ESM co-organises with the Spanish Ministry of Economy a seminar on the role of the ESM in euro area financial stability

05.09
EFSF BoD approves a Portuguese request to make an early €2 billion repayment on its EFSF loans

15.09
ESM management structure reorganisation takes effect, see details in organisational structure section

10.10
ESM launches interactive public programme data-base with data on EFSF and ESM financial assistance programmes, see details in visualising ESM and EFSF programmes

22.10
ESM raises €3.5 billion by issuing a new 5-year bond, the first under Luxembourg law

28.10
EFSF and ESM BoDs agree to waive mandatory repay-ment obligation of ESM/EFSF loans in connection with a partial early repayment by Greece to the International Monetary Fund (IMF)

04.11
ESM commits to eliminating single-use plastics at the institution by end 2020, signing up to the Zero Single-Use Plastic Manifesto

04.12
Eurogroup agrees in principle on the ESM reform, subject to the conclusion of national procedures

12.12
Following a year of preparations, ESM approves the ESM signing the United Nations Principles for Responsible Investment. The signing took place in February 2020

1.

2.

3.

4.

5.

1. The 27 February 2020 signing of the United Nations Principles for Responsible Investment marked the culmination of over a year of ESM preparatory work and underscored the ESM's commitment to responsible investing. **2.** The ESM funding team at the Luxembourg Stock Exchange bell ringing ceremony on 8 November to celebrate having issued its first bond under Luxembourg law in October. **3.** In November 2019, the ESM pledged to eliminate single-use plastics in the institution by the end of 2020. **4.** In October 2019, the ESM launched an interactive public database with data on all EFSF and ESM financial assistance programmes. **5.** Luxembourg Finance Minister Pierre Gramegna (left) and ESM Managing Director Klaus Regling (right) discussed the recently published ESM history book, *Safeguarding the euro in times of crisis*, at an October 2019 event.

ESM reform and treaty change

The year 2019 was one of tremendous work and achievement on ESM reform. Intense discussions took place at all levels on the design and finalisation of enhancements to the euro area's permanent crisis resolution mechanism, seven years after its creation.

- October 2017: Eurogroup discusses possible future roles and tasks for the ESM in the context of the broader discussion on deepening Economic and Monetary Union (EMU). This launched a two-and-a-half year workstream on ESM reform.
- December 2017: Commission sets out a roadmap for deepening EMU, including a policy package on completing it.
- December 2018: Eurogroup agrees on a term sheet for the further development of the ESM as part of a comprehensive package of reforms on deepening EMU.
- June 2019: Eurogroup reaches a broad agreement on revising the ESM Treaty to implement the political agreement of December 2018 and agrees to continue work to finalise the package of documents related to the revision of the ESM Treaty.
- December 2019: Eurogroup reaches agreement in principle on the package of documents related to ESM reform, including the main elements of the changes to the intergovernmental agreement on the contributions to the SRF in case of a potential early introduction of the common backstop, subject to the conclusion of national procedures. The Euro Summit tasked the Eurogroup to continue working on the ESM package of reforms, pending national procedures, as well as on all elements of the further strengthening of the banking union, on a consensual basis.

The ESM reform is composed of four complementary and mutually reinforcing building blocks. Taken together, they will contribute to further strengthening the resilience and crisis resolution capabilities of the euro area, while continuing to fully respect European Union (EU) law.

Backstop to the Single Resolution Fund

The ESM reform will also contribute to completing banking union by adding a new instrument to the ESM's toolbox. If the SRF is depleted, ex post contributions are not sufficient or not immediately available, and the Single Resolution Board (SRB) is not able to borrow on terms and conditions considered acceptable, the ESM may provide the backstop as a last resort and lend the SRF the funds it needs to finance a resolution via a revolving credit line. The BoD will make disbursement decisions by mutual agreement guided by the criteria specified in Annex IV of the amended ESM Treaty. By way of derogation, an emergency voting procedure has also been designed if the European Central Bank (ECB) and the European Commission assess a threat to the economic and financial sustainability of the euro area. Under this procedure, a decision would be taken by a qualified majority of 85%.

Fiscal neutrality over the medium term is one of the key principles of the common backstop. This means that a disbursement may only take place if, among other conditions, the repayment capacity of the SRB is proven to be sufficient to fully repay the loans granted under the backstop facility over the medium term. If the credit line is used, the SRF will pay back the ESM loan within three years with money from bank contributions, although this period can be extended with a final maturity of up to five years. In the case of loans for liquidity support of bank resolutions, the initial maturity will be one year unless the BoD decides otherwise, subject to possible extensions.

The nominal cap for the size of the backstop is set at €68 billion, and the backstop's maximum amount will be in line with that of the SRF, namely 1% of covered deposits in banking union. The BoG may, by mutual agreement, adjust the nominal cap.

The common backstop will be in place at the latest by 1 January 2024, with an earlier introduction possible provided sufficient progress in risk reduction has been made and confirmed by a political decision to be taken in the second half of 2020.

In parallel to the set-up of the common backstop facility, the ESM instrument of direct recapitalisation of credit institutions will be cancelled.

Reform of precautionary instruments

Another key objective of the ESM reform is to enhance the effectiveness of precautionary instruments. These instruments provide support to ESM Members with sound economic fundamentals which could be affected by an adverse shock beyond their control.

Access to a precautionary conditioned credit line (PCCL) will continue to be based on eligibility criteria and will be limited to those ESM Members whose economic and financial situation is fundamentally sound and whose government debt is sustainable.

As regards the PCCL, the eligibility process will be made more transparent and predictable in the draft amended ESM Treaty and the draft amended guideline.[1] The existing ex ante eligibility criteria assessing the sound economic and financial performance of the Member State concerned will be clarified. As a rule, ESM Members will need to meet quantitative benchmarks and comply with qualitative conditions related to EU surveillance as specified in Annex III of the amended ESM treaty. An assessment shall be made on whether the potential beneficiary ESM Member qualifies for the PCCL on the basis of the criteria provided in Annex III of the draft amended ESM Treaty.

The enhanced conditions credit line (ECCL) instrument will continue to be available as foreseen in the current ESM guideline. Access to an ECCL will remain open to ESM Members that are not eligible for the PCCL due to non-compliance with some eligibility criteria but whose general economic and financial situation remains sound and whose government debt is sustainable.

In the case of a PCCL, a requesting country will no longer sign a Memorandum of Understanding (MoU). Instead, the country will specify its policy intentions in a letter of intent committing to continuous compliance with the eligibility criteria, which will be assessed at least every six months. The ESM Member has the right to request funds at any time during the availability period according to the agreed terms. In case of non-compliance with the eligibility criteria for the PCCL or with the conditionality attached to an ECCL in a MoU, access to the credit line shall be discontinued, unless the BoD decides by mutual agreement to maintain the credit line. If the ESM Member has drawn funds before, an additional margin shall apply.

[1] https://www.esm.europa.eu/about-esm/european-stability-mechanism-guideline-precautionary-financial-assistance.

Further development of the ESM

The ESM will have a stronger role in the preparation and monitoring of financial assistance in full respect of the European Commission and ECB competence as laid down in the EU legal framework. When an ESM Member requests support, both the ESM and the European Commission, in liaison with the ECB, will work closely together to prepare the assessments for the decision in principle by the BoG. These include the assessments of a Member's debt sustainability and repayment capacity, of financial stability risks, and of the financing needs of the Member concerned. In particular, the Commission ensures consistency with EU law, in particular with the Union's economic policy coordination framework and measures adopted in that context. The ESM performs its analysis and assessment from the perspective of a lender.

The ESM will also collaborate with the Commission, in liaison with the ECB, in the design and negotiation of policy conditionality. Any future MoU detailing the conditionality attached to the financial assistance facility will be signed by both the European Commission and the ESM. Both the ESM and the European Commission in liaison with the ECB will also monitor together compliance with such conditionality.[2] The Commission will continue to ensure full consistency of the MoU with EU law, in particular, with any relevant measure under the economic policy coordination framework. The ESM will contribute from its perspective as a lender in areas that are directly relevant for the Member State's financing needs and ability to repay the ESM as well as the organisation and operational aspects of the funding of the Member State to help it restore its financial situation and its refinancing capacity.

Moreover, the amended ESM Treaty enables the ESM to follow and assess the macroeconomic and financial situation of its Members, including the sustainability of their public debt, where relevant in order to internally prepare and enable it to appropriately and in a timely manner pursue its tasks.

In performing these analyses, the ESM will closely collaborate with the European Commission in liaison with the ECB, to ensure full consistency with the framework for economic policy coordination provided for in the TFEU [Treaty on the Functioning of the EU], while respecting their institutional roles and prerogatives.

When the ESM Treaty is ratified, the ESM and the European Commission will sign a mutually agreed Memorandum of Cooperation detailing how their collaboration will work.

Debt sustainability issues

The revised ESM Treaty foresees the introduction of single-limb collective action clauses (CACs) in euro area government securities as of January 2022. The commitment to have CACs has existed in the current ESM Treaty since 1 January 2013, however these are double-limb CACs. These require two separate majorities to approve a change in bond terms: one at the level of each series and one at the level of all series combined. Single-limb CACs allow the majority vote to take place at the level of all series combined, without the need for a majority at the level of the holders of each individual series. This should help address the problem of so-called "hold-out" investors, bondholders who resist a restructuring of their holdings by acquiring blocking minorities within individual series.

The recitals of the revised ESM Treaty will state that the ESM should provide stability support only to ESM members whose debt is considered sustainable and whose

2 https://www.consilium.europa.eu/media/39772/revised-esm-treaty-2.pdf.

repayment capacity to the ESM is confirmed. The assessment of debt sustainability and repayment capacity will be carried out on a transparent and predictable basis, while allowing for sufficient margin of judgement.

Finally, in the future the ESM may, if so requested by the relevant ESM Member, facilitate a dialogue between that ESM Member and its private investors on a voluntary, informal, non-binding, temporary, and confidential basis.

ESM: committed to environmental, social, and governance matters

As a public institution whose mandate it is to mobilise funding and provide stability support if indispensable to safeguard financial stability, the ESM recognises the key role capital markets play in that mission. The ESM both finances its assistance to Members through capital markets and invests the funds entrusted to it by its euro area Members in those markets. With its funding and investment activities steeped in capital markets, the ESM understands that embedding environmental, social, and governance (ESG) factors in its market dealings and internal operations will ultimately encourage better, more sustainable outcomes for the societies it serves.

In 2019, the ESM therefore ramped up its efforts to improve its ESG practices, launching a series of initiatives. Throughout this report you will hear from ESM colleagues who are working to enhance the ESM's ESG performance and how they are moving forward on the following topics.

Environment:

In November 2019, the ESM pledged to eliminate single-use plastics throughout the institution by the end of 2020, signing up to the Zero Single-Use Plastic Manifesto – an initiative of Luxembourg's leading sustainability network, Inspiring More Sustainability. In support of this initiative, the ESM hosted a photo exhibition to raise awareness of the environmental effects of plastic waste and the importance of recycling and sustainable solutions.

Spotlight on ESM efforts in responsible investing

The ESM adheres to ESG principles when investing its €80.5 billion paid-in capital. In February 2020, the ESM signed the United Nations Principles for Responsible Investment (UN-PRI). The UN-PRI is recognised as the leading global network for investors dedicated to integrating ESG considerations into their investment practices. As a UN-PRI signatory, the ESM will include ESG criteria within its investment processes and collaborate with peer institutions to further promote responsible investment practices.

This commitment is an extension of ESM's institution-wide ESG efforts in investment operations. Incorporating ESG criteria will enrich ESM's investment practices, while maintaining the high credit quality of the institution, the liquidity of its paid-in capital, and the capital preservation objective. For more information, see the Investment and Treasury section. The Risk management team ensures that investment practices are consistent with the ESM's risk framework and that the risk framework continues to develop including to support ESM's ESG policies and practices.

"Organising and developing the ESM-wide ESG efforts is a tremendously stimulating and rewarding task. It requires us to re-think many of our activities and to find ways to improve them. Through these efforts, the ESM seeks to do its part in driving positive change."

NIYAT HABTEMARIAM
Corporate Governance and Internal Policies
European Stability Mechanism

The ESM also started to examine and report on the carbon footprint arising from its internal operations, culminating in the publication of a report in September 2019. The monitoring, measuring, and reporting of greenhouse gas emissions will help the ESM to design appropriate reduction measures in the future.

The ESM is committed to protecting the environment and follows a prudent approach to environmental matters. The ESM Code of Conduct calls for ESM staff to operate in a way that limits the ESM carbon footprint and maximises the re-use of material. Therefore, the ESM continuously implements measures to improve its internal environmental impact and reduce the use of natural resources and energy as well as the generation of emissions and waste. As a result, each year since 2013, the Luxembourg government has awarded the ESM a certificate on the sound treatment of energy sources and the recycling of waste.

Social:

In 2019, the ESM organised a series of events on the topic of diversity and inclusion, a core ESM value. The ESM has also held workshops collecting the institution's diversity and inclusion experiences. Those findings are now feeding into a wider project revisiting the ESM's institutional culture, to ensure it is best suited to deliver on the ESM's objectives. With its internal policies and procedures, the ESM endeavours to ensure that its activities are conducted in line with the highest standards of integrity.

The ESM considers its members of staff to be its most valuable asset, and therefore strives to foster a diverse working environment with equal opportunity afforded to all. In 2019, the ESM performed an internal equity analysis and a comprehensive review of its human resources framework. These analyses have led to some enhancements, for instance, in hardship situations, as well as legal clarifications, such as an explicit mention of the right of association, to recognise formally the quality and role of social dialogue at the ESM.

ESM staff representatives are formalising their rules of procedure detailing their roles, responsibilities, and framework for internal governance. In addition, the compliance officer is looking to make internal practices more transparent, for example, in the area of personal data protection.

Governance:

The ESM has a robust governance framework in place, which ensures strong accountability and transparency vis-à-vis both the ESM shareholders and other stakeholders. In October 2019, the ESM launched an interactive tool enabling users to explore data on all EFSF and ESM financial assistance programmes. The programme database responds to a recommendation of the 2017 EFSF/ESM Financial Assistance Evaluation Report to enhance ESM transparency, and reflects the organisation's commitment to both transparency and accountability. For more information, see the Governance section.

01 Economic developments

Macroeconomic and financial environment

Despite global downturn, euro area remained resilient in 2019

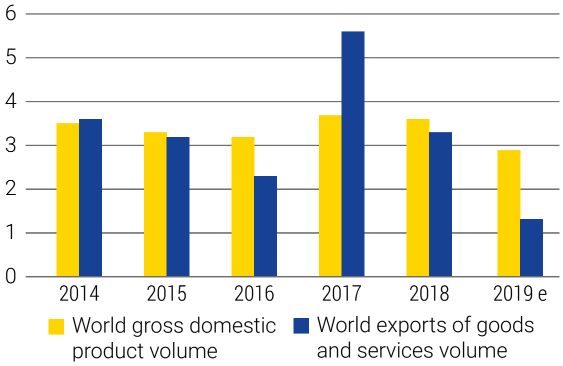
The euro area economy slowed in 2019, growing at its lowest rate since 2014, hit by external developments. The re-emergence of trade tensions between the US and China and the Brexit negotiations heightened global uncertainty, weighing on global growth and exports (Figures 1 and 2). Developments in the manufacturing-auto industry sector further dampened the euro area's economic activity. In contrast, domestic demand remained solid, supported by favourable financing conditions, low inflation, and dynamic labour markets.

In the first months of 2020, euro area economic activity deteriorated sharply, hit by the adverse impact of the Covid-19 pandemic. Both the supply and demand sides of the economy were affected. Further downside risks stem from current high volatility in global financial markets. Uncertainty about the duration and magnitude of the shock and the timing and speed of the subsequent recovery is very high at the current juncture. Member states have taken urgent containment measures together with actions to support citizens and businesses, including discretionary stimulus and coordinated action. This aggregate fiscal response is supported at the European level with the activation of the general escape clause of the Stability and Growth Pact, a specific temporary and flexible state-aid framework issued by the Commission, the Coronavirus Response Investment Initiative, and the joint initiative by the European Commission and the European Investment Bank to preserve liquidity to small-and medium-sized enterprises and midcaps through guarantees. In addition to the fiscal response, the decisions taken by the ECB have provided a strong element of reassurance.

"The ESM provides essential financing to countries in crisis that would otherwise experience more severe setbacks in growth, social conditions, and consequently in areas of ESG performance. As part of the Economic and Market Analysis department, I am researching the interlinkages between ESG and economic growth."

EDMUND MOSHAMMER
Economic and Market Analysis
European Stability Mechanism

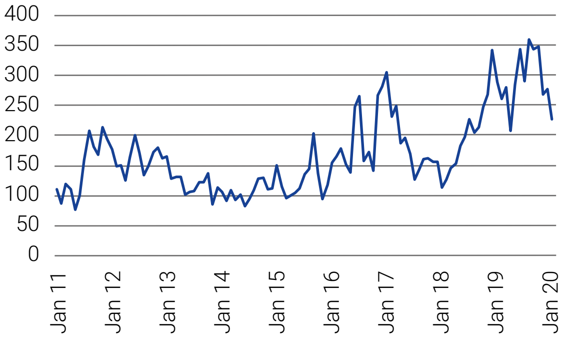
Figure 1
Global economic activity and exports of goods and services
(volume, y/y growth, in %)



Note: 2019 e = 2019 estimate.
Source: European Commission forecast - Autumn 2019

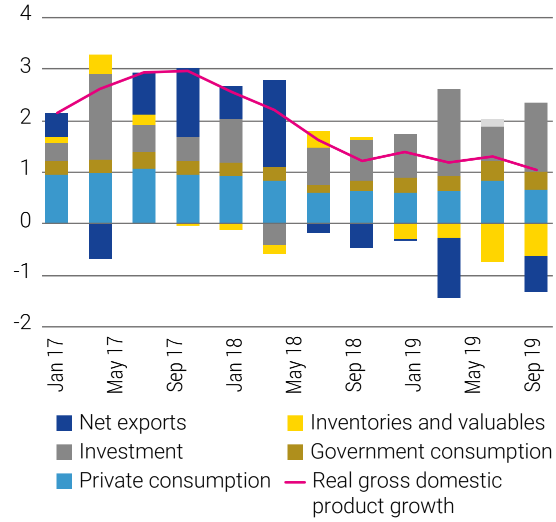
Euro area gross domestic product (GDP) growth eased further in 2019 to 1.2% from 1.9% in 2018. The growth moderation (Figure 3) primarily reflected weaker external demand. Exports decelerated further, while imports gained some momentum driven by solid domestic demand, consequently overall the external sector contributed negatively to growth. Private consumption held up relatively well as households' purchasing power increased on the back of robust job creation and wage increases, while fiscal policy remained supportive in some euro area member states. Investment in the euro area continued its slow recovery, drawing mainly on the support of the construction sector. Unlike the previous year, inventories displayed a negative contribution to growth.

Figure 2
Global economic policy uncertainty index
(1997–2015 = 100)



Note: The index measures policy-related economic uncertainty, from three underlying components: (i) newspaper coverage of policy-related economic uncertainty, (ii) the number of federal tax code provisions set to expire in future years, and (iii) the degree of disagreement among economic forecasters.
Source: Based on Baker, Scott, Nicholas Bloom and Steven J. Davis, 2016. "Measuring Economic Policy Uncertainty," Quarterly Journal of Economics, https://www.policyuncertainty.com/index.html

Figure 3
Contributions to real gross domestic product growth
(y/y growth in %, contributions in percentage points)



Source: Eurostat

"The ESM committed itself in 2019 to eliminating single-use plastics in its offices by year-end 2020 given their detrimental effect on ecosystems. As part of the facilities management team, I am proud to be working to implement this ESG pledge and other measures to improve our environmental impact."

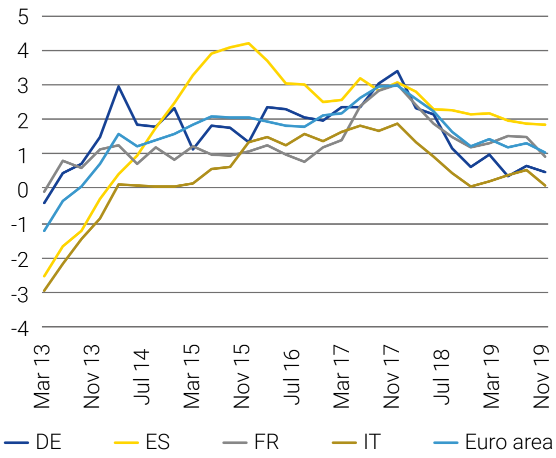
BORIS JUNCKER
IT and Facilities Management
European Stability Mechanism

The moderation in euro area growth reflects divergence in the performance of its main economies (Figures 4 and 5).

The markedly slower growth in Germany in 2019 is a symptom of its export-oriented economy and strong manufacturing base. In contrast, Spain and France reacted more resiliently and experienced milder slowdowns. For the overall euro area, the services sector (Figure 6) remained buoyant, cushioning the effects of the global manufacturing downturn.

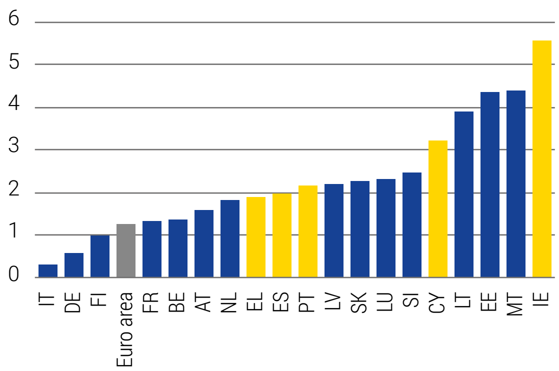
After a pick-up in 2018, euro area inflation moderated to 1.2% in 2019 (Figures 7 and 8). A fall in energy prices and a lack of pass-through from wage increases to core inflation – which excludes energy, food, alcohol, and tobacco products – contained inflationary pressures. Given subdued growth and strong international competition, firms have been absorbing wage pressures by accepting lower profit margins rather than passing them on to consumers. Despite some acceleration in the second half of the year[3] euro area core inflation stayed at 1% year-on-year on average in 2019, unchanged from 2018. Market-based long-term inflation expectations[4] remained muted, reaching a historical low in September. Inflation expectations recovered slightly in the last quarter of 2019 to 1.3%, still below their five-year average of 1.6%.

Figure 4
Real gross domestic product growth for selected countries
(y/y growth in %, quarterly data)



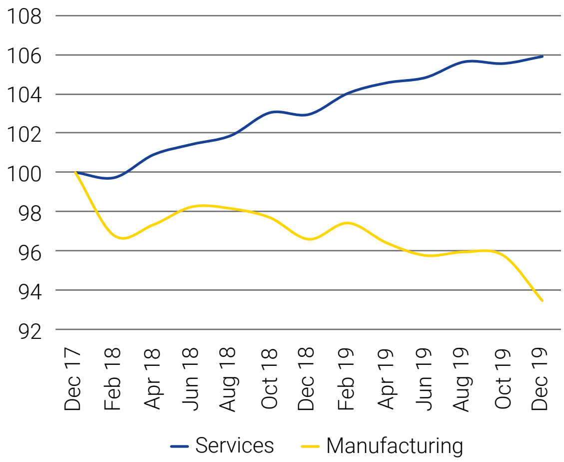
Source: Eurostat

Figure 5
Real gross domestic product growth in 2019
(in %)



Note: EFSF/ESM post programme countries in yellow.
Source: Eurostat

Figure 6
Euro area industrial and services production
(2017m12 = 100)

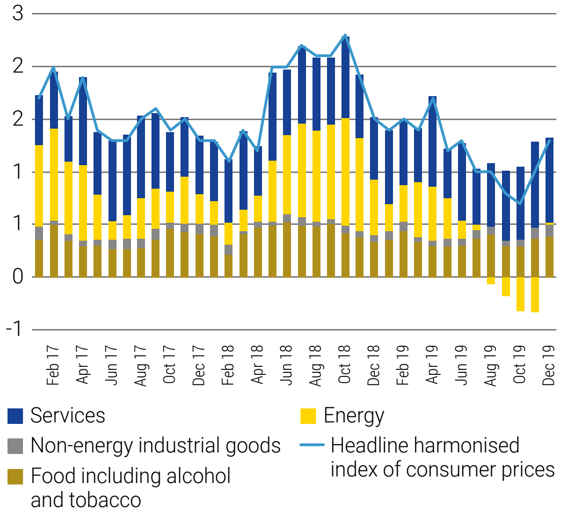


Source: Eurostat

[3] Core inflation (all items except energy, food, alcohol, and tobacco) was 1.3% in the fourth quarter of 2019, up from 1% in the first quarter. The increase is in part attributable to the fading out of the effects of past methodological changes. For more information, refer to "A new method for the package holiday price index in Germany and its impact on HICP inflation rates" (ECB economic bulletin, Issue 2/2019).

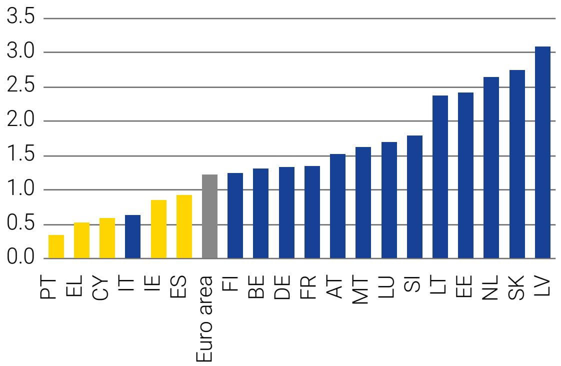
[4] Eurozone 5-year-5 year inflation swap. Source: Bloomberg.

Figure 7
Contributions to harmonised index of consumer price inflation rate
(y/y inflation in %, contribution in percentage points)



Source: Eurostat

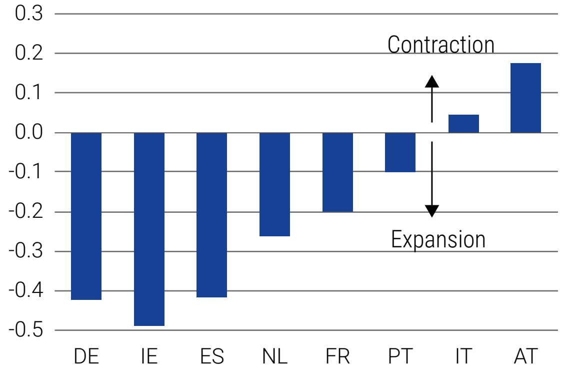
Figure 8
Harmonised index of consumer price inflation rates in 2019
(in %)



Note: EFSF/ESM post programme countries in yellow.
Source: Eurostat

Given supportive fiscal policies in several euro area economies, the region's fiscal position deteriorated slightly in 2019 with the general government balance at -0.6% of GDP in 2019 after -0.5% a year earlier. In structural terms, fiscal policy is regarded as mildly expansionary (Figure 9).[5] The European Commission considers that most of the support stems from countries with available fiscal space under the European fiscal framework. Overall, debt dynamics at the euro area level remained positive as the debt-to-GDP ratio continued its downward trend (Figure 10).

Figure 9
Fiscal effort in 2019/annual change in the structural primary balance
(in % of potential GDP)



Source: European Commission Economic Forecast - Autumn forecast 2019

Figure 10
Euro area government debt
(in % of GDP)

Source: European Commission Economic Forecast - Autumn forecast 2019

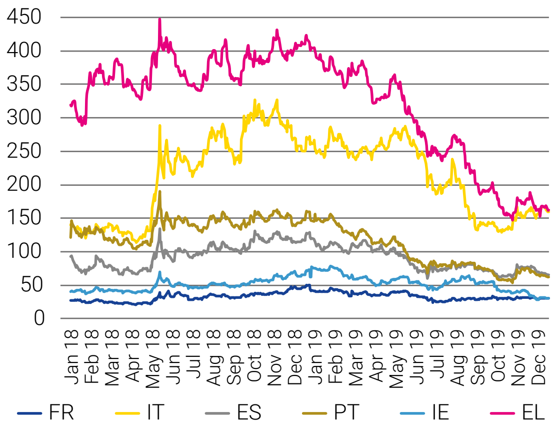
Global financial markets were jittery in the first half of 2019, but sentiment improved from August onwards. Deteriorating economic data and uncertainty about US-China trade relations prompted spikes in risk aversion in May and August. Another round of monetary policy easing by the Federal Reserve and the ECB in September helped to calm markets, and the outlook for trade relations improved towards the end of the year. From July to October, the Federal Reserve cut its policy rate three times by 25 basis points to 1.50%–1.75%, and the ECB announced a comprehensive easing package in September. Overall, US 10-year government bond yields declined by about 75 basis points over the year, to around 1.9%, while Germany's 10-year government bond yield declined by about 40 basis points, to around -0.2%. Most global equity markets performed well, with the US S&P 500 equity index up almost 30%, and the European Stoxx 600 equity index gaining over 20%. The euro's trade-weighted exchange rate weakened about 2%. Sovereign credit spreads also compressed, and former rescue fund programme countries retained good market access throughout the year (Figure 11).

5 According to the latest estimates of the structural balance and output gap.

"In 2019, the ESM examined and reported on its carbon footprint by identifying and measuring its main sources of greenhouse-gas emissions. The report was a cross-divisional effort with an aim to design and implement reduction measures that enhance the ESM's environmental performance."

ANELIYA TILEVA
Finance and Control
European Stability Mechanism

Figure 11
10-year sovereign credit spreads of selected euro area member states vs Germany
(in basis points)



Source: Bloomberg

In 2020, Covid-19 is undermining euro area economic activity, with high downside risks surrounding the outlook

In the first months of 2020, the euro area economy deteriorated sharply, hit by the adverse impact of the Covid-19 pandemic. Both the supply and demand sides of the economy were affected, with further downside risks coming also from global financial markets. Although not yet fully captured in the published official data, disruptions in global supply chains and lower global demand are expected to adversely impact manufacturing production and global trade, while the direct impact of Covid-19 and the containment measures adopted are also dragging down domestic production and demand. So far, survey data and, more specifically, the April flash composite Purchasing Manager's Index, reveals important growth implications from the pandemic for the euro area economy. There is still high uncertainty about the duration and magnitude of the shock and the timing and speed of the subsequent recovery.

Against this backdrop, financial markets have had an extremely volatile start in 2020. The joint shock of the Covid-19 pandemic and oil price drop rattled markets globally: the VIX index, a measure of global risk aversion, spiked above the levels seen in 2009; the S&P 500 US equity index and the European indices suffered their fastest-ever drops, while US Treasury and Bund yields declined to the lowest on record. On euro area sovereign debt markets, spreads widened abruptly and liquidity became scarce and in some markets dried up. In response, the Federal Reserve and the ECB acted forcefully, with noticeable impact on the reduction of spreads, and fiscal policy measures were announced. In April, the euro area also agreed financial support measures during the crisis, including offering an ESM credit line to support domestic financing of direct and indirect healthcare, cure and prevention related costs due to the Covid-19 crisis. A benchmark of the volume per member state is 2% of its GDP. In addition, the Eurogroup of euro area finance ministers welcomed a Commission proposal to set up a temporary instrument supporting Member States to protect employment in the specific emergency circumstances of the Covid-19 crisis. The Eurogroup indicated that the instrument could primarily support efforts to protect jobs and workers and some health-related measures. Leaders also agreed on European Investment Bank funding for small- and medium-sized enterprises. Following the crisis, a recovery fund to support economic recovery is also planned.

Visualising ESM and EFSF programmes

The ESM launched an interactive tool on its website in October 2019, enabling users to explore data on EFSF and ESM financial assistance programmes for Ireland, Greece, Spain, Cyprus, and Portugal.

Would you like to know how much Ireland paid in interest and fees in 2018? What was the forecast in 2012 for Portuguese GDP growth? How were Greek pension system reforms assessed during the EFSF and ESM programmes? When will Spain repay its loans? All these facts and figures are now easily accessible in a visually compelling way, thanks to the EFSF/ESM programme database.

The programme database presents data on dashboards, from which users can select data visualisations according to various criteria and categories. Filters allow users to organise, tailor, and display data according to their needs. Each dashboard focuses on a specific topic:

- programme overview: summarises total amounts the ESM/EFSF has disbursed and programme countries have repaid;
- loan disbursements: displays comprehensive information about each loan tranche, according to use of funds, lending contracts, and funding strategy;
- loan repayments: illustrates a country's repayment profile, viewable at different points in time. This allows users to see year-by-year repayment amounts before and after loan maturity extensions;
- interest and fees: presents all historic payment flows (interest, fees, and principal) between the EFSF/ESM and programme countries. The interest rate charged during a selected period is also visible;
- conditionality: makes detailed policy conditions easily searchable, according to specific topics. Using this unique and innovative dashboard, users can see how the implementation of those conditions was assessed throughout the programmes;
- indicators: shows economic indicators and forecasts as recorded in review reports. Users can view the forecasts prepared during programmes as charts; seeing, for the first time, how the projections were revised as the programme advanced.

Visitors can make use of user guides and texts explaining the institutional and historical context of the data presented in each dashboard. There is also a glossary of technical terms used.

All data is downloadable in spreadsheets, and links to original documents such as programme reviews, press releases, bond term sheets, and lending contracts are provided.

