European Stability Mechanism

Rating report

The AAA/Stable rating of the European Stability Mechanism (ESM) reflects: i) its 'Strong' institutional profile and 'Excellent' financial profile, which drive our 'aaa' assessment of the ESM's intrinsic credit profile and ii) 'Excellent' shareholder support. In detail:

- **Institutional profile:** The ESM has a record of excellent governance and a very strong mandate for its shareholders, with Croatia being the newest member as of March 2023. The ESM occupies a key position within the euro area institutional framework as a financial backstop to safeguard financial stability.
- **Financial profile:** The ESM benefits from prudent risk management and is highly capitalised with EUR 80.6bn of paid-in capital, the highest of any supranational. Its liquid assets ratio of 367% stands out as one of the highest among rated peers, shielding it from refinancing risk.

  The ESM's mandate to provide support to member states undergoing severe funding crises results in a highly concentrated borrower base and weak profitability. It benefits from strong risk mitigants, however, including its preferred creditor status. The ESM's three borrowers, Greece (BBB-/Positive), Spain (A-/Positive) and Cyprus (BBB+/Stable), have so far repaid all loans in full and on time, with Spain expected to make its final repayment in 2027.
- **Shareholder support**: The ESM benefits from a highly rated shareholder base and a very strong capital call mechanism. More than half of its capital is held by sovereigns rated AA- or higher.
- **Outlook and triggers:** The Stable Outlook reflects our view that risks are balanced over the next 12 to 18 months. The ratings/Outlooks could be downgraded if, individually or collectively: i) liquidity buffers significantly reduced; ii) capitalisation ratios deteriorated significantly; and/or iii) the asset quality of the loan portfolio deteriorated significantly.

Figure 1: Scope's assessment of the ESM's rating drivers

Foreign currency

Long-term issuer rating/Outlook

AAA/Stable

Senior unsecured debt

AAA/Stable

Short-term issuer rating/Outlook

S-1+/Stable

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Credit strengths and challenges

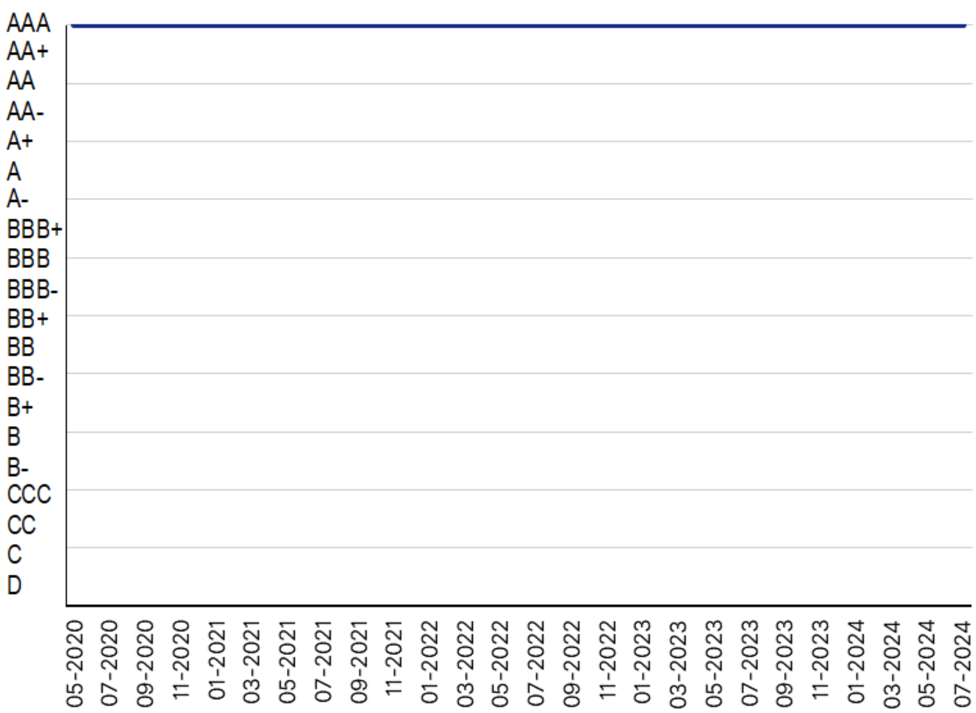
Credit strengths	Credit challenges
• Substantial capital position • Very high liquidity buffers • Excellent access to capital markets • Highly rated shareholders	• Crisis-country exposure and concentrated loan portfolio • Concentrated shareholder base

Outlook and rating triggers

The Stable Outlook reflects Scope's view that risks to the ratings are balanced.

Positive rating-change drivers	Negative rating-change drivers
• Not applicable	• Lower liquidity buffers • Weaker capital base • Weaker asset quality

Figure 2: Rating history



Note. Foreign-currency long-term issuer rating. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment. Source: Scope Ratings

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Credit profile

We determine a capitalised supranational's rating by assessing its intrinsic credit profile based on its institutional and financial profiles, which is complemented with an assessment of shareholder support. We map these two assessments to determine an indicative rating range that can be adjusted by up to one notch to determine the final rating. For details, please see our methodology.

Intrinsic credit profile – Institutional profile: Strong

Notches	2	1	0	-1	-2
Assessment	Excellent	**Strong**	Adequate	Moderate	Weak

We assess the credit risk of supranationals, placing a significant emphasis on the importance of their mandate to their members and associated environmental, social and governance (ESG) considerations.

The ESM's institutional profile is assessed as 'Strong'. This reflects its strong governance and important mandate for its shareholders as a crisis resolution mechanism, underlining its central role within the Economic and Monetary Union of the European Union (EMU).

Mandated activities

Importance of the mandate

Mandate is to support euro area countries facing severe financial difficulty

The ESM was established in October 2012 by the euro area member states. It was set up to provide financial assistance to ESM members experiencing severe financing problems with the aim of safeguarding the financial stability of its members and of the euro area as a whole. This position makes the ESM a crucial player in deepening the EMU and underlines its importance to member states.

To meet its mandate, the ESM can grant loans to member states as part of a macroeconomic adjustment programme, as was used in Cyprus (BBB+/Stable) and Greece (BBB-/Positive), or as part of a plan to recapitalise a country's banking system, as was used in Spain (A-/Positive). No country is under an ESM financial assistance programme following Greece's exit from its programme in 2018. All three countries are now in post-programme surveillance to monitor the sustainability of their recovery. The ESM can also provide financial assistance by purchasing bonds issued by member states on primary and secondary markets and providing credit lines as a precautionary measure.

ESM treaty change still to be ratified by one member state

On 27 January and 8 February 2021, the finance ministers of the Eurogroup signed amendments to the ESM treaty confirming the adoption of the ESM reform. The changes need to be ratified in each member state's national parliament. To date, Italy (BBB+/Stable) remains the only ESM member not to have ratified the revised treaty, with the country's lower house of parliament voting against ratification on 21 December 2023. Still, we expect an eventual ratification of the treaty change, even if with significant delay.

