Briefing

The European Systemic Risk Board: Output since inception

This briefing looks back at five years of existence of the European Systemic Risk Board (ESRB) and gives an overview of its concrete output. It will be regularly updated.

This paper gives an overview of the concrete output of the ESRB over the last five years, focusing on the keys aspects of its mandate, i.e. identifying and assessing systemic risks, recommending appropriate policy responses and coordinating Member States’ macro-prudential policies. It does not describe the ESRB organizational and accountability framework, which is covered in the EGOV briefing ‘The EU macro-prudential policy framework’.

Assessing the risks to financial stability

Over the years, the ESRB has developed processes and tools to enhance its capacity to identify and assess sources of systemic risk in the financial sector. A discussion on the risks takes place at each ESRB General Board meeting, on the basis of the contributions of ESRB members. After these board meetings, the ESRB publishes a press release, which summarises its view of the risks, as well as a quarterly risk dashboard, which gathers a number of macro-economic and financial indicators.

The ESRB has also contributed to raising awareness on certain risks via its work on specific topics and the publication of ad-hoc reports, among which the treatment of sovereign risk, residential and commercial real estate, conduct risk, systemic risk in the insurance sector or the impact of low interest rates.

Last, the ESRB is strongly involved in the design of European Supervisory Authorities (EBA, EIOPA, ESMA) stress testing. As in previous exercises, it has notably elaborated, based on its assessment of the main risks to financial stability, the adverse scenario of the last EBA EU-wide banking stress test, the results of which were published in Q3 2016. The adverse scenario has been prepared, as for past stress tests, by a dedicated ESRB task force, chaired by the ECB. It is built-up as a standard deviation from the Commission’s official forecast, which is taken as the baseline scenario. It has also prepared the adverse scenario of the latest EIOPA stress test.

Recommending appropriate policy responses

On 28 November 2016, the ESRB published eight country-specific warnings on medium-term residential real estate vulnerabilities. The warnings are addressed to the following Member States: AT, BE, DK, FI, LU, NL, SE and UK. It is the first time since its establishment that the ESRB published warnings targeting developments in individual Member States. The key vulnerabilities highlighted by the ESRB assessment are of a medium-term nature and relate to the rising indebtedness and ability of households to repay their mortgage debt or to the valuation or price dynamics of residential real estate. The ESRB’s detailed assessment of the situation in these eight Member States is included in the ESRB report on vulnerabilities in the EU residential real estate sector, which was published together with the warnings. The ESRB assessment is based on available data and covers developments up to mid-September 2016.
The ESRB has published to date ten policy orientated recommendations to the whole of the EU:

- **ESRB/2011/1** on lending in foreign currencies;
- **ESRB/2011/2** on US dollar denominated funding of credit institutions;
- **ESRB/2011/3** on the macro-prudential mandate of national authorities;
- **ESRB/2012/1** on money market funds;
- **ESRB/2012/2** on funding of credit institutions;
- **ESRB/2013/1** on intermediate objectives and instruments of macro-prudential policy;
- **ESRB/2014/1** on guidance for setting countercyclical buffer rates;
- **ESRB/2015/1** on countercyclical buffer rates for exposures for third countries;
- **ESRB/2015/2** on cross-border effects of and voluntary reciprocity for macro-prudential measures.
- **ESRB/2016/14** on closing real estate data gaps.

While a few of these recommendations target specific macro-prudential risks (e.g. funding in US dollar, lending in foreign currency), the bulk of them aimed at building a policy framework for macro-prudential policy in the EU:

- **Recommendation ESRB/2011/3** on the macro-prudential mandate of national authorities has been instrumental in the **setting-up of macro-prudential authorities at national level**;
- **Recommendation ESRB/2013/1** on intermediate objectives and instruments of macro-prudential policy has contributed to the **establishment of a policy framework for macro-prudential policy in the banking sector** (see also the **ESRB flagship report** from 2014);
- **Recommendation ESRB/2015/2 on reciprocity** complements the policy framework built-up by the previous two recommendations by inviting Member States, under certain conditions, to reciprocate macro-prudential measures adopted by other Member States beyond what is mandatory under EU law (see box on reciprocity).

It should be noted that:

- if no recommendation has been addressed to individual Member States so far, warnings were recently addressed to eight Member States as regards risks in the real estate sector;
- recent recommendations, and notably the recommendation on reciprocity, include the ECB, in its supervisory capacity, among the addressees, although the ESRB founding regulation did not explicitly foresee such possibility (as it was adopted prior to the Single Supervisory Mechanism Regulation);
- recommendations have focused on the banking sector while there is probably room to further develop the macro-prudential policy framework for non-banks, also in view of the Capital Markets Union project which aim at fostering non-bank financing and may, in turn, create new risks.