The database's creation responds to a recommendation to increase transparency from the 2017 EFSF/ESM Financial Assistance Evaluation Report, prepared by independent evaluator Gertrude Tumpel-Gugerell.

Programme country experiences

Ireland

EFSF

The Irish economy grew strongly again in 2019, supported by buoyant domestic activity. Year-end data on Exchequer returns point to a general government surplus for 2019. Favourable market access conditions enabled Ireland to maintain ample cash buffers to face upcoming redemption spikes. Irish banks showed capital and liquidity buffers well above regulatory requirements, though strengthening operational efficiency would improve their resilience. Residual Brexit uncertainties and changes to both the international tax regime and the trade environment represent the main risks for the upcoming years, and warrant fiscal prudence. The Covid-19 outbreak is expected to have a substantial economic impact, adding significant uncertainty to the Irish economic and fiscal outlook, as in other parts of Europe.

Real GDP grew 5.5% over 2019. Although the GDP figures are distorted by multinational corporations' activities, domestic activity indicators similarly show Irish growth significantly outpacing the euro area average. Modified domestic demand grew at an annual 2.9% in 2019, mainly driven by private consumption and investment in the construction sector.[6] Ireland's unemployment rate decreased to 4.7% in December 2019, its lowest since 2007, with the economy now operating at full employment. Tight labour market conditions triggered a surge in 2019 earnings. Given skill mismatches of new entrants, positive net immigration provided only a small pick-up to a flat labour force participation rate; the limited supply of housing is discouraging further economic migration to Ireland.

Consumer price inflation remained subdued in 2019 despite the strong domestic economy. Goods prices were the main drag on inflation due to weak sterling. Imputed rents and higher service prices contributed to increasing inflation. Macroprudential measures helped to curb house price inflation, with some easing also observed in rental prices. House completions are picking up but are still below demand.

Ireland recorded a second consecutive general government surplus in 2019 of about 0.4% of GDP, driven by higher-than-expected corporate tax receipts as well as strong results in income tax and VAT receipts. Corporate tax revenues largely stemmed from multinational companies and represent a potentially unstable source of revenue. The Irish government is considering measures to address this vulnerability. Health sector expenditures came under control in 2019, although supplementary spending was included in the 2020 budget. General government debt for 2019 decreased to 58.8% of GDP, from 63.5% in 2018. It remains high, however, if we measure it using alternative metrics.[7]

Ireland enjoys favourable market access conditions, similar to those of Belgium and France. In 2019, the National Treasury Management Agency extended the debt maturity with a weighted average maturity at issuance of 16.4 years for benchmark bonds. The average funding cost at issuance fell to 0.9% from close to 1.1% the previous year. The bond yield spreads vis-à-vis peer issuers widened ahead of the October deadline for Brexit before narrowing again, reflecting the reduced likelihood of a disorderly Brexit, an S&P rating upgrade to (AA-), and the ECB announcement that it would restart its bond purchase programme. Strong economic growth, good fiscal outcomes, sizeable cash buffers, and good credit ratings limit the risks to Ireland's market access.

Irish banks' capital and liquidity ratios sit well above the regulatory minimum requirement. In 2019, Irish retail banks showed further signs of recovery in an improving operating environment. They made additional progress in reducing long-term arrears. The provisioning rate on the stock of distressed debts, however, remains low compared to European peers. High operational costs continue to impinge on banks' profitability. Banks' focus on retail activities limits their ability to diversify revenues.

[6] Final modified domestic demand comprises private and public consumption, and modified investment (excluding aircraft related to leasing and research and development-related intellectual property).

[7] The general government debt in percent of government revenues is estimated to be higher than the euro area average for 2019.

Under its Early Warning System, the ESM's monitoring shows limited risks for Ireland in meeting its loan service payments. However, the Covid-19 outbreak is expected to have a sizeable economic impact, mainly because of lower private consumption, investment, and a likely global downturn. The 2020 fiscal outcome will likely be affected by this shock, due to lower income, consumption, and corporate tax revenues as well as larger-than-expected expenditures in response to the outbreak. A potential negative Brexit outcome, changes to the international tax regime, and the international trade environment represent further risks. The Covid-19 outbreak has opened up a new scenario where available fiscal buffers[8] might be mobilised to counter the impact of the pandemic.

[8] The Irish government has established a Rainy Day Fund, with a first contribution made by transferring €1.5 billion. Moreover, the expected €500 million contribution for 2020 has been frozen in the context of the budget 2020, in view of the uncertain outcome of Brexit (at the time the budget was drafted).

Greece

EFSF ESM

After a decade of adjustment, the economic recovery consolidated in 2019. Growth was mainly driven by consumer spending and net exports while domestic demand rose modestly. Greece reached its fiscal target for the fifth consecutive year and enhanced its market access. Improved market confidence within a benign external environment enabled Greece to prepay part of its IMF debt. Continuing on the reform path pursued under the programme will entrench Greece's economic and financial sector achievements. The Covid-19 outbreak is expected to have a substantial economic impact, adding significant uncertainty to the Greek economic and fiscal outlook, as in other parts of Europe.

Growth stabilised at 1.9% in 2019 and rising labour demand further reduced the unemployment rate. Tourism spurred the recovery while foreign direct investment stimulated real estate activity. Private investment, however, remains weak overall, suggesting that Greece needs to further improve its business environment and competitiveness. After taking office in July, the new government launched related initiatives.

Greece reached the agreed primary surplus for the fifth year in a row. The primary surplus in programme terms stood at 3.5% of GDP, in line with the target. Underspending in public investment again contributed to lower expenditure and reduced drawing on EU funds. Ahead of the June elections, the previous government undertook measures that raised concerns as to the suitability of these steps to achieve more growth-friendly public finances. The new government maintained some of these policy measures, but also reduced personal and corporate income taxes to support growth and took compensatory measures to ensure compliance with fiscal targets.

Greece strengthened its capital market presence amid a benign global environment and with the benefit of a sizeable cash buffer built during the ESM programme. Greece's 10-year government bond yields shrank to 1.4% at end-2019 from 4.4% at end-2018. The Public Debt Management Agency (PDMA) raised €9.3 billion through four well-received issuances in 2019. The proceeds enabled Greece to reduce short-term debt and finance a partial early repayment of its IMF loans, after the ESM and EFSF waived their proportional prepayment rights. Overall, government debt declined to 176.6% of GDP, still the highest in the euro area. Supported by improved ratings and high cash buffers, the PDMA announced an up-to-€8 billion 2020 issuance programme. In January, the PDMA raised €2.5 billion with a 15-year bond at 1.9% and in April it raised €2 billion with a 7-year bond at 2%.

Improving banks' asset quality and the country's insolvency framework is a necessary prerequisite to reviving banks' lending capacity, which is a critical support for the economy. Greek banks met capital requirements and liquidity stabilised, in particular following the complete removal of capital controls. Asset quality must improve substantially, while profitability – though improving – remains low. Lending across all segments of the economy remained subdued, despite improvements in corporate sector lending. While the pace of reduction of non-performing loans (NPLs) accelerated in 2019, NPL ratios remain very high. The implementation of the 'Hercules' Asset Protection Scheme is delayed. While the reduction in terms of NPLs was sizeable, the process of delever-

"The main challenge euro area banks currently face is how to reinvent their business models to remain competitive and factor ESG principles into their risk management and investment strategies. As part of my work in the ESM banking team, I am pleased to see that banks have started allocating more resources into quantifying impacts of climate change on their lending activity."

DÓRA SIKLÓS
Financial Sector and Market Analysis
European Stability Mechanism

The three financial assistance programmes for Greece

FIRST PROGRAMME

agreed in 2010

Initial programme amount: €110 billion

Total amount disbursed: €73 billion

Lenders: The 2010 euro area countries (except Slovakia) under Greek Loan Facility (GLF) managed by the European Commission: €52.9 billion; IMF: €20.1 billion

Grace period and maturity on GLF loans extended in 2012 to 10 and 30 years from 3 and 5 years, respectively

Interest rate: priced with Euribor 3-month with a margin lowered to 50 basis points from 300 basis points for GLF; IMF – around 3.96%

Key areas of legislated reforms: Pension system, healthcare system, public financial management, state budget, public sector benefits, labour market, closed professions

SECOND PROGRAMME

agreed in 2012

Initial programme amount: €164.5 billion

Total amount disbursed: €153.8 billion

Lenders: EFSF: €141.8 billion (including €48.2 billion for bank recapitalisation, €34.6 billion for private sector involvement and bond interest facilities), of which €10.9 billion for bank recapitalisation was not used by the HFSF and was returned to the EFSF; IMF: €12 billion

Maximum weighted average maturity on EFSF loans initially extended in 2012 to a maximum 32.5 years from 17.5, finally extended to a maximum of 42.5 years in December 2018

Interest rate: Guarantee fee cancelled on EFSF loans, some interest payments initially deferred by 10 years and then extended to 20 years, up to 2032, and conditional waiver of step up interest rate margin on certain loan instalments; IMF: between 2.85% and 3.78%

Key areas of legislated reforms: Labour market, income tax, public administration, social protection, healthcare system, public financial management, business environment

THIRD PROGRAMME

agreed in 2015

Total amount committed: up to €86 billion

Total amount disbursed: €61.9 billion

Lenders: ESM: up to €86 billion (including up to €25 billion for bank recapitalisation); IMF: €1.6 billion approved in principal, but stand-by arrangement did not become effective

Maximum weighted average maturity: 32.5 years

Interest rate for cash disbursements: 1.37% (31 December 2019)

Key areas of legislated reforms: VAT, income tax, pension system, insolvency law, out-of-court debt workout, sales and servicing of loans (NPLs), public revenue collection, product markets, management of state assets, public administration, social protection aging led to a more modest decline in NPL ratios. The scheme could play a vital role in assisting banks to improve their asset quality in 2020. The government also committed to implementing a single harmonised insolvency framework by May 2020.

In its first full year under enhanced surveillance, Greece made progress on its post-programme commitments, albeit with delays. Following the European institutions' positive overall assessment, it received the first two tranches of the semi-annual conditional debt relief measures amounting to €1.7 billion. The new government confirmed it would stick to the agreed reform path, ensuring fiscal sustainability, financial stability, implementing growth-enhancing reforms, and modernising public administration.

Despite the generally positive assessment, more progress needs to be achieved in some areas as also stipulated in the fifth enhanced surveillance report. The Hellenic Corporation of Assets and Participations will emphasise improved commercial performance and service quality at state-owned enterprises. The Hellenic Financial Stability Fund (HFSF) will continue implementing its divestment strategy in an independent and orderly manner, but sales are unlikely until asset quality and profitability improve. Progress in financial sector reform would also need to be stepped up. Finally, annual arrears clearance slowed to €0.14 billion, leaving €1.22 billion at end-2019. The authorities set up a clearance plan to eliminate the remaining arrears by end-2020 and to clear pension claims by June 2021. To stop creating new arrears, Greece needs to further streamline its public financial management system.

Looking ahead, growth-enhancing policies are critical to attaining a sustainable growth path, also through public investment, while strengthening social safety and complying with post-programme targets. The reform momentum needs to be translated into bold and concrete actions to safeguard financial stability, enhance productivity through labour and product market reforms, speed up privatisations, and modernise public administration. Downside risks to the Greek economy emerged at the start of 2020 in view of the Covid-19 pandemic shock and the resumption of the migration crisis. The pandemic is expected to have a sizeable impact on this year's growth, which, if prolonged, could have possible second-round effects on the Greek banking sector. The 2020 fiscal outcome will also be affected by the pandemic shock, due to lower tax revenues and larger-than-expected expenditures in response to the outbreak. Despite policymakers' co-ordinated response in Greece and around the world to preserve jobs, and to support workers, firms, and families, the uncertainty about the magnitude and the duration of the pandemic shock remains elevated.

Spain

On the back of past structural reforms and a more balanced growth pattern, the economy again outperformed the euro area average in 2019, despite lower economic growth stemming mostly from the external sector. Domestic demand eased, and the external sector contributed marginally to growth. On the fiscal front, the general government balance improved but at a slower pace than in earlier years in the absence of a new central government budget. The Spanish Treasury maintained good market access in 2019. Spanish banks improved profitability and asset quality supported by the economy and real estate market. The Covid-19 outbreak is expected to have a substantial economic impact, adding significant uncertainty to the Spanish economic and fiscal outlook, as in other parts of Europe.

Real GDP growth eased to 2% in 2019 from 2.5% in 2018, reflecting a more advanced cyclical position as the economy is gradually converging towards its long-term potential, but it benefitted from the positive impact of past structural reforms and a more balanced growth pattern and again outpaced its euro area peers. Domestic demand contributed less to growth than in previous years, on the back of decelerating private consumption and investment, but it remained the main driver. The external sector's contribution picked up slightly as exports increased at a moderate pace while imports slowed. The current account surplus found support in contained oil prices and remained at 2% of GDP in 2019 despite the slowdown in international trade flows. 2019 was the seventh year in a row that Spain recorded a current account surplus. The international debtor position narrowed to 74% of GDP in 2019, the lowest since 2007 and 23 percentage points below its peak during the financial crisis. Inflation eased markedly to 0.8% from 1.7% in 2018, propelled by lower energy prices. Core inflation stabilised at 0.9%.

The stock of private debt has continued decreasing, reaching 131.2% of GDP in consolidated terms in Q3 2019, below the euro area average. This is the first time that it has fallen below the 133% macroeconomic imbalance procedure threshold since the procedure has been in place. Private debt has gone down sharply, by 74 percentage points of GDP since its peak in 2010. However, it still remains above prudential levels and fundamental-based benchmarks.

The maturity of the business cycle has also been reflected in the labour market. Employment growth remained solid but moderated slightly to 2.3% from 2.7% in 2018, with private sector employment accelerating in the second half of the year. The unemployment rate fell below 14% by year-end for the first time since 2008 (about half of its peak in mid-2013), supported by employment growth, even in the context of an increasing active population. Still, the labour market recovery is not complete, and unemployment remains high in some segments of the population, in particular youth.

The general government deficit was 2.7% of GDP in 2019, slightly higher than 2.5% in 2018, in the absence of a 2019 central government budget. Spain exited the excessive deficit procedure for the first time since 2009. The cyclical component continued supporting deficit reduction, but to a lesser extent than in previous years. Public debt was reduced by 2.1 percentage points to around 95.5% of GDP in 2019, but it remained elevated. Nevertheless, public debt is decreasing at the highest pace since 2007 and in 2019 slowed to its lowest level in five years.

Spain retained good market access in 2019, and its 10-year government bond yields declined to 0.4% from 1.4% on the secondary market. The 10-year spread versus Germany narrowed to 70 basis points from 120 over the same horizon. The upward trend in Spain's credit profile resumed in 2019.

Spanish banks improved profitability and asset quality helped by the recovery of the economy and the real estate market. NPL ratios sank to levels close to the euro area average due to continued sales. Banks' capital buffers were adequate, despite a CET1 ratio that remained substantially below the EU average, as opposed to the higher leverage ratios vis-à-vis their European peers. In both aspects, the difference stems from Spanish banks' scant reliance on internal rating based models.

Sareb, the asset management company that divests the assets transferred from the old savings banks, continued to sell assets, albeit at a slower pace given that it recently embarked on a new strategy to deliver larger recoveries. Although it may entail higher costs and more time, the new strategy aims to have a higher volume of recovered assets in order to get higher prices. Like other financial institutions in the euro area, Bankia's share price fell in 2019. The deadline to divest in Bankia was extended to December 2021.

Under its Early Warning System, the ESM continued to assess positively Spain's ability to honour its ESM loan service repayments. In 2019, Spain's ESM outstanding loan stood at €23.7 billion, 57% of the total amount drawn by Spain under the programme. Meanwhile, the Covid-19 pandemic shock has significantly increased uncertainty on economic prospects, as in other areas in Europe. In particular, the necessary government actions to contain the pandemic will have a sizeable impact on both the supply and demand for goods and services, economic activity, fiscal outcome, and financing conditions in 2020. To counteract the economic and social effects, the Spanish government, along with other euro area countries, has undertaken substantial measures to preserve jobs, and to support households and firms.

Cyprus

Cyprus's economy grew at a faster pace in 2019 than most of its euro area peers and the unemployment rate declined further. A solid fiscal performance has lowered financing risks and returned public debt to a downward trajectory. Cyprus enjoyed favourable financing conditions. Capital constraints stemming from still-high NPLs and subdued profitability are limiting the banking sector's contribution to growth. Invigorated reform efforts would strengthen the country's growth path and reduce its vulnerability to the external environment. The Covid-19 outbreak is expected to have a substantial economic impact, adding significant uncertainty to the Cypriot economic and fiscal outlook, as in other parts of Europe.

Cyprus was one of the fastest-growing economies in the euro area in 2019. The Cypriot economy grew by about 3.2% in 2019, mainly driven by domestic demand, after expanding by 4.1% in 2018. Infrastructure projects and government incentives boosted investment, and labour market improvements supported consumption growth. The unemployment rate stood at 6.3% in December 2019, slightly lower than the euro area average of 7.4% that month; Cyprus suffered from higher youth unemployment than the area as a whole. Despite the positive development in 2019, high private debt is burdening the Cypriot economy. The country remains vulnerable to external risks such as rising protectionism and lower-than-expected global growth mainly due to the global pandemic.

The positive fiscal performance reflects both a prudent fiscal policy, which continues to achieve high surpluses, and strong economic growth. The primary surplus rose to about 6% of GDP in 2019, one of the highest in the euro area. Public debt fell to below 100% of GDP in 2019 from 100.6% a year earlier.

The Cypriot banking system has reduced NPLs, with the outstanding amount of bad banking assets down substantially from its peak during the crisis. Reaching a single-digit NPL ratio hinges on further deleveraging efforts. However, uncertainty around the foreclosure law and fewer-than-expected applications to the Estia scheme, which supports borrowers facing difficulties in repaying mortgage loans backed by their primary residence, could slow progress. Banks' profitability is under pressure from narrowing interest margins amid high cost-to-income ratios. Exceptionally high liquidity reserves and low loan-to-deposit ratios reflect limited opportunities for new lending. To curb dependence on deposit funding and interest margins, banks should diversify their business models over time.

Cyprus enjoyed a positive market perception and advantageous financing conditions in 2019. Cyprus tapped the market twice with favourable outcomes. Cypriot yields mostly followed broader euro area developments. Cyprus took advantage of the low interest rate environment to undertake a liability management operation, which substituted a bilateral loan with lower cost or longer maturity loans from the capital markets. The main credit rating agencies, with the exception of Moody's, have rated Cyprus' debt at investment grade since 2018. A stronger banking sector would reinforce the sovereign's creditworthiness, which remains constrained by its high debt levels. Market conditions remain susceptible to a tightening of financial conditions.

Under the ESM's Early Warning System, Cyprus faces no major risks in meeting its ESM loan service payments. Looking ahead, the Covid-19 outbreak is expected to have a sizeable economic impact on the Cypriot economy and its public finances. Given the gloomy economic outlook and high external risks, Cyprus may need to use part of its projected fiscal buffer to cushion the economy from the pandemic. Implementing the reform of the local government, justice system, and the public administration would significantly strengthen the economy.

Portugal

EFSF

Growth moderated in 2019 but remained above the euro area pace. Investment and private consumption drove growth, while exports grew less than imports, and the trade deficit increased. The government exceeded the fiscal deficit target for 2019. Bond market liquidity remained adequate and volatility decreased. Market access conditions remained favourable and bond yields declined. The banking sector continued to recover, and NPLs are down, but contingent liabilities remain. Looking ahead, the Covid-19 outbreak is expected to have a substantial economic impact, adding significant uncertainty to the Portuguese economic and fiscal outlook, as in other parts of Europe.

GDP growth slowed to 2.2% in 2019 from 2.6% in 2018, reflecting weaker external demand. Investment rebounded, and private consumption – underpinned by low unemployment – remained a strong driver of growth. Net external demand remained negative, with nominal import growth (6.6%) almost double that of exports, pushing the trade-in-goods deficit to about 10% of GDP, and the goods and services trade balance to about -0.6% of GDP. The labour market continued its rebound with unemployment at 6.7% in December, and averaging 6.5% for 2019, below pre-crisis levels (7.6% in 2006).

The general government balance improved to 0.2% of GDP in 2019 – overachieving the government's target of -0.2% of GDP for the year – following a strong revenue performance and contained expenditure growth. Both current revenue and current primary spending evolved in line with annual targets, but partly as a result of lower-than-budgeted investment, while growth of public wages and social expenditure accelerated. Public debt declined further to 117.7% of GDP in 2019 from 122% in 2018, following good economic growth and primary balance improvement. Moreover, favourable market conditions enabled Portugal to make an early €2 billion repayment to the EFSF – after having already fully repaid in advance the IMF loan in 2018, thereby smoothing its debt redemption profile.

The four major credit rating agencies rate Portugal at investment grade, and the rating profile improved in 2019. DBRS upgraded the country to BBB (High), the highest level among the four major rating agencies, in October. By the end of the year, Fitch, Moody's, and S&P had assigned positive outlooks to signal further upgrades could materialise in 2020.

The 10-year government bond yields fell to 0.4% at the end of 2019, close to historical lows, from 1.7% at the beginning of the year, following some temporary volatility in the first half of the year. The spread to Germany compressed to 60 basis points from 150, despite the wavering global risk appetite.

Economic growth, higher real estate prices, and heightened investor interest supported the banking sector's continued recovery in 2019. Banks' profitability improved clearly in 2019 compared to previous years. The stock of NPLs is still falling at a fast pace and is now 57% below its peak in mid-2016. The NPL ratio fell to 6.1% at end-2019, from 9.4% at end-2018, but it remains above the euro area average of 3.6%.[9] NPL sales, write-offs, and cures have driven the decline in the NPL stock. The average capital level increased to 14.1% of risk-weighted assets (CET1 ratio) at end 2019. The resolution fund is still liable for future losses of Novo Banco through a capital contingent mechanism, limited to an overall amount of €3.89 billion over approximately eight years. In May 2019, the bank received €1.15 billion from the resolution fund, of which €850 million were financed by a state loan. Novo Banco remains a contingent liability for the state and is likely to request another capital injection by the resolution fund in 2020.

The Early Warning System of the ESM suggests no immediate repayment risk. Portugal's high public debt burden remains an important vulnerability. Public debt is on a medium-term downward trend,[10] but weaker growth, fiscal fatigue, and the ageing population could slow the pace of debt reduction. The Covid-19 outbreak is expected to have a sizeable impact on the Portuguese economy. The 2020 fiscal outcome will likely be affected by this shock, as a result of lower tax collections and larger-than-expected expenditures in response to the outbreak. Portugal, along with other euro area countries, has undertaken substantial measures to cushion the economic and social effects of the pandemic.

[9] As of end-June 2019.
[10] European Commission – Country Report Portugal 2019.

02 ESM activities

Efficiency gains through digitisation at the ESM

As a lean public sector financial institution, the ESM needs to be on top of the rapid changes in digital innovation that are enhancing efficiency in financial markets, operations, and organisational set-up. These innovations are reshaping the world of finance and economics.

In 2019, the ESM was able to devote considerable attention to boosting efficiency, both externally and internally, through digital innovation. Externally, it supported ECB efforts to create a truly pan-European debt market. Internally, it exploited new data tools to better assess risk, conduct routine calculations, and enhance its transparency, by making ESM programme loan data available to the public:

- **Digitisation of debt distribution.** As one of the largest euro-denominated issuers in the Sovereign Supranational and Agencies space, the ESM is a very active supporter of the ECB-led initiative to create a pan-European, integrated, front-to-end platform for the distribution of euro debt instruments. In 2019, the ESM outlined in an ECB market consultation that the proposed European Distribution of Debt Instruments (EDDI) would support deeper, more liquid, and thereby more resilient euro capital markets. EDDI would be voluntary and not disrupt the role of banks. It would increase efficiency and be a true European technology under European data protection rules.

- **Strengthening the loss of market access risk evaluation.** Under its current mandate, and even more under the enhanced mandate, the ESM needs to monitor the risk that one of its Members could lose market access. To spot trends early on requires considerable data. Smart algorithms and artificial intelligence might make this possible. In 2019, the ESM studied the use of more advanced algorithms to strengthen the evaluation of the risk of loss of market access, aiming to replace work now done manually. This work will progress to a sandbox-testing environment in 2020.

- **Data transparency.** In 2019, the ESM launched a public programme database, a repository of data on the six financial assistance programmes that the EFSF and ESM carried out from 2011 to 2018. The innovation lies under the bonnet. The ESM built the technology in-house, in the form of a coding and data hub, using some of the latest micro services architecture. It enables automated data processing and self-service business intelligence, meaning citizens, investors, and academics can build their own tailored and dynamic reports on the rescue programmes on the ESM website more quickly. Users can also download sub-sets of data in various formats.

- **Asset and Liability Management automation.** Comprehensive ESM financial data on loans, bonds, and issuances flows to the Asset and Liability Management (ALM) division; the team, therefore, relies on a web of multiple data sources and intensive calculation processes. Due to the many interlinkages and dependencies, they are prone to operational risks and inefficiencies. In the past, the ESM relied on multiple spreadsheets to set up a flexible and fast infrastructure in times of crisis and under tight deadlines. The ESM is now automating key processes, leveraging the new coding and data hub built in-house for the programme database. In 2019, the ALM team demonstrated the feasibility of the new approach – with the automatic generation of complex financial reports. Delivery will accelerate in 2020 and provide robust, auditable, and automated business reports.

- **Process efficiency.** In 2019, the ESM delivered a first pilot of robotic process automation for middle and back office operations, where the ESM's substantial daily financial operations are validated and processed. The automation pilot significantly reduced the time and effort required as well as the error potential in novating contracts. Intelligent automation will be the next step to look into for automating also unstable processes by combining artificial intelligence with robotics process automation.

- **New ways of working.** The ESM has adopted a new project management framework designed to manage complex software development using iterative and incremental practices. This approach enables project teams to adapt and absorb changes by keeping the focus on quality and business delivery. A continuous interaction between the business and the development teams allows for earlier testing and enables a faster delivery of value to the business. It also contributes to a stronger team spirit, as everyone involved in the project is empowered and contributes actively to achieving project objectives.

Digital innovation makes the ESM more robust and efficient. To capture institution-wide synergies, the ESM recruited a Senior Digital Innovation Officer to identify inefficiencies in standard processes and digital applications. The ESM will then tackle these according to impact and alignment with ESM's mission, objectives, and long-term ambitions with the aim of delivering the best value for Members. The ESM has internal development teams, but also works together with public sector peers, established technology companies, and some innovative fintech start-ups.

Asset and Liability Management and Lending

- ALM monitored the liquidity profile of both the EFSF and ESM, improved its simulation capabilities with a new portfolio analytical tool, and further automated its operational processes, see efficiency gains through digitalisation at the ESM.
- The Lending team started implementing the Greek medium-term debt relief measures and worked on the first voluntary repayment from Portugal.
- Following the proposed ESM reform, the team prepared to fulfil the role of common backstop to the SRF.

Asset and Liability Management

ALM's role is to measure, monitor, and manage liquidity, currency, and interest rate mismatches between assets and liabilities that may arise from the execution of the ESM and EFSF mandate.

In 2019, the ECB launched the euro short-term rate, (€STR). The rate reflects the overnight wholesale euro unsecured borrowing costs of euro area banks. It is computed daily based on transactions reported by 50 different reporting agents, and should progressively replace Eonia until its discontinuation on 3 January 2022, requiring ALM to devote significant preparatory work to ESM invoicing processes.

To better forecast future debt service costs and their variability across different interest rate scenarios, the team developed new portfolio analytics that simulate future issuances over a long horizon. The simulation tests the impact of different issuance patterns to cover future funding needs under specific market constraints that, for example, limit the size of individual bond issuances. It projects future cash flows and calculates the debt service cost using assumptions about future interest rates at each point in time.

Lending

ESM implements the medium-term debt relief measures for Greece

In 2019, the ESM began to implement the medium-term debt relief measures for Greece, in line with an EFSF BoD decision in November 2018. This is the second set of debt relief measures for Greece since 2016, agreed following Greece's exit in 2018 from its ESM programme, and intended to improve Greece's debt sustainability. The measures consist of: an extension of the maximum weighted average maturity; a further deferral of interest and amortisation by 10 years on €96.4 billion of Greece's total €130.9 billion in EFSF

"ESG is a topic of heart and mind. Our heart wants a better planet for our kids. Our mind helps to use ESM's instruments and financial firepower to make reforms socially acceptable, thus improving the functioning of monetary union, while committing for example to the UN-PRI and Zero Single-Use Plastic. Together, we can make a difference."

KALIN ANEV JANSE
Chief Financial Officer and Member of the Management Board
European Stability Mechanism

loans; and a conditional abolition of the step-up interest rate margin on the €11.3 billion debt buy-back instalment disbursed by the EFSF in 2012. The ESM fully implemented the first two of these medium-term debt relief measures on EFSF loans in 2019.

The third measure, the abolition of the step-up margin accruing on one loan instalment, can be implemented step-wise in six-month periods. The EFSF BoD decides on its progressive implementation based on assessments of Greece's continued implementation of key reforms adopted under the ESM programme and compliance with its post-programme policy commitments. In 2019, the Board opted to reduce to zero the step-up margin payable by Greece for both six-month periods. These decisions lowered by €225.5 million the margin payable by Greece in 2019.

Portugal makes the first voluntary early repayment to EFSF

In October, Portugal made a €2 billion early repayment on its EFSF loans. Following its early repayment to the IMF in 2018, Portugal had committed to making early repayments to the EFSF from 2020 to 2023, subject to market conditions and the impact on debt sustainability. Portugal took advantage of its strong market access and liquidity position to fulfil this commitment ahead of schedule. It is the first early repayment of this kind that the EFSF has received.

ESM reform and preparations for the common backstop

During the year, ALM and Lending reviewed the ESM pricing policy and other guiding documents that will be adapted in line with the agreed reforms of the ESM, including the revised guideline for the precautionary credit lines.

The common backstop to the SRF will take the form of a revolving credit line that the SRB can use to finance bank resolutions, should the SRF become depleted. ALM and Lending also helped to design this credit line in 2019, including the facility terms and a fit-for-purpose pricing structure.

Table 1
Total budget savings for all programme countries
(in % of GDP)

YEAR	2011	2012	2013	2014	2015	2016	2017	2018	2019
Ireland	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.2	**0.2**
Greece	0.0	1.6	4.1	5.0	5.2	6.2	6.6	7.0	**7.5**
Greece – EFSF	0.0	1.6	3.7	4.3	4.4	4.7	5.0	5.0	**5.2**
Deferred interest	0.0	0.0	0.4	0.7	0.7	0.7	0.6	0.7	**0.7**
Greece – ESM	0.0	0.0	0.0	0.0	0.2	0.8	1.1	1.3	**1.6**
Spain	0.0	0.0	0.2	0.2	0.2	0.2	0.2	0.1	**0.1**
Cyprus	0.0	0.0	0.7	1.6	1.9	2.0	1.9	1.9	**1.9**
Portugal	0.1	0.4	0.6	0.7	0.7	0.7	0.7	0.7	**0.7**

Notes: As of 21 April 2020. The ESM estimates these savings by comparing the effective interest rate payments on ESM and EFSF loans with interest payments these countries would have paid had they covered their financing needs in the market. First, we estimate the direct budget savings per disbursement by comparing the ESM and EFSF rate to the 10-year bond yield, used as a proxy long-term market rate. We apply a cap of 6.4% on market rates, which from experience of the crisis suggests significant market stress and imminent loss of market access. Second, we calculate the indirect benefits. For each disbursement, the ESM calculates the gains from the previous year's reduced financing needs, making the same market rate assumptions as for direct budget savings.
Source: ESM calculations based on ECB and Eurostat data

Table 2
Total budget savings for all programme countries
(in € billion)

YEAR	2011	2012	2013	2014	2015	2016	2017	2018	2019
Ireland	0.2	0.5	0.6	0.7	0.7	0.7	0.8	0.8	**0.8**
Greece	0.0	3.1	7.5	8.9	9.3	11.0	12.0	13.0	**14.1**
Greece - EFSF	0.0	3.1	6.7	7.6	7.8	8.4	9.0	9.3	**9.8**
Deferred interest	0.0	0.0	0.8	1.2	1.2	1.2	1.1	1.3	**1.4**
Greece – ESM	0.0	0.0	0.0	0.0	0.3	1.5	1.9	2.4	**2.9**
Spain	0.0	0.1	2.2	2.1	2.0	1.9	1.8	1.6	**1.4**
Cyprus	0.0	0.0	0.1	0.3	0.3	0.4	0.4	0.4	**0.4**
Portugal	0.1	0.6	1.0	1.2	1.3	1.3	1.4	1.5	**1.5**

Notes: As of 21 April 2020. The ESM estimates these savings by comparing the effective interest rate payments on ESM and EFSF loans with interest payments these countries would have paid had they covered their financing needs in the market. First, we estimate the direct budget savings per disbursement by comparing the ESM and EFSF rate to the 10-year bond yield, used as a proxy long-term market rate. We apply a cap of 6.4% on market rates, which from experience of the crisis suggests significant market stress and imminent loss of market access. Second, we calculate the indirect benefits. For each disbursement, the ESM calculates the gains from the previous year's reduced financing needs, making the same market rate assumptions as for direct budget savings.
Source: ESM calculations based on ECB and Eurostat data

"A healthy work environment, free from bullying and harassment where all staff operate with the highest level of integrity, is not created by a Code of Conduct and whistleblower protection alone. It must be paired with clear procedures, training, and awareness-raising – with management walking the talk as role models."