When finalised, the changes will enhance the ESM's role in the design, negotiation and monitoring of financial assistance programmes. In addition, it will make the ESM the backstop of the Single Resolution Fund (SRF) should the SRF have insufficient funds to resolve failing banks. This backstop function would take the form of a credit line, with a nominal cap of EUR 68bn, to be repaid with the banking sector's contributions to the SRF. The SRF must repay any such loan within 3-5 years. The reform would thus further reinforce the importance of the ESM's mandate to its shareholders.

Social factors

At the onset of the Covid-19 pandemic in May 2020, the ESM, the European Commission and the European Investment Bank introduced a comprehensive emergency response. This included the ESM's Pandemic Crisis Support credit line worth EUR 240bn to finance direct and indirect healthcare costs stemming from the pandemic. While no requests were made to draw on the credit line, it served as a safety net for member states and thereby contributed to the stabilisation of financial markets at the onset of the crisis.

Increased relevance of social factors

Environmental factors

In accordance with the ESM's mandate, environmental factors are of limited relevance to its lending activities. Still, since February 2022, the ESM participates as an observer in the Network of Central Banks and Supervisors for Greening the Financial System, collaborating with external experts to support its climate risk assessment work. As a result, the ESM continues to enhance its analysis on the impact of climate change on financial stability. This includes its strategy to incorporate climate-related risks in its monitoring framework to better understand how such risks pose challenges to economic activity, public finances and the financial sector. In particular, the ESM is working towards embedding climate-change related considerations into its macro-financial and post-programme surveillance activities, its financial assistance, and its risk management framework.

Limited importance of environmental factors

In 2023, the ESM completed a pilot climate-risk analysis for one of the beneficiary Member States. The aim of the analysis is to strengthen the risk assessment capacity of its regular Early Warning System exercise, created to detect loan repayment risks and allow for corrective action. The ESM is considering gradually extending such analysis to all other beneficiary Member States. To better understand its exposure to climate-related risks, the ESM also began incorporating assessments of both physical and transition risks on its investment portfolios and counterparties.

Governance

The ESM shareholders are the 20 euro area member states. Each member has contributed to the ESM's authorised capital based on its respective share of the EU's total population and GDP. The distribution of capital shares is therefore highly concentrated, with the largest shareholder (Germany) holding more than a quarter of subscribed capital, granting it a blocking majority in some decisions taken by the ESM's board of governors.

Concentrated shareholder structure

The concentrated shareholder structure is balanced by the ESM's very strong governance record. The board of governors is composed of each shareholder country's finance minister and is chaired by the president of the Eurogroup. The board sets the strategic direction, decides on rescue programmes and appoints the managing director. Most major decisions (capital increases, granting financial assistance) are taken by unanimity, while others, such as the appointment of the managing director, are taken by a qualified majority of 80% of votes cast. Each member state's voting right equates to its share of the ESM's capital.

Excellent governance, with strong internal and external controls

The board of directors is the ESM's executive body and made up of high-ranking finance ministers from each country. It ensures operations are in accordance with the ESM treaty. A risk committee assists the board by monitoring the ESM's risk exposure, overseeing the managing director's implementation of the risk management framework, and presiding over the budget review and compensation committee. The ESM's operations are overseen by its board of auditors, an independent body that ensures the regularity, compliance, performance and adequacy of risk management. It monitors the ESM's audit processes, inspects the institution's accounts and issues two reports per financial year. The main audit matter being monitored by the board relates to the recognition of impairments on the ESM's outstanding loans to Spain, Cyprus and Greece.

Intrinsic credit profile – Financial profile: Excellent

We assess a capitalised institution's financial profile along three rating factors: i) capitalisation; ii) asset quality; and iii) liquidity and funding.

	Excellent	Very Strong	Strong	Adequate	Moderate	Weak	Very Weak
Rating notches	**≥ +16**	< 16; ≥ +13	< 13; ≥ +10	< 10; ≥ +7	< 7; ≥ +4	< 4; ≥ 1	< 1

The ESM's financial profile is assessed as 'Excellent'. This reflects its: i) 'Very Strong' capitalisation; ii) 'Excellent' portfolio quality with significant credit protection mechanisms, no equity exposure and no NPLs; and iii) 'Excellent' liquidity coverage and 'Very Strong' funding profile (see Annex II).

Capitalisation

Notches	≥ 5	4	**3**	2	1	0	-1	≤ -2
Assessment	Excellent	**Very Strong**	Strong	Strong	Adequate	Adequate	Moderate	Weak

Our analysis focuses on the supranational's capacity to absorb losses, taking into account the long-term and counter-cyclical nature of its operations and its ability to generate and retain capital.

Maximum lending capacity of EUR 500bn

Our assessment reflects the ESM's very high capitalisation and conservative capital framework, which compensates for its low profitability. An implied leverage ratio forms the cornerstone of our capitalisation assessment, which assumes that the ESM operates at the maximum leverage allowed under its founding treaty, i.e. EUR 500bn.

One of the highest capitalisation levels among peers

For the numerator of this ratio, we include paid-in capital (EUR 81.0bn) and accumulated reserves and retained earnings (EUR 3.6bn). We also include 10% of the callable capital of highly rated shareholders (AA- or above), which we estimate at EUR 36.2bn[1]. Together, these resources amount to EUR 120.8bn. By 2035, paid-in capital will increase to EUR 81.5bn once all instalments from ESM members are received, including those from the newest member Croatia which joined the ESM on 22 March 2023. For the denominator, we use the ESM's EUR 500bn maximum lending capacity. The resulting capitalisation ratio of about 24%, results in a 'Very High' assessment of the ESM's capitalisation.

The ESM's actual capitalisation ratio, based on total disbursed loans of about EUR 82.6bn as of end-2023, stands at 146%, one of the highest among rated peers and up from 139% in 2022. This reflects an exceptional capacity to absorb losses on existing loans.

Figure 3: Capitalisation over time
% 3Y weighted average, pps

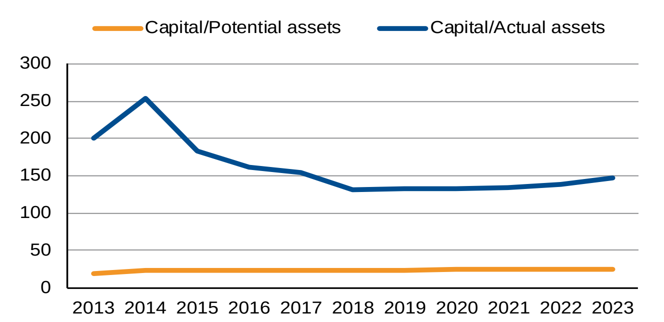
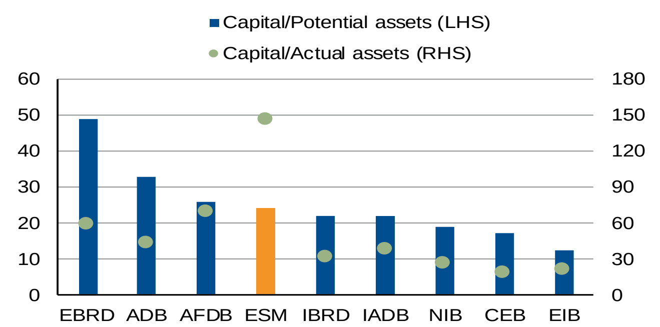


Figure 4: Capitalisation vs peers
% 3Y weighted average, YE 2023



Source: ESM, respective supranationals, Scope Ratings

[1] The callable capital share is capped at 30% of the ESM's total capital (including paid-in capital, accumulated reserves, retained profits and callable capital) per Scope's methodology. We thus use only EUR 36.2bn rather than EUR 39bn, which would correspond to 10% of the EUR 390.4bn in callable capital that is provided by sovereigns rated AA- or higher.

