



Mario Draghi
ESRB Chair

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Dear Jonathan

I am writing in response to your letter dated 16 October 2014. The European Systemic Risk Board (ESRB) welcomes the opportunity to provide its views on possible changes in macro-prudential risks requiring the use of Article 459 of the Capital Requirements Regulation (CRR) – an issue to be considered when preparing the related (annual) report that the European Commission must submit to the European Parliament and the Council. The ESRB emphasises the importance of that Article, which provides the possibility to prevent and mitigate macro-prudential risks affecting all Member States as a complement to other macro-prudential instruments which are, on the contrary, applicable to individual Member States.

Based on the ESRB's experience of working on the identification and categorisation of systemic risks, we have not yet seen circumstances where the Commission would wish to invoke this power, which pursuant to Article 462.2 of the CRR is granted to it with effect from 31 December 2014. The main risks discussed by the ESRB over the past year have included:

- weak macroeconomic activity threatening bank profitability and, more broadly, financial stability;
- an abrupt reversal in the search for yield, amplified by pockets of illiquidity, and relatedly, the risk of asset price over-valuation especially in particular sectors such as real estate;
- sovereign debt sustainability concerns amid low nominal growth and increasing debt levels.

For these risks, actions are being taken at national and European level. Most notably, the Comprehensive Assessment/stress testing exercise has helped ensure that banks have stronger balance sheets and sufficient capital levels. In the context of solving the 'too big to fail'-issue, Member States have introduced higher capital requirements, in line with the CRD IV/CRR, to reduce systemic risk in the banking sector. Member States have also taken pre-emptive action with respect to their local real estate markets. Moreover, the ESRB is sponsoring surveillance/assessment work across a number of areas such as conduct risks, market liquidity, real estate and the cross-border impact of macro-prudential policy measures.

Although there is no evidence of the need to activate Article 459 of the CRR in the current situation, there are two instances where – in theory – it might help to address specific systemic threats.

First, *systemic fragilities* in financial markets may call for comprehensive, uniform and swift policy responses. Therefore, measures affecting the whole Union may be appropriate.

Second, developments in the wake of the financial crisis show that *indirect contagion* in its various forms (for example, through asset price correlations, fire-sales, or the information channel) may



easily spread to other Member States necessitating broad preventive policy measures across the EU.

Article 459 of the CRR could be used to enhance systemic stability by requiring credit institutions or investment firms to improve – albeit temporarily – public disclosures on exposures, indicators or practices of systemic relevance. Using the Article in this way would ensure that there is a coordinated effort to strengthen transparency across the Single Market at times when market participants appear not to have an adequate picture of specific risks. Acting at an EU-wide level would in this case reduce the risk of an inaction bias, avoiding the “first mover” problem.

The ESRB will continue to monitor the outlook for systemic risk, and, of course, be in immediate contact with the European Commission should any conditions requiring action via the said Article materialise.

In the meantime, please do not hesitate to contact the ESRB Secretariat if you have any questions regarding the content of this letter.

Yours sincerely