JOANNE ANKUM-BRINKMAN
Legal and Compliance, Institutional Affairs
European Stability Mechanism

Funding and Investor Relations

- In 2019, the ESM used its funding proceeds solely to fund the rollover of existing debt, because it was the first full year with no ESM disbursements to countries. The funding amount was therefore lower than in previous years.
- ESM issued its first bond under Luxembourg law, a €3.5 billion 5-year bond.
- The total issuance for EFSF and ESM was €29.8 billion, €9.8 billion for the ESM and €20 billion for the EFSF.
- The ESM is supporting an ECB initiative to provide a more efficient, neutral, and standardised way across Europe for securities' issuance and distribution.

Funding programme

The ESM had a strong start to its 2019 funding programme with a €2 billion 10-year bond issued in February. Investor demand was robust with an order book in excess of €8.5 billion. A noteworthy element of this transaction was large Asian investor participation, which represented 33% of the bonds purchased. Given the demand, the ESM reopened this bond in May adding a further €1 billion for a total €3 billion outstanding. The reopening of the 10-year bond in May was part of a dual tranche transaction, in which the ESM also reopened a 3-year bond and increased its size by €1.5 billion for a total €4.5 billion outstanding. Enlarging the size of the bonds allows for greater liquidity in the secondary markets, a very important feature for ESM bonds.

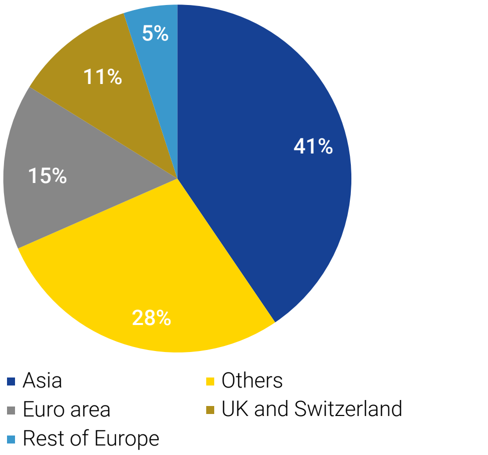
The fourth transaction of the year was a US dollar bond. The ESM started issuing in dollars in 2017 as part of its strategy to diversify its investor base. The ESM must always be able and ready to raise the necessary funds. By broadening its product range to dollar bonds, the ESM has been able to access not only new investors but also the dollar portfolios of existing investors (Figures 12 and 13). This third dollar bond, issued in September, raised USD2 billion and as a 5-year bond, created a new reference point on the ESM dollar yield curve. The ESM now has outstanding dollar bonds in 2020, 2022, and 2024.

Like the first transaction of the year, this new dollar bond also saw strong participation from Asia, with a number of new investors participating.

"Our core financial stability mandate seeks to ensure a more sustainable and prosperous Europe. To do so, our overall ESG strategy is also designed to meet the needs of our investors who, in turn, are defining new global ESG criteria to assess their investment decisions."

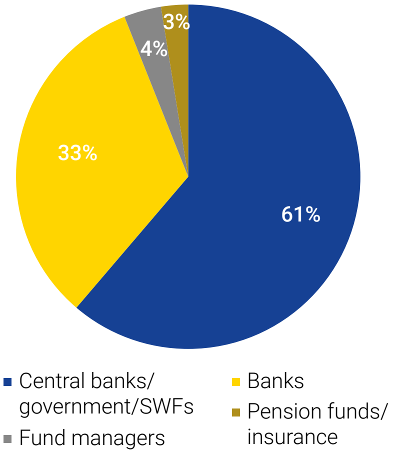
FERNANDO RODRIGUEZ
Funding and Investor Relations
European Stability Mechanism

Figure 12
Investor participation in 2019 5-year US dollar bond, by geography



Source: ESM

Figure 13
Investor participation in 2019 5-year US dollar bond, by investor type



Source: ESM

The ESM completed its funding programme for 2019 with the launch of a €3.5 billion new 5-year bond issued, for the first time, under Luxembourg law.

As part of the ESM's diversified product range and in order to provide attractive investment opportunities for German investors, the ESM continued to issue Namensschuldverschreibungen ('N-bonds'). A total €347 million was raised in issuance for the ESM and EFSF combined during the year.

ESM begins issuing under Luxembourg law

As a Luxembourg-based institution, the ESM took the decision in 2019 to begin using Luxembourg, instead of English, law to govern all its new euro-denominated bonds and bills. Therefore, all new ESM bonds and bills issued in euro from 1 October 2019 are under Luxembourg law.

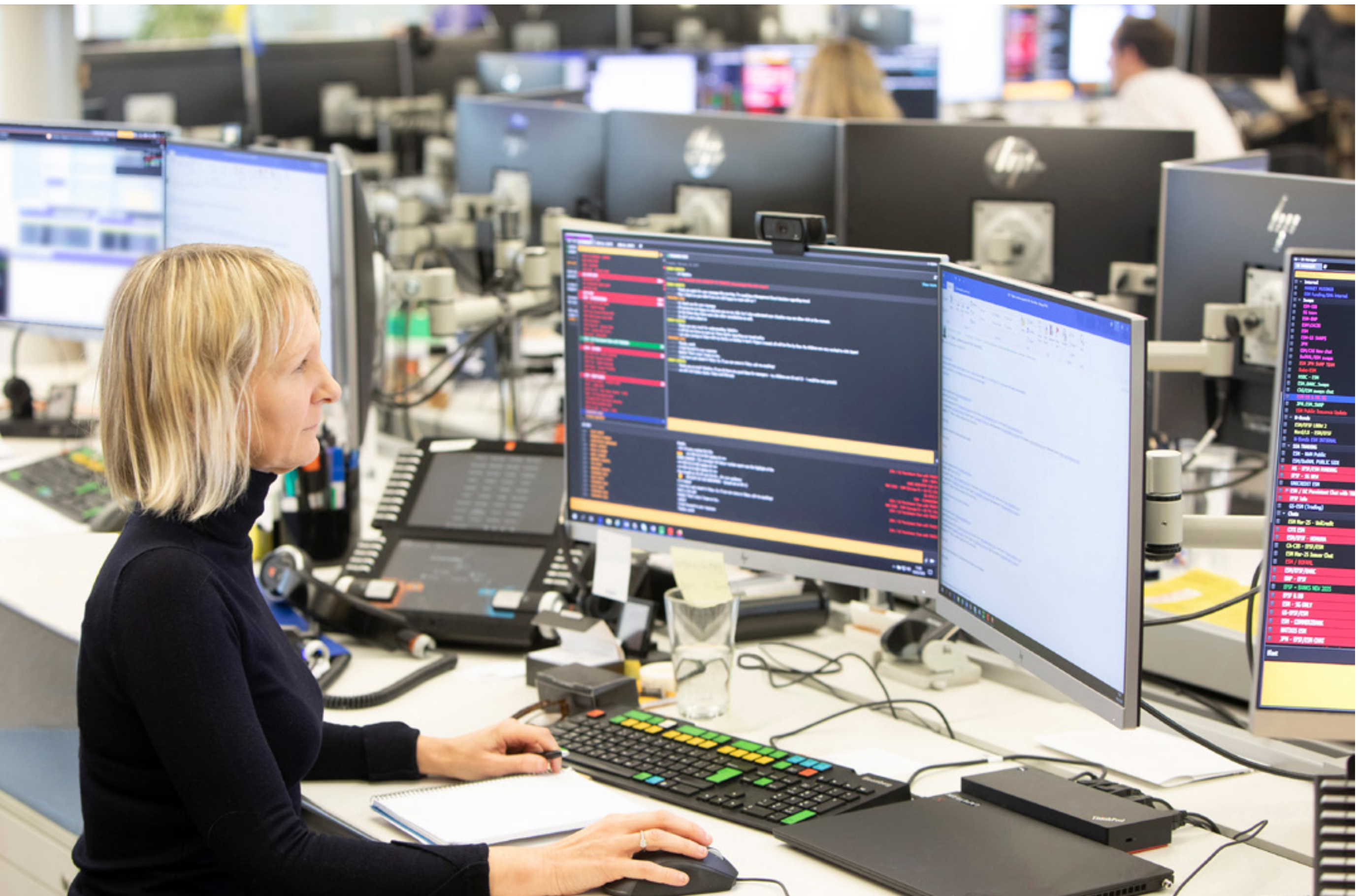
The first ESM bond issued under Luxembourg law was the €3.5 billion 0% 5-year bond issued later that month, on 22 October. Together with the Luxembourg Stock Exchange and the Minister of Finance for Luxembourg, Pierre Gramegna, this transaction was celebrated with a bell ceremony at the Luxembourg stock exchange in November.

ESM bill programme

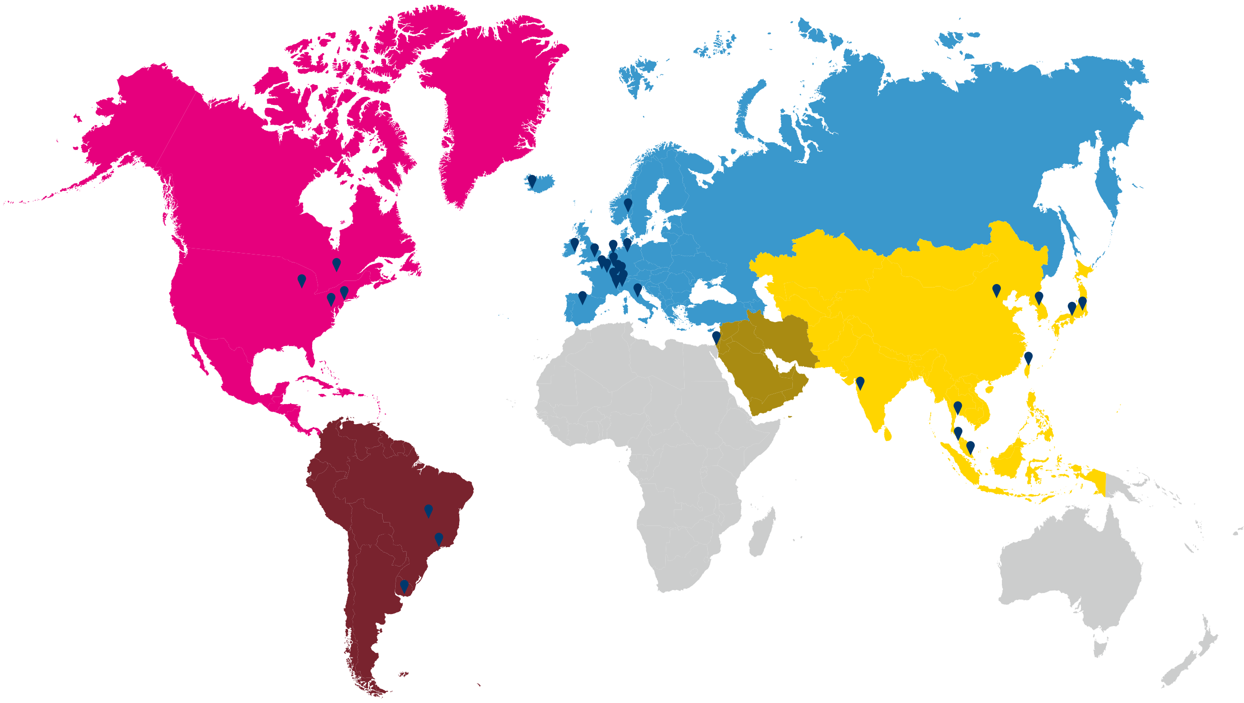
The ESM bill programme continued in 2019 with its regular issuance of 3- and 6-month bills. Over the year, the ESM issued more than €55 billion. This was the largest annual bill programme since the programme's launch in 2013. The increase in short-term funding stemmed from the need to cover collateral requirements for derivatives. The lowest recorded average yield was -0.5875% for a 6-month bill issued on 20 August raising €3.49 billion. The highest average yield was -0.4862% for a 6-month bill issued on 19 February for an amount of €1.99 billion.

Investor relations

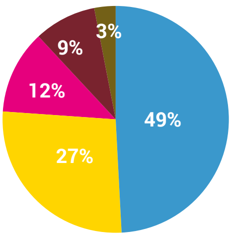
It is important to maintain close relationships with investors to understand their needs and identify the right issuance maturities and volumes. A close investor relationship is also important to assess market developments and identify potential risks. Finally, as the ESM issuance is not as regular as in previous years, investors must remain informed to ensure that the ESM remains on their radar for upcoming transactions.



In 2019, the ESM investor relations team connected with investors in 24 countries and 33 cities worldwide.



Source: ESM



The ESM maintains contact with investors through a combination of one-on-one meetings, industry conferences, and regular conference calls. We also organise investor forums in financial centres around the world. These events enable us to listen to our investors and discuss topics and concerns on the fixed income markets. In 2019, we held investor forums in London, Luxembourg, Amsterdam, and Frankfurt. This year, the ESM also welcomed an increased number of investors to the ESM offices in Luxembourg. Digital outreach communications are also on the rise. At the end of 2019, we had around 1,700 investors globally, having added roughly 50 new investors over the year.

North America

Canada
Ottawa
United States of America
Detroit
New York
Washington DC

South America

Brazil
Brasilia
Sao Paolo
Uruguay
Montevideo

Middle East

Israel
Tel Aviv

Asia

China, People's Republic of
Beijing
India
Mumbai
Japan
Kyoto
Tokyo
Korea, Republic of
Seoul
Malaysia
Kuala Lumpur
Singapore
Singapore
Taiwan, Province of China
Taipei
Thailand
Bangkok

Europe

France
Paris
Germany
Dusseldorf
Frankfurt
Hamburg
Munich
Nuremberg
Iceland
Reykjavík
Ireland
Dublin
Italy
Milan
Luxembourg
Luxembourg
Netherlands
Amsterdam
Norway
Oslo
Spain
Madrid
Switzerland
Basel
Zurich
United Kingdom
London

ESM at the forefront of technology

The ECB, with the full support of the ESM, is currently exploring a new approach to support the market in establishing a truly European mechanism for issuing and distributing securities. EDDI's objective would be to support a harmonised process in Europe, under which the interaction among investors, banks, and issuers is not affected by their location. The idea is that investors in all markets can participate in the issuance process as well as access and transfer these securities in an efficient, neutral, and standardised way across Europe. It could provide a neutral service to cover the entire chain of debt issuance, from deal announcement to settlement. EDDI will be an important step forward on the capital markets union agenda. EDDI offers a number of advantages over the current fragmented process. It will:

- create a single European "domestic" securities market;
- deliver a truly comprehensive "front-to-end" European issuance framework;
- overcome fragmentation from national issuer central securities deposits; and
- harmonise the issuance process of European public debt.

With these key deliverables, EDDI will create a deeper and therefore more liquid capital market in the euro area, strengthening the international role of the euro and providing the resilience required during crises.

The ESM values the advantages of the ECB's public governance for this crucial debt distribution infrastructure. This best mitigates dependence on geopolitical decisions, oligopolistic private infrastructures, and data stored and governed beyond European control. It would ensure reliability and continuity of the debt distribution infrastructure, in particular in situations of market stress when ESM funding potentially peaks. Settlement in central bank money increases the safety of the infrastructure.

EDDI will increase the efficiency of the syndicated issuance process in terms of costs, resources, and time. It will also reduce operational risks and increase transparency for all parties involved. Furthermore, EDDI can enhance the efficiency of private placements through reverse inquiries and posting of issuance spreads, thereby decreasing overall funding costs. For more information, see efficiency gains through digitalisation at the ESM.

Major rating agencies affirm ESM's high rating position

Table 3
ESM ratings

Fitch			Moody's			DBRS		
Long-term rating	Short-term rating	Rating outlook	Long-term rating	Short-term rating	Rating outlook	Long-term rating	Short-term rating	Rating trend
AAA	F1+	Stable	Aa1	P-1	Stable	AAA	R-1 (high)	Stable

Note: DBRS ratings are unsolicited. DBRS has rated the ESM at AAA since it initiated the rating in April 2014. Fitch has rated the ESM at AAA since inception in October 2012, and Moody's at Aa1 since November 2012. In May 2018, Moody's changed the ESM rating outlook to positive from stable and in February 2020 changed it back to stable.
Sources: The rating agencies named, compiled by the ESM

"Credit rating agencies are joining the broader trend in financial markets of analysing the impact ESG factors have on bond issuers' creditworthiness. We monitor those developments from an issuer, investor, and sovereign lender perspective."

LLUÍS SANCHIS I HERRERO
Policy Strategy and Institutional Relations
European Stability Mechanism

Investment and Treasury

- ESM investments outperformed long-term benchmarks.
- ESM created a hold-to-maturity tranche, following its investment guidelines revision.
- ESM introduced bond futures to manage interest rate risk.
- ESM signed the UN-PRI.

ESM paid-in capital records a positive marked-to-market return in 2019

The ESM's paid-in capital stood at €80.5 billion at the end of 2019, and will total €80.8 billion in 2027 when all instalments from existing ESM Members have been received. The capital is invested in three tranches with different investment horizons, liquidity objectives, and financial valuation: the short-term and medium-/long-term tranches, whose assets are marked to market, and a newly created hold-to-maturity tranche, valued on an amortised cost basis.

In 2019, the ESM's marked-to-market portfolio recorded a slight positive return (0.4 basis points), despite the negative yield environment. The value of the assets appreciated as 10-year yields declined by 45 basis points for Germany and by about 70 basis points for public agencies and supranationals. The yield contraction offset the impact of negative yields on ESM investments, in particular cash deposited with Eurosystem central banks, whose remuneration fell to -0.50% from -0.40% following the September ECB decision to cut the Eurosystem deposit facility rate.

The ESM took a range of actions to boost portfolio performance. The ESM progressively increased its interest rate exposure to reflect the more accommodative monetary policy in Europe, and focused its investments on spread products with higher yields, which outperformed, with the restarting of the ECB asset purchase programme. The ESM also favoured investments in longer maturities and benefitted from the 25 basis point yield curve flattening in the 5-to-10 year sector. Finally, the ESM continued to keep significant cash holdings instead of investing in short-term securities with yields as much as 25 basis points lower. However, as the ESM increased its investments across eligible assets and started building the hold-to-maturity tranche, cash holdings decreased to €54 billion from €58 billion on average.

While the investment structure changed over the year, the paid-in capital's credit quality remained high. The percentage of capital held with Eurosystem central banks or invested in assets rated AA- or higher remained very high at 93%, whereas the A-rated investments, the lowest rating the ESM currently invests in, declined slightly (Figure 14). The share of public agencies, sub-sovereign, supranational and covered bonds reached 30% compared to 22.5% in 2018 (Figure 15), while non-euro denominated assets, hedged into euros, rose to an €8 billion equivalent. The ESM's assets, which contribute to increasing return and diversifying credit exposure, are denominated in seven currencies (US dollar, British pound, Japanese yen, Swiss franc, Canadian dollar, Australian dollar, and Swedish krona), with a large share in Japanese yen (€4.8 billion) offering the highest yield pick-up of around 50 basis points over Germany.

As a result, the annual portfolio performance was 22 basis points higher than the long-term benchmarks, taking the outperformance since inception to 16 basis points per year on average. The benchmarks, which the ESM Board Risk Committee reviews annually, consist of indices of AAA/AA rated euro area government and supranational bonds and reflect the objectives and constraints defined in the ESM's investment guidelines.

Despite the positive total return, the negative yield on ESM investments led to a realised loss of €137 million for the year, as a large part of the asset appreciation remained unrealised. This loss was more than offset by the €238 million compensation of negative interest paid on the ESM's Eurosystem cash deposits in 2018. To ensure that the negative interest environment would not erode ESM's capital, France, Germany, and Italy have agreed, as a temporary solution, to return the negative interest payments on ESM's capital deposited with their respective national central banks. In 2020, other countries have indicated they might join this initiative. After taking into account the interest compensation, the accumulated return on the ESM's capital since inception is €1.622 billion.

ESM creates a new paid-in capital tranche to reinforce its long-term financial strength

In May 2019, the BoD revised ESM's investment guidelines to allow for the introduction of a hold-to-maturity tranche of the paid-in capital. This portfolio aims to support the ESM's long-term financial strength, by investing in longer maturities historically associated with higher yields, on average. The ESM intends to hold these assets until maturity, except in cases of eligibility loss. This enables the ESM to value the assets on an amortised cost basis, which will provide a regular stream of interest over time. To ensure the credit quality over a long horizon, the investments have a minimum AA- credit rating at the time of purchase.

The construction of the new portfolio started in 2019, with the objective of spreading the credit and market risk over time. As of year-end, the portfolio reached €1.4 billion invested in 10- to 15-year maturities.

ESM introduces bond futures for managing interest rate risk

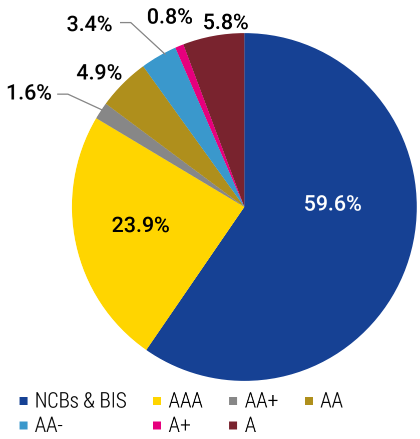
The ESM, which deploys derivatives to manage or hedge risks, has expanded its use of these instruments by starting to use bond futures contracts. This provides the ESM with access to highly liquid, exchange-traded instruments with transparent pricing as an additional tool to adjust the interest rate exposure of the portfolios. The ESM intends to use bond futures to modify the overall portfolio risk as well as to hedge the interest rate risk on specific securities. The eligible contracts include futures on German and French government bonds, which are a core part of the ESM investment universe. The activity started in November 2019 and is expected to progressively increase.

Over the year, the ESM continued to expand its range of counterparties for bilateral derivatives operations to ensure best execution and diversify credit risk exposure. The ESM transferred most relevant contracts with London-based counterparties to euro area counterparties, as a mitigating factor to prepare for the UK's departure from the EU.

ESM commits to responsible investing and becomes a UN-PRI signatory

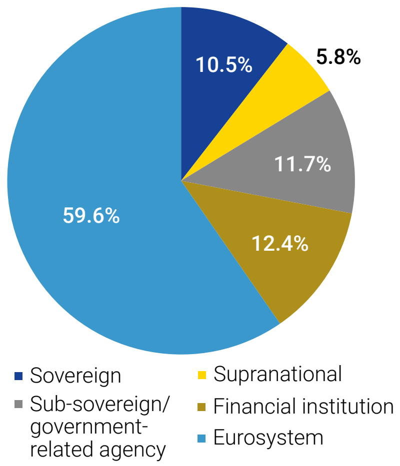
In 2019, the ESM decided to sign the UN-PRI, joining more than 2,000 investors from over 50 countries. The UN-PRI encourages institutional investors to consider ESG issues in investment decisions. By becoming a UN-PRI signatory, the ESM demonstrates its commitment to responsible investment. The ESM intends to apply ESG criteria to its investments while still ensuring ESM's creditworthiness and liquidity.

Figure 14
Ratings distribution of investments



Source: ESM

Figure 15
Asset class distribution of investments



Source: ESM

In 2019, entities, such as governments, public agencies, and supranationals with a significant social and environmental contribution accounted for 69% of the €34 billion ESM invested capital (excluding cash). Out of these investments, for the first time, more than €1 billion have a targeted purpose such as the financing of social housing or environmental projects, more than double the €475 million invested at the end of 2018.

For more information, see ESM: committed to environmental, social, and governance matters.

"Responsible investments are an important driver of global change. By incorporating ESG criteria into our investment approach we help contribute to a better world for future generations."

CARLOS MARTINS
Investment and Treasury
European Stability Mechanism

Risk Management

- The Risk Management division ('Risk') maintained effective control of financial and non-financial risks in line with the BoD's risk appetite.
- Risk reinforced its risk framework given rising global threats.
- ESM strengthened risk governance, raising the Chief Risk Officer's position to management board level.
- ESM restructured BoD-approved risk policies to improve efficiency and transparency and adapt to developing risk and business strategies.

In 2019, the ESM and its Members faced heightened global risks including persistent slow global growth due to US–China trade tensions and uncertainty over the UK exit from the EU. Former programme countries were resilient to these challenges as improvements in sovereign credit ratings, among other things, demonstrated.

In the persistent low and negative interest rate environment, the ESM continued to pass on low-interest funding costs on its loans to Members However, low and negative interest rates on highly liquid, high credit quality, eligible investments resulted in negative investment returns. In addition to its prudent investment strategies, the ESM implemented a hold-to-maturity strategy that enabled investments in longer maturity assets with positive yields while still maintaining prudent risk standards.

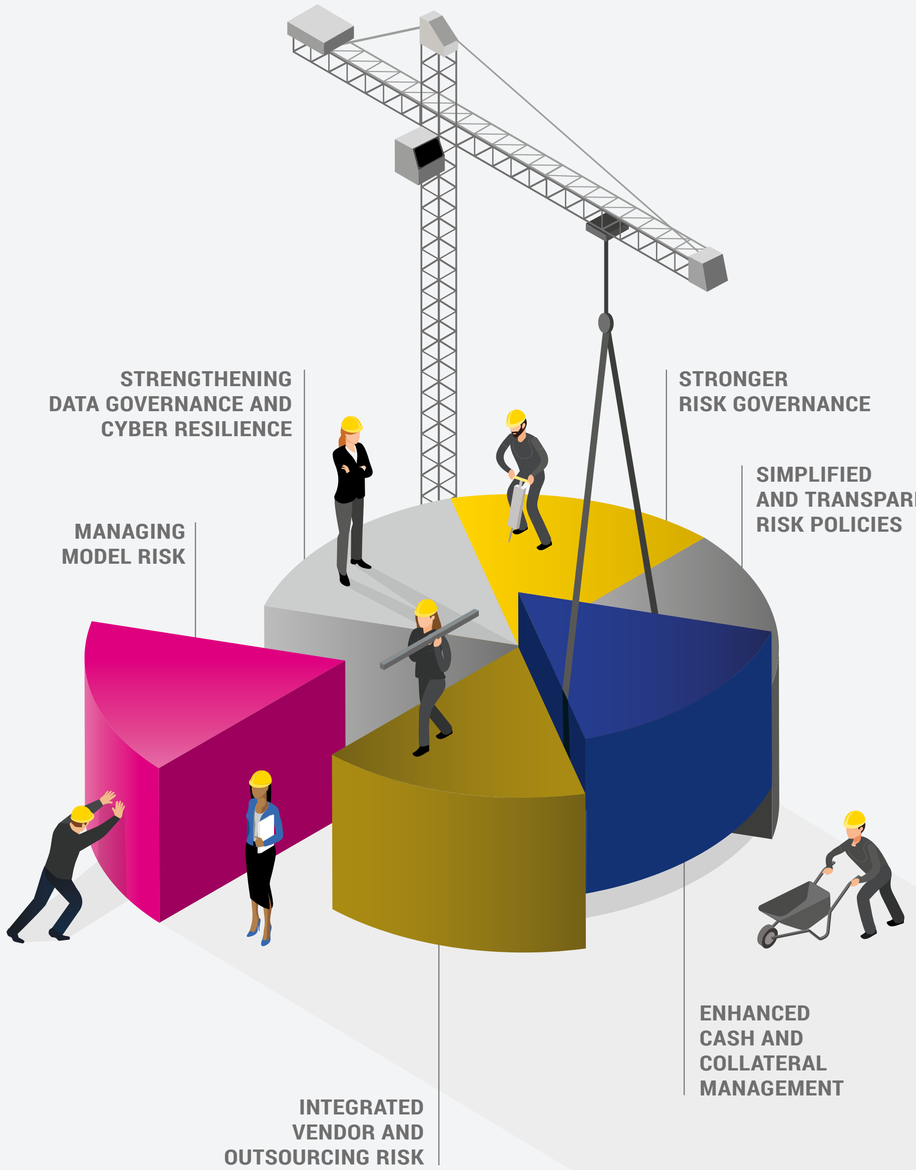
To support ESM Members, and consistent with the ESM's financial stability mandate, Risk provides technical support, as required, in the context of the ESM's Technical Assistance programmes. In 2019, as part of the ESM-wide Technical Assistance for Greece, Risk contributed to the technical assistance for Greece's Public Debt Management Agency to further develop its risk framework and facilitate and support its debt issuances.

In addition, Risk constantly seeks collaboration opportunities with international financial institution (IFI) peers on risk management matters. Risk staff participated in the annual IFI Operational Risk Forum – European Chapter for the fifth consecutive year. Institutions exchanged views and best practices on risk appetite, key risk indicators, and emerging risks. Risk regularly invites speakers and holds trainings/seminars with all internal teams to increase awareness of risks and reinforce the importance of staff members' role in managing risk.

"ESG factors play an important role in ESM risk management when assessing and reviewing issuers and counterparties. The risk management team continues to embed ESG factors in the risk management framework consistent with ESM's ESG corporate and investment strategies for the benefit of ESM Members including future generations."

CRAIG HEPPLESTON
Risk management
European Stability Mechanism

ESM reinforces risk framework



Stronger risk governance. As part of the organisational changes in September 2019, the ESM raised the Chief Risk Officer's position to the management board level. In addition, the Compliance function merged with the now Legal and Compliance division to enhance synergies across these areas.

These changes were consistent with the three lines of defence governance model the ESM follows, which sets out clearly drawn lines of authority and appropriate segregation of powers and duties for risk management.

Simplified and transparent risk policies. The BoD is accountable for the adequacy of the ESM risk management framework. In 2019, the ESM restructured and combined its two main risk management policies into a single ESM High Level Risk Policy, which has been made public to enhance ESM's transparency and accountability to stakeholders. This new simplified risk framework is more efficient to review and maintain in line with industry best practice and evolving ESM business and risk strategies, and it enhances ESM responsiveness to changing business and risk conditions including in times of crisis.

The ESM modified other risk policies and procedures, where appropriate, during the year to support new business strategies, such as the hold-to-maturity investments. The policies will continue to develop as the ESM moves towards implementing its proposed new mandate as backstop to the SRF.

Another important on-going area of development is the incorporation of ESG policies within the risk framework, in line with the ESM's wider corporate policy. For more information, see ESM: committed to environmental, social, and governance matters.

Enhanced cash and collateral management. The ESM undertakes derivative transactions to manage risk. To reduce related hedging and funding costs, it enters into two-way collateral agreements with, for example, banks. These agreements strongly mitigate credit risk, but they also generate liquidity risk since the ESM must always ensure it has sufficient liquid assets/cash collateral at hand to deliver to the counterparties when required. Risk, together with the business areas, has developed ESM's collateral management with forecasts of potential needs.

Integrated vendor and outsourcing risk. To mitigate the risk that a service provider fails to perform adequately, the ESM bolstered its outsourcing risk framework to include an enhanced credit risk assessment of candidate providers for key services. If selected, the ESM monitors their financial strength during the life of the service contract under the oversight of the ESM's Sourcing Committee and Internal Risk Committee.

Managing model risk is an increasingly important element in ESM's management of risks as its operations become more complex and greater reliance is placed on internal models to assist decision making. Model risk can result in loss or reputational damage if decisions are based on incorrect or misused models. To enhance its management of this risk, the ESM established a Model Validation policy that provides a framework for the identification and ownership of business critical models and for an independent risk assessment and validation of the integrity of these models and their outputs.

Strengthening data governance and cyber resilience. The ESM is enhancing its data governance framework to improve quality, usability, integrity, and security of data. Building effective governance around data is essential for improving resilience to cyber threats.

The ESM has reinforced its defences against cybersecurity risk. IT Security Audit, Risk, and IT Security operations form multiple layers of defence. Early warning indicators, regular security assessments, machine learning-based user behaviour analytics, security incident management, and staff security awareness are important enablers of operational security. Zero cybersecurity-risk cannot be guaranteed, but timely, appropriate reaction can. The ESM, therefore, promotes cybersecurity best practices in its governance and business processes.

“We see the work in the ESG area inextricably linked to the mission of the ESM, and human resources management as a critical function to innovate and implement more modern ‘S’ practices. We continuously develop and review our HR policies and practices to grow our staff and create positive social change in the workplace.”

LAURE SALDUCCI
Human resources and Organisation
European Stability Mechanism

Transparency and accountability

The ESM's robust governance framework ensures strong accountability and transparency. Euro area finance ministers form the ESM's BoG, its highest decision-making body, and represent ESM Members' democratically elected governments. National parliamentary procedures, sometimes required by ESM Members before approving ESM decisions, make the ESM also indirectly accountable to parliaments.

The ESM provides extensive information on its operations and financial assistance programmes by regularly publishing programme-related BoG and BoD meeting documents on its website. Following the Eurogroup's decision of 13 September 2019 to review its transparency policy, in 2020 the ESM also expanded the publicly available information related to the work of its decision-making bodies.

To enhance the transparency and evaluability of its work, in October 2019, the ESM rolled out on its website a comprehensive, interactive database with comparable data related to all EFSF and ESM financial assistance programmes to date. The database includes dashboards with detailed lending information, conditionality, and economic indicators for each of the countries that benefitted from the ESM and EFSF financial support programmes. For more information, see visualising ESM and EFSF programmes.