Return to moderate profitability due to higher interest rates

The ESM's ability to generate income is modest, averaging around EUR 300m per year since 2012, and reflects its mandate not to maximise profits on financial support, but still supports the ESM's capitalisation levels. While the ESM has been profitable every year between 2013 to 2021, the large equity base, conservative investment rules and the low interest rate environment have prevented meaningful internal capital generation compared to other supranationals, even if profits are fully retained.

Total profits amounted to EUR 320.5m in 2023, compared with a loss of EUR 60m in 2022. The loss in 2022 marked the first loss recorded since 2012, reflecting realised losses from sales of debt securities following the rebalancing of the paid-in capital portfolio in the rising yields environment. The return to profits reflects the sharp rise in interest income on cash holdings and debt securities. The accumulated accounting profits on the investment portfolio since inception stood at EUR 1.7bn at end-2023. This includes EUR 915.4 million in extraordinary income from negative interest compensation received by the ESM in the 2017–2021 period. The return on equity improved in 2023, amounting to 0.27%, up from a slight decline in 2022 and in line with historical averages. The ratio remains low compared with peers and results in no adjustment under our methodology.

Figure 5: ESM's profitability and return on equity
EUR m; %

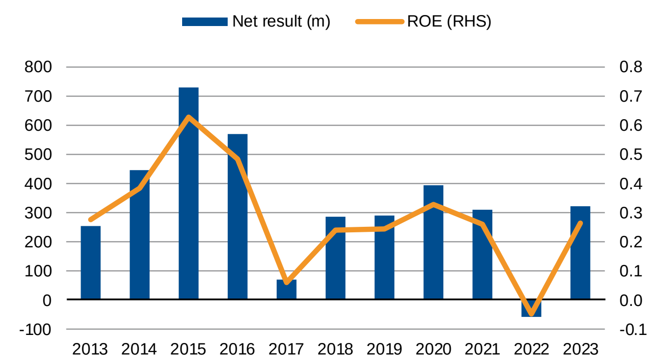
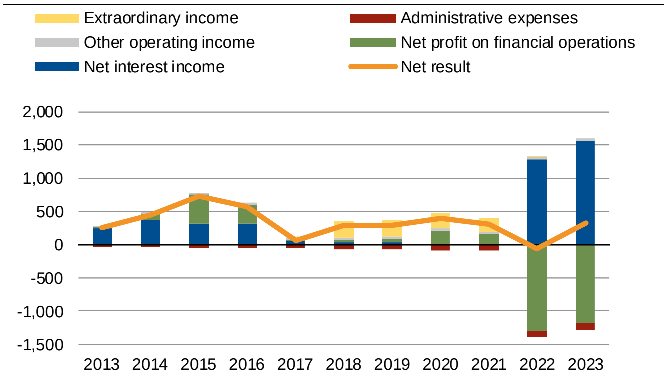


Figure 6: ESM's retained net result
EUR m



Source: ESM, Scope Ratings

Asset quality

Notches	≥ 5	4	3	2	1	0	-1	≤ -2
Assessment	**Excellent**	Very Strong	Strong	Strong	Adequate	Adequate	Moderate	Weak

Our analysis is structured around a forward-looking qualitative assessment of the supranational's portfolio quality, including an evaluation of climate risks and of possible credit enhancements, as well as a quantitative assessment of the portfolio's past asset performance.

Very strong asset quality with strengthening credit ratings of loan exposures

The ESM's 'Excellent' asset quality reflects its robust credit protection mechanisms, in line with its preferred creditor status and mandate of lending to sovereigns only. Its asset performance has also been excellent, with no non-performing loans to date.

Portfolio quality

Average borrower quality improved to investment grade

The ESM's mandate to provide financial assistance to crisis-hit countries results in a concentrated loan portfolio. Outstanding loans, amounting to EUR 82.6bn at end-2023, were granted under strict conditionality and are subject to monitoring of the sovereign's capacity to repay, in the context of the ESM's Early Warning System. The loan portfolio exposures are to Greece (BBB-/Positive) of EUR 59.8bn, Spain (A-/Positive) of EUR 16.4bn, and Cyprus (BBB+/Stable) of EUR 6.3bn. This distribution results in a weighted average borrower quality of 'BBB', which corresponds to an 'Adequate' initial assessment per our methodology. Average borrower quality has improved in recent years following the gradual improvement of Greece's sovereign rating.

Figure 7: ESM's total loans and average credit risk profile
EUR bn, rating

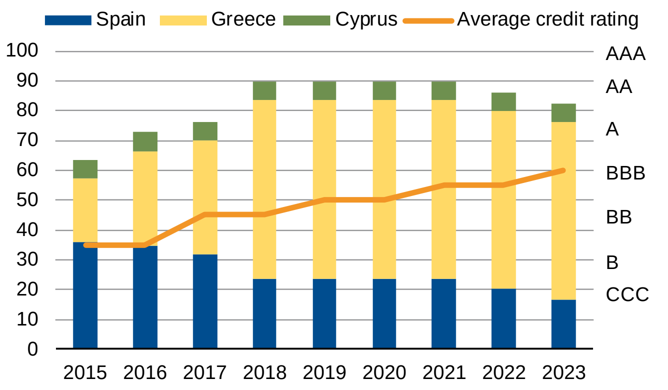
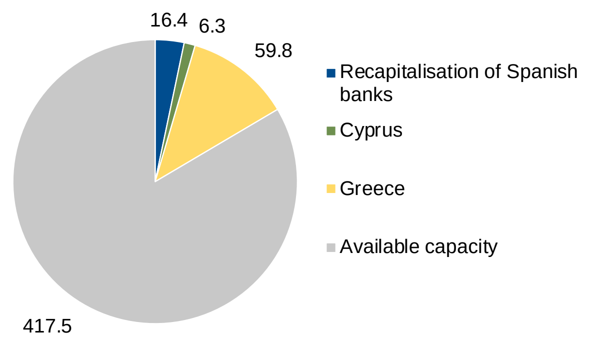


Figure 8: ESM's outstanding loans
EUR bn



Source: ESM, Scope Ratings

Portfolio quality – credit enhancements

We provide significant uplift to our initial portfolio quality assessment given the ESM's risk mitigants, which improve our final assessment of portfolio quality to 'Very Strong' from 'Adequate' (see Annex VI). This balances the ESM's preferred creditor status (PCS) and absence of equity exposure with its highly concentrated portfolio across regions, sectors and individual counterparties.

Preferred creditor status is only second to IMF

The ESM's exposure is entirely related to sovereign borrowers and thus benefits from PCS, which provides its claims an implicit seniority in cases of debt restructuring. This status was agreed by ESM members and is second only to that of the International Monetary Fund (IMF). Under its Early Warning System, the ESM monitors risks to the payment capacity of creditor countries. It has not identified immediate risks to repayment capacities, although long-term vulnerabilities remain in Greece due to its very high public debt.

