ESRB
European Systemic Risk Board
European System of Financial Supervision

RECOMMENDATION OF THE EUROPEAN SYSTEMIC RISK BOARD

of 22 December 2011

on US dollar denominated funding of credit institutions

(ESRB/2011/2)

THE GENERAL BOARD OF THE EUROPEAN SYSTEMIC RISK BOARD,

Having regard to Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board[1], and in particular Article 3(2)(b), (d) and (f) and Articles 16 to 18 thereof,

Having regard to Decision ESRB/2011/1 of the European Systemic Risk Board of 20 January 2011 adopting the Rules of Procedure of the European Systemic Risk Board[2], and in particular Article 15(3)(e) and Articles 18 to 20 thereof,

Having regard to the views of the relevant private sector stakeholders,

Whereas:

(1) The US dollar is a material funding currency for Union credit institutions, which obtain most US dollar funding from wholesale markets.

(2) There is a material maturity mismatch in the US dollar assets and liabilities of Union credit institutions, with short-term wholesale funding being used to finance longer-term activities and assets; moreover, some counterparties are volatile. The combination of maturity mismatch and volatile investors is a key type of vulnerability.

(3) There have been ongoing strains in US dollar funding markets since June 2011, following the material strains experienced in 2008 that led to the introduction of central bank swap lines to provide access to US dollars. These strains create key direct potential system-wide risks: in particular, in the short term, to bank liquidity, and in the medium term, to the real economy from a reduction in lending in US dollars by Union credit institutions and to the solvency of those credit institutions if deleveraging happens at fire-sale prices.

(4) Credit institutions, central banks and supervisors have implemented measures to mitigate general funding and liquidity risks in recent years; some of these measures contributed to

1 OJ L 331, 15.12.2010, p. 1.

2 OJ C 58, 24.2.2011, p. 4.

improve the US dollar funding and liquidity positions of Union credit institutions. However, a more structured approach is needed to prevent a repetition of the tensions in US dollar funding markets.

(5) Micro-prudential tools should be strengthened for the macro-prudential purpose of avoiding the levels of tension in US dollar funding for Union credit institutions seen in the recent financial crises.

(6) Data gaps at the Union level limit the ability to analyse the possible impact of US dollar funding risks; data quality should therefore be improved.

(7) Close monitoring at the level of the banking sector and of individual firms would help the competent authorities to better understand developments in US dollar funding and liquidity risks; it would also help them in encouraging banks to take necessary ex ante measures to limit excessive exposures and correct distortions in risk management. The recommended measures in those fields are consistent with ESRB recommendation F of 21 September 2011 on lending in foreign currencies[3].

(8) One of the instruments to mitigate US dollar funding risks is contingency funding plans, to avoid exacerbating funding problems in extreme situations. However, contingency plans could create new systemic problems if they resulted in similar actions taken by credit institutions at the same time.

(9) The European Systemic Risk Board (ESRB) will review the progress in the implementation of this Recommendation during the second half of 2012.

(10) The Annex to this Recommendation analyses the significant systemic risks to the financial stability in the Union arising from the US dollar funding of Union credit institutions.

(11) This Recommendation is without prejudice to the monetary policy mandates of the central banks in the Union, and the tasks entrusted to the ESRB.

(12) ESRB recommendations are published after informing the Council of the General Board's intention to do so and providing the Council with an opportunity to react,

HAS ADOPTED THIS RECOMMENDATION:

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3 Recommendation ESRB/2011/1 of the European Systemic Risk Board of 21 September 2011 on lending in foreign currencies (OJ C 342, 22.11.2011, p. 1).

SECTION 1

RECOMMENDATIONS

Recommendation A – Monitoring of US dollar funding and liquidity

National supervisory authorities are recommended to:

1. closely monitor US dollar funding and liquidity risks taken by credit institutions, as part of their monitoring of the credit institutions' overall funding and liquidity positions. In particular, national supervisory authorities should monitor:
   (a) maturity mismatches in US dollars;
   (b) funding concentrations by counterparty type, with a focus on short-term counterparties;
   (c) use of US dollar currency swaps (including currency interest rate swaps);
   (d) intra-group exposures.
2. consider, before exposures to the funding and liquidity risk in US dollars reach excessive levels:
   (a) encouraging credit institutions to take action to manage risks arising from maturity mismatches in US dollars appropriately;
   (b) limiting the exposures, while avoiding a disorderly unwinding of current financing structures.

Recommendation B – Contingency funding plans

National supervisory authorities are recommended to:

1. ensure that credit institutions provide for management actions in their contingency funding plans for handling a shock in US dollar funding, and that those credit institutions have considered the feasibility of those actions if more than one credit institution tries to undertake them at the same time. At a minimum, contingency funding plans should consider the contingency funding sources available in the event of a reduction in supply from different counterparty classes;
2. assess the feasibility of these management actions in the contingency funding plans at the level of the banking sector. If simultaneous action by credit institutions is assessed as likely to create potential systemic risks, national supervisory authorities are recommended to consider action to diminish those risks and the impact of those actions on the stability of the Union banking sector.

SECTION 2

IMPLEMENTATION

1. Interpretation

1. For the purposes of this Recommendation, the following definitions apply:

   (a) 'credit institution' means credit institution as defined in Article 4(1) of Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions[4];

   (b) 'Union credit institution' means a credit institution authorised in a Member State under Directive (EC) No 2006/48;

   (c) 'national supervisory authority' means a competent or supervisory authority as defined in Article 1(3)(f) of Regulation (EU) No 1092/2010;

   (d) 'US dollar funding' means raising funds in US dollar denominated liabilities.

2. The Annex forms an integral part of this Recommendation. In the case of conflict between the main text and the Annex, the main text prevails.

2. Criteria for implementation

1. The following criteria apply to the implementation of this Recommendation:

   (a) This Recommendation covers only US dollar funding of Union credit institutions.

   (b) Regulatory arbitrage should be avoided.

   (c) Due regard will be paid to the principle of proportionality in the implementation, with reference to the different systemic significance of US dollar funding of the credit institutions and taking into account the objective and the content of each recommendation.

   (d) Further criteria for the implementation of recommendations A and B are set out in the Annex.

2. Addressees are requested to communicate to the ESRB and to the Council actions undertaken in response to this Recommendation, or adequately justify inaction. The reports should as a minimum contain:

   (a) information on the substance and timeline of the undertaken actions;

   (b) an assessment of the functioning of the undertaken actions from the perspective of the objectives of this Recommendation;

   (c) detailed justification of any inaction or departure from this Recommendation, including any delays.

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4 OJ L 177, 30.6.2006, p. 1.

3. Timeline for the follow-up

1. Addressees are requested to communicate to the ESRB and the Council the action taken in response to recommendations A and B, and adequate justification in the case of inaction, by 30 June 2012.
2. National supervisory authorities may report in aggregate through the EBA.
3. The General Board may extend the deadline under paragraph 1 where legislative initiatives are necessary to comply with one or more recommendations.

4. Monitoring and assessment

1. The ESRB Secretariat:
   (a) assists the addressees, including by facilitating coordinated reporting, providing relevant templates and detailing where necessary the modalities and the timeline for the follow-up;
   (b) verifies the follow-up by the addressees, including by assisting them upon their request, and reports on the follow-up to the General Board via the Steering Committee within two months from the expiry of the deadlines for the follow-up.
2. The General Board assesses the actions and the justifications reported by the addressees and, where appropriate, decides whether this Recommendation has not been followed and the addressees have failed to adequately justify their inaction.

Done at Frankfurt am Main, 22 December 2011

The Chair of the ESRB
Mario DRAGHI