Building on a decade of success

December 2024

Report by the High-Level Group on the ESRB Review

ESRB
European Systemic Risk Board
European System of Financial Supervision

Contents

Executive summary

The ESRB General Board has asked the High-Level Group on the ESRB Review[1] ("the Group") to contribute to the second review of the ESRB Regulation[2] with strategic advice on the future of the ESRB. With a view to further enhancing the ESRB's macroprudential oversight, the Group has examined the institution's work and its experiences over the past decade, including the regulations underpinning its functions. It also conducted a survey to elicit views from the members of the Advisory Technical Committee.

The Group agrees that the ESRB, by leveraging its broad membership and employing its soft powers effectively, has been successful in fulfilling its mandate of macroprudential oversight. The ESRB has contributed significantly to the EU's macroprudential policy for banks, expanded the macroprudential framework to include non-banks and addressed new and cross-cutting systemic risks such as climate change and cyber threats. Although the ESRB's primary responsibility is crisis prevention rather than crisis management, it remains flexible enough to coordinate rapid responses to challenging macro-financial environments.

The Group firmly believes that the comparative advantage of the ESRB lies in its unique position to monitor and assess systemic risks and vulnerabilities across the entire financial system and the whole of the EU. To this end, the first recommendation of the Group aims to enhance the ESRB's holistic assessment of systemic risk. This holistic approach – including assessing interactions, interdependencies and spillovers – requires focus on both cross-sectoral and cross-border risks. To this end, the second recommendation focuses on the cross-sectoral perspective, namely on understanding the role of the non-bank sector in the intermediation system, as well as its connections to the traditional banking sector. The third recommendation concentrates on the cross-country perspective to ensure that the ESRB considers the diverse macroeconomic and financial environment of all EU Member States. Looking ahead, since the ESRB remains relatively unknown to European citizens, the fourth recommendation suggests enhancing its communication on financial stability. The ESRB's analytical work requires timely and continuous ex ante access to granular data. Therefore, the fifth recommendation proposes significant enhancements to the current ESRB data access framework. In recognition of the ESRB's role in facilitating the exchange of insight and best practices and developing new analytical tools for systemic risk indicators, the sixth recommendation focuses on knowledge sharing. Recommendations seven and eight address governance and resource requirements.

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1 The report was prepared by the Group, including the First Vice-Chair of the ESRB Governor Olli Rehn (Chair), Advisory Scientific Committee Vice-Chair Professor Stephen Cecchetti, ECB Vice-President Luis de Guindos and Advisory Technical Committee Chair Pablo Hernández de Cos. The Group wishes to thank Paulina Przewoska for acting as the secretary for this report and the Group. The Group also acknowledges the support of Francesco Mazzaferro, Tuomas Peltonen, Magnus Andersson, Marco D'Errico, Albert Guarner Piquet, Antonio Sánchez Serrano, Julie Manouvrier, and Wojciech Golecki-Mancuso in preparing this report.

2 According to Article 20 of the ESRB Regulation, the European Commission will be required to report to the European Parliament and Council by 31 December 2024 on "*whether it is necessary to review the mission or organisation of the ESRB, also considering possible alternative models to the current one*". The regulation requires the Commission to consult "*the members of the ESRB*". This will be a second review of the ESRB Regulation; the first review was concluded in 2019 with changes targeting the ESRB's mandate and governance. The ESRB contributed to the first review through a **High-Level Group report published in March 2013**.

The objectives set by the Group can be achieved through various approaches and over different time frames. Ultimately, the decision regarding implementation lies with the ESRB General Board, by also considering the resource implications, whereby most recommendations can be implemented without legislative changes. For those cases where legislative changes are needed, they will require a decision to be taken by the European Commission and the EU co-legislators.

Introduction

The European Systemic Risk Board (ESRB) is a unique EU oversight body with a comprehensive mandate, broad and diverse membership, and reliance on soft law instruments. As stated in the ESRB Regulation[3] (Article 3, paragraph 1):

"The ESRB shall be responsible for the macro-prudential oversight of the financial system within the Union in order 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. It shall contribute to the smooth functioning of the internal market and thereby ensure a sustainable contribution of the financial sector to economic growth."

This same regulation calls on the ESRB to create a risk dashboard composed of a quantitative and qualitative set of indicators, identify and prioritise risks, issue warnings where risks are significant and issue recommendations for remedial action where appropriate.

The ESRB's comprehensive mandate requires it to adopt a holistic view of the financial system, encompassing interconnections among sectors of the financial system, as well as between the financial sectors and the real economy. This means that the ESRB's approach is necessarily cross-sectoral, examining interactions and risks across banking, insurance, pension funds, asset managers, investment funds, central counterparties and other financial entities. This approach also involves assessing how adverse macroeconomic conditions and financial market developments may lead to vulnerabilities across relevant sectors. Furthermore, there is a natural progression from indicators to risks to warnings and recommendations that the ESRB can exploit as it further enhances the analytical framework for risk assessment.

Additionally, the ESRB's risk assessment is EU-wide. It is inherently cross-country, taking account of the diverse economic and financial structures of the EU Member States. This cross-country perspective is vital for identifying and addressing risks that originate in one country but have a broader impact. Based on a unified analysis of information from across all Members States, the ESRB strives to detect vulnerabilities that national authorities might miss.

To fulfil its mandate, the ESRB must exploit large amounts of granular data based on a comprehensive risk assessment framework. The aim of the ESRB's analytical work is to identify emerging financial system risks. Through a holistic ex ante analysis, the ESRB seeks to promote stability and resilience across the entire EU financial landscape.

The ESRB's broad and diverse membership is key to its success. To meet its comprehensive mandate, providing a holistic assessment of the EU financial system, the ESRB brings together national central banks, national supervisory authorities, the European Supervisory Authorities (ESAs), the European Central Bank, ECB Banking Supervision, the Single Resolution Board, the European Commission, the Economic and Financial Committee and its own Advisory Scientific

3 **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 (consolidated version)**.

Committee. Bringing together these diverse groups ensures that the ESRB's evaluations of risks and vulnerabilities benefit from a wide range of perspectives and expertise. The inclusion of various stakeholders promotes a culture of collaboration and information sharing, thereby enriching the analytical capabilities and decision-making process of the institution.

Members of the High-Level Group ("the Group") believe that by providing a unique forum where all the authorities contributing to financial stability can collaborate, the ESRB's broad and diverse membership is a key asset for both the ESRB and the EU. With 78 member institutions and 37 voting members, the General Board is quite large. This means that ensuring robust outcomes requires focused agendas with effective collaboration and decision-making. To prevent any single member from blocking the issuance of a warning or recommendation, the ESRB decision-making process is based on majority rule. Additionally, the Secretariat plays a crucial role in offering an impartial perspective to counteract any potential biases from individual members' jurisdictions.

Furthermore, because of its unique position in the EU supervisory landscape, the ESRB relies on soft law powers, i.e., warnings and recommendations. Since the ESRB does not have any binding powers, its warnings and recommendations will only be taken into account if it is able to convince others. Therefore, there is a need for strong analytical input and for clear and transparent communication. Looking back over the past decade, the soft law powers given to the ESRB have served the institution well. These non-binding instruments create the flexibility for the ESRB to address a wide range of risks to financial stability, without having to rely on lengthy legislative processes. Moreover, the soft law approach, exemplified by the rigorous application of the "act or explain" mechanism, combined with decision by majority, creates the right incentives for counteracting inaction bias. This is beneficial in two ways. First, knowing that the ESRB will issue a warning or recommendation if there is a threat, national authorities will act pre-emptively. Second, the records show that the level of compliance with ESRB actions is high. In fact, so far there is only one case in the history of the ESRB where a jurisdiction has been assessed as non-compliant. Furthermore, this structure enables the ESRB to tackle a broad range of country-specific and EU-wide issues relating to a lack of legislative action in the EU or its Member States.

With a view to enhancing the ESRB's macroprudential oversight, the Group examined both the internal functions of the institution and the regulations underpinning its function. To this end, the Group reviewed the ESRB's work and experiences over the past decade. It also conducted a survey to elicit views from the members of the Advisory Technical Committee.

Overall, members of the Group unanimously agreed that the ESRB's mandate is fit for purpose. Furthermore, they agreed that by leveraging its broad membership and employing its soft powers in a flexible and effective manner, the ESRB was successfully fulfilling this mandate. The ESRB contributed to the EU macroprudential policy for banks, helped expand the macroprudential framework to include non-banks and captured new and cross-cutting systemic risks, including climate change and cyber threats. Although the ESRB's primary responsibility is crisis prevention, and not crisis management, it remains sufficiently flexible to coordinate swift responses to challenging macro-financial environments. Looking ahead, as the ESRB remains relatively unknown to European citizens, it may be desirable to enhance its communication to the general public.

Recommendations

To further improve the effectiveness of the ESRB in addressing the challenges created by an evolving financial landscape and the changing nature of risks, the Group recommends the following changes.

