

**ESRB**

European Systemic Risk Board

European System of Financial Supervision

Closing remarks

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Mitigating uncertainty from theory to praxis: new tasks for the ESRB

Francesco Mazzaferro, Head of the ESRB Secretariat, at the ninth annual conference of the European Systemic Risk Board: Broadening horizons: the ESRB's next decade of impact

Ladies and Gentlemen,

I would like to conclude this excellent ninth annual conference of the European Systemic Risk Board with some thoughts on what our discussions imply for the Secretariat of the ESRB, which is hosted here at the European Central Bank, under the aegis of the ESRB Chair, President Christine Lagarde. Once again, I would like to thank her very warmly for the support the Secretariat has received over the last twelve months.

Our work must constantly adapt to new challenges if we are to accomplish the institutional tasks that the ESRB was given in 2010, namely *“to contribute to the prevention or mitigation of systemic risks to financial stability in the Union that arise from developments within the financial system and taking into account macroeconomic developments, so as to avoid periods of widespread financial distress”*. Our annual conferences are key to ensuring that we are not missing new systemic risks.

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The last fifteen years have taught us that we need to look beyond the inherent instability of financial systems, the asset bubbles and the boom-bust cycles that they tend to generate. Over recent years we have learned that widespread financial distress may also originate from developments outside the financial sector. In the worst cases, such exogenous shocks are propagated and amplified by financial markets and the financial system. In the best cases, the financial system operates as a shock absorber and bolsters the resilience of our societies to such shocks. And we have seen quite a few of these shocks in about half a decade: a pandemic, a major war on the European continent, vulnerabilities in our IT and energy systems to cyberattacks, hybrid warfare and a breakdown of global cooperation, which also undermines our ability to avert climate catastrophes.

In March this year, the European Commission presented its Preparedness Union Strategy, which is designed to bolster the EU's resilience to such shocks. A resilient financial system is of crucial importance in this context.

When we met in late September last year for the eighth ESRB annual conference, we devoted much time to the concept of radical uncertainty and its implications for our mission. We had seen exogenous shocks that illustrated how important that concept has become. Few of us would have anticipated how much worse it was going to get, in particular due to the numerous political developments that are now increasingly fragmenting the globe.

Over the last 24 months, the ESRB has referred to “geopolitical risk” in every one of its press releases and publications. But it is not only the geopolitical and geoeconomic fractures outside the European Union that have an impact on our financial markets and systems. We are also seeing worrying developments within the EU and its policies: the rise in political and social polarisation and the crises of governance this brings about are also affecting – directly and indirectly – the financial markets.

In fact, the efficiency of institutional processes in Europe has been questioned recently by former ESRB Chair Mario Draghi. He observed that this year, the

European Union may have experienced a significant loss in its capacity to control its own future in a more hostile global environment where our adversaries may increasingly seek to exploit our internal divisions and weaknesses. We could be a lot stronger if we were more united, also as a global financial power. But to achieve that, we must deliver on our commitments to establish a savings and investment union.

At the ESRB, we understand how much we depend on a resilient financial system. But so do others. The result is that finance is increasingly weaponised as part of a global power game. I would like to make a brief reference to how artificial intelligence, crypto and cyber will determine the new geography of finance.

Today, artificial intelligence is key to winning the arms race; tomorrow it could be quantum computing. Artificial intelligence and quantum computing may determine the balance of power in the world in the near future. We discussed these issues earlier today.

Support for crypto assets is not only driven by a belief in the efficiency gains that distributed ledger technology can bring to financial systems. There has always been a strong political motivation behind crypto assets from the very beginning. Initially, crypto was directed as a libertarian and base democracy-driven tool against governments and major financial institutions. Today, it is more and more often instrumentalised by governments, and established financial institutions are trying to get a foothold in this market. Control of the global financial system also requires control of what is going on with crypto assets. President Lagarde has referred to these issues in her welcome address.

Cybersecurity is another global battleground. Financial institutions are like fortresses that are constantly being assailed. They are engaged in an arms race against cyber criminals and state-sponsored hackers. They depend on ever more sophisticated technologies that are provided by highly specialised and increasingly concentrated third-party providers, which have their own vulnerabilities – remember CrowdStrike. The ESRB has been part of the response to cyber risks through innovative macroprudential recommendations.