The ESM website also contains ample information on the ongoing ESM reform process. Since June 2019, the ESM has published the main draft documents that comprise the ESM reform package, including the draft revised ESM Treaty.

The ESM's evaluation activities represent another important element of its accountability framework. At the Annual Meeting on 13 June 2019, the ESM BoG approved the Terms of Reference for the evaluation of financial assistance provided to Greece, led by a high-level independent evaluator, Joaquín Almunia. The evaluation's objective is to enhance the relevance and effectiveness of the ESM's programme-related activities and to support informed future policy decision-making. The report with the conclusions and recommendations of this second evaluation is available to the ESM BoG and the public from June 2020.

The independent BoA has a full public audit mandate and provides extensive audit oversight, underpinning the ESM's accountability. The BoA's annual report to the BoG, accompanied by the ESM management comments issued in response, are made available to the national parliaments and supreme audit institutions of the ESM Members, the European Parliament, and the European Court of Auditors. The report, along with the ESM management comments, are also available to the public on the ESM website.

"The ESM's programme database, its history book: *Safeguarding the euro in times of crisis: the inside story of the ESM*, and the second independent programme evaluation all testify to the importance the ESM as a public institution places on transparency and its efforts to make all relevant information accessible."

SHARMAN ESAREY
Communications
European Stability Mechanism

To increase the familiarity of the public with the ESM's work, in 2019 the ESM's Managing Director and senior staff members spoke at nearly 100 conferences, seminars, and academic gatherings across Europe and beyond. ESM researchers explored mandate-related topics in publically available series of working and discussion papers. The ESM also published a history of the rescue fund's establishment against the backdrop of the crisis, *Safeguarding the euro in times of crisis: the inside story of the ESM*. The ESM welcomed 19 international visitor and student groups and continued its ongoing dialogue with the media.

The ESM Managing Director engaged throughout the year with national parliaments. The Managing Director spoke, for example, at the inter-parliamentary conference on Stability, Economic Coordination and Governance in the European Union that took place in Helsinki on 30 September 2019. In addition, he meets periodically with the European Parliament and its Economic and Monetary Affairs Committee.

Ten years of rescue funds

The euro area overcame the sovereign debt crisis by progressively building up a framework for financial assistance, emerging from that trial fortified and fitter than ever before. The cornerstone achievement was the foundation of first the temporary, then the permanent, rescue fund. Over 10 years, the euro area framework evolved from an ad hoc solution towards an institutionalised architecture, eventually maturing into the ESM as a permanent institution. With this, the euro area countries that joined forces to launch the euro made it clear that they would also stand together to defend it.

When the crisis struck, the euro area was ill-prepared, lacking collective tools to combat it. While the EU had established a medium-term financial assistance facility for Member States' balance of payments needs (the EU BoP facility) in 1988, its use was, with the entry into force of the Maastricht Treaty, restricted to non-euro area Member States. The euro area's first financial assistance, therefore, came in the form of coordinated bilateral loans for Greece in May 2010. The euro area members committed €80 billion under the GLF, complemented by €30 billion from the IMF. Though the euro area mobilised resources quickly, thanks to pooling bilateral loans, country-specific issues emerged. Ireland and Portugal stepped back from the collective effort after requesting assistance themselves, while the Slovak national parliament opted not to participate.

In parallel, EU and euro area members started to erect a sturdier structure for crisis management that would simultaneously deliver more efficient assistance and reassure markets that Europe would address the crisis resolutely. In May 2010, the EU Member States established the European Financial Stabilisation Mechanism (EFSM), an emergency fund backed by the EU budget. A month later, the euro area members established the temporary rescue fund, the EFSF.

The approach to providing financial assistance under the EFSM was inspired by the EU's BoP facility, allowing the European Commission to borrow on the financial markets on behalf of the EU, passing on the related debt service costs to the beneficiary Members. However, unlike the EU BoP facility, it was also available to euro area member states.

The EFSM provided a multilateral financial assistance framework with a relatively small €60 billion lending capacity. It was first used to disburse a cumulative €46.8 billion in assistance to Ireland and Portugal, and was not called upon again until July 2015, when it provided a short-term €7.16 billion bridge financing to Greece.

The EFSF disbursed €187.6 billion in assistance to Ireland, Greece, and Portugal from 2011 to 2013. The fund's set-up represented a key political achievement, nevertheless it suffered from a number of shortcomings that hampered its effectiveness. For example, it was conceived as a temporary, three-year body; it was to be liquidated on the earliest date after 30 June 2013 on which there was no longer outstanding financial assistance.

With €440 billion in firepower, its effectiveness as a lender was dependent on maintaining the highest possible rating, achieved through a guarantee-backed lending capacity based on its highly rated guarantors. But when one of those guarantors was downgraded, the EFSF confronted a challenge in its funding approach.

Initially, the EFSF could provide assistance only through back-to-back loans, selling debt whose proceeds would then be disbursed to a specific country. As the time between request and disbursement was often short, the process of mobilising the necessary financing could be inefficient. To increase operational flexibility, the fund broadened its lending toolkit and moved to a diversified funding strategy, which enabled it to pool its funding and take greater advantage of market opportunities. In addition to loans, the new lending toolkit provided a possibility to grant assistance through precautionary credit lines, primary and secondary market purchases of sovereign debt securities, and to deliver sectoral support through indirect recapitalisation of financial institutions.

On 8 October 2012, roughly two years after the European Council agreed to establish a permanent crisis resolution mechanism, the euro area members founded the ESM – an IFI with €500 billion in lending capacity. The ESM inherited its lending toolkit from the EFSF, adding in 2014 an instrument to recapitalise banks directly. From July 2013, the ESM replaced the temporary EFSF, which no longer finances new programmes though it continues managing its outstanding loan portfolio. From 2012 to 2018, the ESM provided €109.6 billion in financial assistance loans to Greece, Spain, and Cyprus, including an indirect recapitalisation of the Spanish banking sector.

The ESM reinforced the euro area crisis management architecture in several ways, most importantly through a more robust institutional and capital structure. Established under international public law, it was endowed with

a governance structure similar to that of other international financial organisations. Unlike the EFSF, ESM debt is not rerouted to the euro area member states, and it enjoys a preferred creditor status on its loans junior only to the IMF. It benefits from a strong capital base, given its €700 billion of subscribed capital, of which €80.55 billion is paid-in. It also has a strong framework for using callable capital. These characteristics enabled the ESM to become one of the largest supranational issuers.

The steps to establish the euro area crisis management architecture drew legal scrutiny at European and national courts. While national courts assessed the constitutionality of the crisis resolution mechanisms from a domestic perspective, particularly in relation to sovereign budgetary autonomy, the Court of Justice of the European Union examined the compatibility with EU law of the mechanisms established outside the Union framework. All the assessments ended with overall positive conclusions.

With the ability to make long-term financing available at favourable rates, the regional firewalls were instrumental in securing the integrity of the euro area. Conditionality remains an underlying principle of European crisis lending. The IMF played an important role in supporting the euro area members in difficulties, though its financial role diminished with time as the European crisis management architecture took shape.

The ESM established itself as an effective crisis resolution body, well integrated in the multi-layered global financial safety net. Emblematic of the euro area's commitment to both combatting future crises and sustaining its single currency, policymakers recognised the ESM's role in delivering timely stability support, deciding to grant the rescue fund an enhanced crisis resolution mandate. The ESM will assume a stronger role in managing future programmes and will follow and assess the macroeconomic and financial situation of its members, where relevant in order to internally prepare and enable it to appropriately and in a timely manner pursue the tasks conferred on it by the revised Treaty to ensure better crisis preparedness. Policymakers also reviewed the adequacy of the ESM lending toolkit, enhancing the effectiveness of the precautionary credit lines and replacing the direct recapitalisation instrument for banks with a new SRB backstop facility. For more information, see ESM reform and treaty change.

03 Institutional framework and organisation

The financial assistance toolkit of the ESM

The ESM has a number of financial assistance instruments at its disposal to fulfil its mission, though it has only used two to-date. The ESM grants its financial assistance in exchange for measures to address underlying economic and financial vulnerabilities.

In December 2019, the Eurogroup reached an agreement in principle, subject to the conclusion of national procedures, on the ESM reform package. Under this agreement, the ESM will assume an enhanced role in programmes, effectiveness of the precautionary credit lines will be enhanced, and the direct recapitalisation instrument will be replaced by the common backstop at the time it is introduced. The agreed changes will take effect once the Amending Agreement to the ESM Treaty has entered into force. For more information, see ESM reform and treaty change.

ESM loans

Goal: to assist ESM Members in significant need of financing, and which have impaired access to capital markets, either because they cannot find lenders or because the financing costs are so high it would undermine the sustainability of public finances.

Conditional upon: the implementation of macroeconomic reform programmes.

Used: in Ireland and Portugal (EFSF), in Greece (EFSF and ESM), and in Cyprus (ESM).

Loans for indirect bank recapitalisation

Goal: to assist an ESM Member by addressing those cases where the financial sector is primarily at the root of a crisis.

Conditional upon: measures to address financial stability concerns in the banking sector.

Used: in Spain (ESM).

"It has always been important for us to conduct our activities in a conscientious manner. In the context of our ESG efforts, we have worked towards becoming more transparent on our internal practices, for example, in the area of anti-money laundering and corruption prevention as well as the protection of personal data."

ÉVA KINCZER
Legal and Compliance
European Stability Mechanism

Precautionary credit line

Goal: to prevent crises from emerging or developing, by helping countries whose economic conditions are still sound to maintain market access by strengthening the credibility of their macroeconomic performance.

There are two types of credit lines:

A precautionary conditioned credit line (PCCL) is available to an ESM Member whose economic and financial situation is fundamentally sound, subject to the pre-established eligibility criteria.

An enhanced conditions credit line (ECCL) is available to an ESM Member that does not comply with some of the eligibility criteria required for accessing a PCCL but whose general economic and financial situation remains sound.

Used: no.

Secondary market purchases

Goal: to support the sound functioning of the government debt market when a lack of liquidity threatens the financial stability of an ESM Member whose economic and financial situation otherwise remains sound. This instrument can be used within or outside a macroeconomic adjustment programme.

Conditional upon: specific policy conditions apply for countries not under a programme.

Used: no.

Primary market purchases

Goal: to support an ESM Member's bond auction, the ESM may buy debt securities at market prices in the primary market, in other words directly from the issuing ESM Members.

Conditional upon: no conditionality beyond the underlying programme, as this tool complements a regular loan instrument or a precautionary programme.

Used: no.

Direct recapitalisation of financial institutions (DRI)

Goal: to help remove a serious risk of contagion from the financial sector to the sovereign. The total amount available for this instrument is limited to €60 billion and can only be used for systemically important financial institutions, as defined in the relevant EU legislation.

Conditional upon: measures to address the sources of difficulties in the financial sector and, where appropriate, the general economic situation of the country. Eligible financial institutions are those that, for example, are unable to attract sufficient capital from the private sector and for which existing burden-sharing arrangements on bank recapitalisation, restructuring, and resolution, in particular the bail-in requirements according to Article 27 of the Single Resolution Mechanism regulation, are insufficient.

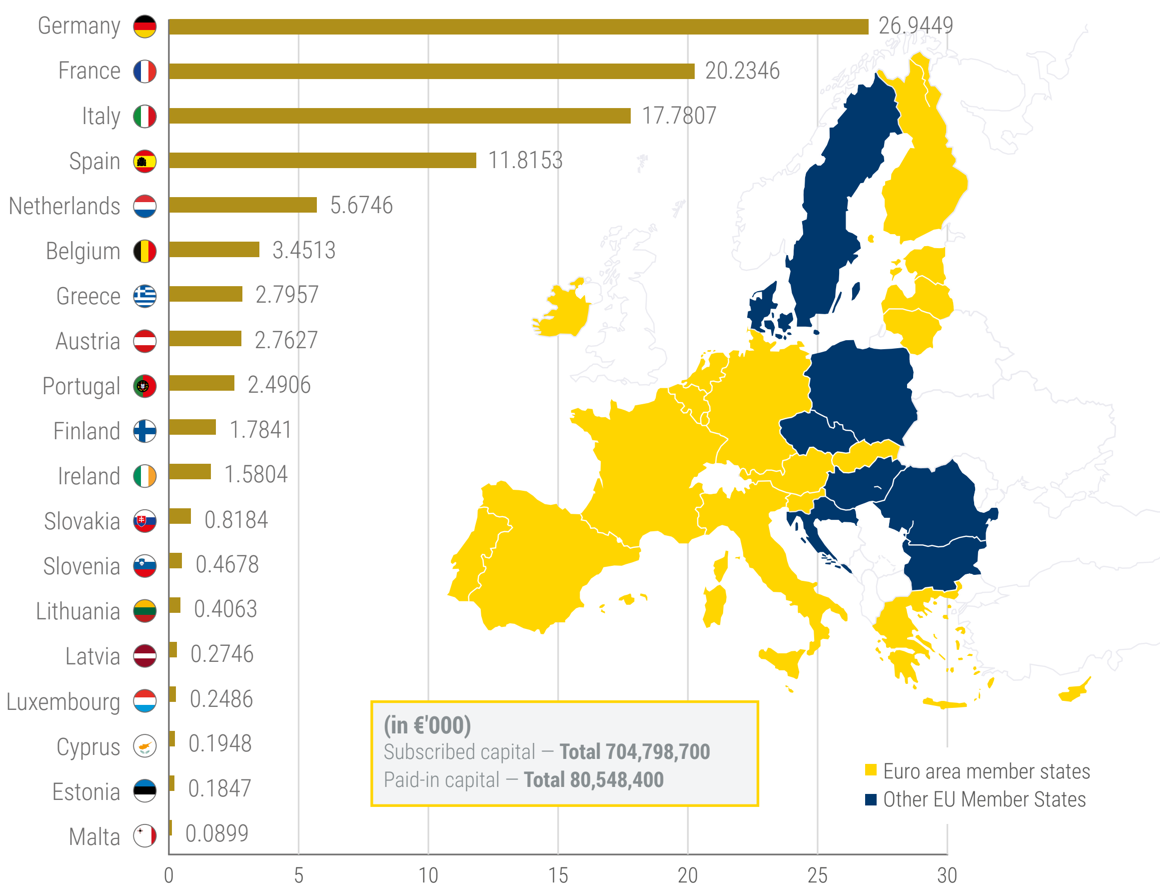
Used: no.

Governance

ESM shareholders

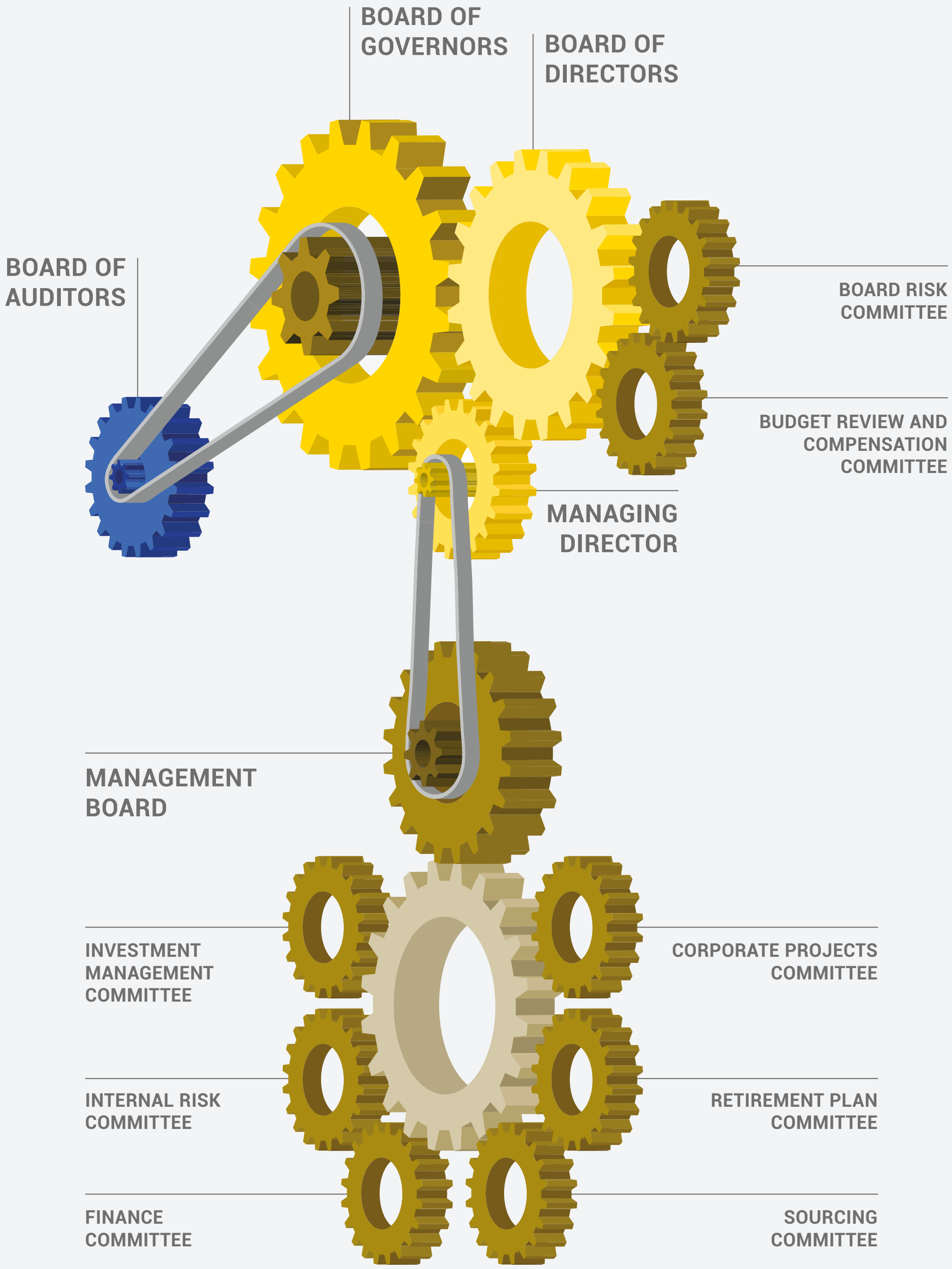
The ESM shareholders are the 19 euro area member states that are also referred to as ESM Members. Each Member has contributed to the ESM's authorised capital based on the ESM Members' respective shares of the EU's total population and GDP. The authorised capital amounts to €704.8 billion and is divided into paid-in and callable capital. The paid-in capital currently stands at €80.55 billion.

ESM contribution key (in %)*



Note: As at 30 April 2020.
Source: ESM
*The accession of new ESM Members is factored into the capital key, reducing the existing ESM Members' contribution keys. Individual nominal capital subscriptions and paid-in capital amounts remain unchanged for the existing ESM Members. In line with Article 42 of the ESM Treaty, ESM Members with GDP per capita of less than 75% of the EU average in the year immediately preceding their ESM accession benefit from a temporary correction mechanism. During this period, the initial capital subscription of the ESM Member benefitting from the correction is lower, thus leading temporarily to a lower paid-in capital contribution. Once this period ends, the ESM Member must deposit the remaining amount. Most recently, Malta's temporary correction period expired on 1 January 2020, and Malta deposited the remaining paid-in capital contribution. Slovakia, Estonia, Latvia, and Lithuania are currently benefitting from temporary corrections, the last of which concludes at the end of 2026.

Governance structure



The BoG meets at least once a year and whenever the affairs of the ESM so require (twice in 2019). The BoD also meets whenever the affairs of the ESM so require (nine times in 2019), while the Board Risk Committee and the Budget Review and Compensation Committee normally meet quarterly and additionally when required.

For more information, visit our website.

Board of Governors

Annual Meeting of the Board of Governors

ESM Managing Director Klaus Regling (left) and Eurogroup President Mário Centeno (right) field media questions ahead of the seventh annual Board of Governors meeting at the ESM premises in Luxembourg on 13 June 2019.

On 13 June 2019, the BoG held its seventh annual meeting at the ESM premises in Luxembourg.

In his presentation to the BoG, the Managing Director highlighted the key achievements of the ESM during the past year, including its funding operations, investment and lending activities, and institutional developments.

In addition, the Chairperson of the BoA addressed the Governors with regard to the BoA's annual report to the BoG as well as the BoA's report in respect of the ESM 2018 financial statements. Furthermore, the external auditor presented its report in respect of the audit of the ESM 2018 financial statements.

At this meeting, the BoG also approved the *ESM 2018 Annual Report* as drawn up by the ESM Managing Director.

Members of the Board of Governors

Mário Centeno
Chairperson of the Board of Governors since 13 January 2018,
Minister of Finance,
Governor since 26 November 2015

Portugal

Christos Staikouras
Minister of Finance,
Governor since 11 July 2019
- replacing Euclid Tsakalotos, Governor since 6 July 2015

Greece

Alexander De Croo
Deputy Prime Minister, Minister of Finance and Development Cooperation,
Governor since 11 December 2018

Belgium

Nadia Calviño
Vice-President and Minister of Economic Affairs and Digital Transformation,
Governor since 7 June 2018

Spain

Olaf Scholz
Federal Minister of Finance,
Governor since 14 March 2018

Germany

Bruno Le Maire
Minister of Economy and Finance,
Governor since 25 May 2017

France

Martin Helme
Minister of Finance,
Governor since 29 April 2019
- replacing Toomas Tõniste, Governor since 12 June 2017

Estonia

Roberto Gualtieri
Minister of Economy and Finance,
Governor since 5 September 2019
- replacing Giovanni Tria, Governor since 1 June 2018

Italy

Paschal Donohoe
Minister of Finance and Public Expenditure and Reform,
Governor since 15 June 2017

Ireland

Constantinos Petrides
Minister of Finance,
Governor since 3 December 2019
- replacing Harris Georgiades, Governor since 3 April 2013

Cyprus

Latvia

Jānis Reirs
Minister of Finance,
Governor since 19 February 2019
- replacing Dana Reizniece-Ozola, Governor since 22 March 2016

Austria

Gernot Blümel
Minister of Finance,
Governor since 4 February 2020
- replacing Eduard Müller, Governor since 15 August 2019
- replacing Hartwig Löger, Governor since 26 January 2018

Lithuania

Vilius Šapoka
Minister of Finance,
Governor since 13 December 2016

Slovenia

Andrej Šircelj
Minister of Finance,
Governor since 13 March 2020
- replacing Andrej Bertoncelj, Governor since 13 September 2018

Luxembourg

Pierre Gramegna
Minister of Finance,
Governor since 4 December 2013

Slovakia

Eduard Heger
Deputy Prime Minister, Minister of Finance,
Governor since 21 March 2020
- replacing Ladislav Kamenický, Governor since 7 May 2019
- replacing Peter Kažimír, Governor since 27 September 2012

Malta

Edward Scicluna
Minister of Finance,
Governor since 13 March 2013

Finland

Katri Kulmuni
Minister of Finance,
Governor since 19 December 2019
- replacing Petteri Orpo, Governor since 29 June 2016

Netherlands

Wopke Hoekstra
Minister of Finance,
Governor since 26 October 2017

Shareholder engagement

The ESM strives to maintain productive and effective shareholder relations in order to fulfil its mandate while remaining fully accountable to its Members.

In 2019, the ESM launched an initiative to nurture the relationship with its shareholders through a series of outreach seminars held in cooperation with ESM Members to provide a more comprehensive overview of the ESM's range of activities. The ESM organised the first seminar in Madrid in July 2019. Since then, other Members have expressed an interest in co-organising other such events.

In 2019, the ESM also organised its sixth annual Shareholders' Day, which once again brought together representatives from all 19 ESM Members, who work in their respective ministries of finance on ESM-related matters, as well as representatives from the European Commission and the Eurogroup Working Group Secretariat. The event focused on cross-departmental themes covering both ESM past achievements and future challenges. The majority of the 2019 participants attended for the first time and said they gained useful insight into a wide range of ESM activities. The agenda covered the ESM's role in safeguarding the euro, the new public programme database providing comparable information on all EFSF and ESM financial assistance programmes, as well as the ESM's efforts in applying the highest ESG standards to its internal operations. The ESM also introduced the participants to the ongoing independent evaluation of the Greek programmes—and the importance of such evaluations in improving future programmes.

To discuss relevant matters, the ESM also participates in various forums where its shareholders are represented, such as the Eurogroup, the Eurogroup Working Group, and the Task Force on Coordinated Action.

Board of Directors

Members of the Board of Directors

CHAIR OF THE MEETINGS OF THE BOARD OF DIRECTORS

Klaus Regling

ESM Managing Director

Ireland

Gary Tobin

Assistant Secretary General, International & EU Division, Department of Finance, appointed on 8 July 2019
- replacing Nicholas O'Brien, appointed on 3 July 2014

Belgium

Steven Costers

Counselor General, Ministry of Finance, appointed on 1 May 2015

Greece

Michael Arghyrou

Chairman of the Council of Economic Advisors, appointed on 22 July 2019
- replacing George Chouliarakis, appointed on 4 February 2015

Germany

Jörg Kukies

State Secretary, Federal Ministry of Finance, appointed on 9 April 2018
- Member of the Budget Review and Compensation Committee since 14 May 2018, appointed until 8 October 2020

Spain

Carlos San Basilio

Secretary General of the Treasury and International Financing, Ministry of Economic Affairs and Digital Transformation, appointed on 19 June 2018
- Member of the Budget Review and Compensation Committee since 13 July 2018, appointed until 8 October 2020

Estonia

Märten Ross

Deputy Secretary General for Financial Policy and External Relations, Ministry of Finance, appointed on 21 October 2013

France

Odile Renaud Basso

Director General of the Treasury, Ministry of Finance and Public Accounts, appointed on 30 June 2016
- Member of the Board Risk Committee since 10 February 2017, reappointed until 8 October 2020

Italy

Alessandro Rivera

Director General of the Treasury, Ministry of Economy and Finance,
appointed on 27 July 2018
- Member of the Board Risk Committee since 20 September 2018, appointed until 8 October 2021

Malta

Alfred Camilleri

Permanent Secretary, Ministry of Finance, appointed on 8 October 2012
- Member of the Budget Review and Compensation Committee since 9 October 2012, reappointed until 8 October 2022
- Chairperson of the Budget Review and Compensation Committee since 24 April 2014, reappointed until 8 October 2022

Cyprus

George Panteli

Director of the Economic Research and European Union Affairs Directorate, Ministry of Finance,
appointed on 29 April 2013

Netherlands

Christiaan Rebergen

Treasurer-General, Ministry of Finance, appointed on 6 June 2018
- Member of the Budget Review and Compensation Committee since 5 September 2019, reappointed until 8 October 2022

Latvia

Līga Kļaviņa

Deputy State Secretary, Ministry of Finance, appointed on 30 January 2015

Austria

Harald Waiglein

Director General for Economic Policy, Financial Markets and Customs Duties, Federal Ministry of Finance,
appointed on 8 October 2012
- Member of the Board Risk Committee since 9 October 2012, reappointed until 8 October 2022
- Chairperson of the Board Risk Committee since 8 June 2018

Lithuania

Miglė Tuskienė

Vice-Minister, Ministry of Finance, appointed on 4 March 2015

Portugal

Ricardo Mourinho Félix

Deputy Finance Minister and Secretary of State for Finance, Ministry of Finance, appointed on 7 December 2015
- Member of the Board Risk Committee since 7 April 2016, reappointed until 8 October 2022

Luxembourg

Nima Ahmadzadeh

Director of Economic and Fiscal Affairs, Ministry of Finance,
appointed on 26 July 2019
- Replacing Isabelle Goubin, appointed on 19 March 2014
- Member of the Budget Review and Compensation Committee until 8 October 2021

Slovenia

Katja Lautar

Head of Office for Fiscal and Economic Policy, Ministry of Finance,
appointed on 19 February 2019
- replacing Gorazd Renčelj, appointed on 10 February 2017

Slovakia

Peter Paluš

Head of Financial Unit at Permanent Representation of Slovakia to the European Union,
appointed on 22 February 2017
- Member of the Board Risk Committee since 8 February 2018, appointed until 8 October 2020

Finland

Marketta Henriksson

Director of the Secretariat for EU Affairs at the Ministry of Finance,
appointed on 28 February 2020
- replacing Tuomas Saarenheimo, appointed on 12 September 2013

"Diversity and inclusion are core ESM values. We continuously work towards making the ESM a more inclusive workplace. As part of this effort, we organised a series of topical events in 2019 and have begun further defining our diversity and inclusion strategy, which we will start implementing in 2020."

CAROLINA ORGAZ
Middle and Back Office,
ESM Diversity and Inclusion values group member
European Stability Mechanism

Board of Auditors

The Board of Auditors (BoA) is an independent oversight body of the ESM. It inspects the ESM accounts and verifies that the operational accounts and the balance sheet are in order. It also audits the regularity, compliance, performance, and risk management of the ESM in accordance with international auditing standards and monitors the ESM internal and external audit processes and their results.

The BoA is composed of five members appointed by the BoG in line with Article 24 of the By-Laws. New members of the BoA are appointed for a non-renewable term of three years.

In 2019, the BoA held seven meetings at the ESM premises. During these meetings, ESM management and senior staff updated the BoA on ESM activities, the decisions of the ESM governing bodies, and other relevant issues and developments. The BoA met regularly with the internal audit function, and monitored and reviewed the work of the external auditors. In addition, the Chairperson of the BoA met once with the ESM BoD. Furthermore, the Chairperson of the BoA met with the Chairperson of the BoG and attended the Annual Meeting of the BoG to discuss the work and views of the BoA.

During the year, the BoA decided to undertake an audit of the ESM internal committees with the support of subject matter experts from the Maltese National Audit Office. The audit will be finalised in the second half of 2020. In fulfilling its role, the BoA also reviewed the ESM 2019 Financial Statements and the working papers of the external auditor.

In addition to its annual report in respect of the ESM financial statements, which is included in the ESM annual report, the BoA also draws up an annual report to the BoG, which summarises its audit work and its recommendations for the respective year.

The BoA's annual report, together with the ESM management comments in response to the report, are made available to the national parliaments, the supreme audit institutions of the ESM Members, the European Parliament, and the European Court of Auditors. The public can access these documents on the ESM website.

Members of the Board of Auditors

Baudilio Tomé Muguruza

Member since 17 December 2019 to 16 December 2022
Appointed upon nomination by the European Court of Auditors
-replacing Kevin Cardiff, Member since 17 December 2016 to 16 December 2019, appointed by the European Court of Auditors

Ilias Dimitriadis

Member since 8 October 2019 to 7 October 2022
Appointed upon nomination by the Greek Supreme Audit Institution
-replacing François-Roger Cazala, Member since 8 October 2016 to 7 October 2019, appointed upon nomination by the French Supreme Audit Institution

Tommaso Fabi

Member since 1 April to 31 March 2022
Appointed upon proposal of the Chairperson of the BoG
-replacing Günter Borgel, Member since 1 April 2016 to 31 March 2019, appointed upon proposal of the Chairperson of the BoG

Noel Camilleri

Member since 8 October 2018 to 7 October 2021
Appointed upon nomination by the Supreme Audit Institution of Malta

Irena Petruškevičienė

Member since 8 October 2018 to 7 October 2021
Appointed upon proposal of the Chairperson of the BoG

Note: In line with Article 24 of the By-Laws, two members are appointed upon proposal of the Chairperson of the BoG, two members upon nomination by the supreme audit institutions of the ESM Members based on a system of rotation, and one member by the European Court of Auditors.

Internal control framework

The ESM internal control framework is embedded in the ESM's daily operations and reflects the nature, complexity, and risks inherent in ESM activities. The ESM internal controls are underpinned by the three lines of defence governance model established by the BoD and are aligned with the principles of the Basel Committee's Framework for Internal Control Systems in Banking Organisations.[11]

[11] Framework for Internal Control Systems in Banking Organisations, Basel Committee on Banking Supervision, Basel, September 1998.

ENTITY-LEVEL CONTROLS

Include management oversight and control culture, risk recognition and assessment, reliable information systems, availability of information relevant to decision making, and processes for monitoring and correcting deficiencies.

PROCESS-LEVEL CONTROLS

Include operational controls embedded in key processes and transactions.

INFORMATION TECHNOLOGY (IT) CONTROLS

Include IT general controls over the IT environment, computer operations, access to programmes and data, programme development, change management, IT security, and IT application controls embedded in ESM systems.

"Staff representatives are a key element of our internal governance. The ESM has three elected staff representatives, who, for example, solicit staff views, channel concerns to management, and provide input and review staff-related policies. As part of our ESG efforts, we are currently developing our rules of procedure, further detailing our precise role, responsibilities, and governance framework."

SHARON BOWMAN
Business Strategy and Project Management, Staff representative
European Stability Mechanism

The Managing Director, under the direction of the BoD, is responsible for the ongoing maintenance of the ESM internal control framework. Assisted by the Management Board, the Managing Director sets a strong tone from the top and oversees internal controls across all areas of the ESM. Each year, the Managing Director issues a management report on the state of internal controls to the BoD (via the Board Risk Committee) and the BoA. The management report on the state of internal controls as of 31 December 2019 does not indicate material or significant internal control weaknesses.

Internal audit provides an independent assurance on the established internal controls and procedures as part of the regular audit cycle. Internal audit independently reviews the entity-level controls and IT application controls on an annual basis.

