

Terms and conditions of capital calls for ESM

Introduction

The ESM is an international financial institution based on authorized capital. The amount of authorized capital is set at EUR 700bn, of which EUR 80bn shall be paid in initially. ESM Members shall meet all capital calls on a timely basis in accordance with the terms set out in the Treaty (Article 8(4)). Capital calls can be launched under different conditions. Article 9 considers

- General capital calls (Art 9(1))
- Capital calls to restore the level of paid-in capital (Art 9(2))
- Capital calls to avoid default (Art 9(3)).

The terms and conditions of each type of capital call are set out below.

The ESM will establish a prudent risk policy in order to limit the risks of capital calls under Art. 9.2 and 9.3. As part of the overall risk policy, the Board of Directors shall define the risk appetite of the ESM and a strong risk governance structure, including an independent risk management function and an internal risk committee. The ESM risk management is specified in the high level principles and its risk policy documentation.

1. Initial level of paid-in capital and general review (Articles 8(2) and 41)

The Treaty sets the initial stock of authorized capital to be paid-in by ESM Members at EUR 80bn. According to Article 41, payment of paid-in shares of the amount initially subscribed by each ESM Member shall be made in five annual instalments of 20 % each of the total amount. The first instalment shall be paid by each ESM Member within fifteen days of the date of entry into force of this Treaty. The remaining four instalments shall each be payable on the first, second, third and fourth anniversary of the payment date of the first instalment.

According to Article 41(3), an ESM Member may decide to accelerate the payment of its share of paid-in capital. On 30 March 2012, the Eurogroup declared that ESM Members intend to effectively accelerate the payment of the initial tranches, with a second tranche being paid by October 2012, the subsequent two tranches in the course of 2013 and the final tranche in the first half of 2014. Finland will pay in its entire contribution to the EUR 80bn paid-in capital in one instalment, when the first tranche is due.

Moreover, during the five-year period of capital payment by instalments, ESM Members shall accelerate the payment of paid-in shares, in a timely manner prior to the issuance date, in order to maintain a minimum 15 % ratio between paid-in capital and the outstanding amount of ESM issuances and guarantee a minimum combined lending capacity of the ESM and of the EFSF of EUR 500bn (Article 41(2)).

The stock of paid-in capital set in Article 8(2) can moreover be adjusted any time. Such a revision may occur in view of the adjustment of the authorized capital stock. According to Article 10, the Board of Governors shall review regularly and at least every five years the maximum lending volume and the adequacy of the authorised capital stock of the ESM. It may decide to change the authorised capital stock and amend Article 8 and Annex II specifying the capital contributions accordingly. An

adjustment of the amount of paid-in capital may be decided at any time irrespective of a change in the amount of authorized capital, among others, for prudential reasons.

2. General capital calls (Article 9(1))

Under Article 9.1, the Board of Governors, acting by mutual agreement may call in authorized capital any time. Unless otherwise foreseen in the Treaty or specified in these terms and conditions, capital calls for the payment of initial capital and related to the revision of the lending capacity as mentioned in Article 10 shall be conducted on the basis of Article 9.1. This does not apply to the acceleration of capital according to Article 41(2).

Approval procedure

A capital call under Article 9.1 shall be based on the proposal of the Managing Director to the Board of Governors. The proposal shall outline the objective of the capital call, the precise amounts and contributions of shareholders, and a proposed payment date or schedule. This proposal shall be sent to Governors at least 3 weeks ahead of the Board of Governors meeting where the item is scheduled to be approved.

Unless otherwise specified herein, the procedures for the preparation of the meeting, voting and documentation have to follow the provisions in the Treaty, the by-laws and the rules of procedure for the Board of Governors. According to Article 5(6)(c), decisions to call in capital pursuant of Article 9(1) can only be adopted by mutual agreement.

Payment

An appropriate schedule shall be set for the payment date which shall not exceed 4 months.

Payments shall be made in cash.

Moreover, payments shall be made on a pro-rata basis in accordance with the contribution key referred to in Article 11.

According to Article 4(8), if any ESM Member fails to pay any part of the amount due in respect of its obligations in relation to paid-in shares or calls of capital under Articles 8, 9 and 10 such ESM Member shall be unable, for so long as such failure continues, to exercise any of its voting rights. The voting thresholds shall be recalculated accordingly.

Acceleration by ESM Member

An ESM Members may accelerate its payment of capital on its own initiative without a capital call being launched. The ESM Member shall notify the ESM and the other ESM members at least 7 days in advance of such accelerated payment.

3. Capital calls to replenish paid-in capital (Art 9.2)

Capital calls may also be made by the Board of Directors, acting by simple majority, under Article 9(2) in order to cover losses arising in the ESM operations. Article 25 stipulates that such losses shall be charged,

(a) firstly, against the reserve fund;

- (b) secondly, against the paid-in capital; and
- (c) lastly, against an appropriate amount of the authorised unpaid capital, which shall be called in accordance with Article 9(3).

The internal risk committee, consisting of the Head of Risk and the ESM Management Board, shall form a view on the financial situation of the borrower and assess the planned repayment schedule against likely scenarios taking into account the information provided by the European Commission, the ECB, national authorities and other relevant external parties providing expert knowledge, such as the IMF. The European Commission and the ECB will be regularly invited to the risk committee to provide their views on the economic and financial situation of the ESM Member concerned.

