



Press release

7 January 2020

The General Board of the European Systemic Risk Board held its 36th regular meeting on 19 December 2019

At its meeting on 19 December 2019 the General Board considered a number of vulnerabilities in the EU financial system, including the indebtedness of non-financial corporations, the liquidity of assets in investment funds, and the misconduct costs facing financial institutions. Moreover, the General Board took note of the risks to financial stability which might result from climate change and disruptions in critical financial infrastructures.

In its discussion the General Board considered the general macro conditions, which remain a source of concern:

- the medium-term outlook for global economic growth has remained weak amid elevated political/geopolitical and policy uncertainties, including international trade disputes and decreasing international cooperation;
- asset prices continue to be subject to the threat of a sudden reassessment of risk premia, possibly leading to sharp corrections, with potential disruptions to market functioning and weakening of economic conditions;
- slowing growth momentum and rising risk premia could further test debt sustainability in the public and private sectors across the EU;
- over time, the macroeconomic environment may pose fundamental challenges to traditional business models in the financial sector, also magnifying existing vulnerabilities in EU banks, insurers and pension schemes.

Against this background the General Board asked the ESRB Advisory Scientific Committee (ASC), the ESRB Advisory Technical Committee (ATC) and the ECB Financial Stability Committee (FSC) to review the findings of their [previous joint analysis on the macroprudential impact of low interest rates and structural changes in the EU financial system](#). They should consider, among others, whether and how the above-mentioned vulnerabilities might be affected by

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the implications of the current low or even negative yield curve, proposing macroprudential policy responses where appropriate. The General Board will receive an update in this regard at its meeting in June 2020. The work will be chaired by Mr John Fell (ECB), Mr Tuomas Peltonen (ESRB Secretariat) and Mr Richard Portes (London Business School, Chair of the ASC).

The General Board has also identified cyber risk as a source of systemic risk to the financial system. A critical point in assessing whether a cyber incident will develop into a systemic financial crisis is whether or not the incident escalates from an operational level to take on financial and confidence dimensions. The ESRB's analysis, which will be published in the coming months, illustrates how a cyber incident could, under certain circumstances, rapidly escalate from an operational outage to a liquidity crisis. In turn – and in common with historical financial crises – this liquidity crisis could, in certain circumstances, lead to a systemic crisis. The ESRB is continuing to work on cyber risk, focusing on how to mitigate the vulnerabilities identified and on the role of authorities in a systemic cyber crisis. This is particularly important in light of the likely speed and scale of such an event and the specific challenges they pose (in particular for communication and coordination strategies).

Furthermore, the General Board highlighted the importance of the global financial cycle and that the developments in the core non-EU economies, particularly the United States and China, may be transmitted to EU countries, affecting their domestic financial conditions. The Advisory Scientific Committee, which brought this matter to the General Board's attention, discussed the empirical evidence showing that macroprudential policy can effectively protect domestic financial systems from shocks originating at the global level. In its report on global dimensions of macroprudential policy, which will be published in the first quarter of 2020, the ASC also noted that stronger coordination in the field of macroprudential policy would be key to addressing potential cross-border spillovers and leakages of domestic macroprudential measures. **As required by Article 138 of the Capital Requirements Directive the ESRB continuously monitors developments in third countries to which the EU banking system has material exposures.**

In line with its strategy for expanding macroprudential policy beyond banking, the General Board believes that the review of Solvency II should result in a revised framework that better reflects macroprudential considerations. In this context the General Board considered solvency tools for preventing and mitigating procyclical investment behavior, liquidity tools for addressing risks stemming from the asset and liability side (such as those resulting from hedging with derivatives or from specific insurance products) and tools for addressing risks stemming from the provision of credit to the economy by insurers, thereby ensuring cross-sectoral consistency of macroprudential policy. These proposals will be described in a forthcoming ESRB report and summarised in the response of the ESRB to the European Insurers and Occupational Pensions Authority's consultation on the review of Solvency II.

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The General Board also noted that the concentration of financial instruments measured at fair value according to IFRS 9 and IFRS 13 and classified in Levels 2 and 3 remains high: according to data reported in the European Banking Authority's recent Transparency Exercise, five and ten banks respectively account for half of the holdings of Level 2 and Level 3 assets in the total sample. The majority of the banks with high shares of Level 2 and 3 assets have been designated as G-SIBs by the FSB, reflecting the size of their balance sheet. The General Board noted that as accounting numbers are inputs into the calculation of prudential regulatory requirements, banks' behaviour, market perceptions and supervisory actions may be affected – depending on the extent to which Level 2 and 3 financial instruments can move banks away from their desired regulatory targets in time of stress. It underlined the need for greater transparency in this regard. These findings will be summarised in the ERSB report, which will be published in the first quarter of 2020.

Finally, the electoral body composed of General Board members, who are also members of the General Council of the European Central Bank, appointed Stefan Ingves, Governor of the Riksbank, as First Vice-Chair of the ESRB. Mr Ingves will replace Mark Carney after the end of Mr Carney's term of office as Governor of the Bank of England. However, in case the incumbent First Vice-Chair loses his status as member of the General Council of the ECB at an earlier point in time, e.g. due to the withdrawal of the United Kingdom from the European Union, the term of office of the first Vice-Chair-elect will commence on that earlier date.

The ESRB is releasing the 30th issue of its risk dashboard today. The risk dashboard is a set of quantitative and qualitative indicators of systemic risk in the EU financial system.

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