The external auditor gains a sufficient understanding of ESM internal controls to provide reasonable assurance on the ESM's financial statements.

There are inherent limitations to the effectiveness of any system of internal controls, including the possibility of human error or circumvention of overriding controls. Therefore, even an effective internal control framework can provide only reasonable assurance.

ESM organisational structure

In September 2019, the ESM began a two-step management reorganisation to ensure a more efficient structure and enhance synergies across an organisation that has grown rapidly both in number of staff and tasks since its establishment in 2012. Further moves will follow in 2020. The most important changes in the management structure are:

- Christophe Frankel, ESM Deputy Managing Director and Management Board member, formerly also Chief Financial Officer, assumed the role of Chief Risk Officer and, with that, the oversight of the Risk Management division. Mr Frankel handed over responsibility for the Investment and Treasury Division to the new Chief Financial Officer.

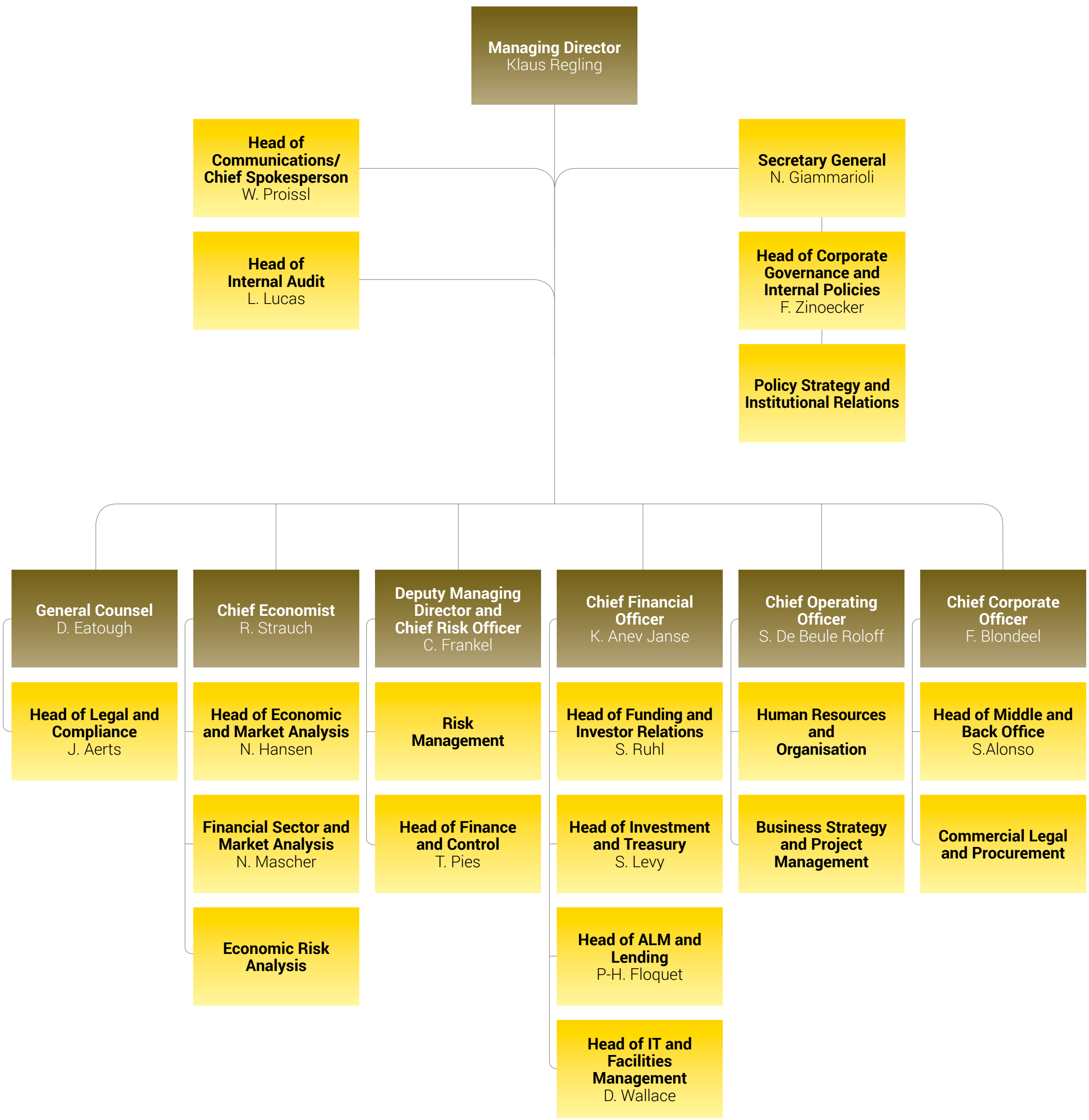
- Kalin Anev Janse, Management Board member and former Secretary General, became the Chief Financial Officer, adding oversight of the Investment and Treasury division to his tasks.

- Sofie De Beule-Roloff, formerly the Head of Human Resources, joined the Management Board as the ESM's Chief Operating Officer, and additionally took over responsibility for Business Strategy and Project Management.

- David Eatough, General Counsel and Management Board member, took over responsibility for Compliance from the Risk division.

- Nicola Giammarioli, the former Head of Policy Strategy and Institutional Relations, became the ESM's Secretary General.

ESM management board: (from left to right) Rolf Strauch, Christophe Frankel, Françoise Blondeel, Klaus Regling, Kalin Anev Janse, Sofie De Beule-Roloff, David Eatough.



Member of the Management Board

Note: As of 1 May 2020

For more information, visit our website.

04 Financial report

Balance sheet

At year-end, the total ESM balance sheet was €819.9 billion. Compared to 31 December 2018, the balance sheet increased by €12.9 billion, mainly due to a €12.0 billion increase in *Debt evidenced by certificates* in relation to the rollover for bonds that have matured and for funding cash collateral needs.

As of 31 December 2019, the total €80.5 billion of paid-in capital was invested in debt securities or held in cash. The *Debt securities including fixed-income securities* increased by €8.0 billion, compared to 31 December 2018, to €33.6 billion.

Unrealised gains or losses resulting from the valuation of the security portfolio are reflected in the *Fair value reserve* within the ESM's equity position. As of 31 December 2019, this reserve was €442.4 million, compared to €140.2 million as of 31 December 2018. The increase in the *Fair value reserve* mainly reflects the appreciation of the investment's values on the market compared to the previous year, largely due to changes in interest rates.

Profit and loss account

The ESM recorded a net income of €289.7 million for the financial year 2019, compared to €284.7 million in 2018.

The 2019 ESM net income mainly comprises the amount received from Germany and France, compensating the ESM for a part of the negative interest charged on the cash held at their national central banks in 2018. These payments, which represent €135.4 million and €102.5 million, respectively, were recorded as part of *Extraordinary income*.

The *Profit before extraordinary items*, which corresponds to the net income generated by ESM operations,[1] increased by €9.4 million to €51.7 million in 2019 from €42.3 million in 2018.

Net profit of financial operations increased by €19.5 million to €63.8 million in 2019 from €44.3 million in 2018.

Operating costs, including depreciation of fixed assets, were €73.2 million compared to €67.5 million in 2018. The increase is mainly driven by additional staff cost as well as a global increase of *Other administrative expenses*. The ESM provides administrative services to the EFSF and therefore charges it service fees of €33.1 million (€32.6 million in 2018), which are recognised as *Other operating income*. The ESM continues to focus on budgetary discipline and effective cost control.

Outlook for 2020

The ESM has actively diversified its investments and continues to look for additional measures to mitigate the impact of the negative yield environment, in line with its guidelines and its mandate. Nevertheless, the persistence of this environment will continue to affect the net income from ESM operations in 2020.

In the first months of 2020, the euro area economy deteriorated sharply, hit by the adverse impact of the Covid-19 pandemic. There is still high uncertainty about the duration and magnitude of the shock and the timing and speed of the subsequent recovery. As part of a set of global measures taken by European Commission and the ECB, the euro area also agreed, in April 2020, financial support measures during the crisis, including offering an ESM credit line to support domestic financing of direct and indirect healthcare, cure and prevention related costs due to the Covid-19 crisis. The impact of this measure on ESM net income in 2020 cannot be reliably assessed.

[1] The net income of the ESM is mainly driven by the interest margin on its lending activity and the return on the investment of its paid-in capital. The ESM Pricing Policy defines the different elements of the total cost of a loan.

Balance sheet

As at 31 December 2019 (In €'000)

	Notes	31.12.2019	31.12.2018
ASSETS			
Cash in hand, balances with central banks and post office banks	4	64,973,149	65,245,717
Loans and advances to credit institutions			
(a) other loans and advances	5	6,412,889	1,291,715
		6,412,889	1,291,715
Loans and advances to euro area Member States	6	89,894,688	89,894,688
Debt securities including fixed-income securities	7		
(a) issued by public bodies		14,637,717	8,327,012
(b) issued by other borrowers		18,932,878	17,255,918
		33,570,595	25,582,930
Intangible assets	8	18	36
Tangible assets	9	6,474	7,207
Subscribed capital unpaid	2.15/15	624,250,300	624,250,300
Subscribed capital called but not paid	2.15/15	-	65,440
Prepayments and accrued income	10	863,108	777,929
Total assets		819,971,221	807,115,962
LIABILITIES			
Amounts owed to credit institutions	11	330,950	277,202
Debts evidenced by certificates	12		
(a) debt securities in issue		110,413,094	98,393,959
		110,413,094	98,393,959
Other liabilities	13	10,824	9,503
Accruals and deferred income	14	1,336,786	1,147,623
Total liabilities		112,091,654	99,828,287
SHAREHOLDERS' EQUITY			
Subscribed capital	2.15/15	704,798,700	704,798,700
Fair value reserve	7	442,403	140,174
Reserve fund	2.7.1/16	2,348,801	2,064,053
Profit for the financial year		289,663	284,748
Total shareholders' equity		707,879,567	707,287,675
Total equity and liabilities		819,971,221	807,115,962

The accompanying notes form an integral part of these financial statements.

Off-balance sheet

As at 31 December 2019 (In €'000)

	Notes	31.12.2019	31.12.2018
OFF-BALANCE SHEET			
Other items	25		
(a) notional value of interest rate swaps			
- interest rate swaps		65,201,500	62,372,500
(b) notional value of cross-currency assets swaps			
- receivable		14,512,182	11,267,278
- payable		(14,700,791)	(11,343,989)
(c) notional value of foreign exchange swaps			
- receivable		-	484,896
- payable		-	(476,996)
(d) notional value of bond futures contracts			
- bond futures		12,500	-

The accompanying notes form an integral part of these financial statements.

Profit and loss account

For the financial year ending 31 December 2019 (In €'000)

	Notes	2019	2018
Interest receivable and similar income			
(a) on loans and advances to credit institutions		1,800	1,688
(b) on loans and advances to euro area Member States	17	1,178,881	1,189,777
(c) on debt securities including fixed-income securities	18	124,846	76,784
(d) on debts issued		116,474	102,783
(e) other	25	423,461	259,200
		1,845,462	**1,630,232**
Interest payable and similar charges			
(a) on cash and cash equivalents	19	(285,828)	(301,295)
(b) on loans to credit institutions		(21,522)	(2,450)
(c) on debts issued		(830,357)	(779,038)
(d) on debt securities including fixed-income securities	18	(10,402)	(7,880)
(e) other	25	(671,059)	(508,420)
		(1,819,168)	**(1,599,083)**
Commissions payable		**(17)**	**(19)**
Other operating income	20	**34,833**	**34,277**
Net profit on financial operations	21	**63,848**	**44,333**
General administrative expenses			
(a) staff costs	22	(32,967)	(32,431)
- wages and salaries		(24,012)	(23,419)
- social security		(8,955)	(9,012)
of which relating to pension		*(7,751)*	*(7,924)*
(b) other administrative expenses	23	(38,651)	(33,768)
		(71,618)	**(66,199)**
Value adjustments in respect of intangible and tangible assets	8/9	**(1,624)**	**(1,258)**
Profit before extraordinary items		**51,716**	**42,283**
Extraordinary income	24	**237,947**	**242,465**
Profit for the financial year		**289,663**	**284,748**

The accompanying notes form an integral part of these financial statements.

Statement of changes in equity

For the financial year ending 31 December 2019 (In €'000)

	Subscribed capital	Fair value reserve	Reserve fund	Profit brought forward	Profit for the financial year	Total
At 1 January 2018	704,798,700	99,119	1,995,465	-	68,588	706,961,872
Allocation of the profit of 2017	-	-	-	68,588	(68,588)	-
Allocation of profit brought forward to the reserve fund	-	-	68,588	(68,588)	-	-
Profit for the financial year	-	-	-	-	284,748	284,748
Change in fair value reserve	-	41,055	-	-	-	41,055
At 31 December 2018	704,798,700	140,174	2,064,053	-	284,748	707,287,675

	Subscribed capital	Fair value reserve	Reserve fund	Profit brought forward	Profit for the financial year	Total
At 1 January 2019	704,798,700	140,174	2,064,053	-	284,748	707,287,675
Allocation of the profit of 2018	-	-	-	284,748	(284,748)	-
Allocation of profit brought forward to the reserve fund	-	-	284,748	(284,748)	-	-
Profit for the financial year	-	-	-	-	289,663	289,663
Change in fair value reserve	-	302,229	-	-	-	302,229
At 31 December 2019	704,798,700	442,403	2,348,801	-	289,663	707,879,567

Statement of cash flows

For the financial year ending 31 December 2019 (In €'000)

	2019	2018
Cash flows from operating activities:		
Profit for the financial year	289,663	284,748
Adjustments for value adjustments in respect of tangible and intangible assets	1,624	1,258
Changes in tangible and intangible assets	(873)	(3,801)
Changes in other liabilities	1,321	1,015
Changes in accrued interest and interest received	(1,303,465)	(1,286,894)
Changes in prepayments	(97,199)	190,185
Changes in accruals and deferred income and interest paid	1,017,841	1,010,025
Interest received	1,315,485	1,139,613
Up-front service fee received	-	108,500
Interest paid	(828,678)	(760,478)
Net cash flow provided by operating activities	**395,719**	**684,171**
Cash flows from investing activities		
Changes in debt securities including fixed-income securities	(7,685,436)	(4,651,191)
Changes in loans and advances to credit institutions	(5,121,174)	(922,541)
Net loans disbursed during the year	-	(13,700,000)
Changes in amounts owed to credit institutions	53,748	244,602
Net cash flow used in investing activities	**(12,752,862)**	**(19,029,130)**
Cash flows from financing activities		
Payment of capital	65,440	109,680
Changes in debt securities in issue	12,019,135	9,192,876
Net cash flow provided by financing activities	**12,084,575**	**9,302,556**
Net increase/decrease in cash and cash equivalents	(272,568)	(9,042,403)
Cash and cash equivalents at the beginning of the financial year	65,245,717	74,288,120
Cash and cash equivalents at the end of the financial year	**64,973,149**	**65,245,717**

The accompanying notes form an integral part of these financial statements.

Notes to the financial statements

1. GENERAL INFORMATION

The **European Stability Mechanism** ("ESM") was inaugurated on 8 October 2012 and established as an international financial institution with its registered office at 6a, Circuit de la Foire Internationale, L-1347 Luxembourg, Grand Duchy of Luxembourg.

The Finance Ministers of the then 17 euro area countries signed a first version of a Treaty establishing the European Stability Mechanism on 11 July 2011. A modified version, incorporating amendments aimed at improving the ESM's effectiveness, was signed in Brussels on 2 February 2012 ("ESM Treaty"). The ESM Treaty entered into force on 27 September 2012 following its ratification by the then 17 euro area Member States.

Latvia joined the euro area on 1 January 2014. The Latvian parliament approved the ESM Treaty on 30 January 2014, and Latvia officially became the ESM's 18th Member on 13 March 2014. The ESM Treaty was amended accordingly.

Lithuania joined the euro area on 1 January 2015. The Lithuanian parliament approved the ESM Treaty on 18 December 2014, and Lithuania officially became the ESM's 19th Member on 3 February 2015. The ESM Treaty was amended accordingly.

The present financial statements cover the period from 1 January 2019 to 31 December 2019, while comparative figures cover the period from 1 January 2018 to 31 December 2018.

On a proposal from the Managing Director, the Board of Directors adopted the financial statements on 30 March 2020 and authorised their submission to the Board of Governors for approval at their 11 June 2020 meeting.

1.1. GENERAL OVERVIEW OF THE FINANCIAL ASSISTANCE PROGRAMMES

The ESM is authorised to use the following lending instruments for the benefit of its Members, subject to appropriate conditionality:

- grant financial assistance in the form of loans to an ESM Member in the framework of a macroeconomic adjustment programme;
- purchase bonds or other debt securities in the primary debt market and conduct operations on the secondary debt market in relation to the bonds of an ESM Member;
- grant precautionary financial assistance to ESM Members in the form of credit lines;
- provide financial assistance for the recapitalisation of financial institutions through loans to ESM Members' governments;
- recapitalise systemic and viable euro area financial institutions directly under specific circumstances and as a last resort measure, following the 8 December 2014 ratification of a new instrument, the Direct Recapitalisation of Institutions.

1.2. OVERVIEW OF THE PRICING STRUCTURE OF THE FINANCIAL ASSISTANCE PROGRAMMES

The total cost of financial assistance to a beneficiary Member State is an aggregate of several distinct elements that are established in the ESM Pricing Policy:

- Base rate – the cost of funding incurred by the ESM, derived from a daily computation of the actual interest accrued on all bonds, bills, and other funding instruments issued by the ESM;

- Commitment fee – the negative carry and issuance costs incurred in the period between the funding by the ESM and the disbursement to the beneficiary Member State, or for the period from the refinancing of the relevant funding instrument until its maturity. The commitment fee will be applied ex-post on the basis of the negative carry actually incurred;
- Service fee – the source of general revenues and resources to cover the ESM's operational costs. The service fee has two components:
  - up-front service fee (50 bps) generally deducted from the drawn amount;
  - annual service fee (0.5 bps) paid on the interest payment date;
- Margin – paid on the interest payment date. The margin charged differs across financial support instruments:
  - 10 bps for loans and primary market support facilities;
  - 5 bps for secondary market support facilities;
  - 35 bps for precautionary financial assistance;
  - 30 bps for financial assistance provided to an ESM Member for the recapitalisation of its financial institutions.

In addition, the ESM Pricing Policy includes specific elements tied to financial assistance for the Direct Recapitalisation of Institutions. This instrument is currently not used. The specific elements are detailed in the ESM Pricing Policy.

Penalty interest may be applied to overdue amounts, which corresponds to a charge of 200 bps over the higher of either the Euribor rate applicable to the relevant period selected by the ESM or the interest rate which would have been payable.

1.3. ESM FINANCIAL ASSISTANCE TO SPAIN

The Eurogroup, composed of the Finance Ministers of the euro area countries, reached political agreement on 20 July 2012 that financial assistance should be granted to Spain for the recapitalisation of its banking sector, following an official request from the Spanish government. The financial assistance was designed to cover the estimated capital requirements along with an additional safety margin, amounting to €100 billion. The loans were provided to Spain's bank recapitalisation fund, Fondo de Reestructuración Ordenada Bancaria (FROB), and then channelled to the relevant financial institutions. The assistance was initially committed under a European Financial Stability Facility (EFSF) programme. On 28 November 2012, the ESM Board of Governors decided that the ESM would assume this commitment, in line with Article 40(1) and (2) of the ESM Treaty.

This was the ESM's first financial assistance programme. It was also the first use of the instrument for recapitalising banks through loans granted to a government. No other lenders contributed.

On 3 December 2012, the Spanish government formally requested the disbursement of €39.5 billion in funds. On 5 December 2012, the ESM launched and priced notes, which were transferred to the FROB on 11 December 2012. The FROB used the notes in the amount of €37.0 billion for the recapitalisation of the following banks: BFA-Bankia, Catalunya-Caixa, NCG Banco, and Banco de Valencia. The FROB also provided €2.5 billion to Sareb, the asset management company, for assets arising from bank restructuring.

The Spanish government formally requested a second disbursement of €1.8 billion for the recapitalisation of Banco Mare Nostrum, Banco Ceiss, Caja 3 and Liberbank on 28 January 2013. The ESM subsequently transferred the funds in the form of ESM notes to the FROB on 5 February 2013.

The ESM financial assistance programme expired on 31 December 2013. In total, the ESM disbursed €41.3 billion to Spain to recapitalise the banking sector. The remaining undisbursed amount of the facility was cancelled.

On 7 July 2014, the ESM Board of Directors approved Spain's request to make an early repayment of €1.3 billion of its loan. This was the first time that a euro area country under a financial assistance programme made an early repayment request. The repayment took place on 8 July 2014 and was accompanied by a scheduled repayment of unused funds of €0.3 billion on 23 July 2014.

The ESM received two further early repayment requests from the Spanish authorities in 2015. The authorities submitted the first request on 27 February 2015. The ESM Board of Directors approved this €1.5 billion early repayment request on 9 March 2015 and the repayment took place on 17 March 2015. On 2 July 2015, the ESM Board of Directors approved another early repayment request from the Spanish government. This €2.5 billion repayment took place on 14 July 2015.

On 11 November 2016, the ESM received the fourth early repayment from Spain of €1 billion, which was approved by the ESM Board of Directors on 7 November 2016.

The ESM received two further early repayment requests from the Spanish authorities in 2017. On 14 June 2017, the ESM received the fifth early repayment from Spain of €1.0 billion, which was approved by the ESM Board of Directors on 1 June 2017. Subsequently on 5 October 2017, the ESM received the request for the sixth early repayment from Spain of €2.0 billion, which was approved by the ESM Board of Directors on 26 October 2017 and the repayment took place on 16 November 2017.

On 30 January 2018 Spain made the request for two further early repayments. On 23 February 2018 and 23 May 2018, the ESM received respectively the seventh and eighth early repayments from Spain of €2.0 billion and €3 billion, which were approved by the ESM Board of Directors on 8 February 2018. On 16 October 2018, the ESM received the ninth early repayment from Spain of €3 billion, which was approved by the ESM Board of Directors on 20 September 2018.

By 31 December 2019 and 2018, Spain had, in total, repaid €17.6 billion of its financial assistance. All repayments were made in cash.

The outstanding nominal amount of loans granted to Spain as at 31 December 2019 and 2018 is €23.7 billion (refer to Note 6).

1.4. ESM FINANCIAL ASSISTANCE TO CYPRUS

The Cypriot government requested stability support on 25 June 2012. In response, the Eurogroup agreed the key elements of a macroeconomic adjustment programme on 25 March 2013.

The agreement on the macroeconomic adjustment programme led euro area members to decide on a financial assistance package of up to €10 billion. On 24 April 2013, the ESM Board of Governors decided to grant stability support to Cyprus. The ESM Board of Directors subsequently approved the Financial Assistance Facility Agreement (FFA) on 8 May 2013. The ESM disbursed €6.3 billion, and the International Monetary Fund (IMF) contributed around €1 billion. Cyprus exited successfully from its ESM programme on 31 March 2016.

According to the terms of the FFA, the first tranche of financial assistance was provided to Cyprus in two separate disbursements: the ESM disbursed the first €2.0 billion on 13 May 2013, and transferred the second in the amount of €1 billion on 26 June 2013. The second tranche of assistance, €1.5 billion of ESM floating rate notes, was disbursed on 27 September 2013. The Cypriot government used the notes for the recapitalisation of the cooperative banking sector. The third tranche of assistance, €0.1 billion, was disbursed on 19 December 2013. Disbursements of a total of €1.1 billion were made in 2014, and another €0.6 billion in 2015.

The financial assistance facility was designed to cover Cyprus's financing needs after including proceeds from burden-sharing measures that the Cypriot government adopted for the banking sector. These needs included budgetary financing, the redemption of medium- and long-term debt, and the recapitalisation of financial institutions. They excluded the country's two largest banks, Bank of Cyprus and Cyprus Popular Bank, which the Cypriot government subjected to restructuring and resolution measures.

The outstanding nominal amount of loans granted to Cyprus as at 31 December 2019 and 2018 is €6.3 billion (refer to note 6).

1.5. ESM FINANCIAL ASSISTANCE TO GREECE

The EFSF financial assistance programme for Greece expired on 30 June 2015. On 8 July 2015, the Greek government submitted a request for financial assistance to the Chairperson of the ESM Board of Governors. On 13 July 2015, the euro area ministers of finance agreed with Greece a set of urgent prior actions in order to start negotiations for a new programme under the ESM. The ESM Board of Governors finally approved a new programme on 19 August 2015. At the same time, the ESM Boards of Governors and Directors approved the financial assistance facility agreement (FFA) with Greece. The ESM was authorised to provide Greece with up to €86.0 billion in financial assistance over three years. Greece successfully exited its programme in August 2018.

The ESM programme focussed on four key areas: restoring fiscal sustainability, safeguarding financial stability, boosting growth, competitiveness and investment, and reforming the public administration. The funds available under the FFA were earmarked to cover needs related to debt servicing, banking sector recapitalisation and resolution and budget financing. To return its economy to growth and make its debt burden more sustainable, the Greek government committed to a series of far-reaching economic reforms.

On 20 August 2015, the ESM approved the first tranche of €26.0 billion in financial assistance for Greece, divided in two sub-tranches. This decision followed the ESM Board of Directors' approval of the FFA, specifying the terms of the financial assistance. The Board of Directors also decided to immediately disburse €13 billion in cash to Greece. This was the first disbursement under the first sub-tranche, of €16 billion, to be used for budget financing and debt servicing needs. The second sub-tranche, of €10.0 billion, was immediately created in ESM floating rate notes and held in a segregated account. These funds were designated to cover the Greek banking sector's potential resolution and recapitalisation costs, with release decisions to be taken on a case-by-case basis.

On 23 November 2015, the Board of Directors authorised the disbursement of €2.0 billion in cash to Greece as the second disbursement under the €16.0 billion sub-tranche approved in August 2015. This decision followed the Greek government's completion of the first set of reform milestones. This disbursement was primarily used for debt servicing.

On 1 December 2015, the Board of Directors decided to release €2.7 billion to Greece to recapitalise Piraeus Bank. Subsequently, on 8 December 2015, the Board of Directors decided to release €2.7 billion to Greece to recapitalise the National Bank of Greece. The ESM transferred these amounts under the €10.0 billion sub-tranche, held in ESM notes in a segregated account. The availability period of the remaining €4.6 billion expired on 31 January 2016.

On 22 December 2015, the Board of Directors approved the disbursement of €1 billion to Greece as the third and final disbursement under the €16.0 billion sub-tranche agreed in August 2015. This decision followed the Greek government's completion of the second set of reform milestones. This disbursement was also used for debt servicing.

On 17 June 2016, the Board of Directors approved the disbursement of €7.5 billion to Greece as the first disbursement under the second tranche of €10.3 billion. This disbursement was used for debt servicing and to help clear domestic arrears.

On 25 October 2016, the Board of Directors approved the disbursement of €2.8 billion to Greece as the second disbursement under the second tranche of €10.3 billion. This €2.8 billion disbursement consisted of two parts: €1.1 billion was approved for release following the full implementation of a set of 15 milestones by the Greek authorities, and was used for debt servicing. A further €1.7 billion was disbursed to a dedicated account for clearing arrears after a positive assessment of the clearance of net arrears by Greece.

On 20 January 2017, the ESM Board of Directors approved three schemes aimed at reducing interest rate risk for Greece. The first was a bond exchange, where floating rate notes disbursed by the ESM to Greece for bank recapitalisation were exchanged for fixed coupon notes. The second scheme allowed the ESM to enter into swap arrangements to reduce the risk that Greece would have to pay a higher interest rate on its loans in case market rates start rising. The third scheme, which entailed issuing long-term bonds that closely matched the maturity of the Greek loans, was eventually replaced by additional swap arrangements.

On 20 February 2017, the ESM received a loan repayment of €2.0 billion from the Greek government. The repayment was a contractual obligation with the ESM and followed the sale of an asset by one of the banks that took part in the 2015 banking recapitalisation, financed with ESM loans.

On 7 July 2017, the ESM Board of Directors approved the first disbursement of the €7.7 billion under the third tranche of €8.5 billion. Out of this amount, €6.9 billion was used for debt servicing needs and €0.8 billion for arrears clearance.

On 26 October 2017, the ESM Board of Directors approved the disbursement of €0.8 billion to Greece for the clearance of arrears.

On 27 March 2018, the ESM Board of Directors approved the fourth tranche of €6.7 billion to Greece for debt service, domestic arrears clearance and for establishing a cash buffer. The ESM Board of Directors approved the release of the first disbursement under this tranche amounting to €5.7 billion, which took place on 28 March 2018.

On 14 June 2018, the ESM Board of Directors authorised the release of the remaining amount of the fourth tranche of ESM financial assistance, approved on 27 March 2018. The disbursement of €1 billion was used for the clearance of arrears.

On 6 August 2018, the ESM disbursed the fifth and final tranche of ESM financial assistance for Greece, amounting to €15 billion. Out of this tranche, €9.5 billion were used for building up Greece's cash buffer and €5.5 billion were used for debt service. After the disbursement, the cash buffer reached around €24.0 billion. That sum was to cover around 22 months of Greece's financing needs after the end of the programme on 20 August 2018.

On 20 August 2018, Greece officially concluded its three-year ESM financial assistance programme with a successful exit. This follows the disbursement of a total of €61.9 billion by the ESM over three years in support of macroeconomic adjustment and bank recapitalisation in Greece. The remaining €24.1 billion available under the maximum €86.0 billion programme volume was not utilised and automatically cancelled.

The outstanding nominal amount of loans granted to Greece as at 31 December 2019 and 2018 is €59.9 billion (refer to note 6).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are set out below.

2.1. BASIS OF PRESENTATION

The accompanying financial statements are prepared and presented in accordance with Directive 86/635/EEC of the Council of the European Communities of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions, as amended by Directive 2001/65/EC of 27 September 2001, by Directive 2003/51/EC of 18 June 2003 and by Directive 2006/46/EC of 14 June 2006 (the 'Directives'). Their specific application by the ESM is described in the subsequent notes.

The ESM prepares an annual report in respect of each financial year and submits it to the Board of Governors for approval at its annual meeting. The annual report contains a description of the policies and activities of the ESM, the financial statements for the relevant financial year, the report of the external auditors in respect of their audit in respect of said financial statements, and the report of the Board of Auditors in respect of said financial statements pursuant to Article 24(6) of the ESM By-Laws.

The preparation of financial statements in conformity with the Directives requires the use of certain critical accounting estimates. It also requires management[2] to exercise its judgement in applying the ESM's accounting policies. Areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 2.3.

2.2. BASIS OF MEASUREMENT

The accompanying financial statements are prepared on a historical cost basis, except for the loans and advances to euro area Member States and the debts evidenced by certificates which are measured at amortised cost, and the paid-in capital and reserve fund investments which are measured at fair value with gains and losses recognised in the fair value reserve. The bond futures are measured at fair value with the changes in the values (mark-to-market) recognised in the profit and loss account.

2.3. USE OF ESTIMATES

In preparing the financial statements, management is required to make estimates and assumptions that affect reported income, expenses, assets, liabilities and the disclosure of contingent assets and liabilities. The use of available information and application of judgement are inherent to the formation of estimates. Actual results in the future could differ from such estimates and the resulting differences may be material to the financial statements. Any revision to accounting estimates is recognised prospectively in current and future periods.

The ESM is entitled to charge 50 bps of up-front service and 0.5 bps annual service fees to the beneficiary Member States, to cover the ESM's operational costs, as Note 1.2 describes. The ESM recognises the up-front service fees over a seven year period, to reflect the expected occurrences of the expenses that it aims to cover.

The ESM reviews its loans and advances to euro area beneficiary Member States at each reporting date, to assess whether a value adjustment is required (see Note 2.8). Such assessment requires judgement by the management and the ESM governing bodies, consistent with the ESM's mandate as a crisis resolution mechanism that aims at supporting beneficiary Member States' return to public financial stability.

No value adjustment was required as at 31 December 2019 and 2018, thus none has been recorded.

2.4. FOREIGN CURRENCY TRANSLATION

The ESM uses the euro (€) as the unit of measure of its accounts and for presenting its financial statements.

Foreign currency transactions are recorded at the rates of exchange prevailing on the date of the transaction. Exchange differences, if any, arising out of transactions settled during the year are recognised in the profit and loss account as 'Net profit or loss on financial operations'.

Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the closing exchange rates on that date.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates on the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates on the date when the fair value was determined.

The exchange differences, if any, are recognised in the profit and loss account and the related assets and liabilities are revalued on the balance sheet.

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[2] As per Article 7 (5) of the ESM Treaty, the Managing Director shall conduct, under the direction of the Board of Directors, the current business of the ESM. As per Article 21 (1) of the ESM By-Laws, the Board of Directors shall keep the accounts of the ESM and draw up its annual accounts.

2.5. DERIVATIVE FINANCIAL INSTRUMENTS

The ESM uses derivatives instruments for risk management purposes only. Cross-currency asset swaps and foreign exchange swaps are used to hedge the currency risk into euro[3] (refer to Note 3.3.2), and interest rate swaps to manage the interest rate risk exposure (refer to Note 3.3.1).

