



22 December 2011 – European Systemic Risk Board Meeting

Kaiserstrasse 29
60311 Frankfurt am Main
Germany
<http://www.esrb.europa.eu>

Media Contact:
Tel.: +49 69 1344 7455
Fax: +49 69 1344 7404
media@esrb.europa.eu

Frankfurt am Main
22 December 2011

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

The current situation

In September, the ESRB characterised the current crisis as a threat to systemic stability. Since then, overall conditions have worsened as a result of the intensification of negative interlinkages between sovereign risks and the uncertainty about the resilience of the financial system, and on account of deteriorating growth prospects.

Reflecting this, European government bond markets continue to be impaired. In a climate of extreme risk aversion, investors lack confidence to continue to provide normal level of funding to financial institutions. Dependence on central banks has risen and signs are intensifying that stressed financial conditions are passing through to the real economy.

Since the previous ESRB meeting, policy-makers have sought to counter these negative developments. In particular, the euro area Heads of State or Government have agreed on a new “fiscal compact” and on a significantly stronger coordination of economic policies.

In order to increase the resilience of, and restore confidence in, the banking sector, the European Banking Authority (EBA) has issued a recommendation for banks to hold a temporary capital buffer, such that their core Tier 1 capital ratios reach 9% at the end of June 2012, based on a one-off valuation of sovereign debt holdings. The European Securities and Markets Authority (ESMA) has published a statement on the disclosure and valuation of sovereign exposures in financial accounts based on the International Financial Reporting Standards (IFRSs).

Central banks of the European Union (EU) have eased monetary conditions. The European Central Bank (ECB) has lowered its main refinancing rate and has introduced extraordinary measures to ease the pressure on banks' balance sheets. In particular, the ECB has announced two longer-term refinancing operations (LTROs) with a maturity of 36 months and the option of early repayment after one year, the reduction of the reserve ratio from 2% to 1% and the broadening of admissible collateral. The Bank of England has also announced a new contingency liquidity facility, the Extended Collateral Term Repo (ECTR) Facility, and central banks around the world have re-established foreign exchange liquidity facilities.

Looking ahead

The ESRB notes the decisions taken thus far both by the Heads of State or Government and by the European authorities. The swift and coordinated implementation of those decisions is now of utmost importance.

Against this background:

- The ESRB urges the committed and timely implementation of measures agreed upon at the summits of 26 October and of 8 and 9 December 2011. A reliable and well coordinated execution of the decisions taken is a prerequisite for the other measures to succeed. It is essential that the EFSF be fully equipped and operational.
- The ESRB reiterates its message on the need to increase the resilience of the financial sector. In that context, strict implementation of EBA criteria to avoid a disorderly or excessive deleveraging process could support the supply of credit and the provision of financial services to the real economy.
- The core Tier 1 capital ratio of 9% should mainly be achieved through an increase in capital levels, also by restricting payouts.

By doing so, public authorities would create the incentives for individual financial institutions to take account of the system-wide implications of their decisions. The ultimate objective of these measures should be to restore banks' function of providing adequate lending to the real economy. As coordinated EU action becomes effective and systemic conditions improve over time, supervisors are encouraged to keep the need for the temporary sovereign buffer under review. Supervisors are also encouraged to regularly collect ex-ante information for the assessment of the aggregate implications of financial institutions' balance sheet decisions. They should

ensure that sufficiently granular and detailed information is collected and that it is shared across the European System of Financial Supervision (ESFS).

The intervention by central banks is expected to assuage the funding pressures felt by banks in the EU in the near term. In the longer term, private funding markets must be revitalised. Work within the ESFS should be intensified in this respect – for example on how to facilitate the re-opening of securitisation markets, in a transparent and prudent way.

Activity of the ESRB

With regard to other issues, work is continuing within the ESRB on risks that may be threatening the resilience of the financial system either individually or collectively and on developing macro-prudential policy and instruments in the EU.

In particular, work at the ESRB has focused on further strengthening banks' management of any risks stemming from US dollar funding. Moreover, with funding markets impaired and given recent developments, the ESRB's General Board decided to examine the structural features of these markets. In particular, the ESRB will assess recourse to certain types of securitised funding and its impact in terms of the encumbrance of assets and the stability of innovative funding sources.

The ESRB has continued work to develop the basis for macro-prudential policy to seek to prevent and mitigate systemic risk in the EU going forward. To this end, and cognisant of the nature and extent of proposed financial system reforms agreed by the G20, the ESRB is examining relevant legislative initiatives in the EU with a view to providing macro-prudential perspectives on the establishment of the new regulatory framework. In recent months the ESRB has written to the EU legislative bodies regarding proposals to implement the Basel III agreement in a revised Capital Requirements Directive and new Regulation for banks and other credit institutions (CRDIV/CRR) and also regarding proposals for the regulation of central counterparties (EMIR).

In particular, the ESRB has emphasised to the legislative bodies the need to ensure that competent national authorities are equipped with broad discretion to take early action at national level, either upon their own initiative or upon recommendation of the ESRB. Such action will be necessary to stem future build-ups of systemic risk associated with banks as well as the procyclical dynamics that can arise out of changes in risk management practices by CCPs when setting margin and collateral haircut requirements. All Members of the EU legislative bodies are called to take full

account during the legislative processes for the CRD/CRR and EMIR of the concerns on the macro-prudential instruments that have been communicated to them by the ESRB.

Consistent with the need for strong and pre-emptive actions to address potential systemic risks at both national and European level, the ESRB is also working on principles to underpin national mandates for macro-prudential actions. Going forward, the ESRB will further its work in this area by considering the minimum set of instruments required at national as well as European level in order to ensure that authorities have sufficient means to take action when risks arise in the future. In doing so, the ESRB is drawing also on work at international level – at the IMF, FSB, CGFS – to ensure a robust basis for macro-prudential policies is put into place.

The ESRB's General Board appointed Ignazio Visco, Governor of the Banca d'Italia, as the new member of the ESRB Steering Committee, replacing Mario Draghi, current Chair of the ESRB.

The ESRB's General Board appointed Daniel Gros, Director of the Centre for European Policy Studies, as a new member of the Advisory Scientific Committee and elected Marco Pagano as the new Vice-Chair of the Committee, replacing Jean-Charles Rochet.

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

Reproduction is permitted provided that the source is acknowledged.