Greece's exposure until 2060

The three-year ESM financial assistance programme for Greece officially concluded in August 2018. There has been substantial progress in implementing reform commitments, resulting in significant economic progress in recent years, with Scope's sovereign rating for Greece returning to investment-grade level in August 2023. Moreover, Scope assigned a Positive Outlook on Greece's BBB- rating in July 2024. Greece made a EUR 5.3bn early repayment to the Greek Loan Facility in December 2023 following waivers issued for mandatory repayment obligations on ESM and EFSF loans in connection with the early repayment. Greece is scheduled to repay the ESM loans from 2034 to 2060.

Cyprus to repay from 2025-2031

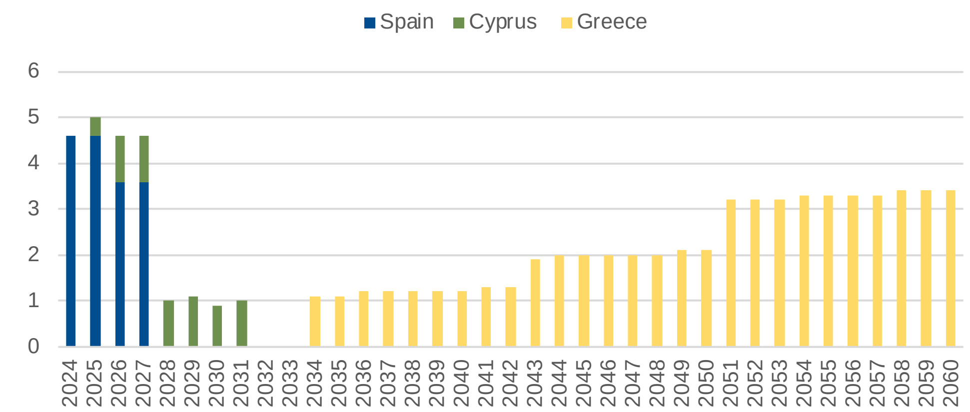
Support measures to Cyprus included an ESM loan of EUR 6.3bn and a EUR 1bn disbursement from the IMF. We upgraded the sovereign credit rating for Cyprus to BBB+ with a Stable Outlook from BBB in November 2023. The country's very favourable debt trajectory better-than-expected economic performance and sustained improvements in the financial sector supported the credit ratings upgrade. Cyprus will repay the principal on ESM loans from 2025 to 2031.

Spain to fully repay ESM loans by 2027

Spain also retains a strong capacity to service its debt to ESM loans. The financial assistance programme expired in December 2013 with a total ESM disbursement of EUR 41.3bn to recapitalise the banking sector. In 2014-2018, Spain made several early voluntary repayments every year. Spain made its second scheduled principal repayment of EUR 3.6bn to the ESM in December 2023. So far, Spain repaid EUR 24.9bn, with EUR 16.4bn still to be repaid by 2027.

Figure 9: Repayment profile of ESM borrowers

EUR bn



Source: ESM, Scope Ratings

Equity exposure

No equity exposure

The ESM can directly recapitalise banks that are systemically significant within the euro area or one of its member states. However, this option is yet to be used and is intended only if all other measures have been exhausted, including bail-in mechanisms. The absence of any equity exposure therefore results in no negative adjustment under our methodology. If the ESM treaty amendment is ratified, the common backstop for the SRF will replace the direct recapitalisation instrument to support financial institutions. This prevents the ESM from building any equity exposure to banks.

Portfolio diversification

Concentrated loan portfolio

In line with its mandate of primarily engaging with sovereigns, the loan portfolio of the ESM is highly concentrated along sectoral lines. It is also highly concentrated by geography as it only has loans outstanding with three countries. We therefore do not provide any uplift for potential diversification benefits in our scorecard.

Climate risks

Our initial borrower quality assessment for sovereign exposures relies on our sovereign ratings, which directly incorporate transition and physical climate factors in line with our sovereign rating methodology. To avoid double-counting, we thus do not further adjust our estimate of the borrower quality since our ratings of the borrower quality for sovereign borrowers directly include climate risks (see Annex III).

Asset performance

No non-performing loans to date

To date, the ESM has been repaid in full and on time by its three borrowers and has thus never recorded a non-performing loan. Spain has made nine early repayments to date, its first two scheduled repayments in December 2022 and 2023 and is on course to repay remaining loans by 2027. Repayments from Cyprus will become due from 2025, with the final payment due in 2031. Finally, Greece’s repayments will start in 2034 and end in 2060.

Liquidity and funding

Notches	≥ 6	≥ 4	≥ 2	1	≥ 0	-1	≤ -2
Assessment	**Excellent**	Very Strong	Strong	Adequate	Adequate	Moderate	Weak

Our analysis focuses on the supranational's: i) available liquid assets to meet financial obligations and expected disbursements over an extended period; and ii) funding operations, including the stability and diversification of its market access.

Our assessment reflects the ESM's 'Excellent' liquid assets coverage and 'Very Strong' market access, given its global benchmark issuer status and diversified funding base.

Liquidity coverage

High liquid assets, moderate liabilities due within the next 12 months

The ESM's prudent liquidity management results in consistently high liquid assets, which we estimate at about EUR 90.3bn as of end-2023. Our estimate includes assets that are the least sensitive to sudden market or interest rate changes, specifically, cash and cash equivalents of EUR 17.1bn (EUR 55.6bn in 2022), highly rated debt securities of EUR 69.1bn (EUR 41.1bn in 2022) mainly with a minimum rating of AA- and deposits of EUR 4.1bn. In response to the sharp rise in interest rates in 2023, a significant part of available liquidity was invested in money market instruments to achieve higher returns.

Very high liquidity coverage

Conversely, ESM liabilities maturing within 12 months amounted to around EUR 24.6bn. No loans have been disbursed since 2018. On this basis, the three-year weighted average liquid assets ratio for 2021-23 stands at around 342%. This is one of the highest liquidity coverage ratios among peer supranationals.

Figure 10: ESM liquid assets, liabilities and disbursements
EUR bn, %

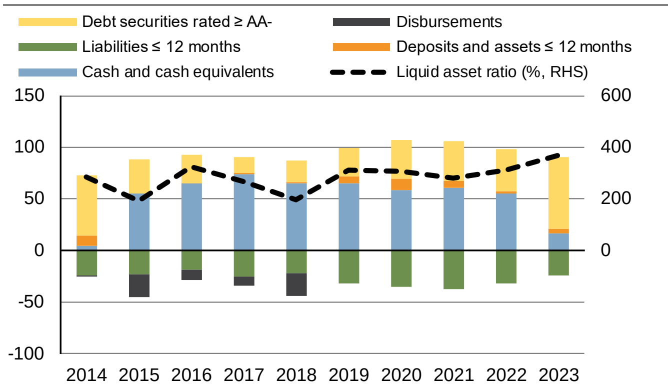
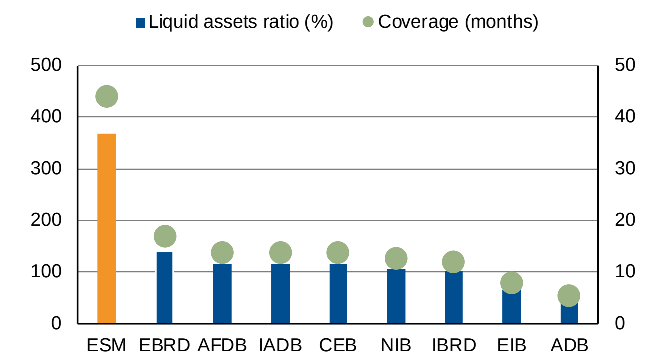


