Press release

8 June 2020

The General Board of the European Systemic Risk Board takes second set of actions in response to the coronavirus emergency at its extraordinary meeting on 27 May 2020

Continued efforts by the **European Systemic Risk Board (ESRB)** to address the exceptional challenges stemming from the coronavirus (COVID-19) pandemic and its potential impact on the financial system of the European Union (EU) have led to a **second set of actions**[1] **agreed by its General Board**. These macroprudential actions, which refer to the five priority areas identified by the ESRB, together with reinforced coordination, both across authorities responsible for different segments of the financial sector and across borders, are aimed at ensuring that the European financial system is able to withstand the shock and thus prevent an even sharper loss of economic capacity and jobs.

Implications for the financial system of guarantee schemes and other fiscal measures to protect the real economy

Debt moratoria, guarantee schemes and other fiscal measures are being put in place by Member States to protect firms and households from the effects of the COVID-19 pandemic. While these programmes target the non-financial sector, i.e. the liquidity and solvency of firms and households, they have implications for the financial system as a whole. The ESRB has already encouraged cooperation and information exchange between the relevant national fiscal and macroprudential authorities so that the implications of the implemented measures for financial stability can be better understood. Moreover, given that EU economies are highly integrated, the different measures implemented by individual countries to support their economies during the COVID-19 pandemic might have an impact on other countries. **In this context, the General Board decided to establish an EU-wide framework to monitor the financial stability implications of the support measures**. **With this framework, the ESRB intends to complement and enhance what is being done at the national level by fostering the exchange of experiences and the early identification of cross-sectoral and cross-border issues.**

[1] The first set of actions was decided on 6 May.

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The General Board also adopted a Recommendation that introduces minimum requirements for national monitoring and establishes a framework for reporting to the ESRB. This Recommendation does not create new reporting requirements for financial institutions, as the ESRB will rely on the reporting and data collected by national macroprudential authorities and member institutions, in particular the European Supervisory Authorities, the European Central Bank and the Single Resolution Board.

Market illiquidity and implications for asset managers and insurers

The General Board highlighted that the monitoring of liquidity risks in the insurance sector needs to be improved. It also noted that the European Insurance and Occupational Pensions Authority (EIOPA) and national insurance supervisors have already been considering developing a liquidity monitoring framework for (re)insurers as a response to the COVID-19 pandemic. In a communication to EIOPA, the General Board strongly encouraged EIOPA and its members to finalise and operationalise that framework promptly. This would facilitate a more informed and timely assessment of any potential financial stability risks stemming from liquidity risks in the insurance sector (including any liquidity risks stemming from the mismatch between the redemption profile and the asset liquidity of their unit-linked products).

Beyond the need to address risks and vulnerabilities stemming from the current crisis, and as the ESRB has emphasised in the past, the Solvency II review provides an opportunity to better enable supervisors to address liquidity risk in the insurance sector. The COVID-19 crisis highlights the need to better equip (re)insurers to deal with future periods of stress. **Reflecting this, as already noted in the past, the Pillar 2 provisions in the Solvency II regulatory regime should be enhanced in the medium term to enable supervisors to require individual (re)insurers with a vulnerable liquidity profile to hold a liquidity buffer.**

Impact of large-scale downgrades of corporate bonds on markets and entities across the financial system

Following the decision of the General Board on 6 May, the ESRB, together with its member institutions, continued to monitor developments in the corporate bond market, including possible implications of large-scale corporate bond downgrades across the financial system.

System-wide restraints on dividend payments, share buybacks and other pay-outs

The General Board decided to support and complement previous initiatives of the European Central Bank, the European Banking Authority, EIOPA and national authorities by issuing a Recommendation on the restriction of distributions during the COVID-19 pandemic. The ESRB Recommendation, which covers banks, certain investment firms, insurers, reinsurers and central counterparties, takes into account the critical role these sectors of the financial system play in the real economy, in particular during crisis times. With this Recommendation the General Board aims to achieve a uniform approach to restraints on pay-outs across the EU and across different segments of the financial sector. The Recommendation is published together with a background report.

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Liquidity risks arising from margin calls

The General Board highlighted that greater central clearing of derivatives and the collateralisation of non-centrally cleared derivatives positions has significantly strengthened the resilience of derivatives markets in the aftermath of the global financial crisis. These reforms – led by the G20 and the Financial Stability Board – helped to ensure that market stress at the onset of the COVID-19 pandemic did not generate widespread concerns about counterparty credit risk. Furthermore, the General Board acknowledged that margins are fundamental to how a central counterparty (CCP) manages counterparty credit risk and that, as an integral part of risk management, they support the systemic resilience of a CCP. At the same time, the General Board noted that market shocks, such as sharp drops in asset prices and high levels of market volatility, translate into increases in variation margins and may also lead to significant initial margin calls on positions in cash securities, commodities or derivatives. Such conditions could have major implications for the liquidity management of market participants, for their funding needs, and possibly even for their solvency if the liquidity stress leads to systematic fire sales of assets. **Therefore, the General Board decided to issue a Recommendation aimed at (i) limiting cliff effects in relation to the demand for collateral, also including client clearing services and non-centrally cleared markets; (ii) enhancing CCP stress test scenarios for the assessment of future liquidity needs; (iii) limiting liquidity constraints related to margin collection; and (iv) promoting international standards related to the mitigation of procyclicality in the provision of client clearing services and in securities financing transactions. The Recommendation is published together with a background report.**

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