



**ESRB**

European Systemic Risk Board

European System of Financial Supervision

## Press release

9 December 2021

# The General Board of the European Systemic Risk Board held its 44th regular meeting on 2 December 2021

**At its meeting on 2 December 2021, the General Board of the European Systemic Risk Board (ESRB) assessed the key systemic risks in the European Union (EU), as well as public policy priorities to address them.** The General Board noted that the risk of an abrupt broad-based asset price correction had increased further owing to continued exuberance in credit, asset and housing markets. It also observed that financial stability risks relating to the non-financial corporate sector and the banking sector had continued to decline, although corporate vulnerabilities remained high in certain sectors and countries that were more heavily affected by the crisis and facing an elevated debt burden.

**The General Board took note that the risk of an abrupt broad-based asset price correction had increased further amid continued exuberance in some financial market segments.** With real yields falling to all-time lows on the back of a moderating economic recovery and rising inflationary pressures, the search for yield had compounded risk-taking in financial markets. The General Board was of the view that the continued buoyancy of financial markets had increased the risk of a sharp price correction, with high-yield bond markets and some equity market segments being particularly vulnerable to adverse interest rate shocks or downward revisions to the growth outlook. It noted that these developments highlighted the need to strengthen the policy framework for non-banks to enhance the resilience of the financial system.

**In this context, the General Board continued its exchange of views on policy options to address risks in money market funds (MMFs) and central counterparties (CCPs).** Given the persisting vulnerabilities in MMFs revealed at the onset of the coronavirus (COVID-19) pandemic, it saw merit in reforming the regulatory framework for MMFs to (i) reduce first-mover advantages, (ii) limit MMF liquidity transformation by strengthening liquidity requirements, (iii) impose trading costs

on redeeming investors via liquidity management tools, and (iv) enhance monitoring and stress-testing frameworks. The General Board also took note of a statement made by European Commissioner Mairead McGuinness on 10 November 2021 saying that she would propose an extension of the temporary equivalence decision for the regulatory and supervisory framework applicable to UK-based CCPs in early 2022. Against this background, the General Board discussed risks to financial stability stemming from the large-scale use of substantially systemic clearing services provided by UK-based CCPs, in particular in times when a UK-based CCP might come under stress. In this context, it saw a need to strengthen ESMA's powers over Tier 2 CCPs to ensure closer cooperation between EU and non-EU authorities in resolving such stress. The General Board also agreed that, from a financial stability perspective, reducing those risks would require developing the offer of clearing services within the EU. Furthermore, it may be advisable to reflect on the allocation of supervisory powers within the EU and strengthen the role of EU-level supervision in parallel with an increase in clearing activity that might take place at some EU-based CCPs. The ESRB will continue to work on addressing risks to financial stability stemming from an over-reliance on CCPs outside the EU.

**The General Board took the view that the broadening economic recovery had further reduced the risk of widespread defaults in the non-financial private sector.** However, it emphasised that corporate vulnerabilities remained high in certain sectors and countries. It also stressed that the impact on inflation and the economic recovery of recent global supply chain disruptions and surging energy prices could last longer than previously anticipated. This could compound the economic impact of the renewed intensification of social distancing measures to address the fourth wave of the pandemic, which is varying considerably across countries owing mainly to large differences in vaccination rates.

**The General Board concluded that the risk of spillovers from the non-financial private sector to the financial system had declined further but remained elevated.** While noting that the EU banking system had so far proved resilient during the pandemic, it stressed that asset quality and profitability concerns remained elevated in some countries and for banks with large exposures to particularly hard-hit sectors. A deterioration in borrowers' balance sheets on account of a weaker-than-currently-anticipated recovery—possibly combined with a correction in asset prices—could lead to a perceptible deterioration in bank asset quality. The General Board emphasised that, despite the recent return of bank profitability in the EU to pre-pandemic levels, the medium-term profitability outlook remained challenging, reflecting narrow interest margins in the low interest rate environment, the unfavourable cost-to-income ratios of many banks and limited cross-border bank consolidation.

**The General Board discussed vulnerabilities in residential real estate markets and macroprudential policies to mitigate them.** While noting that substantial fiscal transfers to households during the pandemic and low debt servicing costs had helped contain short-term vulnerabilities, the risk of price corrections over the medium term had increased perceptibly on the back of continuously strong dynamics in house prices, housing credit and household indebtedness in

many countries. The General Board welcomed the report on vulnerabilities in residential real estate markets in EEA countries, as well as the second compliance report on the six countries (Belgium, Denmark, Luxembourg, the Netherlands, Finland and Sweden) that had received ESRB recommendations on residential real estate vulnerabilities in 2019. Both reports will be published at the beginning of 2022.

**The General Board deliberated the need for coordination among financial authorities to mitigate risks relating to systemic cyber incidents.** To this end, the General Board considered a systemic cyber incident coordination framework for financial authorities (EU-SCICF). The General Board welcomed the report on “Mitigating systemic cyber risk”, which outlines the EU-SCICF and a macroprudential strategy to mitigate systemic cyber risk. This report will also be published at the beginning of 2022.

The ESRB is releasing today the **38th issue of its risk dashboard**. The risk dashboard is a set of quantitative and qualitative indicators of systemic risk in the EU financial system.

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