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FINANCIAL STABILITY

Exchange of Views with ESM Managing Director Pierre Gramegna

ECON Committee on 22 June 2026

Pierre Gramegna, Managing Director of the European Stability Mechanism (ESM) is participating in the first exchange of views with the ECON Committee in the 10th parliamentary term, based on the Memorandum of Cooperation between the ESM and European Parliament signed in 2024. This briefing provides an overview of the ESM setup in 2012, its key features, instruments, and capital structure. It also considers the ESM Annual Report 2025 and discusses the main findings of the joint discussion paper by the ESM and EIOPA on the macroeconomic, fiscal and financial stability implications of climate-related natural catastrophes. Lastly, it reviews various proposals for euro area safe assets, which are becoming increasingly prominent in the debate, as well as the limited role that the ESM can play in that regard and in financing defence investments, bearing in mind that the revised ESM Treaty has not been ratified by all euro area Member States.

1. The unique setup of ESM and its governance structure

The European Stability Mechanism (ESM) was set up in October 2012, following an ad hoc Intergovernmental Treaty (i.e. outside of the EU legal framework) signed in February 2012 by, at the time, 17 euro area Member States. The ESM provides financial assistance to countries facing financial difficulties, conditionally on the implementation of policy measures. Following the accession of Bulgaria to the euro area on 1 January 2026, the ESM is now composed of 21 members.

Before setting up the ESM, euro area Member States created the European Financial Stability Facility (EFSF) in 2010 as a temporary mechanism to address the financial crisis. The EFSF had an effective lending capacity of EUR 440 billion and financed its loans through bonds and other debt instruments issued on capital markets, backed by guarantees from the 17 euro area countries that were members at the time. Financial assistance under the EFSF was provided to Ireland, Portugal, and Greece during the euro area sovereign debt crisis. Following the creation of the ESM, responsibility for providing financial assistance was transferred entirely to the new permanent institution. As a result, the EFSF no longer grants new financial support programmes, but it continues to issue bonds as part of rollover management of existing loans.

The ESM is currently the sole and permanent instrument for providing financial assistance to euro area Member States, acting as a lender of last resort to ensure the financial stability of the euro area. It has an

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effective **lending capacity of EUR 500 billion** (see more in section 3). Loans are financed by the ESM's borrowings on financial markets and are guaranteed by the shareholders (21 Member States in the euro area).

The ESM is governed by the Board of Governors (BoG), composed of the 21 finance ministers of the euro area. The BoG is chaired by the President of the Eurogroup Kyriakos Pierrakakis since December 2025. All major decisions within the BoG are taken by unanimity[1], including capital increases, granting of financial assistance and approval of Memorandum of Understandings. The Commission, the European Central Bank (ECB) and the President of the Eurogroup may participate in the meetings of the BoG as observers, while others, including representatives of institutions or organisations, can be invited by the BoG to attend meetings as observers on an ad hoc basis. **The Board of Directors (BoD) is the executive body of the ESM**, composed of 21 Directors appointed by the Governors, from among people of high competence in economic and financial matters. The BoD is chaired by Pierre Gramegna who was appointed as the Managing Director of the ESM in December 2022. He is also the EFSF's Chief Executive Officer.

1.1 ESM lending instruments and funding

The ESM offers financial assistance to euro area Member States through different lending instruments, while non euro area countries have access to the Balance of Payments (BoP) facility. Its main tools are **macroeconomic adjustment programme loans** (so far used by Greece and Cyprus) where financial support was tied to major macroeconomic economic reforms (prepared by the European Commission[2], in liaison with ECB and where appropriate, the International Monetary Fund (IMF)) and monitoring. The toolkit also includes **precautionary credit lines** (precautionary conditioned credit line (PCCL) and enhanced condition credit line (ECCL)) designed to prevent crises by supporting countries that still have generally sound economic conditions but may face market pressure. In addition, the ESM can conduct **primary and secondary market bond purchases** to stabilise sovereign debt markets. Moreover, it can support the financial sector through bank **recapitalisation loans** (case of Spain in 2012) and the **direct recapitalisation instrument (DRI)**. During COVID-19 pandemic crisis, the ESM introduced a new temporary Pandemic Crisis Support facility to finance healthcare and prevention costs with lighter conditions than traditional bailout programmes. See more about this in a separate EGOV paper.

Both the EFSF and ESM fund themselves primarily through the issuance of debt securities in the SSA (Sub-Sovereign, Supranational, Agency[3]) market. EFSF issuance is backed by Member State guarantees[4], while ESM issuance is supported by its paid-in capital base. They follow a diversified funding strategy, issuing across instruments and maturities to maintain efficient market access. Funds are pooled and not linked to specific countries, before being disbursed to programme beneficiaries. Although financial assistance programmes have concluded, both institutions continue to issue debt, as bond maturities are not aligned with loan repayments and must be rolled over.

The ESM's funding strategy combines short- and long-term instruments. In the short term, it issues bills through its euro bill programme via the Deutsche Bundesbank's ESM Bidding System, as well as through a Euro Commercial Paper programme. In the long term, it issues euro benchmark bonds with maturities of up to 45 years, alongside a US dollar programme, and can also issue "Namensschuldverschreibungen" (N-bonds) on a reverse inquiry basis.

[1] According to the ESM Treaty, it also includes an emergency voting procedure, whereby financial assistance can be granted if supported by a qualified majority of 85 % of the votes, which confers upon Germany, France and Italy a veto right.

[2] The Commission and the ESM have established detailed procedures (in the form of a Memorandum of Understanding) for their working relationship in providing financial assistance to euro area Member States.

[3] For more information about Issuer strategies in European sovereign and SSA markets refer to this ESM paper.

[4] The EFSF similarly issues euro benchmark bonds, with maturities extending up to 2070, and can also issue N-bonds via reverse inquiry through the EFSF/ESM Market Group.

A financial assistance programme (usually provided in separate instalments) under the ESM is a conditional support arrangement for a euro area Member State facing financing difficulties, under which ESM loans are disbursed in exchange for policy commitments over a certain period of time intended to restore financial stability and market access. The policy conditions are negotiated between the Member State concerned and the Commission, in liaison with the ECB, with IMF participation sought where possible. The institutions also assess financing needs and debt sustainability, and financial assistance is granted only if the Eurogroup and the ESM agree with these assessments. Programme implementation is then monitored at regular intervals by Commission, in liaison with ECB staff.