Recommendation 1: To further enhance its risk assessment, the ESRB should develop and implement a framework that provides a holistic assessment of systemic risk in the EU. The ESRB is in a unique position to monitor and assess systemic risks and vulnerabilities across the entire EU financial system. Understanding how risks and vulnerabilities are distributed throughout the financial system enables authorities to address them effectively and allows market participants to allocate risk more efficiently. To facilitate this, the ESRB should employ state-of-the-art methods to create, maintain and employ a set of analytical tools that ensure assessments are as accurate and credible as possible. In the medium to long term, these tools should enable the ESRB to conduct top-down system-wide stress tests covering the entire EU financial system. Such stress tests would allow the ESRB to identify vulnerabilities at an early stage by enabling it to map how specific shocks would propagate within the EU financial system, across sectors, markets and counterparties. In the short to medium term, the ESRB could integrate current sectoral stress tests conducted by the ESAs by assessing possible spillover and contagion effects across different financial institutions. Eventually, the ESRB-led, system-wide top-down stress tests would allow the ESRB to test a broader range of scenarios using available data. This goal should be recognised in the revised ESRB Regulation.

Recommendation 2: To capture emerging risks and the growing role of non-bank financial intermediaries (NBFIs) in the EU financial system, the ESRB should apply and hone its system-wide approach to macroprudential policy. The ESRB is well placed to explore emerging risks that may require EU-wide efforts to be identified, assessed, and managed. This will help ensure that the ESRB and its members are able to act on the insights gained from the enhanced risk assessment set out in Recommendation 1. We also believe it is essential that the ESRB continue devoting resources to understanding the role of NBFIs in the intermediation system. This means continuing and expanding the support for the ongoing ESRB work in terms of monitoring the systemic risks that may arise both from the NBFIs alone, as well as from the interconnections between banks and non-banks. By integrating this work into the holistic risk assessment set out in Recommendation 1, these efforts would mitigate the risk of policy measures being circumvented as activities migrate across different types of entities, including outside the regulatory perimeter.

Recommendation 3: The ESRB's views on a Member State's macroprudential policy stance could feed into the analysis under the EU's macroeconomic imbalance procedure. The ESRB should work to further enhance metrics for assessing the macroprudential stance of individual jurisdictions. These could inform the assessment of a country's macro-financial imbalances and the potential mitigating impacts of macroprudential policies. In this respect, the ESRB's regular country assessments may feed into the work of the European Commission and, ultimately, inform the macroeconomic imbalance procedure from the macro-financial perspective. Such a role could be recognised in the revised ESRB Regulation.[4]

Recommendation 4: Strengthening communication on financial stability. The ESRB should publish a concise, biannual systemic risk monitor at the beginning of the first and third quarters of each year. This monitor should present the ESRB's assessment of financial stability risks within the EU, highlight the latest topical analyses of systemic risks and discuss new developments in macroprudential policy. Its main goal is to provide a comprehensive and concise systemic risk assessment of the EU financial system, complementing and drawing from the existing periodic publications of the ESRB. It could also promote forthcoming ESRB publications. To increase outreach, the First Vice-Chair of the ESRB could highlight the findings from the systemic risk monitor at dedicated communication events. To further improve the transparency of ESRB assessments, the Secretariat should publish background documents explaining the methodology used in the risk assessments.

Recommendation 5: The ESRB Regulation should be amended to introduce the immediate and automatic sharing of granular data between the ESAs and the ESRB. The ESRB's analytical work and monitoring of an increasingly complex, interconnected and evolving financial system requires timely and continuous ex ante access to granular data by the ESRB and its member institutions. Access that is immediate, automatic and continuous, as soon as the data are collected and processed, is crucial for analysing the financial system effectively and identifying risks and vulnerabilities as they materialise.

Recommendation 6: The ESRB should establish a dedicated forum for knowledge sharing among member institutions. In collaboration with the Advisory Scientific Committee, this forum should facilitate the exchange of insights and best practices, as well as the development of new analytical tools for the construction of systemic risk indicators.

Recommendation 7: The ESRB Secretariat should be led by the (re-titled) Secretary General appointed by the General Board for a fixed term of five years, renewable once. The Group notes that such a structure is consistent with current practices in international standard-setting bodies, including the Financial Stability Board and the Basel Committee on Banking Supervision. It is also consistent with the practice whereby all members of the General Board are subject to term limits. These changes should be recognised in the revised ESRB Regulation and in a revised Council Regulation conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board.[5]

Recommendation 8: The ESRB Secretariat should undertake a comprehensive screening of resource needs against our recommendations, with a view to shifting resources to tasks associated with risk assessment. This assessment should determine whether reallocating existing resources can achieve the objectives set by the Group or whether additional resources are necessary. The findings from this exercise should be presented to the ESRB's Steering Committee.

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4 **Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances** already assigns a role to the ESRB, notably in the development of the scoreboard (Art. 4), in in-depth reviews (Art. 5) and in the opening of excessive imbalances procedures (Art. 7).

5 **Council Regulation (EU) No 1096/2010 of 17 November 2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board**, Article 3(2).

Based on these findings, the Steering Committee should prepare a detailed master plan for the approval of the General Board in the first half of 2025. The Secretariat should also screen all instances where EU legislation requires the ESRB to provide opinions, offer consultations or engage in some other capacity, including in its reciprocation framework. It should assess the importance of these capacities with a view to the ESRB recommending to the European Commission and the co-legislators possible legislative changes that could in turn streamline procedures and reduce the burden on the ESRB.

1 Brief description of the ESRB

The global financial crisis revealed the limitations of a financial regulatory framework in which no authority is responsible for taking an EU-wide perspective on systemic risk. The ESRB is the response to this shortcoming. It began operations on 20 January 2011, in the midst of the European sovereign debt crisis. Next came the extended period of near-zero nominal interest rates aimed at combatting the threat of deflation. More recently, there have been Brexit, the COVID-19 pandemic and the Russian invasion of Ukraine. And all along, there have been long-term challenges relating to climate change and digitalisation. Each of these factors creates financial vulnerabilities. These include threats of financial fragmentation, overheating of financial markets, residential real estate imbalances, and threats to insurers from physical risk and cyber risk incidents. The ESRB uses its various powers, including issuing warnings and recommendations, to help ensure that the EU financial system remains strong and resilient. This framework provides a clear foundation for financial system stability.

Against this background of success, we describe the structure, the legally required outputs, and the actions by the ESRB during its 14 years of existence.

We start with the mission and objectives. As stated in the **ESRB Regulation (Article 3, paragraph 1)**:

"The ESRB shall be responsible for the macro-prudential oversight of the financial system within the Union in order 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. It shall contribute to the smooth functioning of the internal market and thereby ensure a sustainable contribution of the financial sector to economic growth."

This mandate strikes us as sufficiently general, and yet widely encompassing, such that we see no rationale for modifying it.

