Mr President,

Following the December Euro Summit in inclusive format, you invited Ministers to give priority to two areas of EMU deepening, namely completing the Banking Union and further developing the ESM. Since then, we have worked extensively on these topics with a view to preparing a first set of decisions to be taken at the June Euro Summit. In this context, we welcome the roadmap for the euro area presented by France and Germany as an important contribution to our discussion. The Eurogroup has also discussed the need for a central fiscal capacity and the possible forms it could take, following Leaders’ reflection at the March Euro Summit.

This letter, written in my personal capacity as President of the Eurogroup, builds on our discussions and lays down the elements for further deepening EMU.

Banking Union roadmap

In 2012, we launched the Banking Union project to ensure that banks in Europe are in a stronger position to finance the economy and face a future crisis. Efforts made at national and at European levels have delivered important progress in risk reduction in the banking system, notably in the reduction of the legacies from the crisis. At the same time, different views on these developments and their link with risk sharing elements included in the June 2016 roadmap led to intense discussions on the appropriate sequencing towards completing the Banking Union. To advance further, an objective assessment of the progress made in the implementation of risk reduction measures became an important part of the discussion on the implementation of the June 2016 roadmap.

The Joint Report submitted by the European Commission, the European Central Bank and the Single Resolution Board on the 6th of June provides a valuable basis for a regular assessment. There is broad agreement on using the six indicators proposed by the institutions: the Capital Ratio; the Leverage Ratio; the Liquidity Coverage Ratio; the Net Stable Funding Ratio; NPLs ratio; and MREL ratio. Views on the usefulness of including additional indicators differ substantially, especially on sovereign exposures, where views are the most divergent.
The Ecofin Council reached a general approach on the Banking Package in May. With a view to a possible summit of Leaders in December, it is important that the co-legislators adopt the Banking Package this year and that the overall balance is preserved. Together with an agreement on the indicators to measure risk reduction, this paves the way for the decision that the ESM provides the backstop facility to the Single Resolution Fund. This will enhance the stability of the banking sector.

At the same time, we should reach an agreement in the Council on a general approach on a number of risk reduction measures, notably on the NPL Package (prudential backstops) and on the existing legislative proposals on insolvency.

Finally, there is agreement on the importance of enhancing the current monitoring of the implementation of Anti-Money Laundering measures. As a first step, the institutions will prepare a report in July. Based on this, and in close consultation with the National Competent Authorities, there should be agreement on further measures by end 2018, possibly as part of an Action Plan.

Risk reduction and risk sharing need to continue beyond 2018, including by adopting the legislative proposals under negotiation and implementing the already approved legislative measures of the roadmap. A regular monitoring should provide decision makers with an updated assessment of progress in risk reduction, informing political decisions on the entry into force of the next steps in risk sharing. Adhering to all elements of the 2016 roadmap in the appropriate sequence, after the European Council in June, the work on a roadmap for beginning political discussions on EDIS could start. Work also needs to continue on a possible framework for liquidity in resolution, including on the possible institutional arrangement.

ESM reform

The ESM has played a key role in crisis management by providing timely and effective stability support to euro area member States. The further development of the ESM’s role would further strengthen the crisis resolution capabilities of the euro area and its resilience.

There is consensus that a reinforced ESM will provide the common backstop to the Single Resolution Fund. This would be part of a broader reform of the ESM. The common backstop will take the form of a revolving credit line. In line with the 2016 Banking Union roadmap, a fully operational common backstop would enter into force ahead of the end of the transitional period in 2024, if sufficient progress is achieved in risk reduction measures. To inform the necessary political decision this should be assessed by the institutions and competent authorities in 2020, on the basis of MREL build-up and trend in the NPLs reduction. No country should be excluded from accessing the backstop.

