



ESRB

European Systemic Risk Board

European System of Financial Supervision

Press release

6 April 2021

The General Board of the European Systemic Risk Board held its 41st regular meeting on 25 March 2021

At its meeting on 25 March 2021, the General Board of the European Systemic Risk Board (ESRB) continued to discuss the impact of the coronavirus (COVID-19) pandemic on financial stability in the European Union (EU). While noting that the economic situation was expected to improve in the course of 2021, it underscored the significant uncertainty surrounding the near-term economic outlook, relating in particular to the dynamics of the pandemic and the rollout of vaccination campaigns, as well as the damage to productive capacity and the debt overhang caused by the crisis. The General Board reiterated that the main source of systemic risk in the EU originated from the impact of the pandemic on economic activity – including through rising pressures on the solvency of non-financial corporations (NFCs) and household indebtedness – and a possible spillover to the financial system. In particular, NFCs in several sectors continued to suffer from a very significant fall in revenues, while already having exhausted their cash buffers and facing difficulties in rolling over maturing debt.

The General Board noted that it was key to continue the extraordinary public support measures until the recovery was firmly entrenched, but saw scope for improving their targeting. Preventing a destructive wave of corporate insolvencies and minimising their cost to society have been crucial for preserving economic and financial stability. The General Board highlighted that to help rebuild the economy and facilitate adjustment to structural change, the current public support measures need to become more targeted as the crisis evolves. It also saw merit in increasingly complementing liquidity support with equity support, possibly including quasi-equity and subsidies, for viable but overindebted firms, noting that success in containing solvency pressures in the non-financial corporate sector was crucial for minimising the spillover effects of the COVID-19 crisis on the financial sector. An ESRB note highlighting the broad issues related to corporate insolvencies will be published in the spring.

The General Board considered that it was essential to contain the negative feedback loops between the real economy and the financial system. It supported the call by microprudential banking supervisors to proactively identify and provision for non-performing loans (NPLs) and enhance their organisational capacity for NPL resolution. It also supported the European

Commission's NPL Action Plan¹, including measures to enhance the depth and efficiency of secondary NPL markets to support NPL resolution. Given the key role of banks in financing EU NFCs, and in particular small and medium-sized enterprises, the assessment and, where warranted, restructuring of the debt of viable but overindebted firms may need to play an important role. Member States should identify a set of options to facilitate this process in order to enhance firms' debt repayment capacity. Furthermore, the General Board called on Member States to review and, where necessary, improve insolvency and collateral enforcement procedures and strengthen the capacity of the judiciary in order to avoid bottlenecks.

The General Board also noted increased evidence of an overvaluation of asset prices in some financial market segments, which could give rise to a sudden and pronounced correction. In this context, it also pointed to the risk that spillovers from the rise in US long-term bond yields to European bond markets could have negative effects on the European economy if the steepening of the yield curve was to perceptibly precede the economic recovery.

In view of the impact of the COVID-19 pandemic on the real economy, and to help deal with a potential wave of insolvencies, a number of macroprudential authorities lowered macroprudential buffer requirements in 2020 in an attempt to prevent banks from acting procyclically and ensure that they continue to provide credit to the economy, thus fostering its recovery. These measures complemented the flexibility provided by microprudential authorities, including that by ECB Banking Supervision, which freed up approximately €120 billion of Common Equity Tier 1 capital to support banks in continuing to fulfil their role of funding the real economy. At the same time, the macroprudential authorities' ability to respond was uneven across Member States due to the varying magnitude of available countercyclical capital buffers. Some macroprudential authorities have therefore responded by either lowering or postponing the phase-in of certain structural capital buffers (such as systemic risk buffers or buffers for other systemically important institutions). Other macroprudential authorities communicated to banks the possibility to use buffers, while deciding against buffer releases to strengthen the stability of and the confidence in their banking systems.

The General Board highlighted that European banks were operating with capital levels above the combined buffer requirement, owing partly to the government support measures which have helped banks' creditors and partly to the prudential and regulatory policy response. The General Board underlined that the full and timely implementation of the Basel III agreement remained a priority. While it was too early for a full assessment of whether the macroprudential buffers were operating as intended, the General Board also noted that the evidence already gathered could be a starting point for a discussion on improving the buffer framework in the medium term, with a view to contributing to the European Commission's review of the macroprudential policy framework in 2022.

The market turmoil in March and April 2020 demonstrated the need to address systemic issues generated by money market funds (MMFs). While significant changes to the regulation and oversight of MMFs have been introduced in recent years, these reforms did not address all sources of systemic risk. In particular, the combination of investor redemptions and deteriorating market liquidity of asset holdings created liquidity management challenges for MMFs that invest in private sector debt securities. These liquidity strains in money markets eased following the monetary policy action, which also had the effect of supporting market functioning. Against this background, and with a view to both informing, and being informed by, related discussions at the global level, the General Board discussed the macroprudential dimension of the reforms of the whole MMF sector, including funds

¹ **Tackling non-performing loans in the aftermath of the COVID-19 pandemic.** Communication from the Commission to the European Parliament, the Council and the European Central Bank, 16 December 2020.

that did not experience stress during last year's market turmoil. The General Board will further consider a range of issues, including the wider markets in which MMFs operate, the behaviour and expectations of investors in MMFs, as well as the structure of MMFs and the liquidity management tools available to them, with a view to adopting a Recommendation by the end of 2021. An ESRB note summarising the initial considerations in this regard will be published in the spring.

Furthermore, the General Board discussed macroprudential policy issues arising from low interest rates and structural changes in the EU financial system, building on an earlier ESRB report published in 2016. The General Board noted that the low interest rate environment had been mainly driven by structural factors, including demographics, productivity, excess savings and/or low investment. Looking beyond the recent cyclical developments, the COVID-19 shock may have increased the probability and persistence of a “low-for-long” scenario, making it “even lower for even longer”. Taking a medium-to-long-term perspective, the General Board assessed risks related to (i) broad-based risk-taking, (ii) the sustainability of business models, and (iii) structural changes in the financial system. It highlighted four main areas of concern, namely:

- i. the profitability and resilience of banks;
- ii. the indebtedness and viability of borrowers;
- iii. systemic liquidity risk;
- iv. the sustainability of the business models of insurers and pension funds offering longer-term return guarantees.

A report summarising the ESRB analysis and policy proposals will be published in the spring.

Finally, the General Board appointed Professor Stephen Cecchetti as Vice-Chair of the Advisory Scientific Committee (ASC). Professor Cecchetti, who is currently the Rosen Family Chair of International Finance in the Brandeis International Business School, replaces Professor Richard Portes. Following the departure of the United Kingdom (UK) from the EU, Professor Portes is no longer eligible for the position of ASC Vice-Chair because UK nationals are no longer EU citizens.² The General Board will continue to benefit from his insights for as long as he remains a member of the ASC and is involved in other work streams, including as Co-Chair of the Expert Group on Non-bank Financial Intermediation. The General Board expressed its sincere gratitude towards Professor Portes, who as Chair and Vice-Chair was a driving force behind the work of the ASC.

The ESRB's current assessment of systemic risks in the EU is summarised in the 35th issue of its risk dashboard, which is being published today. The risk dashboard is a set of quantitative and qualitative indicators of systemic risk in the EU financial system.

² Under Article 5(4) of [ESRB Decision 2011/2](#) on the procedures and requirements for the selection, appointment and replacement of the members of the Advisory Scientific Committee, the Chair and Vice-Chairs of the ASC have to be EU citizens.