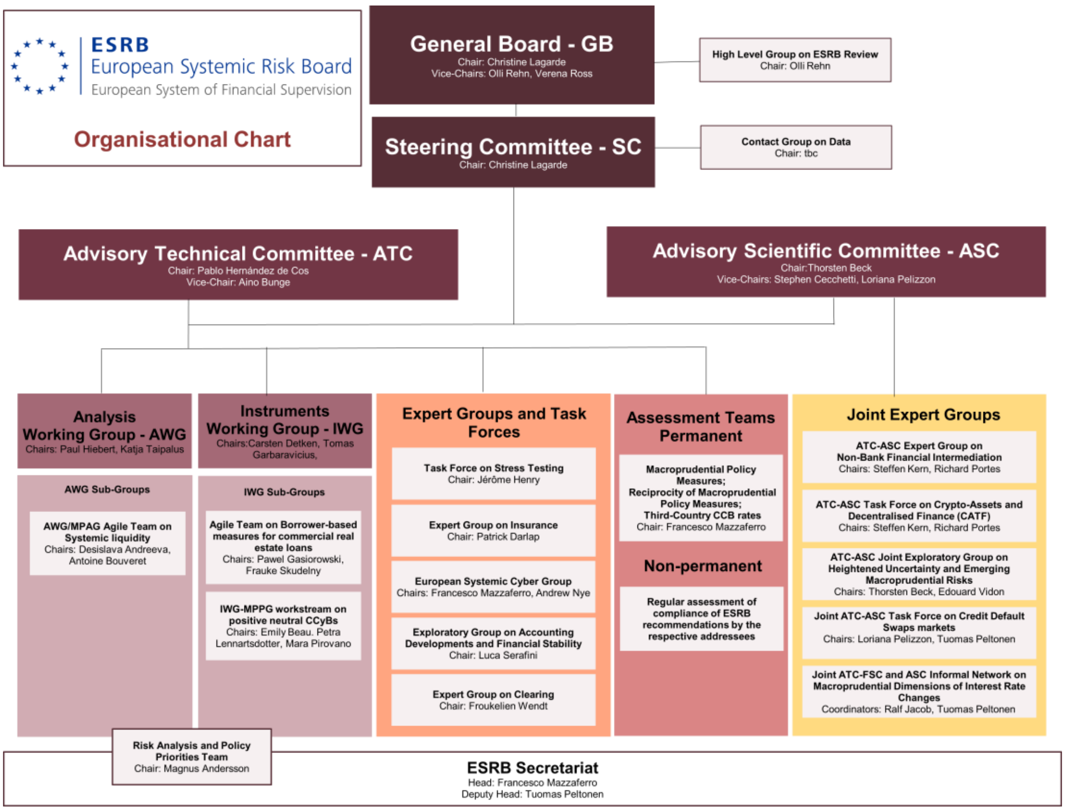
1.1 Structure of the ESRB

The ESRB has a very broad membership. This includes all the central banks and national supervisory authorities of EU/EEA countries (covering banking, insurance and financial markets), the ECB, the ESAs (the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA)), the European Commission, the Economic and Financial Committee and external members from the Advisory Scientific Committee. In addition, since 2019, ECB Banking Supervision and the Single Resolution Board have participated as non-voting members. The General Board has 78 member institutions and 37 voting members. By statute, the President of the ECB is Chair of the ESRB. The size of the membership creates obvious challenges for decision-making. However, while decisions are generally reached by consensus, the operational framework of the General Board allows for decisions to be adopted by majority vote.

Figure 1 shows the current organisational chart of the ESRB. There are two advisory committees − a technical committee and a scientific committee − both created by statute. The first, the Advisory Technical Committee (ATC), considers topics from a policy perspective and is the primary operational arm of the ESRB. Composed of representatives from all member organisations it forms the hub of the analytical work by the ESRB. The second, the Advisory Scientific Committee (ASC), takes a more academic perspective and provides a somewhat different type of support. Composed of 15 external (primarily academic) experts and the Chair of the ATC, it conducts research and also provides advice to support the work in other parts of the ESRB structure. In addition, the ASC Chair and two Vice-Chairs are voting members of the General Board. The additional expert groups and sub-groups that assist in the various risk monitoring assessment tasks were set up by the General Board.

While this structure could benefit from some refinements, we see no reason to change either the make-up of the membership or the operating methods of the ESRB.

Figure 1
Organisational chart of the ESRB



Source: ESRB Secretariat.
Note: Correct as at 13 November 2024.

1.2 Primary statutory responsibilities

The ESRB has numerous procedural and legal obligations that are set out in EU regulations and statutes. We start with those listed in the founding regulation (EU Regulation No 1092/2010). Paraphrasing the relevant portions, the ESRB is expected to:

- collect and analyse all relevant and necessary information for the purpose of achieving its objectives.
- together with the ESAs, develop a common set of quantitative and qualitative indicators to identify and measure systemic risk, creating a risk dashboard.
- identify and prioritise systemic risks, elaborating a colour code to allow interested parties to better assess risks.
- issue warnings where systemic risks are significant and recommendations for remedial action, where appropriate. These may be either general or specific in nature, addressed to the EU as a whole, to one or more Member States, to one or more of the ESAs or to one or more national supervisory authority. The ESRB may also recommend specific legislation to either the European Commission or to a Member State.
- monitor the follow-up to warnings and recommendations.

The ESRB's risk assessment framework is critically important for achieving its objective to prevent and mitigate systemic risks to financial stability across the EU. It is the risk assessment framework that provides the basis for warnings and recommendations. Put slightly differently, without a monitoring system, there is no way to either warn that risks are elevated or to recommend mitigating action. All monitoring frameworks require information. And, finally, whenever there are warnings or recommendations, they need to be clearly communicated and monitored.

In what follows, we discuss each of these. We start with the risk assessment procedure in the following chapter, where we outline our views on avenues for improvement. In Chapter 3, we examine how to enhance the ESRB's communication regarding systemic risk. Information and data are the focus of Chapter 4 of our report. Again, we have suggestions for further improvement. So, here we discuss warnings and recommendations, followed by a discussion of responsibilities and resources.

1.3 Warnings and recommendations

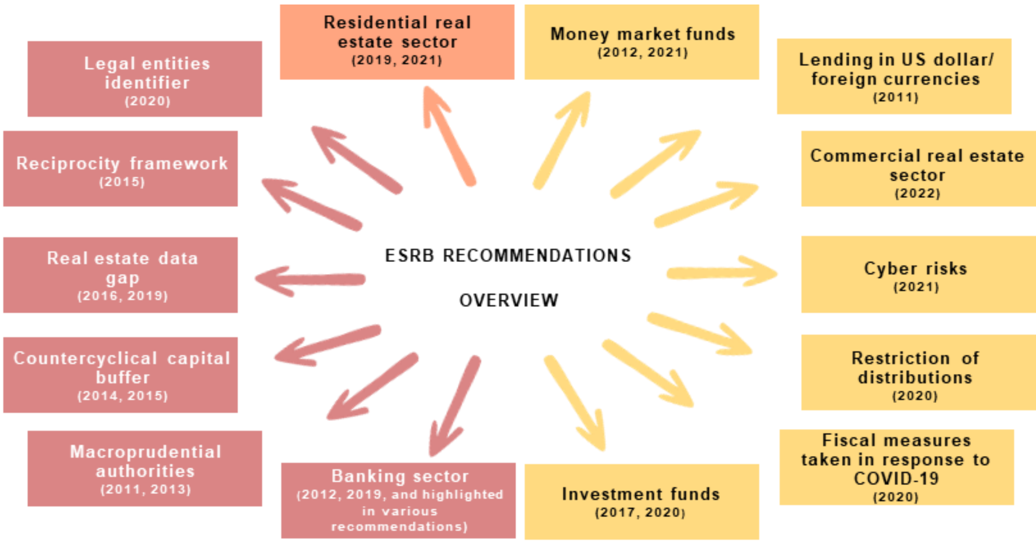
Since its establishment in 2010, the ESRB has made active use of its soft law powers to issue warnings and recommendations. Whenever monitoring activities reveal significant systemic risk, this justifies a warning. By contrast, recommendations are given whenever there is a need for remedial action to mitigate identified risks.

Table 1:
Overview of ESRB warnings

22 September 2016	The ESRB issued warnings for eight EEA countries (Austria, Belgium, Denmark, Finland, Luxembourg, the Netherlands, Sweden and the United Kingdom) of medium-term vulnerabilities in the residential real estate sector.
27 June 2019	The ESRB issued warnings for five EEA countries (Czech Republic, Germany, France, Iceland and Norway) of medium-term vulnerabilities in the residential real estate sector.
2 December 2021	The ESRB issued warnings for five EEA countries (Bulgaria, Croatia, Hungary, Liechtenstein and Slovakia) of medium-term vulnerabilities in the residential real estate sector
22 September 2022	The ESRB issued a general warning of vulnerabilities in the financial system, addressed to the European Union and the supervisory community. Heightened geopolitical risks prompted a call for heightened awareness of the risks to financial stability, emphasising the need for greater resilience in the EU financial sector so that the financial system could support the economy if these risks were to materialise

Source: ESRB.

Figure 2
Overview of ESRB recommendations



Source: ESRB Secretariat.
Note: The colours red, yellow and orange respectively represent the (i) recommendations that contribute to the design of the macroprudential policy framework, (ii) recommendations that advise on policy responses to specific risks, and (iii) recommendations that advise on policy responses to country-specific risks.

Over the years, the ESRB has issued four warnings, as listed in Table 1. Three of these concerned residential real estate and were addressed to 18 individual countries. By contrast, the ESRB general warning issued in September 2022 highlighted vulnerabilities in the EU financial system resulting from the macroeconomic impact of the Russian invasion of Ukraine. Recommendations are more numerous: there have been 30 to date, as summarised in Figure 2.[6]

The ESRB country-specific warnings of vulnerabilities in the residential real estate sector triggered a tightening of measures by the 18 countries that received these warnings, mostly in the form of activating or increasing capital buffers or introducing borrower-based measures. Later, assessments of the vulnerabilities in residential real estate proved that in eight cases, the measures taken were sufficient and appropriate to mitigate the risks highlighted by way of the warning. In ten countries, however, policies continued to remain insufficient and/or inappropriate, a situation which led to the issuance of specific ESRB recommendations.[7]

The general warning was issued at a time of exceptional uncertainty and it stressed the need for private sector institutions, market participants and relevant authorities to prepare for scenarios in which tail risks could materialise. Fortunately, some of the risks that the ESRB had warned about did not materialise. On the one hand, the financial system has proven to be resilient to the challenging macro-financial environment since the general warning was issued. On the other hand, this general warning did expose risks stemming from escalating geopolitical tensions that could have broader financial stability implications. Given the ongoing tensions in the Middle East, the rising political fragmentation in many advanced economies and the prolonged war in Ukraine, tail risk is probably even more pertinent today than it was then. While it is difficult to quantify the impact of the warning, it did enable policymakers and supervisors to anchor their decisions to the ESRB's assessment and helped them to push through necessary reforms to their macroprudential and microprudential policies.[8]

Recommendations are more consequential than warnings. To cite from the regulation, *"Addressees of recommendations should act on them and provide an adequate justification in case of inaction ("act or explain" mechanism)*." Evidence suggests that this mechanism works well. So far, in only one instance was a jurisdiction deemed to be non-compliant.[9] Overall, in 77% of cases, addressees either complied (61%) or largely complied (16%). In 3% of cases, addressees partially complied. And in 20% of cases where there was no action, these cases were sufficiently explained.[10]

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6 Only recommendations issued at the ESRB's own initiative are included. Those recommendations that stem from a legal obligation under Article 133(11) of Directive 2013/36/EU on the systemic risk buffer rate (**Recommendation ESRB/2023/11 regarding the Portuguese notification of its intention to set a sectoral systemic risk buffer rate** and **Recommendation ESRB/2020/14 regarding the Norwegian notification of its intention to set a systemic risk buffer rate**) are excluded. In addition, the recommendations amending **Recommendation ESRB/2015/2 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures** are not included either, as they stem from a formal request submitted to the ESRB by the authority that activated the initial measure.