1.2 Accountability arrangements

As the ESM was established outside the EU Treaties, it is not formally part of the EU institutional framework and is therefore **not automatically subject to EU rules and oversight mechanisms** that apply to EU institutions and bodies[5]. Despite the ESM not being accountable to the Parliament either, the European Parliament has repeatedly called for stronger democratic oversight of the institution. In its resolution of 14 March 2019, Parliament proposed the establishment of a Memorandum of Cooperation (MoC) between the ESM and Parliament to improve interinstitutional dialogue and enhance the ESM's transparency and accountability, while also advocating regular hearings and enhanced parliamentary scrutiny rights. These longstanding calls were partly addressed in **May 2024, when the ESM and the Parliament concluded a Memorandum of Cooperation establishing a formal framework for structured dialogue**.

The MoC aims to improve interinstitutional dialogue between the ESM and Parliament and enhance the ESM's transparency and accountability. It builds on existing engagement, particularly through the ECON Committee and broader EU economic governance discussions. Under this agreement, cooperation is strengthened through regular exchanges of views[6] (either in public or in camera), including annual meetings between the ESM Managing Director and the ECON Committee, as well as reciprocal visits between the ESM and Members of the Parliament.

2. Reform of the ESM Treaty

After the euro area sovereign debt crisis, two different approaches to reforming ESM were considered. The Commission's proposal in 2017, as part of the broader agenda on deepening the Economic and Monetary Union (EMU), was to establish a **European Monetary Fund (EMF)**[7] aimed **to transform the ESM from an intergovernmental institution created outside the EU Treaties into a formal EU body** integrated into the EU legal framework. In March 2019, Parliament adopted a resolution (an interim report) on the Commission proposal[8].

The EMF would have been a unique legal entity anchored within the EU's legal framework, while at the same time essentially preserving the financial and institutional structures of the ESM. This would have also increased the role of EU institutions, strengthened democratic accountability, and subjected the mechanism more directly to EU law and oversight. However, Member States in the Eurogroup were unable to reach political agreement on this proposal, as several countries preferred to preserve the ESM's intergovernmental nature and maintain stronger national control over financial assistance decisions.

[5] This entails that instruments such as the Access to Documents Regulation, the European Ombudsman, the European Court of Auditors, the European Anti-Fraud Office (OLAF), the European Data Protection Supervisor, and EU staff regulations do not directly apply to the ESM. However, euro area Member States that created the ESM agreed that disputes concerning the interpretation and application of the ESM Treaty may be referred to the Court of Justice of the European Union.

[6] According to Memorandum, the Chair of the Committee may also send written questions in English to the ESM Managing Director on matters falling within the purpose of the ESM as outlined in Article 3 of the ESM Treaty.

[7] This proposal has been withdrawn from the Commission's working programme in 2025.

[8] In 2023 a report of the European Court of Auditors also recommended to integrate the ESM into EU legal framework.

As a compromise, instead it was agreed to pursue a more limited reform of the existing ESM Treaty. Discussions in the Eurogroup and Euro Summits in 2018 and 2019 led to the negotiation of a revised ESM Treaty. In November 2020, euro area Member States **reached an agreement on a reform of the ESM Treaty with a view to strengthening its toolbox and mandate**. The ESM retained its current intergovernmental structure, while strengthening some of its functions.

Key proposed changes include:

- **establishment of a common backstop for the Single Resolution Fund,** as part of the Banking Union established by the EU for resolving failing banks, and financed by contributions from the banking sectors a safety net for bank resolution (see Box 1);
- **stronger role** in the definition and monitoring of financial assistance programmes; and
- **additional instruments** to promote debt sustainability.

While it was intended to proceed with ratification in 2021, the amended Treaty is **still pending ratification by the Italian Parliament** before it can enter into force[9]. An **issue that has been raised about the reform** is that it would make the ESM stronger, thus turning an intergovernmental organization into a body with strong powers. More information on amending the Treaty can be found in a separate EGOV briefing here.

The Commission is continuing to advocate for integrating the ESM into the EU legal framework, as stated in its note to the Eurogroup in February 2026, "*to streamline financial assistance operations, support a stronger role of the euro and optimize the use of budgetary resources*". Nowadays, in addition to the EU' safe and liquid bonds, the ESM and the ESFSF issue bonds on capital markets, and the SRF has also ability to borrow (although has not done so far). Thus, **there is a large, unlocked potential for the ESM** to become the single issuer of supranational bonds (see also section 4), which would bring, deeper, more liquid issuances, also **being beneficial for boosting the international role of the euro**. Most importantly, it would: "*reduce market fragmentation and administrative costs associated with issuing separate debt instruments under different legal frameworks*". The Commission further notes that: "*it could facilitate the inclusions of issuances on the main sovereign indices, which serve as benchmarks for large institutional investors, and thereby increase the structural demand for those bonds*."

[9] The Statement by ESM Managing Director Pierre Gramegna on the decision of the Italian Parliament not to ratify the revised ESM Treaty (December, 2023).

Box 1: ESM and the Banking Union

Currently, the ESM may provide funding to failing financial institutions either indirectly - via the indirect recapitalisation instrument - or directly - via Direct Recapitalisation Instrument (DRI). As such, ESM capital can be used in banking resolution only in compliance with the "burden sharing cascade", as defined in the BRRD and SRM regulations. Any capital needs should be met with (sequentially) by:

- **Private sources** (current/new shareholders, bail-in of junior and senior creditors - up to 8 % of total liabilities);
- Once 8% of the total liabilities have been "bailed-in", the **SRF can contribute under strict conditions**. Its intervention is capped at 5 % of total liabilities;
- If the bank remains undercapitalised, but its continuation is imperative to safeguard financial stability, **public funding can be used in "extraordinary circumstances"**, provided that the 5% referred to above has been reached and all unsecured, non-preferred liabilities other than eligible deposits have been written down or converted in full. Funding can either come from national budgets (that may be financed, if needed, by an ESM loan - ESM 'indirect recapitalisation') or from the ESM directly (DRI).
- To be eligible for the implementation of the DRI, the ESM Member State should be unable to provide financial assistance to the beneficiary institution without very serious effects on its own fiscal sustainability. The beneficiary institution should be failing or likely to fail (the DRI is excluded for precautionary recapitalisation) and must be of systemic relevance and supervised by the ECB. It should also be unable to obtain sufficient capital from private sources (including bail-in).

