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Statement of the Eurogroup in inclusive format on the ESM reform and the early introduction of the backstop to the Single Resolution Fund

1. Today, the Eurogroup has **agreed to proceed with the reform of the European Stability Mechanism** (ESM), to sign the revised Treaty in January 2021 and launch the ratification process. Given the progress made in risk reduction and the further measures outlined below, we have also agreed to advance the entry into force of the common backstop to the Single Resolution Fund by the beginning of 2022. These decisions mark another important step towards completing the Banking Union.

2. The reform will further **develop the ESM toolkit** and strengthen the role of the ESM in the design, negotiation and monitoring of financial assistance programmes. It also provides for **establishing a common backstop to the Single Resolution Fund (SRF)** in the form of a credit line from the ESM to replace the Direct Recapitalisation Instrument, providing a financial safety net for bank resolutions in the Banking Union, which will help to protect financial stability. These changes will strengthen the resilience and crisis resolution capacities of the euro area.

3. In 2018, we committed to introduce the common backstop before the end of 2023 provided that risks in the banking sector have been sufficiently reduced[1]. The institutions prepared an extended **Risk Reduction Report**[2], which shows that all risk reduction indicators improved significantly, increasing the banking sector's resilience. In aggregate, we observed a substantial reduction of Non-Performing Loans (NPLs) in the system as well as continuous build-up of MREL-related capacity[3], in line with the benchmarks we identified in 2018 for our decision-making on the early introduction of the common backstop[4]. These were achieved thanks to the combined significant efforts of the banking sector, the supervisors and member states' authorities. Recent legislative changes and further actions have continued to help address legacy issues in the EU banking system since the cut-off date of the report.

4. Some vulnerabilities, however, remain, as reflected in the NPL levels and MREL shortfalls with regard to the agreed benchmarks. These will need to be addressed by a **combination of additional efforts at bank, member state level and at EU level**. Moreover, the Covid crisis is likely to temporarily interrupt or slow down the favourable trends observed over recent years. This underscores the need to closely monitor developments and address any remaining or emerging vulnerabilities, with a view to maintain financial stability, whilst protecting taxpayers, in line with the fundamental goals of the Banking Union. Tackling NPLs and enhancing resolvability will thus remain a priority. We will therefore continue our work towards further reducing risks in the Banking Union, through the measures outlined below. We will also actively monitor progress with NPL reduction with respect to the agreed benchmarks and the build-up of MREL towards the final targets as part of our holistic monitoring of risks, on the basis of regular risk reporting by the European Commission, the European Central Bank (ECB) and the Single Resolution Board (SRB).

5. The Eurogroup welcomes the ECB Banking Supervision's intention to maintain an **extensive and comprehensive supervisory effort** to further reduce risks, in particular for banks under stricter supervisory monitoring, still exceeding the 5% threshold in their gross NPL ratio, notably by ensuring the implementation of banks' NPL reduction strategies, as well as through stress testing and on–site inspection, as part of its comprehensive work to address all types of vulnerabilities in the banking sector. We underline the importance of regular on-site inspections and, where appropriate and provided for in the legal framework, targeted asset quality reviews for banks with significant vulnerabilities such as, but not limited to, high levels of NPLs or opaque and illiquid assets. We also welcome the ECB's intention to focus on banks' proactive preparedness for any impending deterioration in the quality of their assets as the result of the Covid crisis.

6. We look forward to the results of the **EU-wide stress test exercise** in 2021, which should assess banks' ability to respond to current challenges, and we underline the importance of regular stress tests with a sufficiently broad coverage. We welcome the on-going work led by the European Banking Authority (EBA) on changes to the EU-wide stress test framework to enhance its relevance, comparability and transparency, taking into account the recommendations made by the European Court of Auditors in its report[5]. In this context, we encourage the EBA to review the scope of the recurring EU-wide stress test to ensure broader representativeness of the banking population under the remit of the SRB[6]. We welcome improvements on enhancing granularity in the disclosure of EBA stress test results. We invite the EBA to report to the Council on progress by mid-2021.

7. We support the Commission's ongoing work on a **new action plan on NPLs**, building on the 2017 Action Plan, focusing in particular on the development of secondary markets and on reforming insolvency frameworks. This will contribute to financial stability and the protection of taxpayers.

8. The Eurogroup welcomes the SRB's resolve to **set the banks' final individual 2024 MREL targets** in 2021 in line with BRRD2[7] and SRMR2[8] and based on the current SRB policy[9], and to ensure steady build-up of MREL buffers in line with those targets. We take note of the significant **build-up of the SRF** during the last few years, and note that further contributions will be raised in line with the agreed target level of at least 1% of covered deposits at the end of the transition period.

9. We underline the importance of ensuring that banks have **sufficient internal capacity to absorb losses and can be resolved**. We recall the agreement that the use of the SRF on a mutual basis and the transfer of contributions to the SRF are contingent upon the permanence of the legal framework on resolution whose rules are equivalent to, and lead at least to the same result as those under the SRM Regulation[10], including the rules on the resolution tools, notably those concerning the application of the bail-in tool.Furthermore, with regard to the MREL requirements, we support the view of the SRB[11] that SRMR Article 12c(4) provides that the SRB shall require resolution entities of G-SIIs, Top Tier Banks and Other Pillar 1 Banks to achieve a subordination level equal to 8% TLOF (Total Liabilities and Own Funds), including the possible adjustments as provided for in the legal framework[12], and that this requirement is in addition to the Pillar 1 subordinated requirements of SRMR Article 12d and Article 12e [13]. We welcome the Commission's support for this approach. For loss absorption, the use of the SRF, and hence the common backstop for that purpose, will be conditional on the minimum contribution by shareholders and creditors of 8 % TLOF excluding historical losses in accordance with the current legal framework[14].