7 Eight out of the ten countries that received ESRB warnings subsequently received ESRB recommendations. The General Board decided to reassess the situation in the remaining two countries, Bulgaria and Croatia, in the first quarter of 2025.

8 See also the remarks by the ECB President, Lagarde, C., "**The ESRB's first general warning one year on**", speech at the seventh annual conference of the ESRB, Frankfurt am Main, 16 November 2023.

9 The one case of non-compliance concerned liquidity risks arising from margin calls. See the "**Summary compliance report of Recommendation ESRB/2020/6**".

10 This analysis encompasses 24 ESRB recommendations assessed up to now. It aggregates all grades assigned to all addressees (the number of addressees varies from 1 to 90 depending on the recommendation). The grades considered are those documented in the compliance reports published by the ESRB. Depending on the specific ESRB recommendation, the grades considered may reflect either the overall grade given for the entire recommendation, or the grade assigned for a particular sub-recommendation. This variability arises from the diverse content covered by ESRB recommendations, which can address a wide range of addressees with varying scopes of recommendations and/or sub-recommendations. To arrive at an overall level of compliance, the analysis treats every grade per addressee as one observation.

We consider the mechanism for warnings and recommendations to work well. First, warnings generally elicit responses from authorities, as mentioned above, and where these responses were inadequate, they could be followed up by recommendations – as was the case for eight countries. Second, recommendations have clear positive effects. Most obviously, the issuance of a recommendation prompts action. But beyond this, the reputational threat of a recommendation may also lead to pre-emptive action. That is to say, this soft law power is more effective than the simply reporting of action implies. Finally, there may also be cases where national authorities facing political obstacles welcome a recommendation.

1.4 Other statutory responsibilities

In addition to the responsibilities set out in the ESRB Regulation, other regulations give the ESRB additional responsibilities. Table 2 lists 47 instances where EU legislation requires the ESRB to provide opinions, offer consultations or engage in some other capacity. In addition, the ESRB plays a key role in the reciprocation of national macroprudential policy measures.

Table 2

Required ESRB opinions and consultations to be delivered to various authorities in the EU

Article 25 AIFMD	Involvement of the ESRB in determining limits to leverage.
Article 47 AIFMD	Consultation of the ESRB by ESMA before requesting competent authorities to impose measures
Articles 5, 10, 12 and 15 BRRD	ESRB to be consulted on details in relation to recovery/resolution planning
Articles 9, 12 CCP Recovery and Resolution	ESRB to be consulted on details in relation to recovery/resolution planning of CCPs
Article 131 CRD	Consultation of the ESRB by the EBA on guidelines on O-SII buffers
Article 131 CRD	ESRB opinion on O-SII buffer
Article 133 CRD	Consultation of the ESRB by the EBA on guidelines on setting SyRB rates
Article 133 CRD	ESRB to issue opinion and/or recommendation on SyRB rates
Article 134 CRD	ESRB recommendation on recognition of a SyRB rate
Articles 135 and 136 CRD	Recommendation of the ESRB on setting CCyB rates
Article 136 CRD	ESRB guidance on CCyB rates
Article 138/139 CRD	ESRB recommendation on the third-country CCyB rate
Article 124/164 CRR	ESRB opinion to Member States related to exposures secured by immovable property
Article 164 CRR	Recommendation of the ESRB on factors affecting financial stability and on indicative benchmarks for higher minimum loss given default values
Article 458 CRR	ESRB opinion on national macroprudential measures
Article 458 CRR	ESRB recommendation on recognition of national macroprudential measures

Article 459 CRR	ESRB opinion or recommendation on stricter prudential requirements for exposures activated by the Commission
Articles 461 and 509 CRR	Consultation of the ESRB by the EBA on liquidity coverage requirements
Article 501c CRR	Consultation of the ESRB by the EBA on the prudential treatment of exposures related to environmental and/or social objectives
Article 510 CRR	Consultation of the ESRB by the EBA on methodologies for determining stable funding requirements and associated amendments
Article 513 CRR	Consultation of the ESRB every five years by the Commission on the macroprudential rules review in the CRR and the CRD
Article 14 DGSD	Involvement of the ESRB in analysing systemic risk concerning DGSs
Article 32 DORA	ESRB participating as a member of the Oversight Forum
Article 49 DORA	Participation in a pan-European systemic cyber incident coordination framework
Article 58 DORA	Consultation of the ESRB in the context of the Commission's review
Articles 5, 6a EMIR	ESRB involvement on the clearing obligation procedure
Article 10 EMIR	Consultation of the ESRB on specific criteria for OTC derivatives
Article 25 EMIR	Consultation of the ESRB on the recognition of a third-country CCP
Article 46 EMIR	Consultation of the ESRB on collateral requirements
Article 85 EMIR	Involvement of the ESRB in assessing systemic risk implications of interoperability arrangements
Article 29 SFTR	Involvement of the ESRB in publishing an annual report on aggregate SFT volumes
Article 77f Solvency II	Consultation of the ESRB by EIOPA for preparing assessments to the Commission in relation to the impact of insurance regulations on long-term guarantees, investment behaviour of insurance undertakings and implications for financial stability
Article 138 Solvency II	Consultation of the ESRB for assessing exceptional adverse situations
Article 144(b) and 144(c) Solvency II	Consultation of the ESRB regarding measures to be taken in case of liquidity or solvency issues creating financial stability risks
Art 304(a)(1) Solvency II	Consultation of the ESRB by EIOPA on the prudential treatment of exposures related to environmental and/or social objectives
Article 28 SSR	ESMA to consult the ESRB with regard to intervention measures in exceptional circumstances related to short selling
Article 31 STSR	ESRB to publish a report on financial stability implications of the securitisation market every three years

Source: Various EU regulations and directive

In addition, there is **Recommendation of the European Systemic Risk Board of 15 December 2015 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy (ESRB/2015/2)**.This recommendation instructs authorities in Member States to assess their own macroprudential policies, to notify others when they have reciprocation requests and to reciprocate when requests are received. The ESRB Secretariat manages these reciprocation requests.

Considering the scarce resources allocated to the ESRB, especially to the Secretariat, we wonder whether all of these opinions and consultations are truly necessary. In Chapter 5, we recommend assessing the relative importance of them, with an eye to possible legislative changes that might reduce the burden on the ESRB.

2 Enhancing systemic risk assessment

Systemic risk monitoring and assessment is notoriously difficult. Stresses in the financial system can arise from a large shock when there is little apparent vulnerability or from a much more modest shock when the system is very vulnerable. As a result, monitoring and mitigating systemic risk requires gauging both the size of possible shocks and the sufficient level of resilience to ensure financial stability.

Before starting, it is important to keep in mind that the ESRB's risk assessment framework is critically important to the achievement of its objective to prevent and mitigate systemic risks to financial stability in the EU. It is the risk assessment framework that provides the basis for warnings and recommendations. Put slightly differently, without a monitoring system, there is no way to either warn that risks are elevated or to recommend mitigating actions. The drafters of the ESRB Regulation clearly realised the centrality of risk assessment when they set out the requirement that the ESRB identify and prioritise systemic risks, elaborating a colour code to allow interested parties to better assess risks. And, related to this, the regulation states that the ESRB should develop "*a common set of quantitative and qualitative indicators (risk dashboard) to identify and measure systemic risk".*

Systemic risk assessment provides authorities – and, if communicated – also market participants, with information to assess where vulnerabilities exist and where they do not. This enhances the understanding of the likely sources of amplification and contagion. Consequently, it enables authorities to effectively address vulnerabilities and allows market participants to improve the allocation of risk across the system.