Figure 11: Liquid assets ratio and coverage of obligations
%, coverage without capital market access in months (RHS)



NB. 3Y weighted average. A 50% liquid assets ratio implies coverage of obligations for a period of six months without capital markets access. Source: ESM, Scope Ratings

Funding

Regulatory preference, launch of Commercial Paper programme

The ESM's very strong market access reflects its status as a European benchmark and frequent issuer as well as its diversified funding strategy. The Basel Committee on Banking Supervision considers ESM bonds as high-quality liquid assets, allowing banks to apply a 0% risk weight to their holdings. This favourable market status and regulatory treatment provides the ESM with a stable source of funds for its lending operations. As part of its strategy to diversify its funding instruments, the ESM also introduced its EUR 20bn Euro Commercial Paper programme in February 2024. This is in addition to the existing bills and bonds programmes traditionally issued.

European benchmark issuer, mostly in euros

The annual funding volume has remained stable over the past three years at EUR 8bn in 2021 to 2023 after the Greek programme ended in 2018, averaging about EUR 17bn in 2013-2018. This puts ESM funding volumes below those of some highly rated peers and we expect these levels to decline slightly to around EUR 6bn in 2024 and EUR 7bn in 2025.

Figure 12: Annual funding volume vs peers
EUR bn; three-year weighted average 2021-23

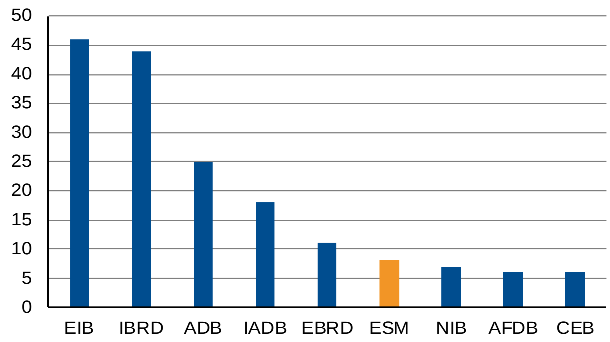
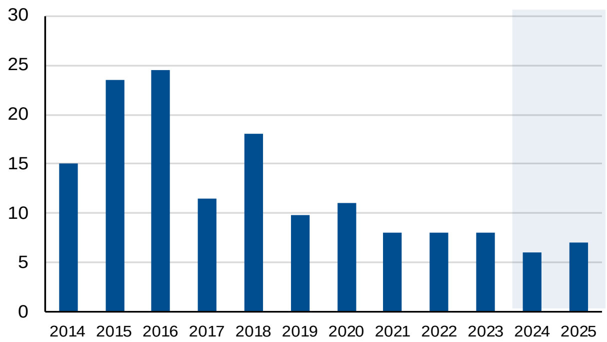


Figure 13: Stable funding volumes
EUR bn



Source: Scope Ratings, respective supranationals, ESM

Globally diversified investor base

The ESM/EFSF's investor base is dominated by the euro area (55%), followed by the UK and Switzerland (21%) and Asia (13%). Its debt stock is held by a variety of investors, dominated by banks (39%), asset managers (30%) and central banks (25%). This broadly diversified investor base provides a stable source of funding, resulting in favourable funding rates and hence lending rates. The latest 5-year bond issuance on 11 March 2024 yielded 2.63%, in line with government bond yields of France (2.61%) and slightly above Germany (2.32%).

Concentrated currency mix

Funding activities focus on large liquid benchmarks in euros, combined with marginal issuances in US dollars. Total debt outstanding was EUR 91.8bn as of end-2023, 92.1% of which was in euro. The ESM returned to the US dollar market in 2023 with a USD 3bn, 3-year issuance to benefit from better issuance conditions at shorter maturities compared with Europe.

Limited risks from longer-term liabilities coming due

The ESM has a stable redemption profile over the coming years, with the average maturity of outstanding debt at 6.9 years as of July 2024. Medium-term assets with a maturity of 1 to 5 years (EUR 42.6bn) fully cover liabilities with the same maturity horizon (EUR 40.6bn), which significantly limits refinancing risk. The three-year weighted average maturity gap is 93% as of 2023, higher than that of other supranational peers.

Social bond framework developed for pandemic credit line

Finally, the ESM developed a Social Bond Framework for its Pandemic Crisis Support credit line, compliant with ICMA's social bond principles. While the credit line was not used during the Covid-19 pandemic, it provides a basis for funding in ESG markets if similar support measures are needed.

Figure 14: Distribution by currency
% total outstanding

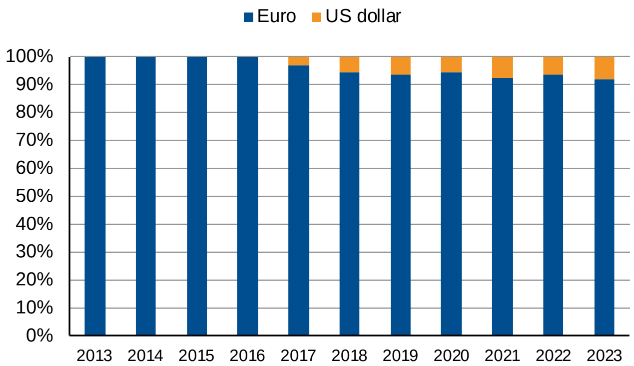
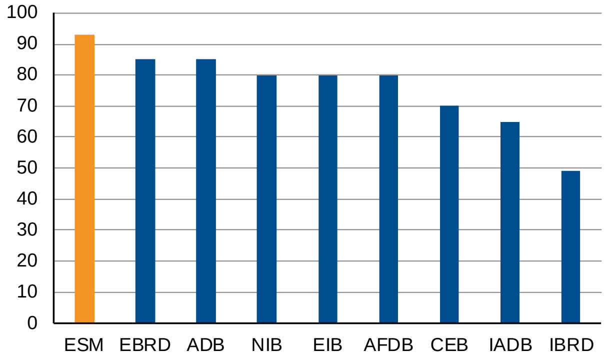


Figure 15: Coverage of medium-term liabilities
%, three-year weighted average



Source: ESM, respective supranationals, Scope Ratings

Additional liquidity considerations

No adjustment for contingent liabilities, interest rate, FX or derivatives exposures

No guarantees were issued and no contingent liabilities recorded. Currency risk and interest rate risk exposures are hedged through derivatives as per the ESM Investment Guidelines.

Shareholder support: Excellent

We assess an institution's shareholder support through the ability and willingness of supranational shareholders to provide timely financial support.

Notches	3	2	1	0
Assessment	**Excellent**	Very High	High	Moderate

The ESM's shareholder support is assessed as 'Excellent'. This reflects its key shareholders' 'high' ability and willingness to provide financial support in case of need.