Should the reform of the ESM Treaty be adopted by all Member States, the DRI will be replaced by the ESM backstopping the SRF. It should be noted that the draft ESM Treaty makes the backstop to the Single Resolution Fund "*contingent upon compliance with the condition of permanence of the legal framework for bank resolution*". In other words, should the resolution framework (e.g. MREL or bail in) be changed or be re-negotiated, the backstop facility could potentially lapse. That safeguard clause has been introduced at the request of some Member States to ensure that risk sharing be only effective after creditors have been sufficiently bailed in. In its June 2019 communication on EMU, the Commission voiced concerns about that **safeguard clause**. According to the Commission, "*the Treaty establishing the European Stability Mechanism must not create obstacles to future amendments of EU legislation, which would give rise to fundamental problems affecting the autonomy of the EU legal order. The EU's banking legislation must remain open to further developments in accordance with the Community method to adjust to changing market circumstances and complete the Banking Union*". The role and room of manoeuvre of the European Parliament as co-legislator would be affected by this draft ESM Treaty.

In addition, where the permanence of the legal framework is no longer ensured, the backstop facility is not automatically suspended but "*a comprehensive review will be initiated and a decision by the Board of Governors shall be required to continue the backstop facility*" in accordance with Article 18A(8) of the draft ESM Treaty. That safeguard clause is broad in scope and include "*principles and rules [that] are relevant for preserving the financial means of the Single Resolution Fund*". This means that, for example, **a possible simplification process like the one that the Commission may possibly start with the publication of the report on competitiveness, that changes *inter alia* the 8% bail-in rules or the level of subordinated debt that banks shall hold in accordance with the BRRD could potentially put at risk the ESM backstop to the SRF**.

3. ESM Annual report 2025

The ESM has published its **annual report for 2025** in June 2026. The report covers the ESM's activities during the year and its end-year financial statements, which have received a clean opinion from the external auditor KPMG Audit S.à r.l., Luxembourg.

3.1 Financial report for the end of 2025

Turning to the end-2025 financials first, **Table 1** shows a simplified balance sheet of the ESM. The **largest asset items** of the ESM are EUR 74.2 billion **loans to euro area Member States**, of which some EUR 73 billion to Member States that have received program funding in the past, and EUR 83.4 billion worth of **debt securities**. Moreover, the ESM reports the **unpaid capital from its Member States**, EUR 627.7 billion, as an asset item that Member States have committed to pay in at short notice.

Table 1: Simplified ESM balance sheet, in EUR billion

Assets	Amount	Liabilities and capital	Amount
Cash and bank deposits	18.2	Bank debt	6.7
Loans to Member States	74.2	Issued debt securities	81.5
Debt securities	83.4	Other liabilities and accruals	1.3
Unpaid subscribed capital	627.7	Subscribed capital	708.5
Other assets	1.7	Reserves	5.2
		Profit for the financial year	2.0
	805.2		805.2

Note: As of 31.12.2025.
Source: EGOV elaboration based on ESM annual report 2025.

The liability side of the balance sheet shows EUR 89.5 billion in **liabilities**, of which EUR 81.5 billion are **outstanding debt securities** that the ESM has issued. There are EUR 715.7 billion in **shareholders' equity**, of which EUR 708.5 billion is the **capital subscribed** by Member States. Thereof, EUR 80.8 billion are **paid-in**, while EUR 7.2 billion **reserves and profit of 2025** also contribute to equity. The capital provided by each Member State is based on the capital key of the ECB, which reflects the respective country's share in the total population and gross domestic product of the euro area.[10] Members thus hold ESM shares corresponding to their subscribed capital (see Annex).

The **total outstanding** ESM loan portfolio amounted to EUR 72.6 billion by end-2025, after EUR 5.3 billion repayments during the year. On this basis, the ESM reports **remaining lending capacity of EUR 432 billion**

[10] In accordance with Article 42 of the ESM Treaty, Member States whose GDP per capita is below 75% of the EU average at the time they join the ESM are granted a temporary adjustment to their capital contribution key when subscribing to the authorised capital stock. This correction applies for a period of 12 years from the date they adopt the euro. Despite this, country is fully protected once it joins the ESM. This temporary correction period for Latvia ended on 1 January 2026. Besides Latvia, the temporary adjustment to the ESM capital contribution key has previously applied to Slovenia, Malta, Slovakia, and Estonia. At present, Lithuania and Croatia are still benefiting from this correction, which will remain in place until the end of 2026 and 2034, respectively. Bulgaria also benefits from a temporary correction period, during which its initial capital subscription to the ESM will be reduced, resulting in a lower paid-in capital contribution in the early years of membership. During this period, total paid-in capital will amount to around EUR 600 million to be paid in 5 instalments. At the end of the period, total paid-in capital will reach EUR 992 million.

by end-2025 (**Table 2**), out of a EUR 500 billion lending capacity agreed when the ESM was set up. The ESM's annual report recalls that combined with EFSF lending, there is a total of EUR 240.6 billion loans to Member States outstanding.

Table 2: An overview of ESM capital, in EUR billion

Capital	Amount
Subscribed capital	708.5
Paid-in capital	81.0
Committed callable capital	627.5
Maximum lending capacity	500.0
Remaining lending capacity (2026): 86%	432.0

Source: ESM.

No euro area Member State is currently under an ESM/EFSF financial assistance programme. The last programme to conclude was Greece's ESM programme in August 2018. **Former programme countries have moved into a repayment phase**, during which the Commission (in liaison with the ECB) conducts Post-Programme Surveillance[11] until 75% of assistance is repaid. Independently, the ESM monitors repayment capacity through its Early Warning System, which runs from first disbursement until loans are fully repaid, and whose missions are in practice combined with the Commission's PPS missions.