Putting this together, the goal is for the ESRB to develop a unified framework in which the indicators in the risk dashboard are inputs into the risk assessment, which then trigger warnings and recommendations. And, ideally, this framework should be sufficiently transparent that, when the indicators change, everyone knows how the risk assessment will adjust and whether this will lead to a warning or recommendation. If this were the case, both national authorities and parties in the private financial sector would know what the ESRB was planning and act before being required to. Furthermore, a deeper understanding of where vulnerabilities exist within the system would enable the private financial sector to enhance its risk allocation. Improved allocation increases the system's capacity to manage risk. In other words, such assessments could allow the system as a whole to take on more risk rather than less.

While we agree that the ESRB's systemic risk assessment framework has served it well over the past decade, our objective in the remainder of this chapter is to suggest refinements that could improve the current procedures. As we do, we should keep two things in mind: (i) the desire to integrate the three statutory requirements – the risk dashboard, the (colour-coded) risk assessment, and the warnings and recommendations – into a unified whole; and (ii) the fact that the comparative advantage of the ESRB is its holistic perspective. In other words, what differentiates the ESRB from both national authorities and the ESAs is that it looks at all sectors in the financial system in all EU Members States.

We start the remainder of this chapter with a brief discussion of the current process for generating the risk assessment.

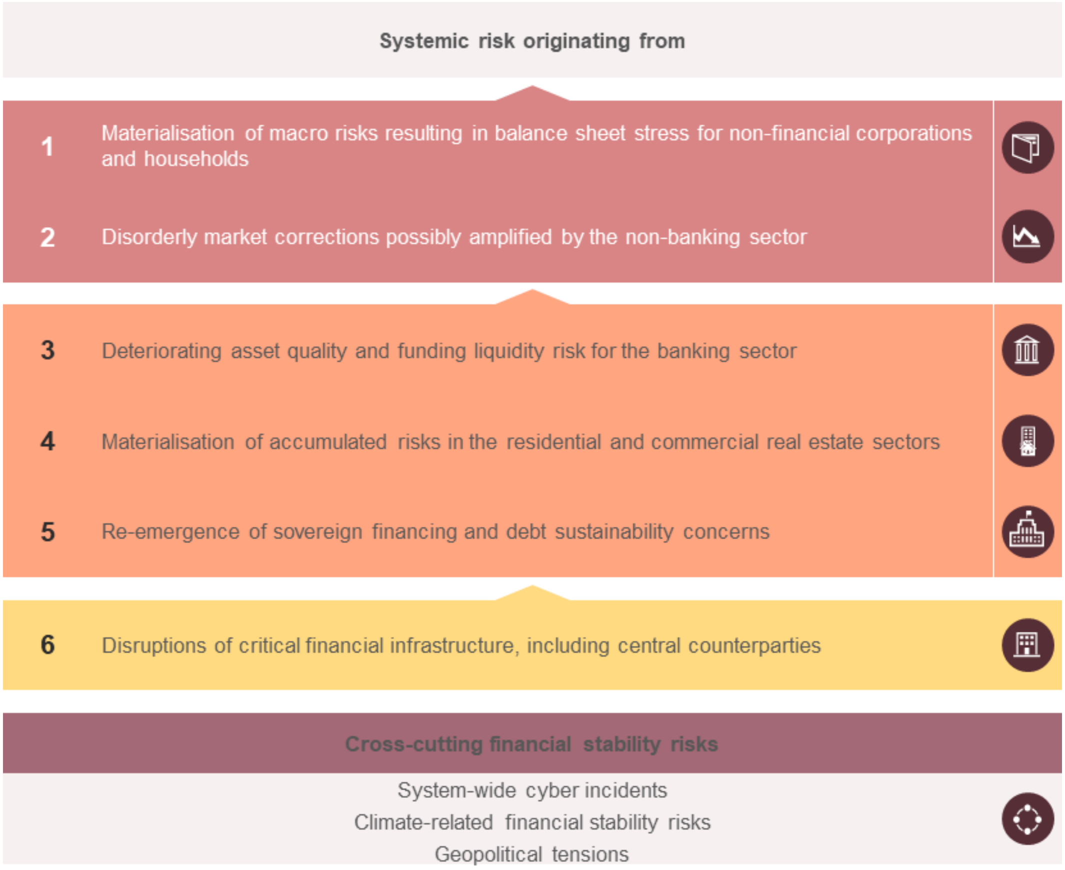
2.1 Current process

The ESRB risk assessment follows a regular quarterly cycle that begins with discussions by various groups in the ESRB structure. The process begins with the Secretariat preparing relevant information. Taking the previous quarter's assessment as a starting point, the question is whether there have been any material changes in either the intensity or composition of the risks. This leads to the preparation of a draft risk assessment for discussion by the ESRB stakeholders from the official sector. This starts with the Analysis Working Group (AWG) and the Instruments Working Group (IWG) before moving to the Advisory Technical Committee and culminating with a discussion at the General Board.[11] Ahead of the General Board meeting, the risk assessment is also discussed with the Risk Analysis and Policy Priorities (RAP) revision team which, apart from ESRB staff, consists of two people from the AWG and two from the IWG. The purpose of this team is to ensure that the final assessment takes on board the views from the two sub-groups. The process includes the ECB as well as the ESAs (EBA, EIOPA and ESMA) at various stages. The ECB plays a central role, with members of the Directorate General Macroprudential Policy and Financial Stability preparing a quarterly surveillance note as well as a presentation for both the Advisory Technical Committee and the General Board.

This process results in an assessment where risks are grouped into three categories: systemic risk (yellow), elevated systemic risk (orange) and severe systemic risk (red). Figure 3 provides a recent example.

[11] We note that, while there is occasional consultation with the Advisory Scientific Committee, this is not a part of the regular quarterly process. However, the Chair of the Advisory Scientific Committee regularly attends the meetings of the Advisory Technical Committee where these risks are discussed and, alongside the Vice-Chair of the Advisory Scientific Committee, is a voting member of the ESRB.

Figure 3
ESRB risk assessment



Source: ESRB Secretariat, September 2024.
Note: Yellow denotes systemic risk, orange elevated systemic risk and red severe systemic risk.

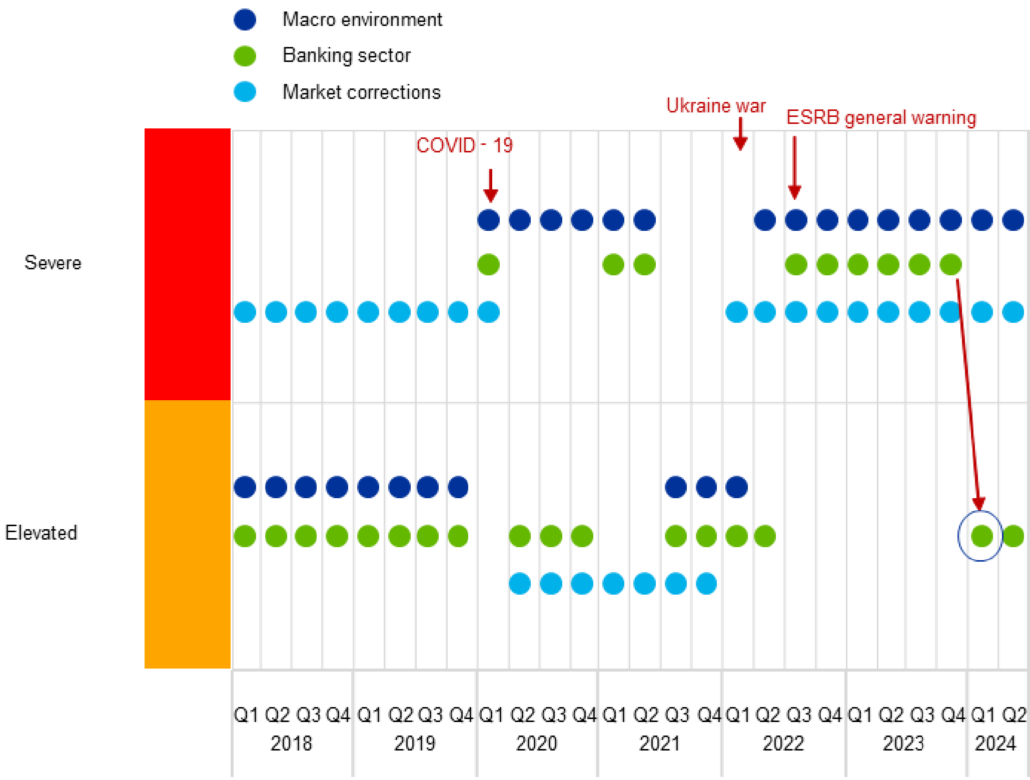
We reiterate that the role of the ESRB is to mitigate systemic risk by identifying vulnerabilities that might justify the adjustment of macroprudential policy. Looking at this list, we note two things. First, colour codes may mix shocks and vulnerabilities. For example, a disorderly market correction is a shock, while deteriorating asset quality and profitability is a vulnerability. Second, the risks labelled “cross-cutting” are in many ways persistent. We will return to these issues below.