Key shareholder rating

Highly rated key members

The ESM's key shareholders based on capital subscriptions are Germany (AAA/Stable), France (AA/Negative), Italy (BBB+/Stable) and Spain (A-/Positive). The average key shareholder rating is AA-, which reflects a very high ability to provide support, and is among the highest of peers.

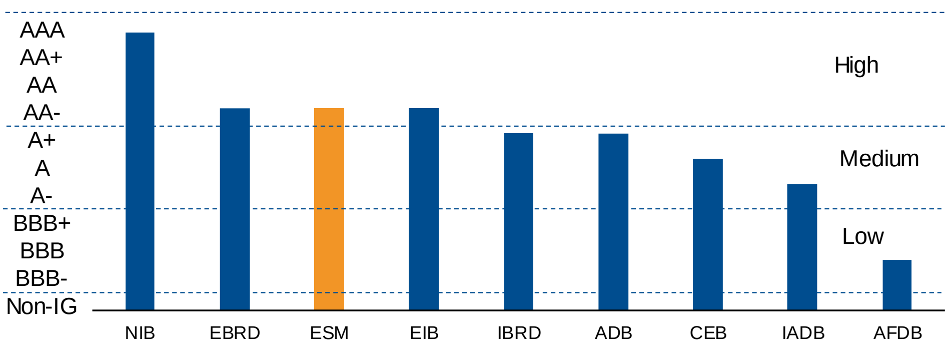
We also note that 8 of the 20 shareholders are rated AA- or above, constituting around 55% of the ESM's subscribed capital. This provides additional confidence about shareholders' ability to provide support if ever needed.

Figure 16: Key shareholders

Key shareholders	Rating	Capital subscription (%)	
		Original	Adjusted
Germany	AAA/Stable	26.74	35.10
France	AA/Negative	20.08	26.36
Italy	BBB+/Stable	17.65	23.16
Spain	A-/Positive	11.73	15.39
		76.2	**100.0**
Key member rating			**AA-**

Figures may not add up due to rounding. Source: ESM, Scope Ratings

Figure 17: ESM's key shareholder rating vs peers



Source: ESM, respective supranationals, Scope Ratings

Some overlap between key members and countries of operation

In line with its mandate, the ESM's loan exposures are only to its shareholder countries. However, the only key shareholder that is a current debtor is Spain. This exposure accounts for 20% of outstanding loans, which in our assessment does not constitute a significant overlap between key shareholders and the ESM's portfolio.

In our view, there is thus no material risk that credit deterioration could arise simultaneously in the countries that are expected to provide support, if support is ever needed, and thus no negative adjustment is made under our methodology.

Willingness to provide support

We assess the willingness of ESM members to provide adequate financial support in a timely manner, if ever needed, as ‘High’.

Very strong framework for capital calls

The ESM has a very strong legal basis for significant and timely shareholder support. Capital calls are permitted in several instances under Article 9 of the ESM Treaty, which provides a very strong assurance that ESM debt securities will be serviced and repaid.

First, the ESM’s Managing Director, rather than the Board of Governors as is the case at most supranationals, can make an emergency capital call to avoid default on any ESM payment obligation, which is to be paid within seven days of receipt by member states as established under the ESM Treaty.

Second, the ESM Board of Directors can make a capital call to restore the level of paid-in capital if it were reduced due to loss absorption. Current paid-in capital can be replenished to either cover for non-payment by a beneficiary country or if losses cause paid-in capital to fall below 15% of maximum lending. Finally, the ESM Board of Governors may call in capital at any time to increase paid-in capital, for example, to raise the ESM’s lending capacity.

Indicative rating: 'aaa'

We first map the assessments for the institutional and financial profiles to determine the supranational's intrinsic credit profile. In a second step, we complement this assessment with our assessment of the strength of shareholder support to determine the indicative rating.

Figure 18a: Intrinsic credit profile for the ESM

Intrinsic Credit Profile		Institutional Profile				
		Excellent	Strong	Adequate	Moderate	Weak
Financial Profile	Excellent	aaa	**aaa**	aaa	aa+	aa
	Very Strong (+)	aaa	aaa	aa+	aa	aa-
	Very Strong	aaa	aa+	aa	aa-	a+
	Very Strong (-)	aa+	aa	aa-	a+	a
	Strong (+)	aa	aa-	a+	a	a-
	Strong	aa-	a+	a	a-	bbb+
	Strong (-)	a+	a	a-	bbb+	bbb
	Adequate (+)	a	a-	bbb+	bbb	bbb-
	Adequate	a-	bbb+	bbb	bbb-	bb+
	Adequate (-)	bbb+	bbb	bbb-	bb+	bb
	Moderate (+)	bbb	bbb-	bb+	bb	bb-
	Moderate	bbb-	bb+	bb	bb-	b+
	Moderate (-)	bb+	bb	bb-	b+	b
	Weak (+)	bb	bb-	b+	b	b-
	Weak	bb-	b+	b	b-	ccc
	Weak (-)	b+	b	b-	ccc	ccc
	Very Weak (+)	b	b-	ccc	ccc	ccc
	Very Weak	b-	ccc	ccc	ccc	ccc
	Very Weak (-)	ccc	ccc	ccc	ccc	ccc

Source: Scope Ratings

Figure 18b: Mapping of intrinsic credit profile and shareholder support for the ESM

Indicative Rating		Shareholder Support			
		Excellent	Very High	High	Moderate
Intrinsic Credit Profile	aaa	**aaa**	aaa	aaa	aaa
	aa+	aaa	aaa	aaa	aaa / aa
	aa	aaa	aaa	aaa / aa	aa+ / aa-
	aa-	aaa	aaa / aa	aa+ / aa-	aa / a+
	a+	aaa / aa	aa+ / aa-	aa / a+	aa- / a
	a	aa+ / aa-	aa / a+	aa- / a	a+ / a-
	a-	aa / a+	aa- / a	a+ / a-	a / bbb+
	bbb+	aa- / a	a+ / a-	a / bbb+	a- / bbb
	bbb	a+ / a-	a / bbb+	a- / bbb	bbb+ / bbb-
	bbb-	a / bbb+	a- / bbb	bbb+ / bbb-	bbb / bb+
	bb+	a- / bbb	bbb+ / bbb-	bbb / bb+	bbb- / bb
	bb	bbb+ / bbb-	bbb / bb+	bbb- / bb	bb+ / bb-
	bb-	bbb / bb+	bbb- / bb	bb+ / bb-	bb / b+
	b+	bbb- / bb	bb+ / bb-	bb / b+	bb- / b
	b	bb+ / bb-	bb / b+	bb- / b	b+ / b-
	b-	bb / b+	bb- / b	b+ / b-	b / ccc
	ccc	bb- / b	b+ / b-	b / ccc	b- / ccc

Source: Scope Ratings

Additional considerations: Neutral

We acknowledge the heterogeneity of supranationals and include in our assessment idiosyncratic factors that may affect the creditworthiness of the supranational.

In the case of the ESM, we have not made an adjustment to our indicative rating.