The financial markets have proven surprisingly resilient to geopolitical developments in the past few years. Certainly, there have been phases of increased volatility in equity and bond markets, including numerous government debt markets. Authorities have so far been able to manage the liquidity stress resulting from such volatility. In addition, global foreign exchange markets have moved quite abruptly at times, but without destabilising financial institutions. The profitability and capitalisation of these institutions have continued to improve. So, the system's first line of defence has not only functioned – it has actually become stronger. This has been reflected in the excellent results of the most recent EU-wide banking stress test conducted by the European Banking Authority and European banking supervision. But it is the entire financial sector which has fared well – notwithstanding the massive valuation losses suffered on long-term bond holdings as a result of the rise in interest rates.

However, macroprudential policymakers need to be ahead of the curve. Clearly, the financial sector has displayed a stronger capacity to perform its functions in a situation of stress than before the reforms that followed the Global Financial Crisis. We would be deceiving ourselves if we took the view that thanks to these reforms the financial system can now weather any storm. In fact, the financial system has been sheltered to a large extent by monetary and fiscal policy interventions during the pandemic and during the energy crisis. With this in mind, last year our General Board tasked four high-level officials with developing proposals to adapt the ESRB's work to the new challenges we expect. These proposals have been approved and published.

The first of these is for the ESRB to assess different scenarios in situations of uncertainty and rapidly changing conditions. To this end, and as a joint endeavour between the ESRB Secretariat, the ECB's Directorate General Macroprudential Policy and Financial Stability and all other member institutions, we will develop a new system-wide, top-down stress-testing tool. But that will only work if we can also overcome legal obstacles to the sharing of transaction-level and firm-level data. The ESRB and the supervisory authorities together form the "European System of Financial Supervision", as defined in the ESRB's founding regulation. But how can

we have an integrated system of supervision without data sharing? This is clearly an area where more regulatory progress is needed at EU level.

A second focus for action identified by the high-level group is to better respond to the way in which risk shifts across different parts of the financial sector. This implies understanding risk transfers between entities which are performing the same activity but have different business models and possibly operate under different legal frameworks. This will also require an understanding of how complex interactions, for instance between private and public markets, mitigate or aggravate financial vulnerabilities.

The resources of the ESRB Secretariat are limited and would not be sufficient to achieve the ambitions defined by the high-level group. But we are meant to be part of a wider European System of Financial Supervision. The ESRB Secretariat can concentrate on the amplification of risks across countries and across sectors, leaving the analysis of vulnerabilities in national systems and specific sectors primarily to its members, national supervisors and the European Supervisory Authorities. The ESRB would increasingly become a place where the other members of the European System of Financial Supervision coordinate their actions, exchange information and develop synergies. The ESRB should certainly not attempt to duplicate what its member institutions are doing at the national or sector level.

The thrust of macroprudential action would remain national, but with cooperation and coordination mechanisms in place, as it would occur in a highly integrated single financial system. As an example of such a solution, the supervision of systemically important core components of financial markets could be gradually transferred to the European Supervisory Authorities – with “hard-law” powers. The ESRB would continue to use its “soft-law” powers to provide general guidance for the use of macroprudential policy instruments and to ensure that the regulatory framework can continue to safeguard financial stability in a changing risk landscape.

Implementing the recommendations of the high-level group will be a process that will take a few years. I will be glad to update you at future conferences on the progress

we are making, and I am glad that I can count on the dedication and professionalism of my staff at the Secretariat. I would like to thank, in particular, my deputy Tuomas Peltonen and the management team, Magnus Andersson, Joana Baptista, Emily Beau, Ralf Jacob, Angel Ivan Moreno Bernal and Olaf Weeken. I would also like to thank Paulina Przewoska and Wojciech Golecki for helping us navigate through all the institutional processes that are involved in decision-making. And let me also express my special gratitude to Tuomas, Shirley Simmons-Nocca, Elena Lanza and Antonio Sanchez for organising this conference. Without them, this event would not have been possible. But it is thanks to you, the participants, that this event has been a success!

I look forward to next year's conference!