To continue with the description, the process necessarily has substantial inertia. In particular, once upgraded to elevated or severe, risks tend to remain at these levels for an extended period of time. This is because most things in the financial system only change slowly, but it also reflects the possibility that ESRB members are overly concerned about missing any risks materialising. Further conceptual work is needed to clearly define the classification and intensity of risks.

The chart 1 below gives a sense of persistence in the risk assessments over a period of 28 quarters from the beginning of 2018 to mid-2024. There are clearly few material changes.

Chart 1

Evolution of the ESRB risk assessment



Source: ESRB Secretariat.

We can contrast the frequency of changes with that of the terrorist threat level system implemented in the United States from March 2002 to April 2011.[12] Three of the five colours in the system were used: red (severe), orange (high) and yellow (elevated). During the eight-year period it was in use, the threat level was only red for a period of one month. In addition, there were a total of six changes between orange and yellow before the system was discontinued. Two differences stand out. First, the highest threat level is used very rarely. Second, there are nearly twice as many changes.

This process raises several specific questions. Starting with the colour-coded systemic risks:

- What are the conditions under which individual risks are upgraded or downgraded?
- Under what conditions would any of the items be removed from the list?
- How does something get added to the list?
- Are the risk levels (red, orange, yellow) relative or absolute?
- Should the highest risk level normally be empty?

[12] See **Homeland Security Advisory System**.

- Should the risk assessment separate shocks from vulnerabilities?

Turning to the cross-cutting risks, we have similar questions:

- Under what conditions would a risk be removed from the list?
- How does a risk get added to the list?

In our view, the predominantly narrative approach currently in use serves the ESRB well. That said, we see the possibility to formulate and implement a more analytical approach that provides further improvements to the risk assessment framework at the same time as providing answers to these and other questions. In fact, the seeds of such an approach already exist in the ongoing work of the ESRB.

2.2 Towards a holistic approach to risk assessment

The comparative advantage of the ESRB is its focus on risks that are both cross-sectoral and cross-border. A cross-sectoral approach to risk assessment enables the ESRB to analyse interactions, interdependencies and spillovers. Moreover, as activities shift out of the banking system and connections become less transparent, it will become more challenging to identify and assess both vulnerabilities and potential triggers for financial stress.

It is essential that the ESRB take a cross-country perspective in order to ensure that it considers the diverse macroeconomic and financial environment of all EU Member States, as well as allow for the identification of systemic risks that originate in a single country. By analysing data and trends from across Member States, the ESRB can detect vulnerabilities that might be missed when looking at individual countries in isolation.

Given its broad membership and mandate to oversee risks in the EU financial system, the ESRB is particularly well-suited to act as a hub, bringing together a wide range of perspectives to assess emerging systemic risks. In fact, many of the risks that currently threaten the financial system require knowledge that extends beyond the traditional fields of economics and finance. For example, financial instability could be triggered by shocks arising from climate change, artificial intelligence, cyber attacks or geopolitics, to name the most prominent. To assess such shocks, the ESRB needs to establish networks that bring together relevant expertise that it can use to feed into its risk assessments.

The ESRB is at the forefront of risk monitoring and the development of macroprudential policy beyond the banking sector. Since setting out its strategy in 2016, the ESRB has identified fragilities arising from a variety of non-bank financial intermediaries (NBFIs). This includes a focus on the systemic risks and vulnerabilities arising from central counterparties, investment funds and insurers, among others. This framework provides information that helps the co-legislators act to ensure the stability of the system. The ESRB's activity-based approach to systemic risk assessment forms a critical part of this system-wide framework.

Looking ahead, the ESRB should continue applying and strengthening its system-wide approach[13] to ensure that its members are able to act on the insights gained from the enhanced risk assessment. Given its mandate and broad membership, the ESRB is in a particularly strong position to assess the growing role of NBFIs in the EU financial system. With this in mind, we believe it is important for the ESRB to continue devoting resources to understanding the role of NBFIs in the intermediation system, as well as their connections to traditional banks. Such efforts would mitigate the risk of policy measures being circumvented as activities migrate across different types of entity, including outside the regulatory perimeter.

This leads us to consider two analytical tools that could help to enhance ESRB risk assessments, which are in various stages of development at the ESRB. The first is a system-wide stress test and the second a measure of macroprudential stance. The second is quite far advanced, with the analytical work for banks largely complete.[14] In our view, the ESRB should step up efforts to explore the practicalities of expanding the scope and implementation of these new tools as they clearly complement the current methods for identifying and assessing risks.

Regarding the first tool, creating a capacity for system-wide stress testing begins with mapping the financial system, building on the ESRB's work on NBFIs.[15] Work that is currently under way focuses on creating a set of balance sheets and linkages for all households, financial institutions and financial markets. We can think of this map as a series of layers, one for each Member State and one for the rest of the world. In each layer, there are banks, investment funds (including money market funds), insurance corporations, pension funds, other financial institutions, non-financial corporations, households, governments, central banks, equity markets, repo markets and derivatives markets. Liabilities for one group or institution are always assets for another; this map shows a series of linkages. We reproduce Figure 4 from Anderson and Sánchez Serrano (see below for reference) to provide a sense of what one layer of such a map looks like.

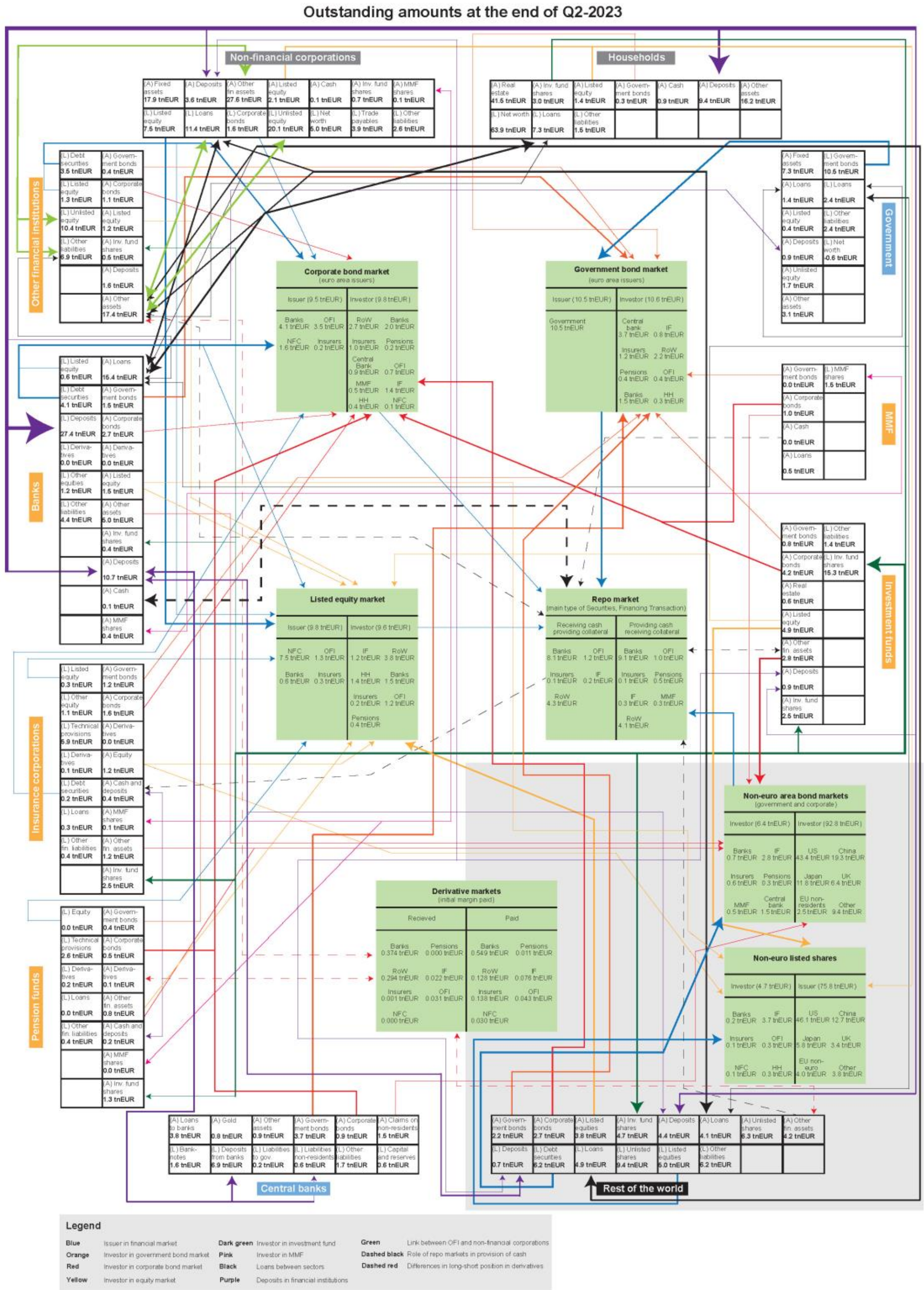
[13] See "**A system-wide approach to macroprudential policy**", ESRB, November 2024.