All cross currency asset swaps, foreign exchange swaps and interest rate swaps transactions are booked at notional amount as off-balance sheet items at the date of the transaction.

The ESM uses also futures contracts in order to manage the interest rate risk of the paid-in capital portfolios (refer to Note 3.3.1). The futures transactions are booked at notional amount as off-balance sheet items at the date of the transaction.

2.5.1. FOREIGN EXCHANGE SWAPS AND FORWARDS

For the management of its paid-in capital portfolios, the ESM can enter into foreign exchange swaps and forwards to hedge back into euro non-euro denominated investments. Ongoing forward and spot exchange transactions are converted at the spot rates of exchange prevailing on the balance sheet date and neutralised in 'Accruals and deferred income' or 'Prepayments and accrued income'. The spread between the spot amount and forward settlement amount is linearly amortised through the profit and loss account in 'Interest receivable and similar income' or 'Interest payable and similar charges'. On the maturity date, the parties exchange the initial principal amounts at the contractual exchange rate. The difference between the spot and the forward rate at maturity is recognised under the caption 'Interest receivable and similar income' or 'Interest payable and similar charges' in the profit and loss account.

2.5.2. CROSS-CURRENCY ASSET SWAPS AND INTEREST RATE SWAPS

The ESM enters into cross-currency asset swaps in order to hedge investments in non-euro denominated assets in its paid-in capital portfolios as well as issuances in USD. In a cross-currency swap, payments are exchanged based on either two floating reference rates, one floating rate and one fixed rate, or two fixed rates, each with a corresponding notional amount denominated in a different currency from a given security (the asset). Notional amounts are exchanged on the effective date and the maturity date. Ongoing forward and spot exchange transactions are converted at the spot rates of exchange prevailing on the balance sheet date and neutralised in 'Accruals and deferred income' or 'Prepayments and accrued income'.

The spread between the spot amount and forward settlement amount is linearly amortised through the profit and loss account in 'Interest receivable and similar income' or 'Interest payable and similar charges'. Interest payments exchanged are also included in 'Interest receivable and similar income' or 'Interest payable and similar charges' in the profit and loss account.

An interest rate swap is a contract under which floating-rate interest is exchanged for fixed-rate interest or vice-versa. Interest received and paid under interest rate swaps is accrued and reported under 'Interest receivable and similar income' or 'Interest payable and similar charges' in the profit and loss account.

On the maturity date the difference between the payable and the receivable interest at maturity is recognised under the caption 'Interest receivable and similar income' or 'Interest payable and similar charges' in the profit and loss account.

All Interest rate swaps and cross-currency asset swaps contracted with commercial counterparties are concluded under the contractual framework of ISDA swap agreements and Credit Support Annexes (CSA), which specify the conditions of exposure collateralisation, in order to offset mark-to-market fluctuations on a daily basis through the exchange of collateral. These are generally accepted and practised contract types (see also Note

[3] As per Article 2 (5) of the ESM Investment Guidelines, any currency risk shall be hedged into euro to ensure a limited remaining foreign exchange risk for the ESM.

3.6.3). Derivative operations concluded with selected highly rated public institutions or central banks can be concluded under ISDA swap agreement only.

The cash collateral received or provided is reported under 'Amounts owed to credit institutions' or 'Loans and advances to credit institutions'.

2.5.3. FUTURES CONTRACTS

Bond futures are financial instruments, which provide the ability to buy or sell a security at a forward date, at a pre-agreed price. Futures contracts are standardised exchange-traded derivatives instruments with pre-defined maturity, underlying assets (a known basket of physically deliverable bonds in the case of bond futures) and specifications.

At the delivery date of the contract, if positions have not been closed or rolled to the next contract, short bond futures positions must deliver a bond from a pre-set basket of possible deliverable bonds, with a pre-defined remaining maturity, to the long positions.

The ESM enters in bond futures contracts with the objective to manage the interest rate risk of the paid-in capital portfolios. The bond futures are initially recognised at zero including any transaction costs, and measured subsequently at fair value with gains and losses recognised in the profit and loss account under the caption 'Interest receivable and similar income – Other' or ' Interest payable and similar charges – Other'.

The changes in the values (mark-to-market) of bond futures positions are recognised in the profit and loss account through daily margin calls. Therefore, the carrying amounts of bond futures represent only the called but not yet settled balances and are recognised under the caption 'Other assets' or 'Other liabilities'.

2.6. CASH IN HAND, BALANCES WITH CENTRAL BANKS AND POST OFFICE BANKS

Cash in hand, balances with central banks and post office banks include cash in hand, demand deposits and other short-term highly liquid investments with original maturities of three months or less. Bank overdrafts, if any, are shown within borrowings in liabilities on the balance sheet.

2.7. DEBT SECURITIES INCLUDING FIXED-INCOME SECURITIES

The ESM has established the following portfolios for the management of its financial assets:

2.7.1. PAID-IN CAPITAL AND RESERVE FUND INVESTMENTS

The ESM's capital provisions are laid down in Chapter 3 of the ESM Treaty. The initial aggregate nominal value of paid-in shares was €80.0 billion and has been increased to €80.5 billion due to the accession of Latvia and Lithuania. The net income generated by ESM operations and the proceeds of the financial sanctions received from the ESM Members under the multilateral surveillance procedure, the excessive deficit procedure, and the macro-economic imbalances procedure established under the Treaty on the Functioning of the European Union (TFEU) are put aside in a reserve fund, in accordance with Chapter 5 of the ESM Treaty.

The Paid-in capital and the reserve fund are invested in accordance with the ESM Investment Guidelines approved by the Board of Directors. The main objective of such investments is to ensure that the maximum lending volume is always readily available, and to absorb potential losses.

According to the investment principles defined in the Investment Guidelines, an appropriate level of diversification of the investment portfolios shall be maintained to reduce the ESM's overall risk. Diversification shall be attained through allocation between various asset classes, geographical areas (and notably supranational institutions, and issuers outside the euro area), issuers and instruments.

According to the ESM Investment Guidelines, any currency risk shall be hedged into euro to ensure a limited remaining foreign exchange risk for the ESM. Derivatives shall be used for risk management purposes only (refer to Note 3.6.2).

In accordance with the Investment Guidelines, the Paid-in capital is divided in the Short-term tranche, the Medium and long-term tranche and the Hold-to-maturity tranche. The assets of the reserve fund are invested in full in the Short-term tranche:

Short-term tranche (STT)

The tranche with the highest liquidity requirements is the Short-term tranche. The main objective of the Short-term tranche is to enable the ESM to face any temporary disbursement to cover any liquidity shortfall, due to a non-payment by a beneficiary Member State. This tranche is invested in liquid investment instruments with a capital preservation objective at a one-year horizon, for a high level of confidence, to the extent possible in light of prevailing market conditions.

Medium- and long-term tranche (MLTT)

The main objective of the Medium- and long-term tranche is to ensure the ESM's financial strength. This tranche is managed to enhance the return of the Paid-in capital and is subject to the constraints specified in the Investment Guidelines. This tranche is also mainly invested in liquid instruments.

Hold-to-maturity tranche (HTMT)

The objective of the Hold-to-maturity tranche is to reinforce the long-term financial strength of the ESM. This tranche shall be invested to enhance the return of the Investment Portfolios, subject to the other investment objectives foreseen in Article 1 of the Investment Guidelines, as well as to comply, as of the time of purchase, with the eligibility criteria set out in the General Eligible Assets List.

The assets in the Hold-to-maturity tranche are intended to be held to maturity, and may be monetised only:

- i. in order to raise liquidity if, in accordance with the ESM High Level Risk Policy, it is necessary to meet due payments to ESM creditors and to avoid or limit a capital call under Article 9(3) of the ESM Treaty; or
- ii. outside of the situation referred in "i". above, to post collateral for derivatives used for risk management purposes in the Investment Portfolios;
- iii. In case any asset loses its eligibility, the ESM may decide to reduce the exposure to this given asset, but to do so within an appropriate timeframe and manner in order to minimise any impact on market prices.

The Paid-in capital and the reserve fund investments in the Short-term and Medium/Long-Term tranches are initially recognised at fair value including any transaction costs, and measured subsequently at fair value with gains and losses recognised in the fair value reserve, except for impairment losses and foreign exchange gains and losses, until the financial asset is derecognised. Unrealised gains or losses are accumulated in the fair value reserve until the asset is sold, collected or otherwise disposed of, or until the asset is determined to be impaired. If the financial asset is determined to be impaired, the cumulative gain or loss previously recognised in the 'Fair value reserve' is recognised in the profit and loss account. Interest, however, is recognised on a straight-line basis.

The Paid-in capital investments in the Hold-to-maturity tranche are initially recognised at cost and measured subsequently at amortised cost.

2.7.2 LIQUIDITY BUFFER INVESTMENTS

The ESM's borrowing strategy must meet several objectives and principles to comply with the purpose established in Article 3 of the ESM Treaty. The general borrowing strategy must therefore offer the possibility to react rapidly to unexpected market developments, including the build-up of liquidity buffers and ensuring market access, even in a difficult market environment.

As per the ESM Investment Guidelines, the management of the liquidity buffer follows the same investment restrictions as the short-term tranche of the paid-in capital described in Note 2.7.1.

2.7.3. DETERMINATION OF FAIR VALUE

The determination of fair values of financial assets and liabilities is based on quoted market prices or dealer price quotations, when such prices are regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Where the fair values of financial instruments recorded on the balance sheet cannot be derived from regular market prices, as described above, they are determined using valuation techniques that include the use of mathematical models. The chosen valuation techniques incorporate factors that market participants would take into account in pricing a transaction and are based whenever possible on observable market data. If such data is not available, a degree of judgement is required in establishing fair values.

2.8. LOANS AND ADVANCES TO CREDIT INSTITUTIONS AND TO EURO AREA MEMBER STATES

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not traded on an active market. Loans and advances are initially recognised at their net disbursement amounts, and subsequently measured at amortised cost.

Transaction costs and premiums/discounts are amortised in the profit and loss account through interest receivable and similar income. Interest income on loans and advances to credit institutions and to euro area Member States are also included in 'Interest receivable and similar income' in the profit and loss account.

Specific value adjustments are accounted for in the profit and loss account in respect of loans and advances presenting objective evidence that all or part of their outstanding balance is not recoverable (refer to Note 2.3) and are deducted from the corresponding asset in the balance sheet.

The underlying securities purchased under the agreements to resell ("reverse repos") are not recognised on the balance sheet while the consideration paid is recorded as loans and advances to credit institutions as appropriate. The counterparties enter into an irrevocable commitment to complete the operation on a date and a price fixed at the outset. The difference between the sale and the repurchase price is treated as interest and recognised over the life of the agreement (refer to Note 5).

2.9. INTANGIBLE ASSETS

Intangible assets are recorded on the balance sheet at their acquisition cost, less accumulated amortisation. Amortisation is calculated on a straight-line basis over the estimated life of each item purchased. Intangible assets comprise computer software that are amortised within three years.

2.10. TANGIBLE ASSETS

Tangible assets are recorded on the balance sheet at their acquisition cost, less accumulated depreciation.

Depreciation is calculated on a straight-line basis over the estimated life of each item purchased, as set out below:

- permanent equipment, fixtures and fittings: nine years or until the end of building rent period;
- furniture and office equipment: five years;
- IT equipment: three years.

If works performed on leased properties are capitalised (as fixture and fittings) then the estimated life of those assets should not exceed the duration of the lease agreement.

2.11. PREPAYMENTS AND ACCRUED INCOME

Prepayments and accrued income are related either to invoices received and paid in advance for expenses related to subsequent reporting periods, or to any income related to the reporting period which will only be received in the course of a subsequent financial year. It includes the spot revaluation, the spread amortisation and also the accrued interest income of ongoing derivative transactions (refer to Note 2.5).

2.12. AMOUNTS OWED TO CREDIT INSTITUTIONS

Amounts owed to credit institutions are presented in the financial statements at their redemption amounts. Transaction costs and premiums/discounts are amortised in the profit and loss account through interest payable and similar charges/income. Interest expense on amounts owed to credit institutions is also included in 'Interest payable and similar charges' in the profit and loss account.

The underlying securities sold under the repurchase agreements ("repos") are not recognised on the balance sheet while the consideration received is recorded as amounts owed to credit institutions as appropriate and carried at the amounts of the cash received on the balance sheet. The counterparties enter into an irrevocable commitment to complete the operation on a date and a price fixed at the outset. The difference between the sale and the repurchase price is treated as interest and recognised over the life of the agreement (refer to Note 11).

2.13. DEBTS EVIDENCED BY CERTIFICATES

Debts evidenced by certificates are presented at their amortised cost. Transaction costs and premiums/discounts are amortised in the profit and loss account through 'Interest payable and similar charges'. Interest expenses on debt instruments are also included in 'Interest payable and similar charges' in the profit and loss account.

2.14. PROVISIONS

Provisions are intended to cover liabilities, the nature of which are clearly defined and which at the date of the balance sheet are either likely to be incurred, or certain to be incurred but uncertain as to the amount or as to the date on which they will arise.

Where there are similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole.

2.15. SUBSCRIBED CAPITAL

On 31 December 2019, the ESM's shareholders were the 19 euro area Member States. In accordance with Article 8 of the ESM Treaty, the authorised capital is €704.8 billion, which is divided into 7,047,987 shares, with a nominal value of €100,000 each. The authorised capital was subscribed by the shareholders according to the contribution key provided in Article 11 and calculated in Annex I of the ESM Treaty. The authorised capital is divided into paid-in shares and callable shares, where the total aggregate nominal value of paid-in shares is €80.5 billion.

In accordance with Article 4 of Directive 86/635/EEC as amended, the authorised capital stock is recognised in equity as subscribed capital. The callable shares are presented as 'Subscribed capital unpaid' on the asset side of the balance sheet. Called capital not yet paid by the shareholders is recognised on the asset side of the balance sheet as 'Subscribed capital called but not paid'.

2.16. ACCRUALS AND DEFERRED INCOME

Accruals and deferred income are related to payments received before the balance sheet date but not exclusively related to the reporting period, together with any charges which, though relating to the financial year in question, will only be paid in a subsequent financial year. It also includes the spot revaluation and spread amortisation of ongoing derivative transactions (refer to Note 2.5).

2.17. INTEREST RECEIVABLE AND PAYABLE

Interest income and expenses for all interest-bearing financial assets and financial liabilities are recognised on an accrual basis within 'Interest receivable and similar income' and 'Interest payable and similar charges' in the profit and loss account.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest applied to discount the future cash flows for the purpose of measuring the impairment loss.

On the balance sheet, accrued interest receivable is included in 'Prepayments and accrued income' under assets while accrued interest payable is included in 'Accruals and deferred income' under liabilities.

2.18. EMPLOYEE BENEFITS

The ESM operates a pension plan with defined contribution characteristics funded through payments to an external insurance company. This insurance scheme also covers the risk of death and disability.

The pension plan is funded by contributions from the employer as well as from the employees. The plan is accounted for as a defined contribution plan and corresponding payments are recognised as employee benefit expenses as they fall due.

2.19. COMPENSATION PAYMENTS FROM ESM MEMBERS

Payments received from a Member State as compensation for expenses or losses (refer to Note 24) incurred in a previous period are recorded as extraordinary income in profit or loss of the period in which they become receivable. Such compensation payments are made with a view to capital preservation and are granted on a case-by-case basis, subject to conditions not controlled by the ESM. Therefore, a receivable is evidenced either through a notification of the payment or the respective transfer of money.

2.20. TAXATION

Within the scope of its official activities, the ESM, its assets, income, property and its operations and transactions shall be exempt from all direct taxes under Article 36 of the ESM Treaty. ESM Members have agreed to remit or refund all indirect taxation, subject to certain exceptions under the same provision of the ESM Treaty.

3. RISK MANAGEMENT

This section presents information about the approach of the ESM to risk management and risk controls and its risk exposure, in relation to the primary risks associated with its use of financial instruments. These are:

- credit risk,
- market risk,
- liquidity risk, and
- operational risk.

3.1. RISK MANAGEMENT ORGANISATION

The ESM follows a prudent approach to risk-taking to limit potential losses and to ensure continuity in fulfilling its mandate and meeting its commitments.

According to the ESM's High Level Risk Policy (published on ESM website) and Annex, the targeted risk appetite should preserve the ESM's funding capacity, ensure the highest creditworthiness, and avoid unexpected capital calls. The High Level Risk Policy and Annex describe the risk appetite and the framework for identifying, assessing, monitoring and managing risks consistent with the risk appetite. It covers all ESM financial and non-financial risks, and both on- and, if applicable, off-balance sheet items. The risk profile is defined by a set of limits to curtail all types of risks within the risk appetite. The ESM does not aim at generating profit on financial support granted to beneficiary Member States and aims to manage its investment portfolios prudently, in accordance with the ESM Investment Guidelines and ESM's risk policies.

The ESM operates under the principles of the three lines of defence approach: departments and business functions assume direct responsibility for day-to-day risk management. All staff are responsible for ensuring that risks relating to their operations are identified, followed up, and reported to Risk Management. Risk Management exercises central oversight of risk and ensures that all business functions, comprehensively and consistently, implement the risk management framework.

The Managing Director bears full accountability for the implementation and functioning of the risk management framework, adequate reporting to the Board of Directors, and for further developing the High Level Risk Policy and the Annex.

The Chief Risk Officer and Deputy Managing Director reports directly to the Managing Director. The Chief Risk Officer is responsible and accountable for informing the Managing Director on all risks which the institution may face to ensure enforcement and oversight. The Managing Director reports risk-related information to the Board of Directors, principally through the Board Risk Committee.

To support the implementation of the ESM's risk policies, an Internal Risk Committee (IRC) has been created. The IRC translates the risk appetite into an internal limit structure, which is described in the High Level Risk Policy approved by the Board of Directors. The IRC assists the Managing Director in ensuring the adequacy of the ESM's internal limit structure and limit setting, providing recommendations on changes to the internal limit structure, on the identification of relevant risks, and on the suitability of methods to monitor and manage them. On a periodical basis, the IRC conducts a risk self-assessment and reports the result to the Managing Director.

3.2. CREDIT RISK

Credit risk is defined as the potential for loss arising from the inability of a counterparty, issuer, insurer or other obligor to fulfil its contractual obligations for full value when due. Counterparty risk is considered a particular form of credit risk and derives from lending and support operations to beneficiary Member States, investment of paid-in capital, placement of possible excess liquidity, and hedging operations. Issuer risk is also a particular form of credit risk and derives from investment in securities of the paid-in capital and excess liquidity. Credit concentration risk is defined as the potential for loss arising from undiversified, correlated exposure to a particular group of counterparties.

Given the nature of the ESM's mandate, where credit risk from lending arises as a result of support to beneficiary Member States under a financial assistance facility agreement (FFA), the credit risk in the ESM's lending exposure is accepted. The ESM has established an early warning procedure to ensure that it receives any repayments due by a beneficiary Member State under a FFA in a timely manner. The note 3.2.4 below further describes the ESM's treatment of loans to euro area Member States.

3.2.1. EXPOSURE TO CREDIT RISK WITHOUT TAKING INTO ACCOUNT ANY COLLATERAL OR OTHER CREDIT ENHANCEMENTS

The following table shows the direct exposure to credit risk for the components of the balance sheet. For on-balance-sheet positions, these exposures are based on net carrying amounts as reported on the balance sheet.

(in €'000)	Exposure 31.12.2019	Exposure 31.12.2018
Cash in hand, balances with central banks and post office banks	64,973,149	65,245,717
Loans and advances to credit institutions	6,412,889	1,291,715
Debt securities including fixed-income securities	33,570,595	25,582,930
On-balance sheet credit risk exposure	**104,956,633**	**92,120,362**
Exposure at default on derivatives [(1)]	1,889,469	1,582,340
Credit risk exposure	**106,846,102**	**93,702,702**

[(1)] The cash-collateral is included in the calculation of the Exposure at Default and reported as exposure in the on balance sheet items.

This table does not include the loans and advances to euro area Member States as the ESM does not manage the credit risk on beneficiary Member States, while it monitors its exposures through the Early Warning System, as described in Note 3.2.4.

3.2.2. RISK PROFILE OF COUNTERPARTIES AND ISSUERS

The following tables show the breakdown of the financial assets by credit rating. For 'Debt securities including fixed-income securities', the credit ratings of individual issuances (or in the case of short-term securities their long-term rating equivalents) are presented. If issuance ratings are unavailable, the issuers rating is presented. For other financial assets, the credit ratings of the counterparties are presented.

These tables do not include the breakdown of the 'Loans and advances to euro area Member States', as the ESM risk function does not manage the inherent risk of non-payment of the beneficiary Member States, as described in Note 3.2.

(in €'000)	Credit rating[(1)]	Clean carrying value 31.12.2019
Cash in hand, balances with central banks and post office banks	not rated[(2)]	64,967,836
	AA	5,313
Loans and advances to credit institutions	not rated[(3)]	330,216
	AA	1,603
	AA-	780
	A+	3,906,450
	A	2,173,840
Debt securities including fixed-income securities	AAA	19,872,817
	AA+	1,330,075
	AA	4,056,564
	AA-	2,852,980
	A+	666,802
	A	4,791,357
Total		**104,956,633**

[(1)] Based on the worst rating provided by the major rating agencies (Moody's, Standard & Poor's or Fitch) presented based on the rating scale used by Fitch.
[(2)] "Not rated" means balances placed with Eurosystem central banks, which do not have ratings.
[(3)] "Not rated" means balances (Reverse repos) placed with Eurex Clearing, which are not rated.

(in €'000)	Credit rating[1]	Clean carrying value 31.12.2018
Cash in hand, balances with central banks and post office banks	not rated[2]	65,243,078
	AA	2,639
Loans and advances to credit institutions	not rated[3]	263,462
	AA	1,603
	AA-	227,480
	A+	108,140
	A	691,030
Debt securities including fixed-income securities	AAA	14,233,063
	AA+	1,504,603
	AA	2,622,472
	AA-	1,916,056
	A+	283,318
	A	5,023,418
Total		**92,120,362**

(1) Based on the worst rating provided by the major rating agencies (Moody's, Standard & Poor's or Fitch) presented based on the rating scale used by Fitch.
(2) "Not rated" means balances placed with Eurosystem central banks, which do not have ratings.
(3) "Not rated" means balances (Reverse repos) placed with Eurex Clearing, which are not rated.

3.2.3. CREDIT RISK ON DEBT SECURITIES INCLUDING FIXED-INCOME SECURITIES

The ESM invests in assets that fulfil the high credit risk standards set by the Investment Guidelines. To mitigate the credit risk on its investments, the ESM has also established a detailed structure of credit limits. The ESM measures credit exposures and monitors limits compliance daily.

3.2.4. CREDIT RISK IN RELATION TO LOANS TO EURO AREA MEMBER STATES

The ESM, as per its mandate, grants financial assistance to euro area Member States experiencing severe financial problems, if indispensable to safeguard the financial stability of the euro area as a whole and of its Members. The assistance, therefore, aims at providing financial support according to rules that differ from those of financial markets, given that the overall aim is to support the beneficiary Member State's return to public financial stability.

The determination and close monitoring of debt sustainability and conditionality attached to all financial assistance to beneficiary Member States, as negotiated with the European Commission in liaison with the European Central Bank (ECB) and whenever possible the IMF, are aimed at addressing and substantially reducing credit risk. It is the mutual understanding of the ESM Members that ESM loans enjoy preferred creditor status that is similar to the IMF, while accepting preferred creditor status of the IMF over the ESM. This does not apply to ESM loans for programmes that existed when the ESM Treaty was signed. Moreover, for the financial assistance to Spain it was decided to not apply the preferred creditor status. The ESM has implemented an early warning procedure as requested by the ESM Treaty to monitor the ability of the beneficiary Member State to repay its obligations. Findings are summarised in a regular report analysed by the Internal Risk Committee.

The ESM provided financial assistance to Spain for the recapitalisation of its financial sector which must be repaid by 2027. The ESM also provided financial assistance to Cyprus, which implemented a macroeconomic adjustment programme. Furthermore, starting from August 2015, the ESM provided financial assistance to Greece. Note 6 provides a breakdown of all disbursed amounts, as well as the movements during the year.

From an investor's point of view, the ESM's capital structure and the possibility of capital calls mitigate the risk arising from beneficiary Member States' non-payment and potential losses from other risks. Under Article 9 of the ESM Treaty, there are different instances when a capital call can be made to cover losses or avert non-payment, as described in Note 15. These mechanisms provide the strongest possible assurance that ESM debt securities will be serviced and repaid.

3.3. MARKET RISK

Market risk is the risk of loss arising from changes in the value of financial assets and liabilities due to fluctuations in interest rates, foreign exchange rates, and other factors affecting the price of securities / financial instruments (e.g. credit spreads and basis risk).

3.3.1. INTEREST RATE RISK

Interest rate risk is defined as the potential for loss arising from adverse movements in interest rates. The main sources of interest rate risk include asset or liability re-pricing following market movements, yield curve shifts, and changes in interest rate credit spread.

Interest rate risk on Lending and Funding is the risk of a mismatch between the interest rate re-pricing of loans granted to beneficiary Member States and of its funding raised through bills and bond issuances. The exposure to interest rate risk arises from differences in repricing and maturity characteristics of the different asset, liability, and hedging instruments.

All funding costs are passed through to beneficiary Member States under financial assistance, as defined by the ESM Pricing Policy.

Interest rate risk on Investments is the risk of market loss due to an adverse change in the overall level of interest rates affecting the value of the investment portfolio. This risk is monitored and controlled on a daily basis through risk indicators and stress tests. Duration bands, cumulated and partial sensitivities, one-day Value at Risk (VaR) with a 99% level of confidence are part of the daily measures that frame the interest rate risk potential exposure. To complement these measures, a series of stress tests with flattening, steepening and parallel shifts of all or a selected number of interest rate curves is daily processed as part of the risk report.

In addition, capital volatility and capital preservation measures frame and limit the Short-Term and the Medium/Long-Term tranches interest rate risk exposures in line with the Risk Appetite of the Institution as described and published in the ESM Investment Guidelines.

Capital volatility is defined as a yearly limit to market losses over a one-year horizon for the Medium/Long-Term tranche. The one-year VaR 99% should be lower than 3% of the market value of the tranche.

Capital preservation is defined as protecting shareholders from losses on the Paid-in capital, which currently stands at €80.5 billion. The market value of the STT (including the Reserve Fund) and MLTT investment portfolios shall not fall below this value over a relevant investment horizon, for a high level of confidence. The relevant investment horizon is set in relation to the nature of each portfolio:

- For the Short-Term tranche, the capital shall be preserved at a one-year horizon, for a high level of confidence, to the extent possible in light of prevailing market conditions.

- For the Medium/Long-Term tranche, the capital shall be preserved at a three-year horizon for a high level of confidence, to the extent possible in light of prevailing market conditions.

To assess capital preservation with a 'high level of confidence', a vast array of scenarios of interest rate movements are used to forecast the market value of the STT and the MLTT investments over the relevant investment horizons.

Scenario analyses are different to sensitivity analysis as they assess the impact of a range of different setups and correlations over a multi-year period, while sensitivity analysis assesses the linear and instantaneous impact to a given change in interest rates.

These scenarios, developed in cooperation with Investment and Treasury, are agreed at the Internal Risk Committee (IRC) and endorsed by the Board Risk Committee (BRC).

Capital preservation scenario analysis results are reported at least once a year to IRC/BRC and for any major investment portfolio strategy proposal to the IMC.

The Preservation of the maximum lending capacity of the ESM requires the paid-in capital portfolios market value to remain above €75.0 billion, with STT, MLTT and HTMT portfolios valued in mark-to-market. However, the HTM portfolio is considered as being interest rate insensitive in the other risk measures as it is valued at amortised cost.

Derivatives contracted with commercial banks are fully collateralised, thanks to the exchange of cash and highly rated securities, regulated by collateral agreements (ISDA and Credit Support Annex – CSA - standards).

The interest rate risk on the ESM investment portfolio is managed prudently to support the ESM's financial stability mandate, which requires the ESM to maintain financial soundness including in period of market stress.

3.3.2. CURRENCY RISK

Currency risk is defined as the potential for loss arising from changes in exchange rates and shall be minimised by limiting net currency exposure, in line with the risk appetite of the Institution.

The ESM is exposed to currency risk whenever there is a currency mismatch between its assets and liabilities. Potential sources of currency risk are investments in non-euro denominated assets and funding activities in foreign currencies.

In 2019 and 2018, the ESM had investment activities in foreign currency assets, mainly Japanese yen and US dollars. In compliance with the Article 2 (5) of the ESM Investment Guidelines, currency risk is hedged into euro to ensure a limited remaining foreign exchange risk for the ESM (refer to Note 3.6).

The ESM also has funding activities in US dollars. In 2017, the ESM decided to broaden its investor base and spread its funding liquidity risk across the euro and dollar markets. On 31 October 2017, the ESM priced its inaugural US dollar issue, raising $3.0 billion. On 23 October 2018, the ESM raised $3.0 billion by issuing a new 2-year bond, its second deal in the dollar market, followed by a 5-year $2.0 billion bond issuance on the 11 September 2019. The ESM does not run currency risk through these transactions, as it has hedged the proceeds back into euros (refer to Note 3.6.1.2).

As it is the case for Interest Rate Swaps, operations contracted with commercial banks are fully collateralised, thanks to the exchange of cash and highly rated securities, regulated by collateral agreements (ISDA and Credit Support Annex – CSA - standards).

31 December 2019 (in €'000)	Euro (EUR)	Japanese Yen (JPY)	US Dollar (USD)	Swedish Krone (SEK)	Other currencies	Total
ASSETS						
Cash in hand, balances with central banks and post office banks	64,973,149	-	-	-	-	**64,973,149**
Loans and advances to credit institutions	6,412,889	-	-	-	-	**6,412,889**
Loans and advances to euro area Member States	89,894,688	-	-	-	-	**89,894,688**
Debt securities including fixed-income securities	25,637,523	4,836,720	2,442,099	180,391	473,862	**33,570,595**
Prepayments and accrued income	809,411	3,418	49,296	983	-	**863,108**
Total financial assets	**187,727,660**	**4,840,138**	**2,491,395**	**181,374**	**473,862**	**195,714,429**
LIABILITIES						
Amounts owed to credit institutions	330,950	-	-	-	-	**330,950**
Debt securities in issue	103,309,606	-	7,103,488	-	-	**110,413,094**
Other liabilities	10,824	-	-	-	-	**10,824**
Accruals and deferred income	1,157,079	100,400	76,571	2,736	-	**1,336,786**
Total financial liabilities	**104,808,459**	**100,400**	**7,180,059**	**2,736**	**-**	**112,091,654**
Shareholders' equity(1)	83,629,277	-	-	-	-	83,629,277
Total shareholders' equity(2)	**83,629,277**	**-**	**-**	**-**	**-**	**83,629,277**
Off-balance sheet derivatives	**423,942**	**(4,730,876)**	**4,729,660**	**(177,088)**	**(446,747)**	**(201,109)**
Net of financial position	**(286,134)**	**8,862**	**40,996**	**1,550**	**27,115**	**(207,611)**

(1) Excluding subscribed capital unpaid.
(2) Shareholder equity has no defined maturity.

31 December 2018 (in €'000)	Euro (EUR)	Japanese Yen (JPY)	US Dollar (USD)	Swedish Krone (SEK)	Other currencies	Total
ASSETS						
Cash in hand, balances with central banks and post office banks	65,245,717	-	-	-	-	65,245,717
Loans and advances to credit institutions	1,291,715	-	-	-	-	1,291,715
Loans and advances to euro area Member States	89,894,688	-	-	-	-	89,894,688
Debt securities including fixed-income securities	18,765,766	4,968,264	1,366,833	183,994	298,073	25,582,930
Prepayments and accrued income	722,022	5,624	49,288	995	-	777,929
Total financial assets	**175,919,908**	**4,973,888**	**1,416,121**	**184,989**	**298,073**	**182,792,979**
LIABILITIES						
Amounts owed to credit institutions	277,202	-	-	-	-	277,202
Debt securities in issue	93,168,174	-	5,225,785	-	-	98,393,959
Other liabilities	9,503	-	-	-	-	9,503
Accruals and deferred income	970,757	113,256	60,095	3,515	-	1,147,623
Total financial liabilities	**94,425,636**	**113,256**	**5,285,880**	**3,515**	**-**	**99,828,287**
Shareholders' equity[1]	82,971,935	-	-	-	-	82,971,935
Total shareholders' equity[2]	**82,971,935**	**-**	**-**	**-**	**-**	**82,971,935**
Off-balance sheet derivatives	**1,372,710**	**(4,843,353)**	**3,871,878**	**(180,403)**	**-**	**220,832**
Net of financial position	**(104,953)**	**17,279**	**2,119**	**1,071**	**298,073**	**213,589**

[1] Excluding subscribed capital unpaid and subscribed capital called but not paid.
[2] Shareholder equity has no defined maturity.

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3.4. LIQUIDITY RISK

The ESM will honour its obligations under its issued debt securities from proceeds that stem from its support programmes, supported by its subscribed capital. The ESM monitors its liquidity position on a daily basis by assessing its funding liquidity risk and market liquidity risk.

