



21 September 2011 – European Systemic Risk Board Meeting

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The General Board of the European Systemic Risk Board (ESRB) held its third regular meeting today.

The current situation

Since the previous ESRB General Board meeting on 22 June 2011, risks to the stability of the EU financial system have increased considerably. Key risks stem from potential further adverse feedback effects between sovereign risks, funding vulnerabilities within the EU banking sector, and a weakening of growth outlooks both at global and EU levels.

Over the last months, sovereign stress has moved from smaller economies to some of the larger EU countries. Signs of stress are evident in many European government bond markets, while the high volatility in equity markets indicates that tensions have spread across capital markets around the world. The situation has been aggravated by the progressive drying-up of bank term funding markets, and availability of US dollar funding to EU banks had also decreased significantly. In that context, central banks have decided on coordinated US dollar liquidity-providing operations with longer maturities.

The high interconnectedness in the EU financial system has led to a rapidly rising risk of significant contagion. This threatens financial stability in the EU as a whole and adversely impacts the real economy in Europe and beyond.

Looking ahead

Decisive and swift action is required from all authorities. In the immediate future this includes:

- implementing, fully and rapidly, the measures agreed upon at the 21 July meeting of the Heads of State or Government of the euro area;

- adopting sustainable fiscal policies and growth-enhancing structural measures so as to achieve or maintain credibility of sovereign signatures in global markets; and
- enhancing the coordination and consistency of communication.

Authorities must act in unison with a total commitment to safeguard financial stability.

Supervisors should coordinate efforts to strengthen bank capital, including having recourse to backstop facilities, taking also into account the need for transparent and consistent valuation of sovereign exposures. If necessary, this could benefit from the possibility for the European Financial Stability Facility to lend to governments in order to recapitalise banks, including in non-programme countries.

Activity of the ESRB

On other issues, work is continuing on other risks which may either individually or collectively threaten the resilience of the financial system, in particular on:

- **FX lending:** The recent fluctuations of some currencies illustrate the risks posed to unhedged borrowers' capacity to repay loans taken out in foreign currency. The ESRB has been analysing the risks stemming from such activity and devising policy proposals targeting credit, liquidity and funding risks, as well as the risk of mis-pricing loans. This approach hinges on tackling the issue holistically, by addressing the roots of the issue and improving the overall resilience of the financial system.
- **"Retailisation":** Recently, the marketing of complex products to retail investors by financial institutions has emerged as a potential source of macro-prudential concern. The ESRB has analysed a number of potential risk factors, such as mis-selling; a loss of confidence in financial markets as a result of negative returns; reputational risks or drying-up of funding for product providers, such as banks. The ESRB will continue to carefully monitor developments in this area.

On more medium-term issues, some concerns have been also expressed internationally about developments in some market practices and products, including high-frequency trading and exchange-traded products. Against this backdrop, the ESRB General Board decided today to respond formally to two consultations that have been initiated by the European Securities and Markets Authority (ESMA) providing a macro-prudential perspective, with the ESRB

responses being made available to the public in due course, in line with ESMA's consultation practices.

- Regarding UCITS exchange-traded funds and structured UCITS, the ESRB is concerned about the opacity and complexity of these structures. Targeted disclosure and increased cooperation between securities market and banking sector supervisors are among a number of measures that might be taken to address these issues.
- Concerning high-frequency trading, two areas of concern from a macro-prudential angle which need to be further studied are the impact on liquidity and the possible amplifying impact on market shocks.

The ESRB General Board appointed Professor Charles Calomiris of Columbia University as a new member of the Advisory Scientific Committee, replacing Professor Stefan Gerlach, who was appointed as Deputy Governor of the Central Bank of Ireland.

More information about the ESRB can be found at www.esrb.europa.eu.

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