



Press release

1 October 2020

The General Board of the European Systemic Risk Board held its 39th regular meeting on 24 September 2020

At its meeting on 24 September 2020 the General Board of the European Systemic Risk Board (ESRB) continued to discuss the consequences of the coronavirus (COVID-19) pandemic for the European Union (EU) economy and the financial system. While economic activity has started to rebound, both the real economy and financial system are facing elevated uncertainty about the evolution of the pandemic and its implications. Against this background, the General Board considered that the main source of systemic risk in the EU originates from the negative impact of the pandemic on economic activity and the risk of widespread defaults in the private sector and their feedback effects on the EU financial system. At the same time the General Board acknowledged that the comprehensive policy measures that have been taken to protect the real economy from the effects of COVID-19 have so far prevented the economic crisis also becoming a financial crisis.

Linked to this, the General Board received an update on the preliminary results of the monitoring exercise, which the ESRB conducts in line with its [Recommendation on monitoring the financial stability implications of debt moratoria, and public guarantee schemes and other measures of a fiscal nature taken to protect the real economy in response to the COVID-19 pandemic](#). The General Board underlined that it is important that consequences of the support measures ending too soon, as well as ending too late, are well understood, in particular given the potential cliff effects that could arise if several measures expire at the same time. The ESRB continues to monitor the financial stability implications of debt moratoria, public guarantee schemes and other measures of a fiscal nature taken to protect the real economy in response to the COVID-19 pandemic.

Furthermore, the General Board highlighted that the difficult macroeconomic environment, together with an uncertain economic outlook and the low interest rate environment, poses significant challenges to financial institutions, particularly in relation to profitability and asset quality. While the overall resilience of EU financial institutions has increased since the global financial crisis, many EU banks, insurers and pension schemes were already facing business-model challenges before the COVID-19 pandemic. These challenges might be aggravated now if the increased credit, market, funding and liquidity risks materialise. Therefore, the ESRB continues to facilitate the dialogue about appropriate policy response among its member institutions (all EU national central banks and national supervisory authorities, the European Central Bank, the European Commission and the

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European Supervisory Authorities, as well as the Economic and Financial Committee and Advisory Scientific Committee of the ESRB).

Finally, the General Board highlighted the risk of instability and pockets of illiquidity in financial markets. While financial markets have largely recovered from the shock during the spring and might have decoupled from the weaker real economy, they operate in an environment of high uncertainty. Given the disruptions in financial markets observed at the beginning of the pandemic, the General Board discussed the impact on selected market segments such as money market funds and exchange-traded funds. This analysis will be summarised in the fifth edition of the EU Non-Bank Financial Intermediation Risk Monitor, which the ESRB will publish in October. The Monitor considers a range of systemic risks and vulnerabilities related to non-bank financial intermediation, including from interconnectedness, liquidity and leverage. In line with its previous [communications](#) and recommendations ([1,2](#)), the General Board emphasised the importance of addressing those risks in investment funds.

With all the above in mind, the General Board continues its COVID-19-related work in the [priority areas](#) that it identified earlier this year and suggested in a [letter](#) to the European Commission and the European Securities and Markets Authority (ESMA) medium-term actions, which could be undertaken with regard to external credit ratings. To provide financial market supervisors with a clearer picture of where systemic issues may arise in stressed market conditions, the General Board highlighted the importance of monitoring the extent to which funds' investment strategies, as defined in their investment mandates and prospectuses, refer to external credit ratings. Therefore, the General Board asked the European Commission, in cooperation with the ESMA, to assess the feasibility of such monitoring. In addition, the General Board asked the European Commission, in cooperation with the ESMA, to assess the transparency of credit rating agencies' methodologies.

Furthermore, the General Board discussed the adoption of the Legal Entity Identifier (LEI) in the EU.¹ In this regard the General Board noted that there is currently no uniform approach across markets. Furthermore, the adoption of the LEI by non-financial sector entities is limited. This leads to a fragmented coverage, with important sectors excluded. The General Board underlined that a coherent implementation across all sectors of the economy would maximise the benefits arising from the use of the LEI, and discussed the need for establishing a legal framework regulating the use of LEI in the EU. The General Board also stressed that since establishing such a legal framework will take some time, it would be important that supervisory authorities, within their remits, encourage all supervised entities to obtain an LEI as soon as possible and increase the reliance on the LEI system for their reporting exercises.

Finally, the General Board approved the adverse scenario parameters which will be included in the ESMA's money market fund stress testing guidelines.

¹ Based also on the findings of the latest Financial Stability Board's Peer Review on the implementation of the LEI.

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The ESRB is releasing the 33rd 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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