10. We recognise the need to continuously improve our crisis management framework. In this context, and also in view of the eventual expiry of the temporary state-aid framework after the pandemic, we invite the Commission to review its **state-aid framework** for banks in the context of the review of the crisis management framework, both starting in 2021 and to be completed in parallel by 2023, ensuring entry into force at the same time with the review of the crisis management framework with a view to ensuring consistency between the two frameworks, adequate burden-sharing of shareholders and creditors to protect taxpayers, and preservation of financial stability. We invite the Commission to report back to the Council by October 2021.

11. We recall that, where the quantitative benchmarks for risk reduction are not met, our 2018 Terms of Reference call for m**ember states to undertake specific efforts**, also involving their insolvency and debt enforcement regimes. In this context, we acknowledge the substantial progress made in risk reduction by Greece and Cyprus and we note with satisfaction that Greece and Cyprus have recently adopted ambitious reforms in their insolvency frameworks and put in place secondary markets, IT systems, and an asset protection scheme or an asset management company respectively to facilitate the further reduction of NPLs. We welcome the commitment by Greece to adopt as soon as possible the necessary secondary legislation for the insolvency reform and to implement the necessary IT system to ensure an effective enforcement of all collateral when the new insolvency rules enter into force. Concerning Cyprus, we welcome the legal initiatives which are being discussed to improve the framework governing the credit-acquiring companies, as well as the intention of the authorities to overhaul the Companies Law, with the aim of simplifying the current legislative framework governing insolvency, and we invite the authorities to transpose in a timely manner the Directive on preventive restructuring. We also welcome the commitments by Greece in the context of enhanced surveillance and Cyprus in the context of post-programme surveillance to continue to make additional targeted efforts aimed at further increasing the efficiency and the effectiveness of their insolvency frameworks, improving the resilience of the banking sector and reducing non-performing loans in the system, and to include such reforms, where appropriate and not covered by another framework, in their respective Recovery and Resilience Plans. The adopted and forthcoming reforms will contribute to maintaining the steady improvement in banks' balance sheets towards bringing the NPLs within the agreed benchmarks.

12. On the basis of these assessments, member states participating in the Banking Union consider that **sufficient progress has been made** in risk reduction to proceed with the early introduction of the backstop to the SRF. The backstop will become operational after the adoption by mutual agreement of the resolution by the Board of Governors of the ESM to grant the backstop facility under the ESM Treaty[15]. Consequently, the Eurogroup also agreed to amend **the Intergovernmental Agreement (IGA) on the Single Resolution Fund,** to bring forward the mutualisation of ex-post contributions.

13. Member states will **strive to complete the process of ratification** of the Agreement amending the IGA at the same time as the agreement amending the ESM Treaty, where possible and taking into account their national requirements, and, in any event, as soon as necessary for the early introduction of the common backstop by the beginning of 2022.

14. The European banking sector today is **far stronger and more resilient** than ten years ago. During the pandemic crisis, it has been able to maintain financing to the economy, thus protecting jobs and preserving the economic preconditions for a rapid recovery. This has been made possible by the work on the Banking Union since 2012. The decisions we are taking today are another crucial step in this regard. With the ESM Treaty reform and the introduction of a common backstop we strengthen the safety net which we created for our European citizens. The Eurogroup is **committed to continue to work** on the completion of the Banking Union and to further develop the Economic and Monetary Union.

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[1] Eurogroup report to Leaders on EMU deepening (press release, 4 December 2018)

[2] Monitoring report on risk reduction indicators, November 2020

[3] Minimum requirements for own funds and eligible liabilities (MREL)

[4] Terms of reference of the common backstop to the Single Resolution Fund, 4 December 2018

[5] Special report n° 10/2019: EU –wide stress test for banks of 10/07/2019

[6] Special Report of the European Court of Auditors No 10/2019 "EU-wide stress tests for banks: unparalleled amount of information on banks provided but greater coordination and focus on risks needed"

[7] The Bank Recovery and Resolution Directive (BRRD)

[8] The Single Resolution Mechanism Regulation (SRMR)

[9] Minimum requirement for own funds and eligible liabilities (MREL), SRB Policy under the Banking Package

[10] As laid down in the rules specified in Article 9(1) of the Intergovernmental Agreement (IGA) on the Single Resolution Fund

[11] Paragraphs 56 and 54(1) of Minimum requirement for own funds and eligible liabilities (MREL), SRB Policy under the Banking Package

[12] Article 12c of the SRMR2

[13] And equivalent as in BRRD Article 45c and Article 45d

[14] As provided for in Article 27.7 SRMR and Article 21.7b SRMR, where applicable

[15] Draft resolution granting the backstop facility and determining the key financial terms and conditions thereof and for the termination of the backstop facility

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