Funding liquidity risk is defined as the risk of loss arising from difficulty in securing the necessary funding, or from a significantly higher cost of funding than normal levels, due to a deterioration of the ESM's creditworthiness, or at a time of unfavourable market conditions (such as periods of high stress). Funding liquidity risk is managed by maintaining a permanent market access to a wide investor base with different funding instruments, multiple credit lines and maintaining an adequate liquidity buffer. The market presence in the USD market which started in 2017 reduces further the funding liquidity risk as it gives access to additional investors in a different market. At the end of December 2019, the ESM's liquidity buffer stood at €15.1 billion (2018: €8.4 billion).

Market liquidity risk is defined as the potential for loss arising from a position that cannot easily be liquidated without significantly and negatively influencing its market price. Market liquidity risk is minimised by investing in high credit quality liquid assets, ensuring the ESM does not hold a significant portion of a security issuance and adopting adequate measurements that allow the timely detection of liquidity deteriorations.

The tables below analyse the ESM's financial assets and liabilities and the shareholders' equity by maturity on the basis of the period remaining between the balance sheet date and the contractual maturity date.

31 December 2019 (in €'000)	Less than 3 months	From 3 months to 1 year	From 1 to 5 years	More than 5 years	Total
ASSETS					
Cash in hand, balances with central banks and post office banks	64,973,149	-	-	-	**64,973,149**
Loans and advances to credit institutions	6,412,889	-	-	-	**6,412,889**
Loans and advances to euro area Member States	-	-	-	89,894,688	**89,894,688**
Debt securities including fixed-income securities	361,112	651,017	17,426,190	15,132,276	**33,570,595**
Prepayments and accrued income	91,652	544,816	-	226,640	**863,108**
Total financial assets	**71,838,802**	**1,195,833**	**17,426,190**	**105,253,604**	**195,714,429**
LIABILITIES					
Amounts owed to credit institutions	330,950	-	-	-	**330,950**
Debt securities in issue	17,500,357	13,166,107	32,893,240	46,853,390	**110,413,094**
Other liabilities	10,824	-	-	-	**10,824**
Accruals and deferred income	358,966	424,464	130,418	422,938	**1,336,786**
Total financial liabilities	**18,201,097**	**13,590,571**	**33,023,658**	**47,276,328**	**112,091,654**
Shareholders' equity(1)	-	-	-	83,629,277	**83,629,277**
Total shareholders' equity(2)	**-**	**-**	**-**	**83,629,277**	**83,629,277**
Net of financial position	**53,637,705**	**(12,394,738)**	**(15,597,468)**	**(25,652,001)**	**(6,502)**

(1) Excluding subscribed capital unpaid.
(2) Shareholder equity has no defined maturity.

31 December 2018 (in €'000)	Less than 3 months	From 3 months to 1 year	From 1 to 5 years	More than 5 years	Total
ASSETS					
Cash in hand, balances with central banks and post office banks	65,245,717	-	-	-	**65,245,717**
Loans and advances to credit institutions	1,291,715	-	-	-	**1,291,715**
Loans and advances to euro area Member States	-	-	-	89,894,688	**89,894,688**
Debt securities including fixed-income securities	433,795	834,702	15,611,898	8,702,535	**25,582,930**
Prepayments and accrued income	95,838	567,510	-	114,581	**777,929**
Total financial assets	**67,067,065**	**1,402,212**	**15,611,898**	**98,711,804**	**182,792,979**
LIABILITIES					
Amounts owed to credit institutions	277,202	-	-	-	**277,202**
Debt securities in issue	11,897,405	9,012,566	32,216,672	45,267,316	**98,393,959**
Other liabilities	9,503	-	-	-	**9,503**
Accruals and deferred income	325,499	445,425	158,941	217,758	**1,147,623**
Total financial liabilities	**12,509,609**	**9,457,991**	**32,375,613**	**45,485,074**	**99,828,287**
Shareholders' equity(1)	-	-	-	82,971,935	**82,971,935**
Total shareholders' equity(2)	**-**	**-**	**-**	**82,971,935**	**82,971,935**
Net of financial position	**54,557,456**	**(8,055,779)**	**(16,763,715)**	**(29,745,205)**	**(7,243)**

(1) Excluding subscribed capital unpaid and subscribed capital called but not paid.
(2) Shareholder equity has no defined maturity.

3.5. OPERATIONAL RISK

Operational risk is defined as the potential loss or damage, and/or the inability of the ESM to fulfil its mandate, resulting from inadequate or failed internal processes, people, and systems or from external events. The categorisation of the ESM operational risks is based on guidance from the Basel Committee on Banking Supervision, as follows:

- execution, delivery, and process management;
- counterparts, products, and business practices;
- fraud;
- business continuity and systems failures;
- employment practices and workplace safety; and
- damage to physical assets.

Management has no tolerance for material operational risks, including those originating from third party/vendor engagements, which may result in the ESM's inability to effectively fulfil its mandate, or in significant loss and/or reputational damage. No material operational risk losses were identified in 2019.

All departments are responsible for the proactive mitigation of operational risks, and for the robustness of the controls in their processes. If operational risk events occur, they are reported to the Risk Management through an internal operational risk register. Formal escalation procedures have been established involving the Internal Risk

Committee and the Board Risk Committee to ensure the active involvement of senior management and, where necessary, the Board of Directors.

All departments, with support from the Operational Risk function, perform a root-cause analysis of operational risk events and implement improvements, as necessary, in the underlying processes and controls to reduce the probability of reoccurrence. This approach is complemented by annual risk control self-assessments for each department, and bi-annual business continuity risk assessment, to identify and assess the ESM's top operational risks (based on potential likelihood and impact). The Risk Management monitors these risks and reports on them to the Internal Risk Committee and to the Board Risk Committee.

3.6. DERIVATIVES

The ESM uses derivatives instruments as described in Note 2.5 for risk management purposes only and this as part of its investment and funding activities. In 2015, the ESM entered into foreign exchange derivative transactions such as foreign exchange swaps and forward contracts to hedge the currency risk related to short-term non-euro denominated investments. Since 2017, the ESM has also entered into interest rate swaps to manage globally the investment portfolio's interest rate exposure and to decrease the interest rate volatility on the Greece's debt repayments. Longer term cross currency asset swaps were contracted as well to hedge longer-term non-euro denominated investments and to hedge in euro the issuances in USD. In 2019, the ESM also started to use bond futures to manage the interest rate risk of the Paid-in capital portfolio.

On 31 December 2019, the derivative instruments had a maximum maturity up to 29 years (2018: maximum maturity up to 30 years) and were concluded with euro area central banks, international financial institutions and commercial banks.

3.6.1. FUNDING-RELATED DERIVATIVES

The derivatives used in the context of funding are:

- Interest rate swaps;
- Cross-currency asset swaps.

3.6.1.1. INTEREST RATE SWAPS

Interest rate swaps exchange future interest payments, usually a fixed interest rate for a floating rate, or vice versa, to reduce or increase exposure to fluctuations in interest rates based on a specified notional amount.

On 20 January 2017, the ESM Board of Directors approved three schemes aimed at reducing interest rate risk for Greece. Amongst others, it allowed the ESM to enter into interest rate swaps arrangements that aimed to stabilise the ESM's overall cost of funding for Greece, i.e. to reduce the risk that Greece would have to pay a higher interest rate on its loans in case market rates start rising.

The following table shows the interest rate swaps according to their notional amount and fair value. The notional amounts are disclosed off balance sheet.

Interest rate swaps (in €'000)	31.12.2019	31.12.2018
Notional amount	59,062,000	60,000,000
Positive fair value	995,527	284,496
Negative fair value	(6,865,169)	(1,139,657)

3.6.1.2. CROSS-CURRENCY ASSET SWAPS

Cross-currency asset swaps are derivative contracts under which two counterparties agree to exchange interest payments (fixed-fixed, fixed-float and float-float) and principal denominated in two different currencies. In a cross-currency asset swap, interest payments and principal in one currency are exchanged for equally valued principal and interest payments in a different currency. Interest payments are exchanged at fixed intervals during the life of the contract. Starting in 2017 and continuing in 2018 and 2019, the ESM broadened its investor base and spread its funding liquidity risk across the euro and dollar markets (refer to Note 3.3.2). The ESM hedges the currency risk of these transactions in US dollars using cross-currency asset swaps contracts.

The following table shows the cross-currency swaps according to their notional amount and fair value. The notional amounts are disclosed off balance sheet.

Cross-currency assets swaps (in €'000)	31.12.2019	31.12.2018
Notional amount	7,121,239	5,240,175
Positive fair value	258,892	88,315
Negative fair value	(30,218)	-

3.6.2. INVESTMENT-RELATED DERIVATIVES

The derivatives used in the context of investment activity are:

- Interest rate swaps;
- Cross-currency asset swaps;
- Foreign exchange (FX) swaps;
- Bond futures contracts.

3.6.2.1. INTEREST RATE SWAPS

Interest rate swaps exchange future interest payments, usually a fixed interest rate for a floating rate, or vice versa, to reduce or increase exposure to fluctuations in interest rates based on a specified notional amount.

Starting in 2017, the ESM has used interest rate swaps to manage the interest rate risk of the paid-in capital portfolio.

The following table shows the interest rate swaps according to their notional amount and fair value. The notional amounts are disclosed off balance sheet.

Interest rate swaps (in €'000)	31.12.2019	31.12.2018
Notional amount	6,139,500	2,372,500
Positive fair value	10,426	4,056
Negative fair value	(201,750)	(33,685)

3.6.2.2. FOREIGN EXCHANGE (FX) SWAPS

In a foreign exchange swap, two parties agree to exchange the principal amounts of two different currencies at the beginning of the transaction and the amounts to exchange at maturity.

Starting from 2015, the ESM has invested limited amounts in short-term (with a maximum maturity of 2 years) assets denominated in a foreign currency.

The following tables shows the foreign exchange swaps according to their notional amount and fair value. The notional amounts are disclosed off balance sheet.

Foreign exchange swaps (in €'000)	31.12.2019	31.12.2018
Notional amount	-	484,896
Positive fair value	-	8,039

3.6.2.3. CROSS-CURRENCY ASSET SWAPS

Cross-currency asset swaps are derivatives contracts under which two counterparties agree to exchange interest payments (fixed-fixed, fixed-float and float-float) and principal denominated in two different currencies. In a cross-currency asset swap, interest payments and principal in one currency are exchanged for equally valued principal and interest payments in a different currency. Interest payments are exchanged at fixed intervals during the life of the contract.

Starting in 2017, the ESM has invested in non-euro denominated securities with longer maturities.

The following table shows the cross currency-asset swaps according to their notional amount and fair value. The notional amounts are disclosed off balance sheet.

Cross-currency asset swaps (in €'000)	31.12.2019	31.12.2018
Notional amount	7,390,943	6,027,103
Positive fair value	20,166	8,942
Negative fair value	(518,579)	(326,163)

3.6.2.4. FUTURES CONTRACTS

The ESM also uses futures contracts in order to manage portfolio interest rate risk by either buying or selling futures contracts.

The following table shows the bond futures contracts according to their notional amount and fair value. The notional amounts are disclosed off balance sheet.

Bond futures contracts (in €'000)	31.12.2019	31.12.2018
Notional amount	(12,500)	-

3.6.3. CREDIT RISK ON DERIVATIVES

Credit risk exposure for derivatives lies in the loss that the ESM would incur if a counterparty were unable to honour its contractual obligations. There are three main forms of credit risk related to derivatives. First, for cross-currency asset swaps and FX swaps, the exchange of notional principal at the beginning and maturity of a trade can lead to settlement risk. Second, the default of a derivative counterparty over the life of the derivative can lead to a loss, if changes in the mark-to-market (MtM) value of the position are not fully collateralised at the time of default. Third, when using derivatives, the ESM is exposed to replacement risk. This is the loss the ESM would face if it had to replace a trade from a defaulted counterparty with a new counterparty.

With regard to derivative transactions, the ESM has contracted FX and interest rate derivatives since 2015. Operations contracted with commercial banks are fully collateralised, thanks to the exchange of cash and highly rated securities. The exposure after collateral posting is then limited to the intraday market movements and their impact on the market value of the exposure and on the posted collateral value.

The ESM has put in place a series of procedures to safeguard against losses arising from the use of such instruments.

- Contractual framework

All of the ESM's derivatives transactions are governed by best practice International Swaps and Derivatives Association (ISDA) agreements. In addition, for all commercial counterparties, the ESM has put in place Credit Support Annexes (CSAs) for over-the-counter transactions, which specify the conditions of exposure collateralisation on a daily basis.

- Counterparty selection

The minimum rating of a counterparty at the outset of a trade is at least BBB+/Baa1. The ESM has the right of early termination if the rating of the counterparty drops below a certain level. The ESM sets derivative limits per counterparty, based on forecasted exposure at default. The ESM approach is aligned with the Basel Committee's recommended standardised approach for measuring counterparty credit risk exposures to quantify exposure at default per counterparty. The methodology also considers potential losses that could occur in between the default and the replacement of the cancelled trade.

- Collateralisation

Exposures towards commercial banks (exceeding limited thresholds) are fully collateralised by cash and/or securities. On a daily basis, the ESM monitors and values its derivative positions, and calls or releases collateral, as applicable. Below a certain counterparty credit rating, the ESM receives an additional independent amount from counterparties, in line with recommendations of the Basel Committee.

- Settlement limits

The ESM limits settlement risk for bilateral FX swaps and cross-currency asset swaps through settlement limits for counterparties, based on these counterparties' creditworthiness. Settlement risk is measured and monitored on a daily basis.

In the context of the United Kingdom leaving the EU, the ESM has reviewed any exposures that it has towards counterparties based in the United Kingdom and has taken pre-emptive measures, as applicable, to mitigate the impact on the ESM's business operations.

4. CASH IN HAND, BALANCES WITH CENTRAL BANKS AND POST OFFICE BANKS

The composition of cash in hand, balances with central banks and post office banks is as follows:

(in €'000)	31.12.2019	31.12.2018
Current account balances with euro area central banks[1]	64,967,836	65,243,078
Current account balances with other banks[2]	5,313	2,639
Total cash in hand, balances with central banks and post office banks	**64,973,149**	**65,245,717**

[1] During the financial year, the ESM held balances with national central banks from France (Banque de France), Germany (Deutsche Bundesbank) and Italy (Banca d'Italia), as well as with the European Central Bank.
[2] The ESM holds current accounts for operational purposes with a state-owned bank as well as clearing accounts with custodians. No current account is held with post office banks.

The cash balance with euro area central banks is comprised of paid-in capital, the reserve fund and the liquidity buffer investment.

5. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

The following table shows the breakdown of the other loans and advances to credit institutions:

(in €'000)	31.12.2019	31.12.2018
Cash collateral provided	6,081,320	1,026,650
Reverse repos	329,966	263,462
Other deposits	1,603	1,603
Total loans and advances to credit institutions	**6,412,889**	**1,291,715**

Other deposits consist entirely of the lease guarantee deposit in relation to the ESM rental agreement. The cash collateral provided for relates entirely to derivatives transactions. The reverse repurchase agreements (`reverse repos`) are transactions exchange-traded on regulated markets.

6. LOANS AND ADVANCES TO EURO AREA MEMBER STATES

In accordance with Article 9 of the ESM Treaty, the Board of Governors may decide to grant financial assistance in the form of a loan to an ESM Member (refer to Note 26).

The following table shows the geographical breakdown of loans per financial assistance programme and by borrowing country:

(in €'000)	No. of loans	Nominal amount	Clean carrying value as at 31 December 2019
Loans to euro area Member States			
- to Spain	5	23,721,460	23,721,460
- to Cyprus	9	6,300,000	6,300,000
- to Greece	11	59,873,228	59,873,228
Total	**25**	**89,894,688**	**89,894,688**

(in €'000)	No. of loans	Nominal amount	Clean carrying value as at 31 December 2018
Loans to euro area Member States			
- to Spain	5	23,721,460	23,721,460
- to Cyprus	9	6,300,000	6,300,000
- to Greece	11	59,873,228	59,873,228
Total	**25**	**89,894,688**	**89,894,688**

The following table shows the movements of the loans to euro area Member States during 2018 and 2019:

(in €'000)	
1 January 2018 balance	**76,194,688**
New disbursements	21,700,000
- to Greece	*21,700,000*
Early repayments	(8,000,000)
- from Spain	*(8,000,000)*
31 December 2018 balance	**89,894,688**

(in €'000)	
1 January 2019 balance	**89,894,688**
New disbursements	-
Early repayments	-
31 December 2019 balance	**89,894,688**

7. DEBT SECURITIES INCLUDING FIXED-INCOME SECURITIES

The following table shows the details of the paid-in-capital portfolio debt securities valuation:

31.12.2019 (in €'000)	Amortised cost	Unrealised gains	Carrying amount	Nominal amount
Short-term, medium-term and long-term tranche	31,699,308	442,403	32,141,711	31,298,338
Hold-to-maturity tranche	1,428,884	-	1,428,884	1,332,059
Total debt securities including fixed income securities	**33,128,192**	**442,403**	**33,570,595**	**32,630,397**

31.12.2018 (in €'000)	Amortised cost	Unrealised gains	Carrying amount	Nominal amount
Short-term, medium-term and long-term tranche	25,442,756	140,174	25,582,930	25,155,501
Total debt securities including fixed income securities	**25,442,756**	**140,174**	**25,582,930**	**25,155,501**

On 31 December 2019, the amortised cost of the debt securities invested in the Short-term tranche and in the Medium and long-term tranche was €31.7 billion (31 December 2018: €25.4 billion), against a carrying amount at fair value of €32.1 billion (31 December 2018: €25.6 billion). The difference represents the unrealised result and is recognised directly in the equity within the fair value reserve.

The debt securities invested in the Hold-to-maturity tranche are initially recognised at cost and measured subsequently at amortised cost (refer to Note 2.7.1), less impairment where needed.

On 31 December 2019, the total carrying amount of the debt securities in the paid-in capital portfolios was €33.6 billion.

In respect of the paid-in capital portfolio invested in debt securities, the ESM has an established investment policy setting strict eligibility criteria that restrict investment to issuers with the highest credit quality. The ESM's risk management defines a limit structure to mitigate the maximum exposure per issuer.

On 31 December 2019, the debt securities including fixed income securities included also investments in money market securities that were not listed on regulated markets with a total carrying value of €156.9 million (31 December 2018: €89.2 million). Their fair values were determined using valuation techniques, as disclosed in Note 2.7.3. All other securities were listed on regulated markets and the fair values of these assets are based on quoted market prices.

The ESM invests in debt securities issued by public bodies and other issuers. Public bodies include central banks, central governments, regional governments, local governments, supranational institutions and governmental agencies. On 31 December 2019, debt securities issued by public bodies amounted to €14.6 billion (31 December 2018: €8.3 billion), while debt securities issued by other borrowers amounted to €18.9 billion (31 December 2018: €17.3 billion).

Starting from 2015, the ESM has invested part of the paid-in capital portfolio in short-term assets denominated in a foreign currency (refer to Note 3.3.2). Starting in 2017, the ESM has invested in non-euro denominated securities with longer maturities.

8. INTANGIBLE ASSETS

The following table shows the movements of intangible assets during 2019:

(in €'000)	Software	Total intangible assets
Historical cost		
1 January 2019 balance	195	195
Additions	5	5
31 December 2019 balance	**200**	**200**
Accumulated amortisation		
1 January 2019 balance	(159)	(159)
Amortisation	(23)	(23)
31 December 2019 balance	**(182)**	**(182)**
Net book value		
31 December 2019 balance	**18**	**18**
31 December 2018 balance	**36**	**36**

9. TANGIBLE ASSETS

The following table shows the movements of tangible assets during 2019:

(in €'000)	Fixtures and fittings	Furniture and office equipment	Total tangible assets
Historical cost			
1 January 2019 balance	9,787	2,575	12,362
Additions	658	210	868
31 December 2019 balance	**10,445**	**2,785**	**13,230**
Accumulated depreciation			
1 January 2019 balance	(3,306)	(1,849)	(5,155)
Depreciation	(1,345)	(256)	(1,601)
31 December 2019 balance	**(4,651)**	**(2,105)**	**(6,756)**
Net book value			
31 December 2019 balance	**5,794**	**680**	**6,474**
31 December 2018 balance	**6,481**	**726**	**7,207**

10. PREPAYMENTS AND ACCRUED INCOME

The following table shows the breakdown of prepayments and accrued income. The receivables are due within a year:

(in €'000)	31.12.2019	31.12.2018
Interest receivable on:		
- Debt securities including fixed-income securities	102,140	78,620
- Loans and advances to euro area Member States	395,467	431,006
- Loans and advances to credit institutions	91	92
Amounts charged to the EFSF for administrative services (Notes 20/26)	9,414	9,789
Commitment fee receivable	617	75
Prepayments	842	115,372
Amounts from sanctions to Member States[1]	-	26,820
Prepayments and accrued income on derivatives[2]	354,537	116,155
Total prepayments and accrued income	**863,108**	**777,929**

[1] The ESM received in 2019 the payments of certain sanctions paid by its Member States (refer to Note 24).
[2] Spot revaluation, spread amortisation and accrued income of ongoing derivative transactions (refer to Note 2.11).

11. AMOUNTS OWED TO CREDIT INSTITUTIONS

On 31 December 2019, the €331.0 million (31 December 2018: €277.2 million) of amounts owed to credit institutions were composed of cash collateral received for the derivatives for €1.3 million (31 December 2018: €14.2 million) and repurchase agreements ("repo") for €329.7 million (31 December 2018: €263.0 million).

12. DEBTS EVIDENCED BY CERTIFICATES

The following table discloses the details of debt securities in issue outstanding on 31 December 2019, together with the coupon rates and due dates.

Type of funding Programmes	ISIN code	Nominal amount (in €'000)	Issue date	Maturity date	Coupon
Long-term Funding	EU000A1U9803	3,000,000	20/11/2013	20/11/2023	2.125%
Long-term Funding	EU000A1U9803[2]	990,750	27/06/2014	20/11/2023	2.125%
Long-term Funding	EU000A1U9811	6,000,000	04/03/2014	04/03/2021	1.375%
Long-term Funding	EU000A1U9894	3,000,000	23/09/2015	23/09/2025	1.000%
Long-term Funding	EU000A1U9894[2]	999,850	29/09/2016	23/09/2025	1.000%
Long-term Funding	EU000A1U9902	3,000,000	20/10/2015	20/10/2045	1.750%
Long-term Funding	EU000A1U9910	4,000,000	03/11/2015	03/11/2020	0.100%
Long-term Funding	EU000A1U9910[2]	992,750	11/03/2016	03/11/2020	0.100%
Long-term Funding	EU000A1U9928	1,500,000	17/11/2015	17/11/2036	1.625%
Long-term Funding	EU000A1U9928[2]	1,000,000	31/03/2016	17/11/2036	1.625%
Long-term Funding	EU000A1U9936	1,000,000	01/12/2015	01/12/2055	1.850%
Long-term Funding	EU000A1U9936[2]	1,000,000	01/03/2016	01/12/2055	1.850%
Long-term Funding	EU000A1U9936[2]	750,000	05/09/2018	01/12/2055	1.850%
Long-term Funding	EU000A1U9944	3,000,000	02/03/2016	02/03/2026	0.500%
Long-term Funding	EU000A1U9944[2]	2,500,000	19/07/2016	02/03/2026	0.500%
Long-term Funding	EU000A1U9951	3,000,000	22/04/2016	22/04/2024	0.125%
Long-term Funding	EU000A1U9951[2]	961,100	28/07/2016	22/04/2024	0.125%
Long-term Funding	EU000A1U9951[2]	989,750	11/11/2016	22/04/2024	0.125%
Long-term Funding	EU000A1U9969	3,000,000	03/05/2016	03/05/2032	1.125%
Long-term Funding	EU000A1U9969[2]	1,000,000	18/10/2016	03/05/2032	1.125%
Long-term Funding	EU000A1U9977	2,500,000	19/07/2016	18/07/2042	0.875%
Long-term Funding	EU000A1U9985[1]	3,000,000	18/10/2016	18/10/2022	N/A
Long-term Funding	EU000A1U9985[2]	996,500	16/11/2017	18/10/2022	N/A
Long-term Funding	EU000A1U9985[2]	998,550	23/02/2018	18/10/2022	N/A
Long-term Funding	EU000A1Z99A1	3,500,000	01/02/2017	02/11/2046	1.800%
Long-term Funding	EU000A1Z99A1[2]	1,500,000	14/06/2017	02/11/2046	1.800%
Long-term Funding	EU000A1Z99B9	3,000,000	14/03/2017	15/03/2027	0.750%
Long-term Funding	EU000A1Z99B9[2]	1,500,000	19/06/2018	15/03/2027	0.750%
Long-term Funding	EU000A1Z99D5	2,000,000	23/05/2018	23/05/2033	1.200%
Long-term Funding	EU000A1Z99E3	4,000,000	31/07/2018	31/07/2023	0.100%
Long-term Funding	EU000A1Z99F0	3,250,000	05/09/2018	05/09/2028	0.750%
Long-term Funding	EU000A1Z99G8[1]	3,000,000	16/10/2018	17/01/2022	N/A
Long-term Funding	EU000A1Z99H6	2,000,000	05/03/2019	05/03/2029	0.500%
Long-term Funding	EU000A1Z99H6[2]	1,000,000	14/05/2019	05/03/2029	0.500%
Long-term Funding	EU000A1Z99J2[1]	3,500,000	29/10/2019	14/03/2025	N/A
Long-term Funding	XS1704649158[4]	2,670,465	31/10/2017	03/11/2022	2.125%
Long-term Funding	XS2051117195[4]	1,780,310	11/09/2019	11/09/2024	1.375%
Long-term Funding	ESMNBOND0001[3]	80,000	22/01/2016	22/01/2041	1.572%
Long-term Funding	ESMNBOND0002[3]	30,000	10/02/2016	11/02/2041	1.360%

Type of funding Programmes	ISIN code	Nominal amount (in €'000)	Issue date	Maturity date	Coupon
Long-term Funding	ESMNBOND0003[3]	25,000	09/03/2016	09/03/2056	1.559%
Long-term Funding	ESMNBOND0004[3]	25,000	09/03/2016	09/03/2056	1.559%
Long-term Funding	ESMNBOND0005[3]	25,000	31/03/2016	22/03/2046	1.316%
Long-term Funding	ESMNBOND0006[3]	30,000	11/04/2016	11/04/2046	1.220%
Long-term Funding	ESMNBOND0007[3]	40,000	03/08/2016	03/08/2056	1.156%
Long-term Funding	ESMNBOND0008[3]	150,000	09/08/2016	09/08/2056	1.150%
Long-term Funding	ESMNBOND0009[3]	50,000	19/08/2016	19/08/2053	1.025%
Long-term Funding	ESMNBOND0010[3]	50,000	19/08/2016	18/08/2056	1.064%
Long-term Funding	ESMNBOND0011[3]	50,000	19/09/2016	19/09/2051	1.030%
Long-term Funding	ESMNBOND0012[3]	50,000	19/10/2016	19/10/2054	1.145%
Long-term Funding	ESMNBOND0013[3]	40,000	19/10/2016	19/10/2056	1.125%
Long-term Funding	ESMNBOND0014[3]	25,000	27/10/2016	27/10/2056	1.086%
Long-term Funding	ESMNBOND0015[3]	110,000	14/03/2017	14/03/2047	1.800%
Long-term Funding	ESMNBOND0016[3]	40,000	31/03/2017	30/03/2057	1.850%
Long-term Funding	ESMNBOND0017[3]	100,000	21/04/2017	21/04/2047	1.573%
Long-term Funding	ESMNBOND0018[3]	60,000	27/11/2017	27/11/2057	1.591%
Long-term Funding	ESMNBOND0019[3]	25,000	11/12/2017	11/12/2057	1.530%
Long-term Funding	ESMNBOND0020[3]	50,000	12/12/2017	12/12/2057	1.505%
Long-term Funding	ESMNBOND0021[3]	50,000	19/12/2017	19/12/2057	1.442%
Short-term Funding	EU000A1Z99G8[2]	1,500,000	14/05/2019	17/01/2022	N/A
Short-term Funding	XS1896646137[4]	2,670,465	23/10/2018	23/10/2020	3.000%
Short-term Funding	EU000A2SB810[1]	2,499,760	18/07/2019	23/01/2020	N/A
Short-term Funding	EU000A2SB836[1]	3,493,280	22/08/2019	20/02/2020	N/A
Short-term Funding	EU000A2SB851[1]	2,999,980	19/09/2019	19/03/2020	N/A
Short-term Funding	EU000A2SB869[1]	3,499,200	10/10/2019	09/01/2020	N/A
Short-term Funding	EU000A2SB877[1]	2,994,580	24/10/2019	23/04/2020	N/A
Short-term Funding	EU000A2SB885[1]	2,499,000	07/11/2019	06/02/2020	N/A
Short-term Funding	EU000A2SB893[1]	2,499,090	21/11/2019	21/05/2020	N/A
Short-term Funding	EU000A2SB9A0[1]	2,497,750	05/12/2019	05/03/2020	N/A
Total		**110,138,130**[5]			

[1] Zero-coupon bond.
[2] Tap issue.
[3] N-bond with technical ISIN: the ESM issued its first N-bond (Namensschuldverschreibungen) in 2016. N-Bonds are privately placed, long-term funding instruments that are neither centrally cleared nor listed.
[4] USD denominated debt securities issued starting from 2017.
[5] The difference with the total amount in the balance sheet comes from the premium and discount amortisations. The debt evidenced by certificates are presented at their amortised cost in the balance sheet (refer to Note 2.13).

The following table discloses the details of debt securities in issue outstanding on 31 December 2018, together with the coupon rates and due dates.