Approval procedure

A capital call under Article 9(2) shall only be permissible to cover losses in relation to the level of paid-in capital (set by Article 8(2) or adjusted afterwards in accordance with Article 10). They shall be made based on a proposal of the Managing Director to the Board of Directors, which shall specify the losses incurred and the underlying reasons. Losses are defined as a negative realised net result of the ESM in the quarterly financial accounts which shall be circulated to ESM Members in line with Article 27(2) of the Treaty. The losses shall be certified by an external auditor in case they lead to a proposal of a capital call by the Managing Director.

The Managing Director shall propose a call of capital under Article 9(2), under two conditions:

Firstly, if paid-in capital has been used in line with Article 25 to cover a shortfall due to a non-payment by a beneficiary country; and/or

secondly, if losses occurring due to other factors have led to a reduction in the countervalue of the paid-in capital below the threshold of 15% of the maximum lending volume of ESM. Until paid-in capital has been fully paid, in line with the provisions of Article 41, the threshold shall be compiled against the maximum lending volume adjusted by the ratio of effectively paid-in capital to total paid-in capital. As the investment strategy of ESM is designed so as to preserve the value of the paid in capital, such an event is highly unlikely to occur.

The proposal shall specify the precise amounts and contributions of shareholders, and a proposed payment date. It must be sent to the Directors at least 2 weeks ahead of the Board of Directors meeting, where the item is scheduled to be approved.

Unless otherwise specified herein, the confidential procedures for the preparation of the meeting, voting and documentation have to follow the provisions in the Treaty, the by-laws and the rules of procedure of the Board of Directors. According to Article 9(2), decisions to call in capital to cover losses can be adopted by simple majority.

Payment

The Managing Director shall submit a proposal for the payment date not exceeding 2 months from the time of the capital call.

The Board of Directors shall specify the terms and conditions of payment in accordance with the same rules as specified above for capital calls made under Article 9(1).

In addition, in accordance with Article 25(2), if an ESM Member fails to meet the required payment under a capital call made pursuant to Article 9(2), a revised increased capital call shall be made to all ESM Members with a view to ensuring that the ESM receives the total amount of paid-in capital needed. This call shall be made by grossing up the contribution rate of the remaining ESM Members on a pro-rata basis. The renewed call shall be completed as closely as possible to the original payment date.¹

The Board of Governors shall adopt by qualified majority, in accordance with Article 5(7)(g) of the ESM Treaty, an appropriate course of action for ensuring that the ESM Member concerned settles its debt to the ESM within a reasonable period of time. The Board of Governors shall be entitled to require the payment of default interest on the overdue amount (Article 25(2)). The default interest rate shall be set at the weighted average funding costs of the ESM Members serving the portion of the capital payments plus 200bp. This mark-up is reduced to 50bps for ESM Members receiving financial support of ESM in the context of a macroeconomic adjustment programme.

When an ESM Member settles its debt to the ESM, the excess capital shall be returned to the other ESM Members within 30 days in proportion to the initial payment contribution provided to cover the shortfall. The same approach should apply to the distribution of the returns from the default interest payments.

4. Emergency capital calls (Art 9.3)

Finally, capital calls have to be made in accordance with Article 9(3) if needed to avoid a default of any scheduled or other payment obligation due to ESM creditors. When a potential shortfall in ESM funds is detected, the Managing Director shall make such capital call(s) as soon as possible with a view to ensuring that the ESM shall have sufficient funds to meet payments due to creditors in full on their due date. The Managing Director shall inform the Board of Directors and the Board of Governors of any such call.

During the initial paying in period, such calls should also cover the acceleration of capital required under Article 41(2) to maintain a minimum 15% ratio between paid-in capital and the outstanding amount of ESM issuance.

The internal risk committee, consisting of the Head of Risk and the ESM Management Board, shall form a view on the financial situation of the borrower and assess the planned repayment schedule against likely scenarios taking into account the information provided by the European Commission, the ECB, national authorities and other relevant external parties providing expert knowledge, such as the IMF. The European Commission and the ECB will be regularly invited to the risk committee to provide their views on the economic and financial situation of the ESM member concerned.

If the risk committee concludes that there may be a doubt on timely repayment which could lead to a payment default by ESM, it shall notify the Managing Director, who in turn shall on a confidential basis immediately inform the Board of Directors of this warning. The Managing Director will also

¹ The obligation of each ESM Member is strictly limited in all circumstances – including capital calls – to its portion of the authorised capital stock at its issue price, as foreseen in Article 8(5).

indicate possible provisions or other corrective financial measures, if feasible. Once a warning has been launched the Managing Director shall regularly update the Board of Directors on the situation of the borrower and market conditions, as well as any corrective measures taken.

In case the Managing Director concludes that a default would be inevitable, he shall launch the capital call in accordance with Article 9(3) and provide the necessary evidence on the financial situation of the ESM and the outcome of the measures taken to prevent the call.

Payment

The Managing Director shall specify the terms and conditions of payments in accordance with the same rules as specified above for capital calls under Article 9(2), except that ESM Members irrevocably and unconditionally undertake to pay on demand any capital call made on them by the Managing Director pursuant to Article 9(3) to be paid within seven days of receipt.²

In addition, if an ESM Member fails to meet the required payment under the capital call made pursuant of Article 9(3), the procedure of Article 25(2), as described in section 3 above, shall apply.

² The obligation of each ESM Member is strictly limited in all circumstances – including capital calls – to its portion of the authorised capital stock at its issue price, as foreseen in Article 8(5).