JOINT COMMITTEE OF THE EUROPEAN SUPERVISORY AUTHORITIES

05 May 2015
JC/2015/02

PRESS RELEASE

ESAs - main risks to EU financial market stability have intensified

The Joint Committee of the European Supervisory Authorities (ESAs) published its fifth *Report on Risks and Vulnerabilities in the EU Financial System*. Overall, the report found that in the past six months, risks affecting the EU financial system have not changed in substance, but have further intensified.

The EU's economic performance improved slightly in early 2015, however the financial sector in general continues to be affected by a combination of factors such as low investment demand, economic uncertainty in the Eurozone and its neighbouring countries, a global economic slow-down and a low-interest rate environment.

The main risks affecting the financial system remain broadly unchanged from those identified in the report's previous edition, but have become more entrenched. The major risks include:

- Low growth, low inflation, volatile asset prices and their consequences for financial entities;
- Search for yield behaviour exacerbated by potential rebounds;
- Deterioration in the conduct of business; and
- Increased concern about IT risks and cyber-attacks.

Despite these risks, a number of ongoing policy and regulatory initiatives are contributing to improving the stability and confidence in the financial system as well as facilitating additional funding channels to the real economy. These include ongoing regulatory reforms in the securities, banking and insurance sectors such as the Markets in Financial Instruments Directive (MiFID II) and Regulation (MiFIR), the work on the implementation of the Capital Requirements Directive and Regulation (CRDIV/CRR), the work on the Bank Recovery and Resolution Directive (BRRD), the Deposit-Guarantee Schemes Directive (DGS) and the

Solvency II Directive, as well as the European Commission's plan for a Capital Markets Union (CMU).

Steven Maijoor, Chair of the European Securities and Markets Authority (ESMA) and the current Chairman of the Joint Committee, said:

> "The Joint Committee has noted some improvement in overall market conditions; however, the recovery is not yet sustained and is exposed to risks related to broad macroeconomic conditions, in particular the low interest environment and resulting search-for-yield behaviour. Additionally regulators continue to have concerns about the operational risks generated by some financial institutions' inappropriate business conduct, as well as those risks posed by inadequate management of IT risks.
>
> "However, recent regulatory initiatives across the banking, insurance and securities sectors, such as the Comprehensive Assessment, the insurance sector stress test and Solvency II along with, the ongoing MiFID, EMIR and PRIPS reforms are contributing to improving the stability and confidence in the EU financial system."

Key Risks Identified

The identified risks in the Report can be divided into macro risks to the EU financial system and economy and operational risks.

Macro Risks

The key macro risks identified relate to:

1. Risks from weak economic growth and low inflation environment, which include:
    - Adverse effect that low interest rates and uncertainties about the economic recovery have had on the outlook for the financial industry;
    - Higher valuation and market liquidity risk has raised concerns about the outlook for financial entities' stability in the event of reversals in interest rates and asset prices;
2. Low profitability is motivating financial institutions and other investors to search for yield, which requires increased supervisory attention to the viability of business models, related restructuring activity and adequate management of risks. However, the promotion of sound and innovative business models for market-based funding structures could help to deliver additional stimulus; and

3. Some continued doubts on the comparability and consistency of banks' calculations of risk weighted assets.

Operational Risks

The key operational risks relate to:

4. Business conduct risk remains a key concern with the Report recommending that supervisors should include misconduct costs in future stress tests where appropriate, while financial institutions should strengthening product oversight and governance frameworks. Further improvements in the regulatory framework and supervisory practices to address conduct risks are also warranted. In addition, further progress needs to be made on benchmark reforms where continuity and integrity remain a source of concern even if key panels remained stable; and
5. IT operational risk and cyber risk remain of great concern and pose challenges to the the safety and integrity of financial institutions. IT risk increased due to costs pressures, outsourcing, the need for additional capacities and a mounting number of cyber-attacks. The adequate integration of IT risk into overall risk management is a key policy for mitigation.

Notes for editors

1. JC/2015/007 Joint Committee Report on Risks and Vulnerabilities to the EU Financial System

2. The Joint Committee is a forum for cooperation that was established on 1st January 2011, with the goal of strengthening cooperation between the European Banking Authority (EBA), European Securities and Markets Authority (ESMA) and European Insurance and Occupational Pensions Authority (EIOPA), collectively known as the three European Supervisory Authorities (ESAs).

3. Through the Joint Committee, the three ESAs cooperate regularly and closely and ensure consistency in their practices. In particular, the Joint Committee works in the areas of supervision of financial conglomerates, accounting and auditing, micro-prudential analyses of cross-sectoral developments, risks and vulnerabilities for financial stability, retail investment products and measures combating money laundering. In addition to being a forum for cooperation, the Joint Committee also plays an important role in the exchange of information with the European Systemic Risk Board (ESRB).

Further information:

David Cliffe
Team Leader - Communications
Tel: +33 (0)1 58 36 43 24
Mob: +33 6 42 48 29 06
Email: press@esma.europa.eu