The ESM's annual report contains the following information on the **status of repayments** for the Member States concerned:

- **Cyprus** owed the ESM EUR 6.0 billion at end-2025 made after making its first principal repayment to the ESM of EUR 350 million in 2025. It had received a facility of EUR 10 billion in total out of which a last disbursement was made in 2015; the facility was not fully utilised.
- **Greece** owed the ESM EUR 59.4 billion by end-2025 after an unscheduled repayment of EUR 0.4 billion in 2025 and total repayments 0.5 billion euro. It also made a scheduled repayment to the EFSF of EUR 1.7 billion to the EFSF and EUR 5.3 billion early repayment to the multilateral Greek Loan Facility in December, which required that the ESM waived the requirement for itself to be repaid proportionately.
- **Ireland** did not borrow from the ESM, but from its predecessor ESFS. Repayments are scheduled from 2029.
- **Portugal** did not borrow from the ESM, but from its predecessor ESFS. Portugal repaid in 2025 EUR 1.5 billion to the EFSF as scheduled, making its first principal repayment since 2019. The EFSF waived its right to a proportional early repayment triggered by Portugal's early repayment of EUR 2.5 billion to the European Financial Stabilisation Mechanism.

[11] Post-programme surveillance is foreseen by Art. 14 of the Regulation (EU) N°472/2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability: *"a Member State shall be under post-programme surveillance as long as a minimum of 75 % of the financial assistance received from one or several other Member States, the EFSM, the ESM or the EFSF has not been repaid."*

- **Spain** owed the ESM EUR 7.3 billion at end-2025 after having repaid EUR 34.0 billion financial assistance in total. In 2025, it repaid EUR 4.6 billion to the ESM, its third scheduled repayment of indirect bank recapitalisation loans.

As to the repayment perspectives, the ESM's annual report provides the following information:

- **Cyprus** retains the capacity to meet all obligations due to the ESM in 2026. Over the medium to long term, Cyprus faces low risks to the sustainability of public debt. Medium- term challenges include ageing and climate change, including the energy mix and water supply resilience.
- **Greece** retains the capacity to meet all obligations due to the ESM/EFSF in 2026. The cash position is expected to remain comfortable, and the ESM assesses the risk of short-term market distress as low. A priority remains closing the still significant productivity gap vis-à-vis the rest of the euro area. The strong pick-up in investment under the recovery and resilience plan should help channel resources into productive sectors of the economy capable of generating new and well-paid jobs. Fiscal prudence remains a pillar of the authorities' policy priorities.
- **Ireland** retains the capacity to meet all obligations due to the EFSF in 2026. The cash buffer is projected to remain adequate, sufficient to withstand a variety of negative shocks. The ESM assesses the risks of market stress to be low over the short term. Over the medium to long term, Ireland faces low risks to the sustainability of public debt affecting its repayment capacity, but costs associated with ageing and climate change pose a significant challenge.
- **Portugal** retains the capacity to meet all obligations due to the EFSF in 2026. The ESM's assessment is that risks of market distress are low over the short term. An ageing population, climate change, and rising defence costs pose significant long-term fiscal challenges.
- **Spain** retains the capacity to meet all obligations due to the ESM in 2026. The ESM assesses the near-term risks of market stress to be low. However, medium- to long-term debt sustainability hinges on the steadfast implementation of the government's reform agenda. It remains important to continue addressing productivity challenges, ageing demographics, and climate-related vulnerabilities. Fiscal plans would benefit from the delivery of investments, reforms, and fiscal adjustments per the medium-term fiscal structural plan, which accommodate spending pressures and strengthen long-term growth.

3.2 Other developments and activities in 2025

Bulgaria's ESM membership was approved in December 2025, with a view to its accession to the euro, and **Latvia left a transitional period** with reduced contributions for countries with less than 75% of EU per capita GDP. Lithuania and Croatia still benefit and so will Bulgaria.

The ESM and EFSF **issued EUR 28.5 billion debt securities in 2025** This comprised EUR 21.5 billion for the EFSF and EUR 5 billion for the ESM and 2 billion for the ESM in US-dollar. The US-dollar issuance in 2025 was a first, and the ESM reported strong demand. The ESM currently receives **AAA long-term ratings with stable outlooks** from S&P, Moody's, Fitch, SCOPE rating and Morning Star DBRS (the latter, unsolicited). In 2025, the ESM mandated the European rating agency SCOPE ratings, adding it to the range of US American agencies it had previously mandated. Strong external credit ratings for its debt securities enable the ESM to borrow at **favourable market terms** and pass on low financing costs to beneficiary Member States; the loans to Member States are priced based on the ESM's own average funding cost, plus certain add-ons such as a service fee.

The ESM reports that its **own investments in debt securities** outperformed benchmarks, delivering EUR 1.97 billion net profit. More than half of the investments are rated AAA, and close to 90% AA- or better. The investments are more than 90% in public sector debt and just above 9% in financial institutions' debt.

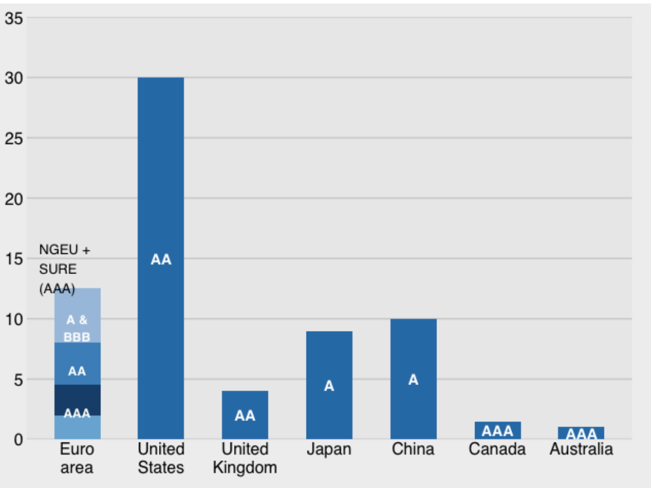
In 2025, the **ESM joined EUREX Clearing** as a clearing member and it underlines that it is the first among European multilateral and supranational institutions to do so, thereby delivering a signal for strengthening clearing and settlement through central counterparties in the EU.

