Box 3.2

THE RESPONSE OF THE EUROPEAN SYSTEMIC RISK BOARD TO THE COVID-19 CRISIS

The European Systemic Risk Board (ESRB) was established at the end of 2010 with a mandate of macroprudential oversight of the financial system within the EU. The objective of the ESRB[1] is to contribute to the prevention and mitigation of systemic risks to financial stability in the EU, so as to avoid periods of widespread financial distress, thus contributing to the smooth functioning of the internal market and, ultimately, ensuring a sustainable contribution of the financial sector to economic growth.

The profound macroeconomic and financial impact of the COVID-19 pandemic – and of the subsequent confinement measures and restrictions adopted by the public authorities to combat it – is the most significant challenge that this institution has had to face since its creation, barely a decade ago.

In a context of rapid and extensive institutional reaction at global, EU and national level, driven by the urgent need to mitigate the impact of the pandemic on society and the productive system, the ESRB decided in April to adapt its regular work programme to the new situation. Specifically, the General Board of the ESRB resolved[2] to focus its attention temporarily on five priority areas for action and coordination:

(i) implications for the financial system of guarantee schemes and other fiscal measures to protect the real economy;

(ii) market illiquidity and implications for asset managers and insurers;

(iii) impact of procyclical downgrades of bonds on markets and entities across the financial system;

(iv) system-wide restraints on dividend payments, share buybacks and other payouts;

(v) liquidity risks arising from margin calls.

These five areas of ESRB work "in crisis mode" were mainly developed in the period April-June, with the involvement of its Advisory Technical Committee and Advisory Scientific Committee.[3] Notably, the work of the ESRB produced:

— A Recommendation (ESRB/2020/8)[4] addressed to all the macroprudential authorities of the EU to monitor the financial stability implications of debt moratoria and public guarantee schemes and other measures of a fiscal nature taken to protect the real economy in response to the COVID-19 pandemic. This recommendation was preceded by a letter[5] sent by the ESRB to the Economic and Financial Affairs Council (Ecofin) inviting fiscal authorities to cooperate and exchange information with the central banks and supervisory authorities of their countries. In the case of Spain, the authority to which this Recommendation was addressed is AMCESFI (Spanish macroprudential authority), which must send information to the ESRB on a quarterly basis on the measures introduced in Spain. Accordingly, the Financial Stability Technical Committee of the AMCESFI[6] is developing an analytical framework to assess these measures, as stipulated in this recommendation;

1 Central banks and the national supervisory authorities for banks, securities markets, insurance companies and pension funds of all the Member States of the EU/European Economic Area participate in the ESRB, along with the EU institutions and agencies with regulatory and supervisory responsibilities in this area. The ECB hosts the ESRB's secretariat and provides the resources necessary for its operations.

2 See the ESRB's press releases: "The General Board of the ESRB held its 37th regular meeting on 2 April 2020", of 9 April 2020; "The General Board of the ESRB takes first set of actions to address the coronavirus emergencyy at its extraordinary meeting on 6 May 2020", of 14 May 2020; "The General Board of the ESRB takes second set of actions in response to the coronavirus emergency at its extraordinary meeting on 27 May 2020", of 8 June 2020; and "The General Board of the ESRB held its 38th regular meeting on 25 June 2020", of 2 July 2020.

3 The ESRB's Advisory Technical Committee has been chaired since July 2019 by Pablo Hernández de Cos, Governor of the Banco de España. The ESRB's Advisory Scientific Committee has been chaired since September 2020 by Javier Suárez, professor at the Centro de Estudios Monetarios y Financieros (CEMFI).

4 Recommendation ESRB/2020/8 of 27 May 2020 on monitoring the financial stability implications of debt moratoria, and public guarantee schemes and other measures of a fiscal nature taken to protect the real economy in response to the COVID-19 pandemic.

5 See "ESRB letter to Governments on the financial stability impact of the national guarantee schemes and other fiscal measures", 14 May 2020.

Box 3.2

THE RESPONSE OF THE EUROPEAN SYSTEMIC RISK BOARD TO THE COVID-19 CRISIS (cont'd)

— A Recommendation (ESRB/2020/7)[7] addressed to prudential authorities on restriction of distributions during the COVID-19 pandemic, until 1 January 2021, applicable to banks, insurers, investment firms and central counterparties (CCPs). As regards banks, the ECB and national authorities of the Single Supervisory Mechanism, including the Banco de España, which issued its own recommendation at the end of July[8], have adhered to this recommendation;

— A Recommendation (ESRB/2020/6)[9] addressed to competent microprudential authorities, the European Securities and Markets Authority (ESMA) and the European Commission on liquidity risks arising from margin calls, to: i) limit cliff effects in relation to the demand for collateral; ii) improve the stress scenarios of CCPs; iii) limit liquidity constraints related to margin collection, and iv) to promote international standards in relation to the mitigation of procyclicality in the provision of client clearing services and in securities financing transactions. In the case of Spain, the CNMV (Spanish National Securities Market Commission) is the main authority to which this recommendation is addressed, although it also affects the Banco de España in its capacity as the supervisor of credit institutions that are members of CCPs.

— A Recommendation (ESRB/2020/4)[10] addressed to ESMA to coordinate with the national competent authorities to undertake a supervisory excercise with investment funds that have significant exposures to corporate debt and real estate assets, to assess their preparedness to potential future adverse shocks.

— A Technical Note[11], published in July, in which the ESRB summarises the findings of a top-down analysis of the impact of a mass bond downgrade scenario on the financial system. The ESRB's study suggests that, hypothetically, if the scenarios and assumptions considered materialize, losses could be generated in the EU as a whole of between €156 billion and €298 billion. A significant portion of these losses would stem from fire sales by financial institutions forced to divest themselves of corporate debt holdings that lose their investment-grade rating due to a downgrade to below BBB. The sectors most affected would be investment funds and insurance companies.

— A letter[12] addressed to the European Insurance and Occupational Pensions Authority (EIOPA) urging in the near term improved monitoring of liquidity risks in insurers, in order to reinforce the strength of the sector in case of a deterioration in financial conditions.

Finally, it should be noted that the ESRB has launched on its website a detailed directory[13] of national financial policy measures adopted within the EU/EEA by central banks, supervisory authorities and governments in response to COVID-19. This repository of information is regularly updated with the latest actions undertaken in each country.

4 Recommendation ESRB/2020/8 of 27 May 2020 on monitoring the financial stability implications of debt moratoria, and public guarantee schemes and other measures of a fiscal nature taken to protect the real economy in response to the COVID-19 pandemic.

5 See "ESRB letter to Governments on the financial stability impact of the national guarantee schemes and other fiscal measures", 14 May 2020.

6 The Financial Stability Technical Committee of the AMCESFI is chaired ex officio by Margarita Delgado, Deputy Governor of the Banco de España.

7 Recommendation ESRB/2020/7 of 27 May 2020 on restriction of distributions during the COVID-19 pandemic.

8 See the Banco de España's press release "The Banco de España conveys to less signfiicant institutions under its direct supervision the ECB recommendation on dividend distributions and variable remuneration", of 28 July 2020.

9 Recommendation ESRB/2020/6 of 25 May 2020 on liquidity risks arising from margin calls.

10 Recommendation ESRB/2020/4 of 6 May 2020 on liquidity risks in investment funds.

11 "A system-wide scenario analysis of large-scale corporate bond downgrades", ESRB Technical Note, July 2020.

12 See "ESRB letter to EIOPA on Liquidity risks in the insurance sector", 8 June 2020.

13 Accessible at this link: Policy measures in response to the COVID-19 pandemic.