



## 22 March 2012 – Meeting of the European Systemic Risk Board

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

### The current situation

Since the last meeting of the General Board in December 2011, the ESRB has observed signs of stabilisation in the EU economy and an improvement in the situation of financial markets, notably in response to the measures adopted by central banks, the agreement on the fiscal compact, and the progress made in fiscal consolidation and economic reforms in many countries. At the same time, an environment of uncertainty and fragility in segments of the EU financial system persists. The key systemic risk remains the mutual negative feedback loops between three main risks, namely: (i) persistent uncertainties on sovereign debt; (ii) pressures on bank funding and excessive and/or disorderly bank deleveraging in some countries; and (iii) subdued growth prospects. It is therefore crucial that:

- countries make further progress towards restoring sound fiscal positions and implementing the structural reform agenda in order to strengthen their growth potential, increase employment and enhance competitiveness;
- banks strengthen their resilience further – the soundness of banks' balance sheets is a key factor in exiting from current dependence on central bank support measures and facilitating an appropriate provision of credit to the economy.

Market conditions continue to be characterised by difficulties in financial intermediation across EU borders (including within the euro area). The ESRB calls on all public and private institutions to undertake efforts to preserve the integrity of the European financial system. In this respect, the ESRB supports efforts by international and European institutions to reduce – through the so-called “*Vienna 2.0 Initiative*” – risks of financial fragmentation in some economies from central, eastern and south-eastern Europe, both within and outside the EU.

## Looking ahead

The main issue is how to ensure the provision of credit to the economy in the current environment. The ESRB has identified the following areas that might warrant macro-prudential policy measures.

- Since summer 2011, banks have started a deleveraging process. The ongoing deleveraging can also be seen as an overdue correction of excessive leverage accumulated over the past – albeit at different speeds across countries. At the present time such readjustment could be achieved without risks to a smooth provision of credit to the economy.
- Towards the end of 2011, banks faced severe strains in funding markets, both domestically and internationally. Central bank measures, such as the recent LTROs, have alleviated such pressures. The full extent of their impact on the credit supply will become clear over time. The ESRB will monitor lending conditions in the EU and stands ready to draw attention to the need for corrective actions in case clear signs of a credit crunch materialise.
- Investors have shown uncertainty over banks' resilience. By providing ample liquidity and requiring banks to achieve stronger capital positions, authorities are putting banks in a position to improve their financial conditions. There are first signs of banks returning to market funding, namely by issuing secured and unsecured liabilities. Banks should use this window of opportunity to further strengthen their capital base (e.g. by retaining earnings) and to implement business models that rely on private funding.
- In a weak economy banks are exposed to a materialisation of credit risk; they should make adequate provision for this. Banks should manage their loan portfolios through the cycle by taking into account the medium-term creditworthiness of their borrowers without perpetuating non-viable credit positions. The ESRB intends to work – in cooperation with the EBA and national supervisory authorities – on the lack of qualitative and quantitative information on forbearance.
- In the past, ample liquidity conditions have been associated with the emergence of imbalances in different segments of financial markets. While markets are still recovering their pre-crisis values, there are signs of a decrease in risk aversion in some selected financial market segments.
- Finally, it is central that governments continue with fiscal consolidation and structural reforms, the provision of credible firewalls against contagion risk,

and implementation of the fiscal compact. This would contain the impact of further adverse shocks and limit negative spillover.

### **Activity of the ESRB**

Work is also continuing on structural issues, such as developing a sound basis for macro-prudential policy and instruments in the EU and at the national level.

At the EU level, the ESRB is monitoring developments regarding relevant legislative initiatives in the EU, such as the implementation of the Basel III agreement in a revised Capital Requirements Directive and a new Regulation for banks and other credit institutions (the so-called “CRD4”<sup>1</sup>). The ESRB welcomes recent progress in the legislative process.

In this respect, the ESRB has brought to the attention of competent European institutions the fact that relevant national authorities need to be equipped with the tools necessary for taking early action at the local level – either on their own initiative or on the recommendation of the ESRB, taking into account reciprocity – to stem build-ups of systemic risk associated with banks. This should occur within the framework of an EU system of safeguards of the Single Market, to which the ESRB is ready to contribute.

The ESRB decided today to send a letter to the EU legislative bodies putting forward its macro-prudential views on certain aspects of the CRD4, taking into account recent developments in the legislative process. In its letter, the ESRB has identified a number of areas in which it considers further strengthening and development of the proposals to be critical. Such areas relate to: the scope for macro-prudential policies, the flexibility for authorities to conduct effective macro-prudential policies, and the governance arrangements for the use of macro-prudential instruments. This letter will be published on the ESRB’s website once it has been communicated to the recipients.

More information about the ESRB can be found at [www.esrb.europa.eu](http://www.esrb.europa.eu).

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<sup>1</sup> European Commission, Proposal for a Directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate. 2011/0203 (COD), 20 July 2011; and Proposal for a Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms. 2011/0202 (COD), 20 July 2011.