The ESM furthermore reports that it has worked on its **toolkit** to remain fit for purpose and that it has strengthened its precautionary instruments. Together with the European University Institute, the ESM has published a Handbook on **crisis communication for public institutions**. Moreover, the ESM reports that it has completed a "refresh" of its **organisational values**, which are "strengthening Europe", "teaming up for excellence", and "acting with integrity".

The ESM **strengthened cooperation** with what it refers to as "peer institutions" – it renewed a memorandum of understanding with the EIB, and it reports that it has extended its collaboration with AMRO[12], FLAR[13] and the Arab Monetary Fund. Moreover, a new memorandum of understanding was signed with the African Development Bank.

4. Facts and figures behind European safe assets

Figure 1: Relative scarcity of European safe assets, in USD trillion



Source: EGOV elaboration based on the analysis by Beetsma, R. and Janse, K.A. (2026).

Over the past few years, the EU has significantly expanded the supply of safe, liquid euro-denominated assets[14]. Landmark programmes financed through EU bonds include NextGenerationEU (NGEU), financial assistance to Ukraine, other neighbouring countries and the Security Action for Europe (SAFE) instrument. Broader estimates of European supranational safe assets (including EU, ESM, and European Investment Bank (EIB) paper) put the total at roughly EUR 1.5 trillion at the end of 2025. At that size, the supranational segment now rivals the euro area's fifth-largest sovereign bond market and is close to surpassing Spain as the fourth-largest market in terms of depth and scale.

In terms of size, the volume of European safe assets is **only one third compared to the (Figure 1) US total outstanding debt stock which currently stands at 40 USD trillion** (around 33 EUR trillion at current prices). While US government bonds are issued by a single, highly-rated issuer (the US Treasury), sovereign bonds in the euro area are issued by 21 national issuers with varying credit ratings.

In the coming years, at the EU level additional issuance is planned, including EUR 90 billion for Ukraine-related support[15] and EUR 150 billion for defence spending, as well as proposed instruments for 2028–2034: i) "Catalyst Europe" (EUR 133 billion) and, ii) "Crisis Mechanism" (EUR 350 billion). At the same time, bonds issued under pandemic-era programmes are expected to mature from 2028 onwards without reinvestments.

12 Members are the ASEAN countries and China, Hong Kong, Japan and Korea.

13 Members are Bolivia, Colombia, Ecuador, Peru, Venezuela, Costa Rica, Uruguay and Paraguay.

14 The ECB notes that EU-level bonds are less liquid than French or German bonds. See more in Lane's speech here.

15 More recently in the ECON public hearing on global role of the euro it was argued that the EU's loan facility for Ukraine under enhanced cooperation has created an important precedent for ESM-style borrowing within the EU legal framework. This instrument should offer a constructive path around the persistent political obstacles to full ESM integration.

Although the supply of sovereign euro-denominated safe assets has been growing, it remains susceptible to the inherent fragilities of the unique design of the EMU, as recently underscored by the ECB's Executive Board Member Philip Lane. At the moment, the German Bund is the highest-rated large-country bond in the euro area, and it functions as the de facto anchor safe asset for the currency union. However, the stock of Bunds is too small (only EUR 2.5 trillion) relative to the size of the euro area and the global financial system to meet the growing demand for euro-denominated safe assets. Nevertheless, the ECB's announcement to enhance its repo facility should make these assets more attractive to global investors. Another critical constraint is the amount of sovereign euro safe assets that are actually available on the market, as the **Eurosystem's public sector purchase programmes have absorbed a significant share over the years**. More information on this is available in EGOV briefing here.

The largest existing euro safe asset remains the EU's own issuance under the unified funding approach. The Commission has indicated that its SAFE programme and broader funding operations will be financed through EU borrowing, using EU-Bonds and EU-Bills, and it reported very strong investor demand alongside a substantial outstanding stock of EU debt in early 2026. The market is deepening through established issuance calendars, a primary dealer quoting framework, and a repurchase facility, but EU bonds remain treated differently from sovereign benchmarks, which limits their role as a full safe-asset substitute. It is worth highlighting that global investors do not treat EU bonds as sovereign debt, instead, they classify them as supranational bonds. As a result, **EU bonds are excluded from sovereign bond indices, which reduces demand** and keeps their yields higher than they would be if they were treated on a sovereign basis. As Bonfanti (2025) argues, this has a major consequence on demand as the demand for EU-bonds and EU-bills is cut by up to 80% compared with comparable sovereign bonds.

Box 2: Own-initiative (INI) report on the global role of the euro

On 15 April, the draft own-initiative (INI) report on the global role of the euro was published (Rapporteur: Rasmus Andresen, Greens). The draft report takes note of the gradual but profound transformation of the international monetary and financial system and calls for the EU to reduce its strategic dependencies, including on foreign financial market infrastructures.

The draft report, inter alia, highlights the need for the development of a deep and liquid common European safe asset as a key precondition for strengthening the euro's international role. It can "*fulfil these functions if issuance reaches a scale sufficient to create a deep and liquid market amounting to 20% of the EU's GDP.* "

The **EU safe asset as such could also act as a high-quality collateral in global repo markets and provide a euro-denominated liquidity buffer**. These assets would reduce overall financing costs and entail both new common issuance to finance European public goods and the partial mutualisation of existing national sovereign debt through exchanges into common EU bonds. In this context, the report supports the establishment of a European debt agency.

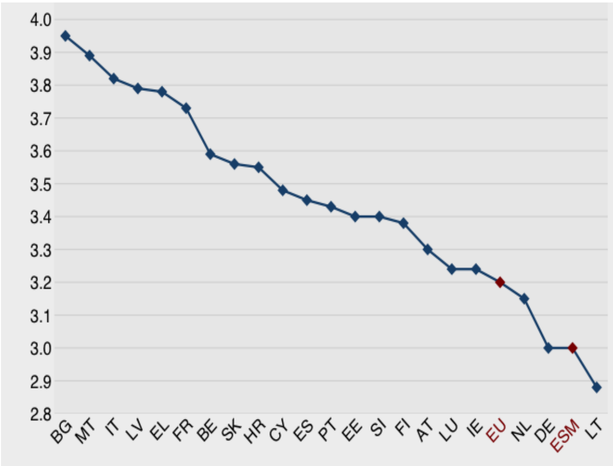
The draft report is still under negotiation by political groups. A total of 212 amendments have been tabled and are currently under consideration (see here and here). The European Parliament's final position will only be determined following committee and then plenary adoption of the draft report.