SCOPE

Annex I: Shareholders – European Stability Mechanism

EUR 000s

ESM Shareholders	Paid-in capital	Callable capital	Subscribed capital	Key (%)	Rating	Callable capital ≥ AA-
Germany	21,651,750	167,801,050	189,452,800	26.7	AAA/Stable	167,801,050
France	16,259,660	126,012,340	142,272,000	20.1	AA/Negative	126,012,340
Italy	14,287,850	110,730,850	125,018,700	17.6	BBB+/Stable	
Spain	9,494,290	73,580,710	83,075,000	11.7	A-/Positive	
Total key shareholders*	**61,693,550**	**478,124,950**	**539,818,500**	**76.2**		**293,813,390**
Netherlands	4,559,860	35,338,940	39,898,800	5.6	AAA/Stable	35,338,940
Belgium	2,773,280	21,492,920	24,266,200	3.4	AA-/Negative	21,492,920
Greece	2,246,550	17,410,750	19,657,300	2.8	BBB-/Positive	
Austria	2,220,020	17,205,180	19,425,200	2.7	AA+/Stable	17,205,180
Portugal	2,001,300	15,510,100	17,511,400	2.5	A-/Stable	
Finland	1,433,630	11,110,670	12,544,300	1.8	AA+/Stable	11,110,670
Ireland	1,269,910	9,841,790	11,111,700	1.6	AA-/Positive	9,841,790
Slovakia	792,790	6,144,110	6,936,900	1.0	A/Stable	
Croatia**	442,290	3,610,542	3,695,000	0.5	BBB+/Positive	
Slovenia	375,930	2,913,470	3,289,400	0.5	A/Stable	
Lithuania	327,200	2,536,200	2,863,400	0.4	A/Stable	
Latvia	221,200	1,714,100	1,935,300	0.3	A-/Stable	
Estonia	204,650	1,586,050	1,790,700	0.3	A+/Stable	
Luxembourg	199,740	1,547,960	1,747,700	0.2	AAA/Stable	1,547,960
Cyprus	156,530	1,213,070	1,369,600	0.2	BBB+/Stable	
Malta	72,260	560,040	632,300	0.1	A+/Stable	
Total	**80,990,690**	**627,860,842**	**708,493,700**	**100.0**		**390,350,850**

*We include shareholders whose cumulative capital share, starting from the largest shareholder, comprises at least 75% of the supranational's capital. We add all marginal shareholders with identical capital subscription to calculate the key shareholder rating.

**Croatia became an ESM member on 22 March 2023. Following the end of a 12-year correction period, Croatia's total capital subscription will amount to EUR 5.7339 bn. The table reflects the paid-in capital subscribed by Croatia upon accession to the ESM. The payment of the corresponding contribution of EUR 422.29 m is to be paid in five equal annual instalments of EUR 84.46 m. The first instalment was paid on 30 March 2023.

Figures may not add up due to rounding. Rating of ESM members as of July 15, 2024. Source: ESM, Scope Ratings

Annex II: Scope's supranational scorecard – European Stability Mechanism

Analytical Pillar			Variables		Unit	+4	+3	+2	+1	0	-1	-2	ESM Value	ESM Assessment	ESM Notches	
Intrinsic Credit Profile (90%*)	Institutional Profile (10%)	Mandate & ESG	Mandate (50%)	Importance of mandate	Qualitative	--	--	--	Very High	High	Declining	--	--	Very High	1	Strong
				Social factors	Qualitative	--	--	--	Strong	Medium/ N/A	Weak	--	--	Strong		
				Environmental factors	Qualitative	--	--	--	Strong	Medium/ N/A	Weak	--	--	Medium/ N/A		
			Governance (50%)	Shareholder concentration	HHI	--	--	--	--	≤ 1500	> 1500	--	1600.0	Moderate/Weak	0	Medium
				Shareholder control	%	--	--	--	--	≤ 25	> 25	--	27.0	Moderate/Weak		
				Strategy and internal controls	Qualitative	--	--	--	Strong	Medium	Weak	--	--	Strong		
	Institutional Profile (10%)													Strong		
	Financial Profile (90%)	Capitalisation (30%)	Capital/ Potential assets		%	≥ 30	< 30; ≥ 20	< 20; ≥ 15	< 15; ≥ 10	< 10; ≥ 7.5	< 7.5; ≥ 5	< 5	24.0	Very High	3	Very Strong
			(Capital/ Actual assets) - (Capital/ Potential assets)		pps	--	--	--	≥ 7.5	< 7.5	--	--	119.0	Excellent	1	
			Profitability (Adjusted return on equity)		%	--	--	--	≥ 3	< 3; ≥ 0	< 0	--	0.0	Moderate	0	
			Trend (-1; +1)												0	
		Asset quality (30%)	Portfolio quality	Incl. risk mitigants	Qualitative	--	Excellent	Very Strong	Strong	Adequate	Moderate	Weak	Very Strong	Very Strong	2	Excellent
			Asset performance	NPLs	% total loans	--	≤ 1	> 1; ≤ 3	> 3; ≤ 5	> 5; ≤ 7	> 7; ≤ 10	> 10	0.0	Excellent	3	
			Trend (-1; +1)												0	
		Liquidity & funding (40%)	Liquid assets ratio		%	> 100	≤ 100; > 75	≤ 75; > 50	≤ 50; > 25	≤ 25; > 15	≤ 15; > 10	≤ 10	340.0	Excellent	4	Excellent
			Funding access, flexibility and profile		Qualitative	Excellent	Very Strong	Strong	Adequate	Moderate	Weak	Very Weak	Very Strong	Very Strong	3	
			Trend (-1; +1)												0	
	Financial Profile (90%)													Excellent		
Intrinsic Credit Profile (90%*)														aaa		
Shareholder Support (10%)		Shareholder Strength	Weighted average rating of key shareholders**		Avg. rating	--	≥ AA-	≥ BBB-	< BBB-	--	--	--	--	AA-	3	Excellent
			Share of portfolio related to key shareholders		%	--	--	--	--	≤ 50	> 50	--	20.0	Low / No adjustment		
			Adjusted key shareholder rating		Avg. rating	--	--	--	--	--	--	--	--	AA-		
		Willingness to support	Willingness to support		Qualitative	--	--	High	Medium	Low	--	--	High	High		
Shareholder Support (10%)														Excellent		
Indicative Rating														aaa		
Additional considerations (-1; +1)														Neutral		
Final Rating														AAA		

Source: Scope Ratings. Figures in the financial profile refer to three-year weighted averages for 2021-23.
* Weights are approximated and for illustrative purposes. ** Notches shown correspond to Shareholder Support uplift given 'Willingness to support' is assessed as 'High'.

