4 December 2018

Term sheet on the European Stability Mechanism reform

The European Stability Mechanism (ESM) has played a key role in crisis management by providing timely and effective stability support to euro area Member States in order to safeguard the financial stability of the Euro Area as a whole and of its Member States. The ESM will be further developed to strengthen the resilience and crisis resolution capacities of the euro area. The ESM will notably take a stronger role in the design, negotiation and monitoring of financial assistance programmes and will provide a backstop for the Single Resolution Fund (SRF), in full respect of the Commission and ECB competences as laid down in the EU legal framework. The Commission and the ESM, within their respective competences and according to the modalities agreed in their joint position on future cooperation, will follow and assess macroeconomic and financial risks as well as debt sustainability. The Commission and the Managing Director of the ESM will sign the MoU detailing the conditionality. Conditionality remains an underlying principle of the ESM Treaty and all ESM instruments, but the exact terms need to be adapted to each instrument.

Common backstop to the SRF

At the latest by the end of the transition period the common backstop will be established. The ESM will provide the common backstop to the SRF in the form of a revolving credit line. The terms of reference on this backstop are attached. The size of the credit line will be aligned with the target level of the SRF and will have a nominal cap set above the initial size.

Equivalent treatment will be ensured with non euro area Member States participating in the Banking Union, via parallel credit lines to the SRF as well as appropriate governance arrangements.

The backstop will be a last resort instrument subject to the principle of fiscal neutrality in the medium-term.

The common backstop will cover all possible uses of the SRF, according to the current regulation, including liquidity provision, subject to, where needed, adequate safeguards, to be discussed in 2019. These safeguards should be without prejudice to the existing legal competences of the ECB and the SRB. The Direct Recapitalisation Instrument will be replaced by the common backstop at the time it is introduced.

Procedures will be put in place to allow for swift and efficient decision making to fit the timeline of resolution, whilst respecting national constitutional requirements. Disbursements under the common backstop will be approved by a unanimous decision of the ESM Board of Directors guided by a number of criteria.

The backstop will be introduced earlier provided that sufficient progress has been made in risk reduction to be assessed in 2020. We endeavour to find an agreement on limited Intergovernmental Agreement (IGA) changes. Risk reduction requirements will be commensurate with the level of ambition of the common backstop in the transition period compared to that of the steady state.

The political decision on the early introduction of the backstop will be informed by the assessment of the institutions and competent authorities in 2020 including with respect to minimum requirement for own funds and eligible liabilities (MREL) build-up and trend in non-performing loans (NPLs) reduction[1]. The SRF should be able to access the backstop for banks of all participating Member States.

ESM toolkit

The effectiveness of precautionary instruments will be enhanced for countries with sound economic fundamentals, which could be affected by an adverse shock beyond their control.

As regards the precautionary conditioned credit line (PCCL), the eligibility process will be made more transparent and predictable. The existing ex ante eligibility criteria assessing the sound economic and financial performance of the Member State concerned will be clarified.

They will be used in an assessment on the basis of quantitative and qualitative elements related to the economic and fiscal performance of Member States.

As a rule, Member States need to meet quantitative benchmarks (i.e the debt benchmark, the minimum benchmark and a deficit below 3% of GDP[2]) and to comply with qualitative conditions related to EU surveillance (i.e not experiencing Excessive Imbalances and not being subject to the Excessive Deficit Procedure).

Sustainability of general government debt will always be needed.

A formal commitment from the eligible beneficiary Member State to continuous adherence to the ex-ante eligibility criteria (highlighting the main elements of its policy strategy) would take place at the moment the facility is approved by the BoG in a Letter of Intent (LoI) signed by the beneficiary Member State.

Compliance with the ex-ante eligibility criteria will be assessed at least every six months by the competent institutions. In case of non-compliance, access to the funds would be discontinued. Upon the Member State's request, and in line with ESM decision-making processes, the arrangement can be changed to an enhanced conditions credit line (ECCL) or a full macroeconomic adjustment programme.

The ECCL instrument will continue to be available as foreseen in the current ESM guideline. Access to an ECCL shall be open to ESM Members that do not comply with some of the eligibility criteria required for accessing a PCCL but whose general economic and financial situation remains sound.

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[1] This assessment will be made against the aim of 5% gross NPLs, and 2.5% net NPLs or adequate provisioning, for all SRB banks and progress thereto. Banks should build up subordinated bail-in buffers steadily in line with the 2024 targets and 2022 intermediate targets. There should be appropriate monitoring by the competent authorities to assess progress. As regards NPLs reduction, competent authorities define individual strategies for the reduction of NPL stocks for relevant banks. In case these aims are not met, Member States will undertake specific efforts also involving their insolvency/debt enforcement regimes to reach these goals in a short period of time.

[2] The minimum benchmark is the level of the structural balance providing a safety margin against the 3% Treaty threshold under normal cyclical conditions. It is mainly used as one of three inputs into the calculation of the minimum MTO. The debt benchmark requires a Member State to have a debt to DGP ratio below 60% or a reduction in this ratio of 1/20th per year. The three benchmarks need to be met in the 2 years preceding the request for support.

As regards the financing terms of precautionary instruments, the margin will be set at 35 bp In case of an extension of maturities, a step-up margin of 50 bp will be applied.

Once the credit line is drawn, in case of non-compliance with the LoI for the PCCL or with the MoU for the ECCL, which is not due to events outside the control of the government as assessed by the ESM BoD, an additional margin of 50 bps will be applied, which increases by 65 bp after six months, and access to the funds would be discontinued.

Debt sustainability issues

There is broad support for the need to improve the existing framework for promoting debt sustainability in the euro area. We intend to introduce single limb collective action clauses (CACs) by 2022 and to include this commitment in the ESM Treaty. We also reaffirm the principle that financial assistance should only be granted to countries whose debt is sustainable and whose repayment capacity is confirmed. This will be assessed by the Commission in liaison with the ECB, and the ESM as described in the attached working arrangements. The debt sustainability assessment will be done on a transparent and predictable basis, while allowing sufficient margin of judgement.

Finally, when appropriate and if requested by the Member State, the ESM may facilitate the dialogue between its Members and private investors. This involvement would take place on a voluntary, informal, non-binding, temporary, and confidential basis.

Cooperation between the ESM and the Commission

The ESM and the Commission have also agreed on new modalities of cooperation within and outside financial assistance programmes, in full respect of the EU legal framework (see joint position on future cooperation between the European Commission and the ESM in annex). This agreement is without prejudice to the role and competences of the ECB as defined in the existing legal framework.