4.1 ESM's role in financing EU common debt

Together with EFSF transactions, the ESM issued close to EUR 295 billion in bonds since 2012. Although the outstanding bonds issued by the ESM and EFSF, possibly together with the EIB and the EU **could represent the foundation of a genuinely safe European asset capable of rivalling US Treasuries**, the market still lacks the scale and liquidity needed to fully play that role. Nevertheless, momentum behind this is building rapidly and the attention has increasingly turned to measures that could expand their supply. Against this backdrop, we **examine several proposals and assess the potential role that the ESM** could play in this arena, especially if we consider that 86% of ESM lending capacity is not used.

A recent proposal from the Peterson Institute for International Economics (PIIE) by Blanchard and Ubide prioritises **expanding EU-Bonds and EU-Bills as the core Eurobond instrument issued by Commission on behalf of the EU**[16], given their established legal basis under EU law, their growing scale, and their existing market infrastructure[17]. The proposal envisions replacing up to **25% of GDP** of each EU country's national debt with Eurobonds over the coming years, ultimately creating a market of around **EUR 5 trillion**. Under their proposal and with an aim to optimise debt management, each country would earmark a dedicated revenue stream, such as a share of indirect tax receipts, to service the jointly issued bonds. The proceeds from issuing these common bonds, commonly called "**blue bonds or Eurobonds**" would then be used to buy a predetermined amount of national bonds from each participating Member State, often referred to as "**red bonds**." This would increase the stock of common bonds while reducing the stock of national bonds, thereby deepening the European safe asset market while preserving sufficiently large national debt markets to maintain liquidity and mitigate moral hazard[18]. While other EU institutions, including ESM, also issue debt, their bonds are smaller in volume and governed by different legal frameworks. So, the authors note that, in principle, **ESM issuance could be consolidated into a unified EU funding approach to deepen the market further.** However, doing so would require significant **institutional changes as the ESM is an intergovernmental body** distinct from the EU legal framework. As a result, authors consider it more practical to **keep ESM bonds separate** rather than integrate them into the proposed Eurobond system.

Figure 2: 10-year bond yields, in %



Note: Data refers to April 2026. An approximation for ESM bond yield of around 3.0% is shown.
Source: EGOV elaboration based on Eurostat and ESM.

One of the concerns about this proposal is that introducing Eurobonds would concentrate default risk on a smaller pool of national bonds, which ceteris paribus could raise their risk premium and widen spreads. This follows a Modigliani Miller type logic: if governments continue to finance themselves at the margin through national bonds, marginal yields on those bonds may rise. Yet the authors note that average yields on total government debt, which includes both national debt and each country's indirect share of Eurobonds, should decline.

Ultimately, the feasibility of this and other proposals depends on whether markets continue to view supranational issuers as providers of genuinely safe assets. Recent market developments provide some evidence in this regard. Despite the EU spreads widening slightly more than ESM, supranational safe assets have proven to be resilient in the market distress in 2025 and 2026 related to fiscal concerns. In other words, **ESM has kept strong safe asset status, with its bonds trading very close to those of Germany and Netherlands (Figure 2).**

According to another model by Rey and Subran (2026), increasing the stock of Eurobonds by up to EUR 2.5 trillion would not have a material effect on the current convenience yield[19], while an additional EUR 500 billion in issuance would likely increase the EU bond convenience yield by 15 to 20 basis points, driven by a stronger liquidity premium, while leaving the safety component intact and having little effect on the convenience yield of other highly rated sovereign bonds.

[16] The stock of EU-Bonds and EU-Bills is approaching EUR 1 trillion in 2026.

[17] See also Blanchard and Ubide (2025): Now is the time for Eurobonds: A specific proposal.

[18] An alternative solution and complementary approach that could also deliver a larger stock of safe assets from the pool of "red bonds" is provided by the sovereign bond-backed securities (SBBS) proposal. See for example a paper by ESRB High-Level Task Force on Safe Assets in 2018.

[19] Convenience yield is the benefit of holding an asset directly rather than through a contract, reflecting the value of immediate access and the ability to use the asset when needed. See more here.

In parallel, the ESM's role is becoming central to the debate on both safe assets and defence financing. Analysis by Hildebrand, Rey and Schularick (2025) on European defence governance and financing underscores a **more specific and potentially critical role for the ESM in this contex**t: with a total lending capacity of EUR 500 billion and approximately EUR 430 billion currently available the ESM has substantial firepower that could be mobilised to support defence related spending. As a triple A rated issuer with one of the tightest spreads among public sector issuers, the ESM could lend at favourable rates to euro area Member States facing financial stability pressures from increased defence outlays and could act as a lender of last resort if countries encounter widening spreads as they finance defence investments. Another analysis by Janse and Beetsma (2024) argues that the ESM, the Commission, and the EIB should work together to unlock up to **EUR 1 trillion** in additional capacity for defence and security investment.

A concrete governance model for future **European defence bonds** centred on the ESM was proposed by Hildebrand et al. (2025) while acknowledging that alternatives such as the EIB or a new agency are also possible. Under this design, the ESM would house a Financing Committee for defence and be restructured into two distinct pillars:

- **Pillar I**: continue the ESM's current EMF functions focused on crisis management.
- **Pillar II**: create a new financing pillar dedicated to the **European Defence Architecture.**

The authors highlight **several advantages** in this regard as the ESM is established by intergovernmental Treaty, has deep experience in bond issuance, is well capitalised, and its debt is off member-state balance sheets, which is important given existing fiscal constraints and NATO defence commitments. To make this work in practice, authors argue the **ESM treaty should be amended** to: i) allow lending not only to Member States but also to agencies such as a future European Defence Agency; ii) explicitly recognise and frame the second pillar as a common investment function of a different nature from the crisis-management pillar; and iii) permit non-euro area and some non-EU members to participate in Pillar II. However, the **key disadvantage is that the ESM was originally designed as a crisis mechanism for the euro area**, not as a general financing vehicle for defence or other common investments, so creating a new financing agency could be a viable alternative.