Annex III: Climate risks

Legend:

- Methodology input / assumptions
- Supranational input
- Output / calculations

Average (initial) portfolio quality		% of total exposure	Before climate credit risk	Comment
	Sovereign	100%	BBB	Based on country exposures / sovereign ratings
	Public Sector	0%	N/A	Adjusted by 2 notches
	Financial Institutions	0%	N/A	Adjusted by 3 notches
	Non-financial corporates	0%	N/A	Adjusted by 6 notches
	Total	**100%**	**bbb**	

1. Transition risks: NFC	Sectors with high transition risks	% NFC Portfolio	Aligned with path towards Paris Agreement	High Risk (unmitigated)
	Oil & Gas	0%	0%	0%
	Power Generation (oil, coal)	0%	0%	0%
	Metals & Mining (coal & steel)	0%	0%	0%
	Petrochemicals, cement & concrete manufacture	0%	0%	0%
	Total	**0%**	**0%**	**N/A**

2. Physical risks: NFC	ND-GAIN Percentile	Physical risk assessment	% portfolio in countries	% of NFC with high climate risks*	NFC portfolio with high climate risks
	0.00	Very High	0%	100%	0%
	0.10	High	0%	75%	0%
	0.25	Medium	0%	50%	0%
	0.50	Moderate	0%	25%	0%
	0.75	Low	0%	5%	0%
	0.90	Very Low	0%	0%	0%
	*This share is assumed and fixed.	Portfolio coverage	N/A		**N/A**
					N/A

3. 'High' climate risks (NFC portfolio)		% NFC portfolio
	Transition risks	0%
	Physical risks	0%
		N/A

4. Adjustment for maturity	Avg. Maturity of portfolio	Adjustment
	< 1Y	100%
	> 1Y; < 7Y	50%
	> 7Y	0%
	Maturity of NFC loan portfolio*	N/A
	*If unavailable, proxied with total loan portfolio.	
	Adj. high climate risk exposure	**N/A**

5. Notches adjustment to NFC borrower quality	Notches	% portfolio high climate risks
	0 notch adjustment	≤ 25%
	-1 notch adjustment	> 25%; ≤ 50%
	-2 notch adjustment	> 50%
Adjustment (notches)	**0**	

6. Average portfolio quality (climate risk adjusted)		% of total exposure	Before climate credit risk	After climate credit risk	Comment
	Sovereign	100%	BBB	BBB	Climate risk incorporated via sovereign rating/estimates
	Public Sector	0%	N/A	N/A	Climate risk incorporated via sovereign rating (anchor for public sector)
	Financial Institutions	0%	N/A	N/A	Climate risk incorporated via sovereign rating and assumption of widely diversified portfolio
	Non-financial corporates	0%	N/A	N/A	No adjustment since share of physical and transition risks assessed as having 'high' climate risks ≤ 25%
	Total	**100%**	**bbb**	**bbb**	

Source: Scope Ratings

Annex VI: Asset quality assessment

Portfolio quality (initial assessment)	Excellent	Very Strong	Strong	Adequate	Moderate	Weak
Indicative borrower quality	aaa	aa	a	bbb	bb	b

Adjustments		Indicator	Assessment/ Thresholds								
Points			+5	+4	+3	+2	+1	0	-1	-2	-3
Credit Protection	Sovereign PCS Private sector secured	*% of gross loans*	100	≥ 80	≥ 60	≥ 40	≥ 20	< 20			
Diversification	Geography	*HHI*				≤ 1000	≤ 2000	> 2000			
	Sector	*HHI*					≤ 2000	> 2000			
	Top 10 exposures	*% of gross loans*				≤ 25	≤ 75	> 75			
Equity Exposure		*% of equity*						≤ 25	> 25	> 50	> 75

Total points	+5
Adjustments	+2 categories

Portfolio quality (final assessment)	Excellent	Very Strong	Strong	Adequate	Moderate	Weak
Notches	3	2	1	0	-1	-2

Note: Three points usually correspond to one assessment category. In the case of the ESM, this implies up to two higher categories from the initial portfolio quality assessment based on the estimated average borrower quality. Source: Scope Ratings.

Annex V. Statistical table

	2017	2018	2019	2020	2021	2022	2023
Capitalisation (EUR m)							
Mandated potential assets	500,000.0	500,000.0	500,000.0	500,000.0	500,000.0	500,000.0	500,000.0
Mandated assets (disbursed)	76,194.7	89,894.7	89,894.7	89,894.7	89,867.5	86,210.4	82,552.9
Capitalisation ratio, potential (%)	23.6	23.7	23.8	23.9	24.0	24.0	24.2
Capitalisation ratio, actual (%)	154.6	131.6	132.2	132.8	133.4	138.9	146.4
Profitability (EUR m)							
Net income, adjusted	68.6	284.7	289.7	392.9	311.0	- 60.2	320.5
Return on equity, adjusted (%)	0.1	0.2	0.2	0.3	0.3	- 0.0	0.3
Asset quality (EUR m)							
Total gross loans	76,194.7	89,894.7	89,894.7	89,894.7	89,867.5	86,210.4	82,552.9
Non-performing loans / gross loans (%)	-	-	-	-	-	-	-
Liquidity (EUR m)							
Liquid assets and undrawn credit facilities	90,844.2	86,813.6	99,498.5	107,209.0	105,789.9	98,677.9	90,318.9
Cash and cash equivalents	74,288.1	65,245.7	64,973.1	58,217.2	60,401.8	55,568.4	17,108.3
Loans and advances to credit institutions	369.2	1,291.7	6,412.9	11,084.0	7,098.4	1,959.7	4,090.0
Debt securities rated ≥ AA-	16,187.0	20,276.2	28,122.4	37,907.8	38,289.7	41,149.7	69,120.6
Liabilities maturing within 12 months and disbursements	34,017.8	43,667.6	31,792.5	34,771.7	37,974.6	31,558.6	24,578.6
Liabilities ≤ 12 months	25,517.8	21,967.6	31,792.5	34,771.7	37,974.6	31,558.6	24,578.6
Disbursements over the next 12 months	8,500.0	21,700.0	-	-	-	-	-
Liquid assets ratio (%)	267.0	198.8	313.0	308.3	278.6	312.7	367.5
Funding (EUR m)							
Volume	11,500.0	18,000.0	9,800.0	11,000.0	8,000.0	8,000.0	8,000.0
Share of total outstanding (%)							
EUR	97.2	94.7	93.6	94.5	92.5	93.6	92.1
USD	2.8	5.3	6.4	5.5	7.5	6.4	7.9
Others	-	-	-	-	-	-	-
Equity (EUR m)							
Paid-in capital	80,373.3	80,483.0	80,548.4	80,548.4	80,548.4	80,548.4	80,970.7
Retained earnings and reserves	2,064.1	2,348.8	2,638.5	3,031.5	3,342.4	3,282.2	3,602.7
Total equity	82,437.3	82,831.8	83,186.9	83,579.8	83,890.8	83,830.6	84,573.4
10% of callable capital rated ≥ AA-	38,165.7	38,165.7	38,148.9	38,257.5	39,177.7	39,177.7	39,193.7
25% of callable capital authorised and appropriated	-	-	-	-	-	-	-
Callable capital cap (set at 30% of total capital)	35,330.3	35,499.3	35,651.5	35,819.9	35,953.2	35,927.4	36,245.8
Total equity, reserves, and high-quality callable capital	117,767.6	118,331.1	118,838.4	119,399.7	119,844.0	119,758.0	120,819.2
Key shareholders							
Average capital-key weighted rating	AA-	AA-	AA-	AA-	AA-	AA-	AA-
Shareholders rated at least AA- (%)	61.1	61.1	61.1	61.3	62.8	62.8	62.5

Source: ESM, Scope Ratings

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Applied methodology

Supranational Rating Methodology, June 2024

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