### Coordinating Member States’ actions

In a highly integrated financial system (like the Single Market) strong policy coordination is needed to ensure the effectiveness of national macro-prudential policy. If national measures may be justified given the differences in cyclical and structural systemic risks across Member States, national macro-prudential measures can have negative spillover effects to other countries. Moreover national measures can sometimes be circumvented by foreign branches and cross-border lending (See Box on reciprocity). The ESRB regulation has entrusted the ESRB with a general coordination role in the field of macro-prudential policy. The coordination role of the ESRB from a cross-border perspective...
has been further specified in recommendation ESRB 2015/2 on the assessment of cross-border effects of and voluntary reciprocity for macro-prudential policy measures.

In addition, the CRD IV package gave a role to the ESRB in the activation of specific national macro-prudential instruments:

- The ESRB shall notably provide its opinion on whether the conditions for the activation of national macro-prudential measures adopted under Article 458 of CRR (‘flexibility package’) and Article 133 of the CRD (systemic risk buffer) are met;
- Decisions of Member States on countercyclical capital buffer rates should be coordinated as much as possible. In this regard, the ESRB should issue recommendations in order to guide Member States and should facilitate discussion between authorities about setting buffer rates, including defining relevant variables. The coordination role of the ESRB in the activation of the counter-cyclical capital buffer has been formalised in two recommendations: ESRB/2014/1 on guidance for setting countercyclical buffer rates and ESRB/2015/1 on recognising and setting countercyclical buffer rates for exposures for third countries.

**Box: ESRB RECOMMENDATION ON THE ASSESSMENT OF CROSS-BORDER EFFECTS OF AND VOLUNTARY RECIPROCITY FOR MACRO-PRUDENTIAL POLICY MEASURES**

Reciprocity is the voluntary recognition by a Member State of a measure adopted by another Member State. Without reciprocity, macro-prudential measures taken in a given Member States only apply to domestic institutions and subsidiaries of foreign financial institutions operating in that Member State and do not necessarily affect branches of foreign financial institutions nor do they cover cross-border lending. For example, if a given country is of the view that housing prices are overvalued in its territory and decides to apply higher capital requirements for mortgages in its jurisdiction, such higher requirements will only apply to loans granted by domestic banks but will not cover loans granted by branches of foreign banks or lending from abroad (which are under the jurisdiction of their home country as far as prudential requirements are concerned). The absence of reciprocity makes the implementation of macro-prudential policy inconsistent at EU level (i.e. different prudential treatment may apply to the same risk depending on the legal status and location of the financial service provider) and makes it easy for financial institutions to circumvent national macro-prudential measures.

**Recommendation ESRB/2015/2** on reciprocity sets out a voluntary reciprocity framework of macro-prudential policies in the EU beyond what is mandatory according to CRD IV/CRR (which essentially mandates the reciprocation of counter-cyclical buffer rates, as foreseen in the Basel III agreement). It is the outcome of more than one year of intensive work in a dedicated ESRB working group, chaired by the Commission.

According to the recommendation, Member States are invited to reciprocate all national macro-prudential measures adopted by another Member State that target a specific domestic risk (‘exposure-based’ measures) when their own financial institutions are exposed to the same risk. Such recommendation aims at protecting the consistency of macro-prudential policy across borders and eliminating regulatory arbitrage. Ultimately the same macro-prudential treatment should apply to the same risk, independently from the legal status and location of the financial service provider. In 2016, there were also the first cases of application of the new framework for voluntary reciprocity. These applications related to a real estate measure adopted by Belgium under the CRD IV/CRR national flexibility framework and a systemic risk buffer by Estonia.
In order to better coordinate the actions of national macro-prudential authorities and to prepare its opinions (under Article 458 of the CRR and Article 133 of the CRD), the ESRB established in 2014 an Assessment Team, revised in 2015 to take into account the new reciprocity framework established by recommendation ESRB 2015/2.

The ESRB Assessment Team is composed of 2 representatives from the ESRB secretariat (including the chair of the Assessment Team), 9 representatives from national central banks, one representative from the ECB (‘from the macro-prudential function’) and one representative from the SSM, one representative from the EBA and one representative from the Commission. The ESRB Assessment team reports to the ESRB Advisory Technical Committee (one of the two committees that advise the ESRB General Board).

The role of the ESRB Assessment Team has gradually evolved beyond the mere preparation of ESRB opinions under Article 458 of the CRR and Article 133 of the CRD. Today Member States tend to notify to the ESRB all measures of macro-prudential interest, in a broad sense. These measures are discussed in the Assessment Team, even in the cases where a formal opinion of the ESRB is not requested by law. Such first-hand information allows the ESRB to keep track of all macro-prudential measures activated at national level, their rationale, objectives and calibration. It publishes an overview of macro-prudential measures on a yearly basis.