Type of funding Programmes	ISIN code	Nominal amount (in €'000)	Issue date	Maturity date	Coupon
Long-term Funding	EU000A1U9803	3,000,000	20/11/2013	20/11/2023	2.125%
Long-term Funding	EU000A1U9803(2)	990,750	27/06/2014	20/11/2023	2.125%
Long-term Funding	EU000A1U9811	6,000,000	04/03/2014	04/03/2021	1.375%
Long-term Funding	EU000A1U9829	3,000,000	14/05/2014	15/10/2019	0.875%
Long-term Funding	EU000A1U9829(2)	2,000,000	28/07/2015	15/10/2019	0.875%
Long-term Funding	EU000A1U9894	3,000,000	23/09/2015	23/09/2025	1.000%
Long-term Funding	EU000A1U9894(2)	999,850	29/09/2016	23/09/2025	1.000%
Long-term Funding	EU000A1U9902	3,000,000	20/10/2015	20/10/2045	1.750%
Long-term Funding	EU000A1U9910	4,000,000	03/11/2015	03/11/2020	0.100%
Long-term Funding	EU000A1U9910(2)	992,750	11/03/2016	03/11/2020	0.100%
Long-term Funding	EU000A1U9928	1,500,000	17/11/2015	17/11/2036	1.625%
Long-term Funding	EU000A1U9928(2)	1,000,000	31/03/2016	17/11/2036	1.625%
Long-term Funding	EU000A1U9936	1,000,000	01/12/2015	01/12/2055	1.850%
Long-term Funding	EU000A1U9936(2)	1,000,000	01/03/2016	01/12/2055	1.850%
Long-term Funding	EU000A1U9944	3,000,000	02/03/2016	02/03/2026	0.500%
Long-term Funding	EU000A1U9944(2)	2,500,000	19/07/2016	02/03/2026	0.500%
Long-term Funding	EU000A1U9951	3,000,000	22/04/2016	22/04/2024	0.125%
Long-term Funding	EU000A1U9951(2)	961,100	28/07/2016	22/04/2024	0.125%
Long-term Funding	EU000A1U9951(2)	989,750	11/11/2016	22/04/2024	0.125%
Long-term Funding	EU000A1U9969	3,000,000	03/05/2016	03/05/2032	1.125%
Long-term Funding	EU000A1U9969(2)	1,000,000	18/10/2016	03/05/2032	1.125%
Long-term Funding	EU000A1U9977	2,500,000	19/07/2016	18/07/2042	0.875%
Long-term Funding	ESMNBOND0001(3)	80,000	22/01/2016	22/01/2041	1.572%
Long-term Funding	ESMNBOND0002(3)	30,000	10/02/2016	11/02/2041	1.360%
Long-term Funding	ESMNBOND0003(3)	25,000	09/03/2016	09/03/2056	1.559%
Long-term Funding	ESMNBOND0004(3)	25,000	09/03/2016	09/03/2056	1.559%
Long-term Funding	ESMNBOND0005(3)	25,000	31/03/2016	22/03/2046	1.316%
Long-term Funding	ESMNBOND0006(3)	30,000	11/04/2016	11/04/2046	1.220%
Long-term Funding	ESMNBOND0007(3)	40,000	03/08/2016	03/08/2056	1.156%
Long-term Funding	ESMNBOND0008(3)	150,000	09/08/2016	09/08/2056	1.150%
Long-term Funding	ESMNBOND0009(3)	50,000	19/08/2016	19/08/2053	1.025%
Long-term Funding	ESMNBOND0010(3)	50,000	19/08/2016	18/08/2056	1.064%
Long-term Funding	ESMNBOND0011(3)	50,000	19/09/2016	19/09/2051	1.030%
Long-term Funding	EU000A1U9985	3,000,000	18/10/2016	18/10/2022	0.000%
Long-term Funding	EU000A1U9985(2)	996,500	16/11/2017	18/10/2022	0.000%
Long-term Funding	ESMNBOND0012(3)	50,000	19/10/2016	19/10/2054	1.145%
Long-term Funding	ESMNBOND0013(3)	40,000	19/10/2016	19/10/2056	1.125%
Long-term Funding	ESMNBOND0014(3)	25,000	27/10/2016	27/10/2056	1.086%
Long-term Funding	EU000A1Z99A1	3,500,000	01/02/2017	02/11/2046	1.800%
Long-term Funding	EU000A1Z99A1(2)	1,500,000	14/06/2017	02/11/2046	1.800%
Long-term Funding	EU000A1Z99B9	3,000,000	14/03/2017	15/03/2027	0.750%
Long-term Funding	ESMNBOND0015(3)	110,000	14/03/2017	14/03/2047	1.800%
Long-term Funding	ESMNBOND0016(3)	40,000	31/03/2017	30/03/2057	1.850%
Long-term Funding	ESMNBOND0017(3)	100,000	21/04/2017	21/04/2047	1.573%
Long-term Funding	XS1704649158(4)	2,620,087	31/10/2017	03/11/2022	2.125%
Long-term Funding	ESMNBOND0018(3)	60,000	27/11/2017	27/11/2057	1.591%
Long-term Funding	ESMNBOND0019(3)	25,000	11/12/2017	11/12/2057	1.530%
Long-term Funding	ESMNBOND0020(3)	50,000	12/12/2017	12/12/2057	1.505%
Long-term Funding	ESMNBOND0021(3)	50,000	19/12/2017	19/12/2057	1.442%
Long-term Funding	EU000A1U9985(2)	998,550	23/02/2018	18/10/2022	0.000%
Long-term Funding	EU000A1Z99D5	2,000,000	23/05/2018	23/05/2033	1.200%
Long-term Funding	EU000A1Z99B9(2)	1,500,000	19/06/2018	15/03/2027	0.750%
Long-term Funding	EU000A1Z99E3	4,000,000	31/07/2018	31/07/2023	0.100%
Long-term Funding	EU000A1U9936	750,000	05/09/2018	01/12/2055	1.850%

Type of funding Programmes	ISIN code	Nominal amount (in €'000)	Issue date	Maturity date	Coupon
Long-term Funding	EU000A1Z99F0	3,250,000	05/09/2018	05/09/2028	0.750%
Long-term Funding	EU000A1Z99G8	3,000,000	16/10/2018	17/01/2022	0.000%
Long-term Funding	XS1896646137[4]	2,620,087	23/10/2018	23/10/2020	0.000%
Short-term Funding	EU000A1Z98Y3[1]	1,922,350	19/07/2018	24/01/2019	N/A
Short-term Funding	EU000A1Z9808[1]	1,999,250	23/08/2018	21/02/2019	N/A
Short-term Funding	EU000A1Z9824[1]	1,970,200	20/09/2018	21/03/2019	N/A
Short-term Funding	EU000A1Z9832[1]	1,999,750	04/10/2018	10/01/2019	N/A
Short-term Funding	EU000A1Z9840[1]	1,998,400	18/10/2018	18/04/2019	N/A
Short-term Funding	EU000A1Z9857[1]	1,998,300	08/11/2018	07/02/2019	N/A
Short-term Funding	EU000A1Z9865[1]	1,998,900	22/11/2018	23/05/2019	N/A
Short-term Funding	EU000A1Z9873[1]	1,999,500	06/12/2018	07/03/2019	N/A
Total		**98,161,074**[5]			

[1] Zero-coupon bond.
[2] Tap issue.
[3] N-bond with technical ISIN: the ESM issued its first N-bond (Namensschuldverschreibungen) in 2016. N-Bonds are privately placed, long-term funding instruments that are neither centrally cleared nor listed
[4] USD denominated debt securities issued starting from 2017.
[5] The difference with the total amount in the balance sheet comes from the premium and discount amortisations. The debt evidenced by certificates are presented at their amortised cost in the balance sheet (Refer to Note 2.13).

The following table shows the movements of the debt securities in issue in 2018 and 2019:

(in €'000)	
1 January 2018 balance	**89,201,083**
Issuance during the period	63,821,416
Maturities during the year	(54,631,850)
Exchange adjustments	118,056
Premiums/discounts amortisation	(114,746)
31 December 2018 balance	**98,393,959**

(in €'000)	
1 January 2019 balance	**98,393,959**
Issuances during the year	65,756,716
Maturities during the year	(53,673,530)
Exchange adjustments	63,221
Premiums/discounts amortisation	(127,272)
31 December 2019 balance	**110,413,094**

All debt securities in issue on 31 December 2018 are issued under English law as the governing law, except the N-bonds which are issued under German law. The euro-denominated debt securities in issue on 31 December 2019 are until October 2019 issued under English law and then issued under Luxembourgish law.

13. OTHER LIABILITIES

On 31 December 2019, the other liabilities were composed of suppliers' invoices and staff cost related payables not yet settled, amounting to €10.8 million (31 December 2018: €9.5 million).

14. ACCRUALS AND DEFERRED INCOME

The following table shows the breakdown of the accruals and deferred income:

(in €'000)	31.12.2019	31.12.2018
Interest payable cash and cash equivalents	28,338	24,100
Interest payable on loans to credit institutions	2,555	306
Interest payable on debts evidenced by certificates	294,671	282,193
Deferred income on up-front service fee	185,512	262,179
Accruals and deferred income on derivatives[1]	825,710	578,845
Total accruals and deferred income	**1,336,786**	**1,147,623**

[1] Spot revaluation, spread amortisation and accrued expense of ongoing derivative transactions (refer to Note 2.16 and Note 2.5).

As explained in Note 2.3, the amortisation of the up-front service fee is recognised in the profit and loss account on a linear basis under 'Interest receivable and similar income on loans to euro area Member States'.

15. SUBSCRIBED CAPITAL

(in €'000)	Subscribed capital	Subscribed, uncalled capital	Subscribed, called capital
1 January 2018	704,798,700	(624,250,300)	80,548,400
Subscription to the authorised capital	-	-	-
Authorised capital calls	-	-	-
31 December 2018	704,798,700	(624,250,300)	80,548,400

(in €'000)	Subscribed capital	Subscribed, uncalled capital	Subscribed, called capital
1 January 2019	704,798,700	(624,250,300)	80,548,400
Subscription to the authorised capital	-	-	-
Authorised capital calls	-	-	-
31 December 2019	704,798,700	(624,250,300)	80,548,400

On 31 December 2019, the ESM's shareholders were the 19 euro area Member States. The contribution key for subscribing to the ESM authorised capital is based on the key for subscription, by the national central banks of the ESM Members, of the ECB's capital.

Latvia joined the ESM on 13 March 2014 and subscribed to an authorised capital of 19,353 shares with a par value of €100,000 each, representing €1.9 billion of subscribed capital of which €221.2 million was called. On 31 December 2018 Latvia had made all instalments for the payment of paid-in shares. Lithuania joined the ESM on 3 February 2015 and subscribed to an authorised capital of 28,634 shares with a par value of €100,000 each, representing €2.9 billion of subscribed capital, of which €327.2 million was called. On 31 December 2019 Lithuania had made all instalments for the payment of paid-in shares.

On 31 December 2019, the authorised capital was €704.8 billion (31 December 2018: €704.8 billion), divided into 7,047,987 shares (31 December 2018: 7,047,987 shares), with a par value of €100,000 each, and is split according to the contribution key. Out of the total authorised capital, €624.3 billion (31 December 2018: €624.3 billion) is callable. On 31 December 2019, the total called subscribed capital amounted to €80.5 billion is paid (31 December 2018: €80.5 billion).

ESM Members 31 December 2019	ESM Key (%)	Number of shares	Subscribed capital (in €'000)	Subscribed capital called and paid (in €'000)
Federal Republic of Germany	26.9496	1,899,406	189,940,600	21,707,497
French Republic	20.2382	1,426,383	142,638,300	16,301,520
Italian Republic	17.7839	1,253,406	125,340,600	14,324,640
Kingdom of Spain	11.8174	832,888	83,288,800	9,518,720
Kingdom of the Netherlands	5.6756	400,015	40,001,500	4,571,600
Kingdom of Belgium	3.4519	243,285	24,328,500	2,780,400
Hellenic Republic	2.7962	197,078	19,707,800	2,252,320
Republic of Austria	2.7632	194,753	19,475,300	2,225,749
Portuguese Republic	2.4910	175,566	17,556,600	2,006,469
Republic of Finland	1.7845	125,768	12,576,800	1,437,349
Republic of Ireland	1.5806	111,404	11,140,400	1,273,189
Slovak Republic	0.8184	57,680	5,768,000	659,200
Republic of Slovenia	0.4679	32,977	3,297,700	376,880
Republic of Lithuania	0.4063	28,634	2,863,400	327,200
Republic of Latvia	0.2746	19,353	1,935,300	221,200
Grand Duchy of Luxembourg	0.2486	17,521	1,752,100	200,240
Republic of Cyprus	0.1948	13,733	1,373,300	156,949
Republic of Estonia	0.1847	13,020	1,302,000	148,800
Malta	0.0726	5,117	511,700	58,480
Total	**100.00**	**7,047,987**	**704,798,700**	**80,548,400**

On 31 December 2019, the subscribed capital called but not paid is nil (31 December 2018: €0.1 billion related to Lithuania).

There are three different instances when a capital call can be made, in accordance with Article 9 of the ESM Treaty.

- A general capital call under Article 9(1) of the ESM Treaty concerns payment of the initial capital and an increase of paid-in capital that could be necessary, for example, to raise the lending capacity. To initiate such a call, the Managing Director of the ESM would make a proposal to the Board of Governors outlining the objective of such a call, the amounts and contributions for each shareholder, and a proposed payment schedule. The Board of Governors, by mutual agreement, may call in authorised capital at any time.

- A capital call under Article 9(2) of the ESM Treaty to replenish the paid-in capital could happen for two reasons:

  - to cover a shortfall due to a non-payment by a beneficiary country and,

  - if losses occurring due to other factors reduce the countervalue of the paid-in capital below the threshold of 15% of the maximum lending volume of the ESM.

The Managing Director would make a proposal to the Board of Directors, which would specify the losses incurred and the underlying reasons. A simple majority of the Board of Directors is required to agree to call in capital under these circumstances.

- An emergency capital call, under Article 9(3) of the ESM Treaty to avoid default of an ESM payment obligation to its creditors.

The Managing Director has responsibility for making such a capital call to ESM shareholders if there were a risk of default. As stated in the ESM Treaty, the ESM shareholders have irrevocably and unconditionally undertaken to pay on demand such a capital within seven days of receipt of the demand.

If an ESM Member fails to meet the required payment under a capital call made pursuant to Article 9(2) or (3) of the ESM Treaty, a revised increased capital call would be made to all ESM Members by increasing the contribution rate of the remaining ESM Members on a pro-rata basis, according to Article 25 (2) of the ESM Treaty. When the ESM Member that failed to contribute settles its debt to the ESM, the excess capital is returned to the other ESM Members.

16. RESERVE FUND

As foreseen by Article 24 of the ESM Treaty the Board of Governors shall establish a reserve fund and, where appropriate, other funds. Without prejudice to the distribution of dividends pursuant to Article 23 of the ESM Treaty, the net income generated by the ESM operations and the proceeds of possible financial sanctions received from the ESM Members under the multilateral surveillance procedure, the excessive deficit procedure and the macroeconomic imbalances procedure established under the Treaty on the Functioning of the European Union (TFEU) are put aside in a reserve fund, in accordance with Chapter 5 of the ESM Treaty. The primary purpose of the reserve fund is the absorption of potential losses.

On 11 June 2019, the Board of Governors decided at their annual general meeting to appropriate the net result of 2018 amounting to €284.7 million to the reserve fund. As a result the outstanding balance of the reserve fund as at 31 December 2019 is €2.3 billion (31 December 2018: €2.1 billion).

17. INTEREST RECEIVABLE AND SIMILAR INCOME AND ADVANCES TO EURO AREA MEMBER STATES

Interest receivable and similar income on loans and advances to euro area Member States are detailed as follows:

(in €'000)	2019	2018
Interest on loans [(1)]	1,101,597	1,119,179
Amortisation up-front service fee	76,667	70,523
Commitment fee	617	75
Total interest and similar income	**1,178,881**	**1,189,777**

[(1)] The interest on loans comprises base rate interest representing the cost of funding of the ESM, the margin and the annual service fee as the ESM Pricing Policy defines them.

18. NET INTEREST RECEIVABLE AND SIMILAR INCOME ON DEBT SECURITIES INCLUDING FIXED-INCOME SECURITIES

The geographical breakdown of the interest receivable and similar income on debt securities including fixed-income securities is detailed as follows:

(in €'000)	2019	2018
Euro area issuers	55,842	32,728
Other EU issuers	4,224	6,433
EU supranational organisations	12,890	5,318
Total European Union	**72,956**	**44,479**
Other non-EU issuers	26,808	16,657
Other supranational organisations	14,680	7,768
Total outside the European Union	**41,488**	**24,425**
Total interest and similar income	**114,444**	**68,904**

19. INTEREST PAYABLE AND SIMILAR CHARGES ON CASH AND CASH EQUIVALENTS

On 31 December 2019, the interest payable and similar charges on cash and cash equivalents represents negative interest paid for the balances with central banks and amounts to €285.8 million (2018: €301.3 million). The ESM was charged a negative interest rate of - 0.40% per annum on the cash held at national central banks from February 2017 to September 2019. Since September 2019, the ESM is being charged a negative interest rate of -0.50% per annum. In order to limit the negative implications on ESM's Paid-in capital, some Member States have compensated the ESM for the amount charged by their national central banks on the part of ESM paid-in capital that is held by them in cash deposits. The compensation has been recorded as an extraordinary income (refer to Note 24).

20. OTHER OPERATING INCOME

The EFSF has asked the ESM to provide administrative and other support services to assist it in performing its activities. To formalise this cooperation, the ESM and EFSF entered into a service level agreement from 1 January 2013. Under the agreement's terms, the ESM is entitled to charge the EFSF service fees to achieve a fair cost-sharing arrangement. For the services during the financial year 2019, the ESM charged the EFSF €33.1 million (2018: €32.6 million), from which €9.4 million had yet to be paid on the balance sheet date (refer to Note 10).

In 2019, the internal tax on salaries retained from staff members amounts to €1.7 million (2018: €1.7 million). Salaries are recorded on a gross basis within staff costs. In accordance with Article 36(5) of the ESM Treaty, such internal tax is for the benefit of the ESM.

21. NET PROFIT ON FINANCIAL OPERATIONS

Net profit on financial operations is detailed as follows:

(in €'000)	2019	2018
Net realised result of sales of debt securities	63,857	44,320
Net foreign exchange result	(9)	13
Total net result on financial operations	**63,848**	**44,333**

The net realised result of sales of debt securities reflects gains and losses realised at the date of derecognition of the respective financial assets. Up to that date, the debt securities as part of the Short-term tranche and the Medium and long-term tranche of the paid-in capital portfolio are carried at fair value and unrealised gains and losses are recorded in the equity within the fair value reserve.

22. STAFF COSTS

Staff costs are detailed as follows:

(in €'000)	2019	2018
Salaries (1) and allowances	24,012	23,419
Social security costs	1,204	1,088
Pension costs	7,751	7,924
Total staff costs	**32,967**	**32,431**

(1) Of which €1.71 million (31 December 2018: €1.67 million) relate to the ESM Management Board members, including €0.37 million (2018: €0.36 million) to the ESM Managing Director.

The ESM employed 186 persons on 31 December 2019 (179 on 31 December 2018).

In addition to its own employees, the ESM has expenses for employees seconded from other international financial institutions, as well as interim and temporary staff hired from external agencies. The related costs amount to €2.1 million for the 2019 financial year (2018: €1.3 million) and are accounted for as 'Other administrative expenses' (refer to Note 23).

The pension costs represent the ESM's contributions during the financial year to the outsourced employee retirement plan.

Social security costs include the ESM's contributions during the financial year to the health care scheme and for death and disability coverage, which is outsourced to external insurance companies.

23. OTHER ADMINISTRATIVE EXPENSES

Other administrative expenses consist of fees paid for professional services and miscellaneous operating expenses and are detailed as follows:

(in €'000)	2019	2018
Outsourced services (mainly IT, HR and accounting services)	10,955	11,054
Advisory services	8,291	8,262
Rental and related services	5,726	4,057
Other services	5,110	4,378
IT hardware	2,561	2,114
Treasury related services	2,029	1,542
Interim and secondment fees (Note 22)	2,110	1,304
Legal services	1,104	639
Rating agencies fees	765	418
Total other administrative expenses(1)	**38,651**	**33,768**

(1) For comparability purposes, 2018 figures have been restated following a reclassification in 2019 within the administrative expenses categories.

24. EXTRAORDINARY INCOME

In 2019, the extraordinary income, totalling €237.9 million, was composed of the amounts received from the Federal Republic of Germany and the French Republic, to compensate the ESM for a part of the negative interest charged on the cash held at their national central banks during 2018. These represent €135.4 million and €102.5 million respectively.

In 2018, the extraordinary income, totalling €242.5 million, was mainly composed of negative interest compensation on the cash held at the national central banks during 2017. These represent €128.9 million on behalf of the Federal Republic of Germany and €86.7 million from the French Republic.

In accordance with the article 24(2) of the ESM Treaty, the ESM receives the proceeds of the financial sanctions paid by ESM Members. These are imposed under the multilateral surveillance procedure, under the excessive deficit procedure and under the macroeconomic imbalances procedures established under the Treaty on the Functioning of the European Union. The ESM also receives the financial sanctions imposed by the Court of Justice pursuant to Article 8(2) of the Treaty on Stability, Coordination and Governance (TSCG) on euro area Member States. These proceeds are recorded as extraordinary income and put aside in the reserve fund.

Accordingly, in March 2019, the ESM received an amount of €26.8 million following a decision in May 2018 from the Council of the European Union imposing a fine on Austria. In 2018, the ESM received an amount of €18.93 million following a judgement of the Court of Justice in December 2017, which confirmed a decision in July 2015 from the Council of the European Union imposing a fine on Spain.

The financial sanctions imposed on Austria by Council implementing decision (EU) 2018/818 on 28 May 2018 and on Spain by Council implementing decision (EU) 2015/1289 on 13 July 2015 are sanctions pursuant to Article 8(1) Regulation (EU) No. 1173/2011. Such sanctions are collected by the European Commission and are assigned to the ESM.[4]

25. DERIVATIVES

The ESM uses derivatives for risk management purposes only, as described in Note 2.5. Since 2015, the ESM has been entering into foreign exchange derivative transactions such as foreign exchange swaps and foreign exchange forward contracts to hedge the currency risk related to short-term non-euro denominated investments. Starting from 2017, the ESM has entered into interest rate swaps and cross-currency asset swaps for the purpose of hedging interest rate risk on euro and non-euro denominated issued debt, as well as euro and non-euro denominated investments. Since 2019, the ESM started to use also bond futures to manage the interest rate risk of the Paid-in capital portfolio.

All derivatives transactions are booked at notional value as off-balance sheet items at the date of the transaction.

On 31 December 2019, the derivative financial instruments had a maximum maturity up to 29 years (31 December 2018: maximum maturity up to 30 years) and were concluded with euro area central banks, international financial institutions or commercial banks.

The following table discloses the details of result on derivative contracts during the year ending on 31 December 2019.

(in €'000)	Interest receivable and similar income	Interest payable and similar charges	Net result
Interest result on interest rate swaps[(1)]	210,118	(572,685)	(362,567)
Interest result on cross-currency asset swaps	170,964	(93,702)	77,262
Up-front payments on cross-currency asset swaps	41,682	(3,456)	38,226
Spread on foreign exchange swaps	301	(344)	(43)
Unwind result	5	(872)	(867)
Result on futures	391	-	391
Total	**423,461**	**(671,059)**	**(247,598)**

[(1)] The net result from the IRS executed to reduce Greece's interest rate risk is passed through to Greece (refer to Note 3.6.1.1).

The following table discloses the details of result on derivative contracts during the year ending on 31 December 2018.

(in €'000)	Interest receivable and similar income	Interest payable and similar charges	Net result
Interest result on Interest rate swaps[(1)]	136,062	(446,803)	(310,741)
Interest result on cross-currency asset swaps	82,166	(54,745)	27,421
Up-front payments on cross-currency asset swaps	34,589	(1,525)	33,064
Spread on foreign exchange swaps	7,259	(6,229)	1,030
Spread on foreign exchange forwards	(876)	882	6
Total	**259,200**	**(508,420)**	**(249,220)**

[(1)] The net result from the IRS executed to reduce Greece's interest rate risk is passed through to Greece (refer to Note 3.6.1.1).

The realised part included in 'Interest receivable and similar income' amounts to €367.2 million (31 December 2018: €188.7 million), while for 'Interest payable and similar charges' this represents €644.9 million (31 December 2018: €401.0 million).

[4] Cf. Article 10 of Regulation 1173/2011.

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26. RELATED - PARTY TRANSACTIONS

KEY MANAGEMENT

The ESM has identified members of the Board of Governors, Board of Directors and the Management Board as key management personnel.

The members of the Board of Governors and the Board of Directors were not entitled to remuneration during the period.

TRANSACTIONS WITH SHAREHOLDERS

The ESM granted loans to Spain, Cyprus and Greece, which are also ESM shareholders, as disclosed in more detail in Note 6. In the course of its investment activity, the ESM purchases debt securities issued by its shareholders. Such securities are reported as 'Debt securities including fixed-income securities' on the balance sheet. On 31 December 2019, the total carrying amount of purchased securities issued by shareholders of the ESM was €3.4 billion (31 December 2018: €1.6 billion).

In 2019 and 2018, the ESM received payments from France and Germany to compensate for the negative interest charged on the cash balances held with their respective national central banks (refer to Note 24). In January 2018, €86.7 million was received from France and in August 2018 €128.9 million was received from Germany. In 2017, both Member States expressed their willingness to compensate the ESM up to the amount of negative interest charged by their national central banks with the intention to limit the negative implications on ESM's paid-in capital. The transfers were made under certain conditions and following parliamentary approval.

On 2 January 2019 and 27 December 2019, the ESM received €100 million and €2.5 million respectively from the French Republic and on 4 February 2019 €135.4 million from the Federal Republic of Germany. These amounts were recorded as extraordinary income in 2019 (refer to Note 24).

In November 2019, the ESM transferred a part of its cash to the Italian central bank (Banca d'Italia) also subject to negative interest. Similarly to the French and German compensation, Italy also expressed its willingness to compensate the ESM for the negative interests paid to its national central bank.

TRANSACTIONS WITH THE EUROPEAN FINANCIAL STABILITY FACILITY (EFSF)

The EFSF is a public limited liability company (Société Anonyme) incorporated under Luxembourg law on 7 June 2010 following decisions taken by the euro area Member States on 9 May 2010 within the framework of the Ecofin Council. The EFSF's mandate is to safeguard financial stability in Europe by providing financial assistance to euro area Member States within the framework of a macro-economic adjustment programme.

The EFSF was created as a temporary rescue mechanism. In accordance with its Articles of Association, the EFSF will be dissolved and liquidated when all financial assistance provided to euro area Member States and all funding instruments issued by the EFSF have been repaid in full. As of 1 July 2013, the EFSF may no longer engage in new financing programmes or enter into new loan facility agreements.

The EFSF has asked the ESM to provide certain administrative services and other support services to facilitate the performance of its activities. To formalise this cooperation, the two organisations have entered into a service level agreement. In line with the terms of this agreement, the ESM charged the EFSF €33.1 million for the financial year 2019 (31 December 2018: €32.6 million), from which €9.4 million (31 December 2018: €9.8 million) had not yet been paid at balance sheet date (refer to Note 10). The ESM recognised these amounts as other operating income in the profit and loss account.

27. AUDIT FEE

The total fees accrued in 2019 by the ESM to Ernst & Young, Société Anonyme are presented as follows:

(in €'000)	2019	2018
Audit fees	249	249
Audit related fees	136	131
Total Audit fees	**385**	**380**

In 2019 and 2018, the external auditors provided the ESM with audit-related services in relation with the US-dollar denominated bond issuance.

28. EVENTS AFTER THE REPORTING PERIOD

On 11 February 2020, the ESM received €131.7 million from the Federal Republic of Germany, following a political commitment to compensate the ESM for negative interest paid on the cash balances held with its national central bank, as explained in Note 26. This amount will be recorded as extraordinary income in 2020 (refer to Note 2.19).

In the first months of 2020, the euro area economic activity deteriorated sharply, hit by the adverse impact of the coronavirus global pandemic. Both the supply and demand sides of the economy are being affected. Further downside risks stem from current high volatility in global financial markets. Uncertainty about the duration and magnitude of the shock and the timing and speed of the subsequent recovery is very high at the current juncture. In line with the global reaction to the Covid-19 emergency, most of the ESM staff are teleworking to ensure full continuation of the institution's activities. With the current uncertainty, the impact on ESM's future net income cannot be reliably assessed at this time.

05 External auditor's report on the 2019 financial statements

To the Board of Governors of the European Stability Mechanism

Report on the audit of the financial statements

Opinion

We have audited the financial statements of European Stability Mechanism (the "Entity" or "ESM"), which comprise the balance sheet as at 31 December 2019, the profit and loss account, the statement of changes in equity and the statement of cash flows for the year then ended, and the notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Entity as at 31 December 2019, and of the results of its operations and its cash flows for the year then ended in accordance with the general principles of the Directive 86/635/EEC of the Council of the European Communities of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions, as amended by Directive 2001/65/EC of 27 September 2001, by Directive 2003/51/EC of 18 June 2003 and by Directive 2006/46/EC of 14 June 2006 (the "Directives").

Basis for opinion

We conducted our audit in accordance with EU Regulation N° 537/2014, the Law of 23 July 2016 on the audit profession (the "Law of 23 July 2016") and with International Standards on Auditing ("ISAs") as adopted for Luxembourg by the "Commission de Surveillance du Secteur Financier" ("CSSF"). Our responsibilities under those Regulation, laws and standards are further described in the « Responsibilities of the "réviseur d'entreprises agréé" for the audit of the financial statements » section of our report. We are also independent of the Entity in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants ("IESBA Code") as adopted for Luxembourg by the CSSF together with the ethical requirements that are relevant to our audit of the financial statements, and have fulfilled our other ethical responsibilities under those ethical requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of the audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Impairment of loans and advances

As at 31 December 2019, the loans and advances to euro area Member States amounted to EUR 89.9 billion and related to financial assistance granted to Spain, Cyprus and Greece in line with ESM's mission to provide financial assistance to euro area countries experiencing or threatened by severe financing problems. These loans were granted to recapitalise banks in Spain, and as part of a macroeconomic adjustment programme in the case of Cyprus and Greece. For the year ending 31 December 2019, no impairment has been recorded by ESM on these outstanding loans.

We considered this as a key audit matter as ESM applies complex judgments with respect to the estimation of the amount and timing of the future cash flows when determining the necessity to record or not an impairment loss on the loans granted.

To assess the required impairment allowance and in accordance with article 13(6) of the ESM Treaty - the ESM shall establish an appropriate warning system to ensure that it receives any repayments due by the ESM Member under the stability support in a timely manner - ESM assesses individually each loan and advance granted to the beneficiary ESM Members on a regular basis through the analysis of the main following indicators of the beneficiary country:

- the liquidity situation of the sovereign;
- the market access;
- the long-term sustainability of public debt;
- the banking prospects, whenever relevant to assess repayment flows;
- the review of the medium-term economic and financial outlook;
- the identification of default events.

The determination of the necessity to record an impairment will be based on the identification of impairment events and judgments to estimate the impairment against specific loans and advances.

Refer to the notes 2 and 6 to the financial statements.

How the matter was addressed in our audit

We assessed the design and implementation, and tested the operating effectiveness of the key controls over ESM's processes for establishing and monitoring specific impairment estimation. This includes:

- the testing of the entity level controls over the process, including the review and approval of the assumptions made by the Management;
- the testing of the quarterly Early Warning System reports issued per country and checking if impairment recommendations have been adequately applied;
- the testing of assumptions underlying judgments made by the Management when an impairment event occurs on expected cash flows and estimated recovery from any underlying collateral;
- the testing of a sample of loans to form our own assessment as to whether impairment events have occurred and to assess whether impairment was identified and recorded in a timely manner, where required;
- the reading and assessment of the related contents of the major internal committees minutes;
- Checking that reimbursements [and waivers granted] are made in accordance with the terms and conditions agreed;
- Reconciling amounts disbursed with the loan agreements and ensuring that loans granted to ESM Members are within the limit of commitments approved by the governing bodies of ESM.

Responsibilities of the Board of Directors and of those charged with governance for the financial statements

The Board of Directors is responsible for the preparation and fair presentation of the financial statements in accordance with the general principles of the Directive 86/635/EEC of the Council of the European Communities of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions, as amended by Directive 2001/65/EC of 27 September 2001, by Directive 2003/51/EC of 18 June 2003 and by Directive 2006/46/EC of 14 June 2006 (the "Directives"), and for such internal control as the Board of Directors determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Board of Directors is responsible for assessing the entity's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Board of Directors either intends to liquidate the Entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Entity's financial reporting process.

Responsibilities of the "réviseur d'entreprises agréé" for the audit of the financial statements

The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue a report of the "réviseur d'entreprises agréé" that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with EU Regulation N° 537/2014, the Law of 23 July 2016 and with the ISAs as adopted for Luxembourg by the CSSF will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with EU Regulation N° 537/2014, the Law of 23 July 2016 and with ISAs as adopted for Luxembourg by the CSSF, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Entity's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board of Directors.

- Conclude on the appropriateness of Board of Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our report of the "réviseur d'entreprises agréé" to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our report of the "réviseur d'entreprises agréé". However, future events or conditions may cause the Entity to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our report unless law or regulation precludes public disclosure about the matter.

Report on other legal and regulatory requirements

We have been appointed as "réviseur d'entreprises agréé" by the Board of Governors on 15 June 2017 and the duration of our uninterrupted engagement, including previous renewals and reappointments, is 3 years.

We confirm that the audit opinion is consistent with the additional report to the audit committee or equivalent.

We confirm that the prohibited non-audit services referred to in EU Regulation No 537/2014 were not provided and that we remained independent of the Entity in conducting the audit.

Ernst & Young
Société anonyme
Cabinet de révision agréé

Bernard Lhoest | Papa Saliou Diop
Luxembourg, 30 March 2020

06 Report of the Board of Auditors on the 2019 financial statements

Luxembourg, 30 March 2020

The Board of Auditors of the European Stability Mechanism (ESM) was set up pursuant to Article 30 of the Treaty establishing the ESM and Article 24 of the ESM By-Laws. The Board of Auditors is independent from the Board of Directors and its members are appointed directly by the Board of Governors[1].

This Board of Auditors report in respect of the financial statements is addressed to the Board of Governors in accordance with Article 23 (2) (d) of the ESM By-Laws. It is delivered in respect of the financial statements of the ESM for the year ended 31 December 2019.

The Board of Auditors notes that based on its own work and considering the work of the external auditor, to the best of its judgment, no material matters have come to its attention that would prevent it from recommending that the Board of Governors approve the ESM financial statements for the year ended 31 December 2019.

On behalf of the Board of Auditors

Baudilio Tomé Muguruza
Chairperson

[1] The Board of Auditors carries out independent audits of regularity, compliance, performance and risk management of the ESM, inspects the ESM accounts, and monitors and reviews the ESM's internal and external audit processes and their results. Information on the audit work of the Board of Auditors, its audit findings, conclusions and recommendations for the year ended 31 December 2019 will be included in the annual report, to be prepared in accordance with Article 24(6) of the ESM By-Laws and submitted to the Board of Governors.

Acronyms and abbreviations

ALM	Asset and Liability Management
BoA	Board of Auditors
BoD	Board of Directors
BoG	Board of Governors
BoP	Balance of payments
CACs	Collective action clauses
DRI	Direct recapitalisation of financial institutions
ECB	European Central Bank
ECCL	Enhanced Conditions Credit Line
EDDI	European Distribution of Debt Instruments
EFSF	European Financial Stability Facility
EFSM	European Financial Stabilisation Mechanism
EMU	Economic and Monetary Union
ESG	Environmental, Social and Governance
ESM	European Stability Mechanism
GDP	Gross domestic product
GLF	Greek Loan Facility
IFI	International financial insitution
IMF	International Monetary Fund
MoU	Memorandum of Understanding
NPL	Non-performing loan
PCCL	Precautionary Conditioned Credit Line
SRB	Single Resolution Board
SRF	Single Resolution Fund
TFEU	Treaty on the Functioning of the European Union
UN-PRI	United Nations Principles for Responsible Investment

EURO AREA

COUNTRY CODE	COUNTRY NAME
BE	Belgium
DE	Germany
EE	Estonia
IE	Ireland
EL	Greece
ES	Spain
FR	France
IT	Italy
CY	Cyprus
LV	Latvia
LT	Lithuania
LU	Luxembourg
MT	Malta
NL	Netherlands
AT	Austria
PT	Portugal
SI	Slovenia
SK	Slovakia
FI	Finland

NON-EURO AREA

COUNTRY CODE	COUNTRY NAME
US	United States

EUROPEAN STABILITY MECHANISM

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