ESRB
European Systemic Risk Board
European System of Financial Supervision

Press release

31 March 2022

The General Board of the European Systemic Risk Board held its 45th regular meeting on 24 March 2022

At its meeting on 24 March 2022, the General Board of the European Systemic Risk Board (ESRB) expressed its full solidarity with the people of Ukraine. The General Board noted that the Russian invasion of Ukraine has led to heightened uncertainty and a multiplication of tail risk scenarios, implying a perceptible increase in financial stability risks in the European Union (EU). The ESRB and its member institutions are closely monitoring the financial stability implications of the war.

The war in Ukraine has caused a significant rise in volatility in the financial markets and a pronounced correction in asset prices. The prevailing pre-war trend of rising risk-free bond yields partially reversed, and equity prices fell significantly. The correction in asset prices has so far been orderly and the financial sanctions against Russia, including the exclusion of selected Russian banks from SWIFT, have not caused severe strain in the money markets. However, the General Board emphasised that the risk of further abrupt asset price corrections remains severe, with a possible escalation of the war, its impact on economic growth and the extent of monetary policy tightening needed to reign in rising inflationary pressures all playing a role in the likelihood of said risk materialising, among other factors. The General Board also noted that extreme price swings in some energy or commodity markets could give rise to very large margin calls and related liquidity strains of actors in derivative markets.

The General Board emphasised that the war will have a pronounced impact on economic growth and inflation in the EU on account of weakening business and consumer confidence, rising energy and commodity prices, and further disruptions of global supply chains. Although the full impact on growth crucially hinges on the evolution and duration of the war, as well as on the severity of sanctions, it was already compounding risks to corporate balance sheets, which in several sectors and EU Member States still remain strained on account of the impact of the pandemic. The General Board was concerned that if growth in the EU were to slow sharply and high inflation were to persist, risks to non-financial corporations' balance sheets would increase, most notably through the negative impact of surging energy and commodity prices on real household income and corporate profit margins. In this context, the General Board noted that decisive and well-targeted policy support was essential to mitigate the fallout of the war.

The General Board noted that the impact of the war in Ukraine on the EU banking sector had so far been well contained, reflecting generally low exposures to Russia, robust capital positions and the recovery in bank profitability to pre-pandemic levels. However, while non-performing loans in the euro area continued to decline in the fourth quarter of 2021, the General Board was concerned that the negative growth impact of the war could lead to a renewed deterioration in bank asset quality, particularly in a more adverse macroeconomic scenario. While noting that rising nominal interest rates should generally have a positive impact on bank profitability, this impact could – at least in part – be counterbalanced by a weakening of credit demand, potential new impairments and low interest income on portfolios of fixed-interest mortgages at low rates and with long maturities.

The General Board expressed severe concerns about financial stability risks arising from cyber incidents. The risk of systemic cyber incidents has significantly increased on account of the war in Ukraine, which could be accompanied by an increase in the number and intensity of cyber incidents.

The General Board also agreed on the need for a quick adoption and implementation of the Markets in Crypto-Assets Regulation (MiCA), which, among other objectives, aims to address financial stability risks that could arise from a wide use of crypto-assets and distributed ledger technology-based solutions in financial markets.

The General Board also exchanged views on the future of the macroprudential framework for banks, discussing priorities to make the framework fit for the next decade as well as enhancements achievable in the short term. In this context, the General Board endorsed:

- a Concept Note on the review of the macroprudential framework for the banking sector, which highlights the ESRB’s priorities for the next decade;
- the ESRB’s response, set to be published in the coming weeks, to the European Commission’s recent call for advice, which is intended to support the forthcoming legislative review.

The past ten years’ experience in the implementation of macroprudential policy points to a need for more consistent, forward-looking, proactive and countercyclical use of macroprudential instruments, as well as a need to reduce the complexity of the legal framework. Looking ahead, macroprudential policy for the banking sector – and more generally for the financial sector – should:

- be proactive, seeking to foster resilience before systemic risks materialise;

- be flexible, responding to structural changes in the financial system as well as cyber risks and risks relating to climate change;
- form part of a holistic framework, fostering a consistent approach to regulation across all activities in the financial system and facilitating cooperation between authorities at all levels.

On the first point, the General Board noted the need to ensure more releasable and effectively usable capital buffers and to supplement the EU's macroprudential toolkit with borrower-based measures. Capital could be made more releasable and more effectively usable by building up buffers more proactively and earlier in the cycle. Furthermore, the General Board emphasised that including a minimum set of borrower-based measures in EU legislation would close an important gap in the toolkit. Borrower-based measures can help ensure sound lending standards and increase the resilience of borrowers, helping mitigate systemic risk at the EU level. The General Board also stressed the need for appropriate legal arrangements so that decisions on the activation, calibration and cancellation of borrower-based measures remain with national authorities.

On the second point – the need for a flexible macroprudential policy able to respond to structural changes in the financial system and emerging risks – the General Board emphasised that the priority was to enhance the toolkit with a view to addressing cyber risks and climate-related risks. The ESRB has already stressed in previous **publications** that cyber incidents could reduce confidence in the financial system's ability to provide critical services, with a negative impact on financial stability. Consequently, the macroprudential mandate needs to be extended to cover cyber resilience. As regards climate-related risks, preliminary findings indicate that, with some amendments, systemic risk buffers and limits on large exposures could be used to address systemic aspects. As a growing body of analysis on climate-related risks becomes available, further adjustments could be made to the macroprudential toolkit and new tools could be added in order to mitigate risks to financial stability.

Looking ahead, regarding the third point, the General Board stressed that having a consistent approach to regulation, in which similar requirements were applied to all entities carrying out the same type of financial activity, would help to avoid regulatory arbitrage and the transfer of risk to other parts of the system. Consequently, entity-specific tools could be supplemented with activity-based tools. For example, borrower-based measures could, in principle, address all types of lending, regardless of the type of institution providing the loan. For more information on these considerations, as well as details of other ESRB proposals, see the **Concept Note** that the ESRB published today.

In accordance with ESRB Regulation (EU) No 1092/2010, the General Board reappointed Professor Thorsten Beck, Professor Loriana Pelizzon and Professor Richard Portes to the Advisory Scientific Committee. Moreover, the electoral body comprising national voting members of the General Board elected two new members to the Steering Committee: Mário Centeno, Governor of the Banco de Portugal, and Lars Rhode, Chairman of the Board of Governors of Danmarks

Nationalbank. They replace Governor Ignazio Visco and Governor Pierre Wunsch, whose mandates on the Steering Committee ended in December and March respectively.

Finally, the ESRB today released the 39th issue of its risk dashboard. The ESRB's risk dashboard is a set of quantitative and qualitative indicators measuring systemic risk in the EU financial system.

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