[14] See "**Improvements to the ESRB macroprudential stance framework**", *Report by the Contact Group on Macroprudential Stance of the ESRB's Instruments Working Group (IWG)*, ESRB, January 2024.

[15] See, for example, "**Macroprudential policy beyond banking: an ESRB strategy paper**", ESRB, July 2016; "**Enhancing the macroprudential dimension of Solvency II**", ESRB, February 2020; **Recommendation of the European Systemic Risk Board of 6 May 2020 on liquidity risks in investment funds (ESRB/2020/4)**; **Recommendation of the European Systemic Risk Board of 2 December 2021 on reform of money market funds (ESRB/2021/9)**; the ESRB's letters to the co-legislators on this topic: "**Letter to Members of the European Parliament on the EMIR review**", 20 March 2023; and the "**Letter to the Council Working Party on the EMIR review**", 20 March 2023.

Figure 4

Map of the financial system



*Source: Anderson, I. and Sánchez Serrano, A., "**A map of the euro area financial system**", Occasional Paper Series, No 26, ESRB, August 2024.*

This risk map can serve as the starting point for a system-wide stress test. Recall that systemic risks arise from a combination of increases in the likelihood of larger shocks and heightened vulnerabilities. We can use a system-wide stress test to identify both. Conventional stress testing entails the development of adverse scenarios – large negative shocks – which are then applied to the balance sheet of an individual financial institution. In the case of a stress test for bank capital, these shocks influence combinations of assets and liabilities to determine the outcome for the net worth of a given institution.

Conceptually, we can imagine something similar for the system as whole using a map like the one in Figure 4. Furthermore, we can proceed in two ways. First, we can examine whether the system is more fragile for a given scenario. This addresses the potential for vulnerabilities to increase. Second, we can ask how large a shock needs to be – how adverse the scenario – to create a certain amount of stress. In both cases, we would be able to identify the weakest link in the system. This could ultimately lead to the development of a set of indicators that would populate a risk dashboard.

Approaches to conducting system-wide stress tests already exist.[16] Given the analytical challenges inherent in devising system-wide stress tests for the EU as a whole, such a methodology would be developed and implemented gradually. As a first step, the ESRB could build on its unique vantage point to increase coordination among the ongoing sector-specific risk assessments by aligning scenarios and assessing second-round effects of those results, as has been done in the Fit-for-55 exercise, for example.[17] Over the medium to long term, the ESRB could aim to include a top-down system-wide stress testing tool in its analysis. Work is already under way on a system-wide liquidity stress test. Moreover, the ESRB could build on the models developed by the ECB. Importantly, it is in principle possible to cross-check the results of system-wide stress tests with vulnerabilities identified by the sectoral stress tests conducted by the ESAs, and by national authorities. In this way, the results of the system-wide stress test can guide both the country risk assessments and the EU-wide systemic risk assessment. Furthermore, the vulnerabilities identified can form the basis for warnings and recommendations.

To summarise, developing a holistic approach to risk assessment goes hand in hand with linking the three statutory responsibilities of the ESRB: the publication of a risk dashboard, the performance of a risk assessment and the issuance of warnings and recommendations.

Importantly, making significant changes to the contribution of the ESRB to EU policymaking may require amendments to the ESRB Regulation to give it a legal mandate to conduct system-wide stress tests (in the same way as the ESAs are mandated to conduct sectoral stress tests).

We note that prior to such statutory and regulatory changes being implemented, it may be prudent to reflect on the capacity of the ESRB to perform system-wide stress tests in terms of both data access and resources. The analytical depth of any system-wide stress test may be seriously compromised if the data access discussed in Chapter 4 is not forthcoming. To reiterate, the ESAs have access to institution-level data to conduct their stress tests, which often necessitate a

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16 See, for example, Sydow, M. et al., "**Shock amplification in an interconnected financial system of banks and investment funds**", *Journal of Financial Stability*, Vol. 71, April 2024.

17 See **Transition risk losses alone unlikely to threaten EU financial stability, "Fit-For-55" climate stress test shows**, *Press release*, EBA, 19 November 2024.

separate data collection exercise.[18] Second, implementing system-wide stress tests would require the resources allocated to the ESRB to be either increased or redirected, with realistic expectations on what can be achieved. One potential redirection of resources could be to reduce the risk assessment frequency to half-yearly, which could also address issues around short-sightedness and excessive emphasis on financial market events. To this end, in Chapter 5 we recommend a comprehensive assessment of tasks and required resources.

We also believe that ESRB member institutions should work to develop a macroprudential stance framework in the medium term. Such a framework could be a useful tool in the discussion of macroprudential policies at both the EU and national levels, providing a common language as well as metrics that are free of common behavioural biases. The work could start with the intermediate objective "mitigation and prevention of excessive credit growth and leverage", where the current framework is already most advanced. As a first step, the framework could be fully operationalised to include both a set of indicators (which allows for an intuitive comparison of risks, resilience and policy) and the growth-at-risk approach. Next, the framework could be extended to cover non-bank lenders and relevant policy measures that could be applied to them. Finally, it could incorporate cross-border lending, including from outside the EU. Once the macroprudential policy stance framework includes credit growth and leverage, it will be possible to consider the other intermediate objectives of macroprudential policy.[19]

We agree that other sources of information will always be needed alongside strictly model-based assessments. The risk landscape is complex, and emerging threats (not necessarily captured by standard analytical tools) can have a material impact on the macroprudential stance at any time. For instance, the various channels through which geopolitical risk and cyber threats may lead to financial instability will always be difficult to capture in such models. Thus, efficient information sharing across expert institutions, a well-developed market intelligence framework and improved scenario analysis combined with human judgement will always remain an integral part of the macroprudential policy toolkit.

Using the enhanced macroprudential stance framework, the ESRB will be able to improve its holistic assessment of a country's macro-financial imbalances. Importantly, by sharing its country assessments, the ESRB could contribute to the EU's macroeconomic imbalance procedure during the European Semester.[20] Thus, macroprudential policies would join fiscal, industrial and trade policy in a broader discussion on macroeconomic policies in the EU. Such an endeavour may feed into the work of the European Commission and, ultimately, inform the discussions in the Council of the European Union. Based on the initial identification of country-level macroeconomic imbalances by the European Commission, the ESRB could identify cases where those imbalances might become a source of systemic financial risk (e.g., sovereign-bank feedback loop, housing and credit developments, etc.), but more importantly whether the implementation of macroprudential (and other) policies is expected to mitigate the identified imbalances.

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[18] See, for instance, **2025 EU-wide stress test - Templates**.

[19] These include (i) mitigating and preventing excessive maturity mismatch and market illiquidity, (ii) limiting direct and indirect exposure concentrations, and (iii) limiting the systemic impact of misaligned incentives with a view to reducing moral hazard.

[20] See **The European Semester** on the European Commission's website.

Finally, building an effective and robust risk assessment framework requires various well-known behavioural biases to be overcome. The most important of these are anchoring bias, confirmation bias, loss aversion bias and herding bias. These create various challenges. The first two, anchoring bias and confirmation bias, create a tendency for risk assessments to be more persistent. A form of the third − loss aversion bias − leads to a fear of missing some risk that eventually materialises, resulting in an overly lengthy (and generally unhelpful) list of possibilities. And herding bias leads to a desire for consensus among participants, creating a type of race to the bottom in which risk assessments are based on the lowest common denominator.

While it is difficult to overcome these biases completely, it is possible to make progress. The first step is to move away from a purely narrative approach, thus reducing the role of judgement in the risk assessment. Doing this requires the creation of an agreed analytical framework based on a set of indicators and thresholds. Biases can be reduced if stakeholders all agree on the structure and implementation of the framework. It would be equally important to be transparent about the analytical framework; we come back to this in the next chapter, which contains recommendations on communication.

Another way to reduce bias is to seek the views of people outside the statutory membership of the ESRB. The current process mainly includes all ESRB member organisations – national central banks, national supervisory authorities, the ESAs, the ECB, ECB Banking Supervision, the SRB and the European Commission. The contribution from the ASC is mainly conceptual, as its members are not so much focused on conjunctural issues. Therefore, to obtain a broader set of views of the financial stability landscape in the EU, the ESRB could explore expanding its consultations to encompass market participants and risk managers at financial institutions, while being aware of their potential conflict of interest.[21] The ESRB Regulation already allows for this. The ESRB could also participate in outreach activities of the ECB and the ESAs; findings and insights from such market intelligence activities could be presented more explicitly and considered in the work of ESRB workstreams.