Based on the work done in the relevant expert group so far, technical work on an earlier implementation, including on the relevant risk reduction requirements and the need to review the Inter-Governmental Agreement, should continue in the second half of 2018. The backstop would be a last resort instrument and respect the principles of fiscal neutrality and equivalent treatment. Its size would be aligned with the target level of the SRF. The ESM Board of Directors could take decisions on the use of the common backstop, with procedures put in place to allow for swift and efficient decision making to fit the timeline of resolution, whilst respecting national constitutional requirements. We should further develop this option in the second half of 2018. The Annex includes elements that could form the basis of the common backstop to the SRF and provide guidance to further technical work in the coming months.
On the ESM toolkit, the Eurogroup will continue its review, including an examination of the usefulness of existing instruments and the need for any new instruments. Conditionality remains an underlying principle of the ESM Treaty and all ESM instruments, but the exact terms need to be adapted to each instrument. As regards the precautionary tools, there is broad agreement to enhance their effectiveness while ensuring the appropriate level of conditionality. This should take the form of more effective ex-ante eligibility criteria assessing the sound economic and financial performance of the Member State and respecting the limits of the EU treaties and national constitutional requirements. A formal commitment from the eligible beneficiary Member States to continuous adherence to the ex-ante eligibility criteria should take place at the moment the facility is drawn. A majority of Members suggested a further development of the precautionary credit line, which should also be used to provide stability support to Member States at risk of losing market access without needing a full programme. Once the common backstop for the SRF is in place, it should replace the direct bank recapitalisation instrument, in order to release ESM lending capacity.

A reinforced ESM should take a stronger role in designing and monitoring programmes, in close cooperation with the European Commission and in liaison with the ECB, in accordance with its competences. Some countries suggested that the ESM could also have capacity to assess the overall economic situation in the Member States, without overlapping the role of the Commission and in full respect of the allocation of competencies under the EU Treaty.

Debt sustainability issues remain one of the most sensitive areas. Subject to guidance from the Leaders, we may work further on a possible introduction of single-limb CACs for new issuances to prevent holdouts. Furthermore, it has been suggested that the ESM may, when appropriate, facilitate the dialogue between Member States and their creditors, following IMF practice. It should be noted that some Member States expressed concerns about the market impacts of this approach.

The Eurogroup will prepare by the end of the year an outline of the key features of a reinforced ESM. These include concrete proposals on the role of the ESM in programmes, possible changes to the toolkit, a final term sheet for the backstop to the SRF (including on its early introduction). It will also discuss possible further steps to reinforce the role and governance of the ESM. Thereafter, the ESM and the Commission could update the MoU on working arrangements. In a second step, and following agreement at political level, we will prepare the necessary changes to the ESM Treaty and guidelines. In the longer term, Leaders could decide to incorporate the ESM into the EU framework, preserving the key features of its governance.

Possible instruments for convergence and stabilisation in EMU

Finally, differences of views remain on the need for and possible features of a Eurozone budget for competitiveness, convergence and stabilisation in EMU.

Subject to guidance from the Leaders, the Eurogroup stands ready to discuss the recent proposals on a possible euro area budget for competitiveness, convergence and stabilisation purposes, including on the basis of the legal architecture proposed by the Commission for its investment stabilisation function within the MFF. A European unemployment insurance fund for episodes of severe economic crises, could also be considered. As regards funding, different options in terms of national contributions and allocation of tax revenues, as well as sourcing from the European level could be explored. The concerns related to moral hazard raised by some Members and the possible fiscal impacts will need to be taken into account.
I hope that the present contribution of the Eurogroup is a good basis for taking decisions in some areas at the Euro Summit of 29th of June and I look forward to your further guidance on other areas.

Yours sincerely,

Mario Centeno

Mario Centeno
ANNEX: Landing zone on the common backstop to the SRF

<table>
<thead>
<tr>
<th>General characteristics</th>
<th>The ESM will provide the common backstop, in the form of a revolving credit line.</th>
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<tbody>
<tr>
<td></td>
<td>The size of the credit line will be aligned with the target level of the SRF.</td>
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<td></td>
<td>The Direct Recapitalisation Instrument (DRI) should be replaced by the common backstop.</td>
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<td></td>
<td>No country should be excluded from accessing the backstop.</td>
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<tr>
<td>Modalities</td>
<td>Fiscal neutrality - Maturities: 3 years+ possible 2 years extension.</td>
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<td></td>
<td>Equivalent treatment would be ensured with non-euro area Member States participating in the Banking Union, via parallel credit lines to the SRF.</td>
</tr>
<tr>
<td>Decision making arrangements</td>
<td>ESM BoD could take decisions on the use of the common backstop, with procedures in place for swift and efficient decision making whilst respecting national constitutional requirements.</td>
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<td></td>
<td>Option to be developed further in second half of 2018.</td>
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<tr>
<td>Early introduction</td>
<td>Common Backstop would enter into force ahead of 2024 if sufficient progress is achieved in risk reduction measures.</td>
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<td></td>
<td>Technical work, including on a possible revision of the IGA, to continue in the second half of 2018.</td>
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