The direction of travel is toward more common issuance, not less. Numerous EU institutions and independent think tank and academics explicitly called for expanding the supply of euro safe assets, while policy discussions on EU borrowing for defence, recovery, and other shared priorities are gradually building a larger stock of high-quality euro-denominated debt. In a recent interview, the ESM Managing Director **supported expanding European issuance**, yet ESM bonds remain legally distinct from EU-Bonds and EU-Bills and are not integrated into a single sovereign-style market. In practice, this means ESM bonds add to the stock of euro area safe assets.

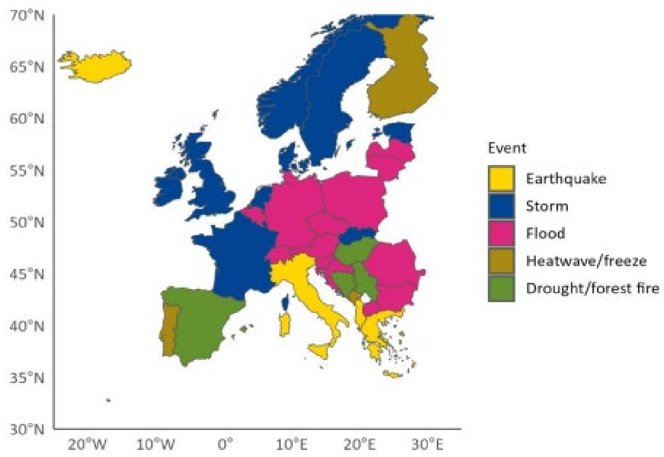
Regarding the ESM, what is clear is that its role can be expanded only under the assumption that its founding Treaty is amended. Given the ratification hurdles and the fact that Italy has locked in its position, there is limited scope for further institutional innovation through the ESM in the near term. This constraint reinforces the **practical case for building on the EU's existing bond framework** (EU-Bonds and EU-Bills) as the primary vehicle for a deeper, more liquid safe asset market, while **keeping the ESM as a complementary, crisis-focused pillar** rather than the core of a new Eurobond architecture.

5. European risk-sharing for natural catastrophe risks

In April 2026, the ESM, together with the European Insurance and Occupational Pensions Authority (EIOPA), published a joint discussion paper entitled *"Sharing the risk: a European approach to natural catastrophe risk management"*. The paper, which explicitly does not represent an official institutional position of either body, builds on previous analytical work carried out by EIOPA, the ECB and the ESM (see here and here) on the **macroeconomic, fiscal and financial stability implications of climate-related natural catastrophes**. The initiative is particularly relevant given the increasing fiscal costs associated with natural disasters and the potential implications for debt sustainability.

The paper starts from the observation that Europe faces **a large and persistent "insurance protection gap"**, i.e. the difference between total economic losses generated by natural catastrophes and the share of those losses effectively covered by insurance. Between 1981 and 2024, natural catastrophes caused more than EUR 900 billion in direct economic damage across the EU, with roughly one fifth of these losses occurring in only the last few years. However, only a limited proportion of these losses has been insured, leaving households, firms and ultimately public authorities exposed to substantial residual costs.

Figure 3: Main exposure to natural perils by geography, based on maximum economic loss



Source: *ESM-EIOPA paper*.

The paper highlights both aggregate estimates and concrete examples to illustrate the scale of the problem. Depending on the methodology used, the protection gap at EU level is estimated at **around 75% on the basis of historical losses** and **around 50% using forward-looking catastrophe models**. The gap also differs significantly across countries and perils. Earthquake risks, for instance, appear particularly underinsured, while countries such as Italy, Greece, Bulgaria, Portugal, Slovenia and Romania display especially large uninsured shares (**Figure 3**). Recent events illustrate the magnitude of the issue (see **Table 3**).

To address these challenges, the paper outlines a possible **European risk-sharing mechanism combining** two complementary pillars: a European-level insurance pool and a public loan-based backstop facility. The overall objective is not to replace national systems or private insurance markets, but rather to increase the overall risk-bearing capacity of the system through cross-country and cross-peril diversification.

The first component consists of a **European risk pool aggregating natural catastrophe risks across Member States and across different types of hazards**. The mechanism relies on the classical insurance principle of diversification: by combining exposures that are only partially correlated geographically and across perils (e.g. floods, earthquakes, storms, wildfires), the overall volatility of losses can be reduced. The paper notes that natural catastrophes are not fully independent events, but that diversification effects remain substantial when risks are pooled across countries and hazards. For instance, geophysical risks dominate in countries such as Italy and Greece, hydrological risks are more prominent in Central and Eastern Europe, while meteorological risks are comparatively more relevant in Northern Europe. According to the simulations presented in the paper, pooling risks at European level could reduce the amount of capital required to back aggregate risks by up to 67% relative to fragmented national approaches.

Table 3: Illustrative list of natural catastrophes

Event	Economic loss	Insured loss
2012 – Earthquake in Italy	~ EUR 20.5 billion	~EUR 2 billion
2021 – Ahr valley floods (Germany and adjacent countries)	~ EUR 51 billion	~ EUR 13 billion
2024 – Flooding in Valencia, Spain	~ EUR 11 billion	~ EUR 4.5 billion
2024 – Central Europe floods	~ EUR 9 billion	~ EUR 4 billion

Source: *ESM-EIOPA discussion paper*.

