Speech

Frankfurt am Main, 8 December 2022

Closing remarks

Speech by Francesco Mazzaferro, Head of the ESRB Secretariat, at the ESRB Annual Conference, 8 December 2022

2022 has a been a challenging year for the ESRB and its Secretariat.

Let us revisit together – in chronological terms – the most important moments.

Starting in January, the exposure of money market funds to recurrent sudden outflows has been the object of the second recommendation of the ESRB on this market segment since its inception 11 years ago.

The ESRB has thereby solicited immediate action by the EU legislator, also offering an European interpretation of the broad indications by international bodies.

Money market funds are – at least in theory – among the possible winners of a normalization of monetary policy. Typically, when interest rates are rising, these funds may offer higher yields, compete with bank deposits and therefore receive important inflows. Therefore, from an economic point of view, we are in a favourable environment for a correction of the current regulatory weaknesses. Time has come to solve long recognized issues.

There is a risk however that this opportunity is lost. Waiting might imply that the Commission would intervene in more tense market conditions, and possibly after new fragilities have materialised. In line with the ESRB Recommendation, we call for a regulatory reform during this Parliamentary tenure.

Still in January, the ESRB has also issued the first recommendation on the creation of a systemic cyber incident coordination framework. We know that severe macroprudential incidents may potentially escalate and trigger systemic risk.

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The three European Supervisory Authorities will be the key operators of the new framework, as defined by Article 49 of the Digital Operational Resilience Act (DORA), whose entry into force has been wisely accelerated by the EU legislator.

Implementation work of our Recommendation, to enhance situational awareness and ensure a proper interaction between all institutions, has already started at the technical level.

Furthermore, we have announced today further advances on the definition of tailor-made analytical tools to understand the macroprudential implications of cyber risk.

In February we have completed a new phase of our constant examination of vulnerabilities in the residential real estate, issuing warnings to Bulgaria, Croatia, Hungary, Liechtenstein and Slovakia, and recommendations to Austria and Germany.

Since 2016, 17 of the 30 ESRB Member States – encompassing the 27 EU countries and three additional members of the European Economic Area – have been object of a warning or a recommendation of the ESRB in the area of residential real estate.

Today we have announced that analytical and policy work has continued over the year around commercial real estate, which is a volatile segment, particularly exposed to economic and financial cycles.

We think we have created awareness about the need to increase resilience in the European real estate markets. We are aware to have soft-law powers only. Our recommendations and warnings have however a signalling effect.

In the course of the year, we have seen price movements in real estate markets which are not any more aligned with the continuous ascending profile of the last years. Our attention to new market developments will continue to be high in 2023.

February has been, for all of us, a turning point after the unjustified attack of Russia to the Ukraine. It has marked an immediate deterioration in overall economic expectations.

The aggravation of geopolitical tensions has made global trade more difficult and costly. The impact on energy prices has been particularly drastic. The EU economy has been hit by a terms of trade shock like it had not happened since the 1970s.

While the EU financial sector has proved to be resilient, we have progressively monitored since spring an aggravation of all vulnerabilities. We have also seen them more and more mutually interconnected, also due to worrisome concerns on liquidity in some market segments. This happened globally, but also within the European Union. Understanding the nature of liquidity problems in markets and their implication for individual players will be a priority for next year.

President Christine Lagarde has already explained – opening today's Annual Conference – the reasons which have led the ESRB to issue its first general warning on 22 September. For us at the Secretariat, this has been the work of a full and intense summer.

The key messages of the Warning are: (i) the risk of materialization of tail scenarios has become higher; (ii) therefore authorities need to preserve and, when needed, enhance market resilience; and (iii) to this end, they must remain well-tuned and coordinated.

Understanding the economic and financial cycle in current conditions – and therefore the room for active use of macroprudential tools – will remain the focus of our work next year.

Tensions in energy derivative markets in late summer have compelled several EU Member States to intervene with guarantees and credit lines. The ESRB has been following closely events, also providing to other institutions a set of granular information based on the real time reporting of trade repositories.

We observed that – immediately after the deterioration of security conditions – non-financial corporations in the energy sector have been exposed to a sizeable increase in margin calls. In a first phase, this has been counteracted via increased leverage, with larger and larger margin calls being financed by a concentrated number of lenders. After their risk appetite has come to its limit, energy derivative markets have been exposed to the risk of a market squeeze. We saw that excessive leverage also caused an important accident in Nickel derivative markets in the City, in March this year.

Once again, the sudden reappraisal of 'Risk on' and 'Risk off' factors continues to amplify the volatility of underlying markets, potentially impacting on highly significant benchmark prices for the economy. Therefore, we need to improve our understanding of how the clearing ecosystem - going beyond the CCPs and encompassing clearing banks and their clients – is reducing or amplifying risk for the economy.

Another factor of volatility during 2022 have been crypto assets and their financial infrastructure. Already in June this year the ESRB Chair has stressed – in front of Parliament – the need to reinforce the legal framework.

The European Union has made a first big step with the forthcoming Markets in Crypto-Assets Regulation (MiCA), which is expected to come into force by end 2024.

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However, also the scope of this important piece of regulation does not cover all issues, as it focuses on the so-called ‘stable coins’ and the provision of services. Other cyber assets – think of Bitcoins – continue to be outside a regulated legal framework. The recent events around the FTX cryptocurrency exchange reinforce the message that the European Union should need start working soon at MiCA II.

The events in this turbulent 2022 have confirmed in our view the need for a strong macroprudential policy. New macroprudential tools would create sufficient space for policy action. We would also need them to mitigate the new defy of hybrid risks: systemic exposures of the financial sector to climate change, cyber risk and crypto.

The ESRB has therefore finalized earlier this year a ‘Concept Note’ on how we would like macroprudential policy to be shaped in the next ten years: more forward-looking, proactive and countercyclical. We stressed the need to ensure more releasable and effectively usable capital buffers. At the same time, the existing EU macroprudential toolkit must be supplemented with borrower-based measures.

Looking forward, we need to entrench activity-based regulation in the Acquis Communautaire. Similar requirements must be applied to all entities carrying out the same type of financial activity. This would help to avoid regulatory arbitrage and the transfer of risk to other parts of the system.

At this stage, it is not clear whether the review of macroprudential policy will be activated by the Commission in the next months. Also here, like with Money Market Funds, it is important to keep pace with history.

Altogether, 2022 has been a year of extraordinary activity for the ESRB Secretariat. This would have not been possible without the dedication of my Deputy Tuomas Peltonen and the advisors Emily Beau, Olaf Weeken and Andreas Westphal. I am naming them also to express my full recognition and gratitude to the entire team of forty dedicated staff, which remains the humble, but effective engine of the ESRB.

Also a big thank is due to all member institutions. Working together has continued to be the secret of our mutual success. Certainly, we have been all under pressure. I am sure we will be able to remain focused and productive also in 2023.

The constant support of the Chair has provided us with the energy to continue looking forward with perseverance, despite all limitations in resources.

A particular tribute goes today to Stefan Ingves, the long-time Vice Chair of the ESRB and earlier Chair of the Advisory Technical Committee, who just spoke. Many thanks for your multi-year commitment to this young institution.

Finally, I would like to thank all colleagues involved in organizing this insightful event today, in particular Shirley Simmons-Nocca, Stefan Seitz, Anja Sinsch, Justyna Ferstl, Antonio Sanchez Serrano and Tuomas Peltonen.

And herewith, I would like to declare this Annual Conference as closed.

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