The paper also provides more operational detail regarding the potential architecture of the pool. In the authors' terminology, the members of the pool would not be Member States as such, but participating insurers, reinsurers, national natural-catastrophe schemes or other dedicated vehicles ceding part of their exposure to the European mechanism. One option discussed is a **catastrophe excess-of-loss (Cat XL) structure**, under which the pool would intervene once losses exceed a predefined national threshold ("attachment point"). In the illustrative calibration used by the authors, the attachment point would correspond to a 50-year return-period loss at national level, while the upper limit of coverage would extend up to a 1,000-year return-period event. In practical terms, losses below the threshold would remain with the original risk-bearing entities, whereas losses exceeding that threshold would be transferred to the European pool. Where the pool's resources were insufficient, the public backstop would provide liquidity through a loan to the pool (see below). The authors also explore a **hybrid structure combining the Cat XL mechanism with a quota-share arrangement**. Under this configuration, the quota share would not apply to total catastrophe losses, but to the loss layer falling above the Cat XL attachment point and below the upper coverage limit. In the illustrative calibration used in the paper, the pool would cover 50% of that layer, while the remaining 50% would be retained by the original risk-bearing entities. Compared with a pure Cat XL structure, this would reduce the expected payout of the European pool and leave a larger role for private or national risk-bearing capacity. According to the paper, such a structure could preserve stronger incentives for prudent underwriting and risk prevention, while simultaneously reducing volatility and stabilising the overall system. The inclusion of a quota-share layer would also preserve a larger role for private insurers and reinsurers rather than replacing market-based solutions or national arrangements entirely. The paper further stresses that **the pool would need to operate on a risk-based ex ante basis**. Participation would take place before catastrophes occur, with premiums reflecting the risk profile of the exposures ceded to the pool by each participating insurer, reinsurer, national scheme or other dedicated vehicle. . This is considered important to **limit moral hazard and adverse selection problems**. The authors also underline that the diversification benefits generated by the pool would need to be redistributed among participants according to their contribution to aggregate risk and diversification. The paper additionally mentions the possible use of insurance-linked securities, such as catastrophe bonds, as a complementary way to transfer part of the risks to capital markets.

The second pillar of the mechanism is a **loan-based public backstop** intended to act as a "reinsurer of last resort" for extreme tail events exceeding the capacity of both insurers and the European pool. The backstop could potentially be provided by a highly rated public institution, such as the ESM, capable of raising funds on capital markets at favourable conditions. The core idea is that, in the event of very severe disasters, the backstop would provide liquidity to the pool through loans rather than through permanent fiscal transfers. The proposed design places strong emphasis on **medium-term fiscal neutrality**. The paper explicitly argues that any loans extended by the backstop facility should ultimately be repaid by pool participants over time, including financing costs. In this way, the mechanism would smooth losses intertemporally without permanently shifting the burden onto taxpayers. The paper draws a parallel with the (as yet not implemented) ESM backstop for the Single Resolution Fund, which similarly combines the principles of fiscal neutrality and last-resort intervention. The authors argue that such a structure could lower financing costs relative to insurers raising additional capital directly on markets, particularly for extreme low-frequency events. Simulations presented in the paper suggest that the **required size of the backstop could range between EUR 10 billion and EUR 65 billion** depending on assumptions regarding climate dynamics and the risk tolerance of the facility. Over time, as reserves accumulate within the pool, reliance on the backstop would gradually decline, although it would remain essential for extreme scenarios.

As far as public finance is concerned, the proposal aims to **reduce the need for ad hoc fiscal interventions following major disasters**. At present, governments frequently act as de facto insurers of last resort, often through discretionary ex post support measures. The reformed preventive arm[20] of the EU fiscal framework allows Member States to deviate from their agreed net expenditure paths in the event of "*exceptional circumstances outside the control of the Member State*"[21], including through activation of the **national escape clause** under Article 26[22]. However, such flexibility mechanisms remain reactive in nature and may generate **heterogeneous fiscal impacts** depending on national fiscal space. By contrast, the ESM/EIOPA proposal seeks to create a more ex ante and rules-based risk-sharing arrangement capable of smoothing losses over time and shifting part of the burden to private-sector risk-sharing mechanisms.

At the same time, the introduction of a European-level backstop raises a number of technical and governance questions. One important issue concerns the **statistical treatment** of the mechanism under ESA 2010 rules (and potentially under the future ESA framework), notably whether the backstop should be treated as a contingent liability or whether it would affect government debt metrics ex ante. A second issue concerns the **precise meaning of fiscal neutrality**. As mentioned above, in the paper fiscal neutrality refers primarily to the design of the public backstop: any loan granted to the pool should be repaid over time by the pool and ultimately by its members. This would limit the risk of a permanent fiscal transfer at European level. However, this does not mean that the costs of natural catastrophes would disappear or that there would be no public-finance implications. If some pool members are public or mandatory national natural-catastrophe schemes, the repayment burden could ultimately be passed on to policyholders or taxpayers. Moreover, residual fiscal risks could arise if losses exceeded the capacity of the pool and backstop, or if loan repayments were not fully recoverable, or if governments decided to provide additional support for uninsured losses. The proposal therefore shifts the question from discretionary ex post fiscal support towards a more rules-based allocation of losses, but it does not fully eliminate the need to clarify who ultimately bears the cost.

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[20] In the corrective arm, natural disasters could be taken into account when assessing whether a breach of the deficit threshold is exceptional and temporary.

[21] Recital 41 of Regulation (EU) 2024/1263 further clarifies that this country-specific escape clause is intended for exceptional circumstances such as "*unpredictable exogenous events*" requiring a fiscal response.

[22] Where the Council has authorised a deviation under the national escape clause, those deviations are not recorded in the control account.

ANNEX

Table 4: Capital contribution of ESM Members as of June 2026

Member	ESM key (%)	Subscribed capital (EUR billion)	Paid capital (EUR billion)
Austria	2.74	19.43	2.22
Belgium	3.42	24.27	2.77
Croatia	0.52	3.70	0.42
Cyprus	0.19	1.37	0.16
Estonia	0.25	1.79	0.20
Finland	1.77	12.54	1.44
France	20.06	142.27	16.26
Germany	26.71	189.45	21.65
Greece	2.77	19.66	2.25
Ireland	1.57	11.11	1.27
Italy	17.62	125.02	14.29
Latvia	0.40	2.84	0.32
Lithuania	0.40	2.86	0.33
Luxembourg	0.25	1.75	0.20
Malta	0.09	0.63	0.07
Netherlands	5.62	39.90	4.56
Portugal	2.47	17.51	2.00
Slovakia	0.98	6.94	0.79
Slovenia	0.46	3.29	0.38
Spain	11.71	83.08	9.49
Total	**100.00**	**709.40**	**81.07**

Note: Data for Bulgaria is not shown. As Bulgaria benefits from a temporary correction period, its initial capital subscription to the ESM is reduced, resulting in a lower paid-in capital contribution during the early years of membership.

Source: ESM shareholders (2026).