All the above considerations bring us to the first set of recommendations:

Recommendation 1: To further enhance its risk assessment, the ESRB should develop and implement a framework that provides a holistic assessment of systemic risk in the EU. The ESRB is in a unique position to monitor and assess systemic risks and vulnerabilities across the entire EU financial system. Understanding how risks and vulnerabilities are distributed throughout the financial system enables authorities to address them effectively and allows market participants to allocate risk more efficiently. To facilitate this, the ESRB should employ state-of-the-art methods to create, maintain and employ a set of analytical tools that ensure assessments are as accurate and credible as possible. In the medium to long term, these tools should enable the ESRB to conduct top-down system-wide stress tests covering the entire EU financial system. Such stress tests would allow the ESRB to identify vulnerabilities at an early stage by enabling it to map how specific shocks would propagate within the EU financial system, across sectors, markets and counterparties. In the short to medium term, the ESRB could integrate current sectoral stress tests conducted by the ESAs by assessing possible spillover and contagion effects across different

21 For example, market participants could minimise the severity of a risk in order not to draw attention from the ESRB, thereby avoiding regulatory action that could directly affect them.

financial institutions. Eventually, the ESRB-led, system-wide top-down stress tests would allow the ESRB to test a broader range of scenarios using available data. This goal should be recognised in the revised ESRB Regulation.

Recommendation 2: To capture emerging risks and the growing role of non-bank financial intermediaries (NBFIs) in the EU financial system, the ESRB should apply and hone its system-wide approach to macroprudential policy. The ESRB is well placed to explore emerging risks that may require EU-wide efforts to be identified, assessed and managed. This will help ensure that the ESRB and its members are able to act on the insights gained from the enhanced risk assessment set out in Recommendation 1. We also believe it is essential that the ESRB continue devoting resources to understanding the role of NBFIs in the intermediation system. This means continuing and expanding the support for the ongoing ESRB work in terms of monitoring the systemic risks that may arise both from the NBFIs alone, as well as from the interconnections between banks and non-banks. By integrating this work into the holistic risk assessment set out in Recommendation 1, these efforts would mitigate the risk of policy measures being circumvented as activities migrate across different types of entities, including outside the regulatory perimeter.

Recommendation 3: The ESRB's views on a Member State's macroprudential policy stance could feed into the analysis under the EU's macroeconomic imbalance procedure. The ESRB should work to further enhance metrics for assessing the macroprudential stance of individual jurisdictions. These could inform the assessment of a country's macro-financial imbalances and the potential mitigating impacts of macroprudential policies. In this respect, the ESRB's regular country assessments may feed into the work of the European Commission and, ultimately, inform the macroeconomic imbalance procedure from the macro-financial perspective. Such a role could be recognised in the revised ESRB Regulation.[22]

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[22] **Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances** already assigns a role to the ESRB, notably in the development of the scoreboard (Art. 4), in in-depth reviews (Art. 5) and in the opening of excessive imbalances procedures (Art. 7).

3 Further strengthening communication of macroprudential policy

Effective macroprudential policy requires strong communication. But communicating about financial stability is always extremely challenging. First, communicating on risks to financial stability can, in extreme cases, trigger a panic, if not done with prudence. Second, the longer a policy is successful, the less people are willing to believe they should bear the necessary costs. In other words, unlike inflation or growth, there is no simple, transparent and observable measure of financial stability beyond the absence of instability. This means that the public and their elected representatives will balk when asked to pay the price in the form of perceived increases in costs and limits on credit to households and firms, or increased costs of transactions in financial markets, among other things. Nevertheless, these policies are essential. And in a democratic society, it is incumbent upon policymakers to explain them.

The complexity of the EU macroprudential architecture adds to these communication challenges. With multiple players and shared responsibilities between the EU and national authorities, it is often unclear who is responsible for what. This is especially true in the case of the ESRB, where all but a few members have other important official responsibilities. For example, the ESRB Chair is also the President of the ECB. While this is intended to lend credibility to the ESRB, it can also blur its messages. Is a particular message coming from the ESRB and its General Board or the ECB and the restricted membership of its Governing Council? Additionally, ESRB members do have their own communication strategies, including on financial stability, sometimes expressing views that may diverge from the official position of the ESRB. While the presence of divergent views is not inherently negative and does not hamper ESRB decision-making, it can undermine ESRB credibility if it is not well explained.

Communication of risks both aids the ESRB in meeting its overarching objective of identifying and mitigating systemic risks to financial stability in the EU and enhances accountability. By creating an awareness of risks and an understanding of the need to take mitigating action, strong communication improves effectiveness of macroprudential policy. It also facilitates sufficient scrutiny by all relevant stakeholders, including the European Parliament.

In accordance with the EU macroprudential architecture and the hierarchy of mandates, ESRB messages are targeted primarily at both financial sector entities and relevant authorities, including national supervisors, macroprudential authorities, governments, the ESAs, the SRB and the European Commission. As emphasised above, the ESRB itself has only soft law powers. This means that it is reliant on others to implement its policy recommendations or, in the case of the European Parliament, to scrutinise them. At the same time, warnings and recommendations are key communication tools for the ESRB. Some messages, like the general warning issued in September 2022, need to reach financial sector entities in a manner that leads to appropriate changes in risk management. This means that executives in financial institutions must have a clear understanding of why and how the ESRB acts.

Risk communication and accountability necessitate an adequate degree of transparency. Transparency builds credibility, trust and a reputation for predictable, consistent policymaking. The ESRB achieves this by publishing almost all documents related to the General Board's discussions online. And, during periods of stress, publications are relatively frequent. At the onset of the pandemic, for example, the ESRB communicated on a monthly basis, offering comprehensive assessments of risks and policy priorities.

3.1 Current process

Risk communication is naturally the focal point of ESRB activities. Since it was set up, the ESRB has used various means, including warnings and recommendations, to communicate the main risks to financial stability that it sees in the EU. This involves various channels. Following each quarterly General Board meeting, a press release includes a concise, forward-looking description of financial-system vulnerabilities and risks to financial stability. In line with regulatory requirements, a risk dashboard is published four times a year. Furthermore, the ESRB's colour-coded risk assessment is published once a year in the ESRB Annual Report.

It would be possible to improve the connection between the quantitative and qualitative indicators in the risk dashboard on the one hand and the colour-coded risk assessment on the other. A consistent link between the indicators and colour-coded risk assessments to the warnings and recommendations would further enhance the effectiveness of the entire framework for monitoring and mitigating systemic risk.

However, it may be challenging for external stakeholders to locate the relevant ESRB risk assessment on the ESRB website or across its various publications. The extremely modest numbers of views of risk publications seem to confirm this. Table 3 summarises.

Table 3
Views of systemic risk publications

ESRB			ECB		
Quarterly press release of the ordinary meetings of the General Board	Quarterly risk dashboard	ESRB Chair's opening remarks at the ESRB annual conference	Annual Report	Financial Stability Review (half-yearly)	Governing Council statement on macroprudential policies (ad hoc)
354	316	349	294	7,077	853

Source: ESRB Secretariat.
Notes: Cut-off date for website analytics 31 October 2024. ECB/ESRB views include non-unique views, external views only (excludes views from within the ECB/ESRB) and only those who accepted the cookie policies. Quarterly press release: the average number of views of the last four press releases from publication to cut-off date. Opening remarks at the annual conference: views from publication on 26 September 2024 to cut-off date. Annual Report 2022: views over one year. ECB Financial Stability Review: May 2024 edition, views from publication to cut-off date. Governing Council statement: views from publication on 28 June to cut-off date.

3.2 Further improving communication

We believe that improving the accessibility and coherence of the ESRB’s risk communications could enhance stakeholders’ understanding of risk and the necessary policy responses. This, in turn, should enhance the overall effectiveness of the macroprudential framework. Ideally, changes in the economic and financial environment that are evident in the risk dashboard indicators would lead to the expectation of a change in the ESRB risk assessment, which would trigger a pre-emptive action by relevant authorities or financial sector entities. Transparency and understanding of the framework would mean that the threat of action would suffice.

We believe that a number of simple refinements can move us toward this ideal framework. The first step is publication of analytical methods. Second, the current risk dashboard could be modified to make clear the linkage to the risk assessment. Third, the risk assessment itself could be published more frequently. And finally, there should be an increase in outreach. The Group suggests that the First Vice-Chair participates in outreach activities, as this would help better distinguish ESRB communications from those of the ECB. In cases where confusion is unlikely, ESRB members should be able to speak in public in their ESRB capacity.

This brings us to the next recommendation:

Recommendation 4: Strengthening communication on financial stability. The ESRB should publish a concise, biannual systemic risk monitor at the beginning of the first and third quarters of each year. This monitor should present the ESRB’s assessment of financial stability risks within the EU, highlight the latest topical analyses of systemic risks and discuss new developments in macroprudential policy. Its main goal is to provide a comprehensive and concise systemic risk assessment of the EU financial system, complementing and drawing from the existing periodic publications of the ESRB. It could also promote forthcoming ESRB publications. To increase outreach, the First Vice-Chair of the ESRB could highlight the findings from the systemic risk monitor at dedicated communication events. To further improve the transparency of ESRB assessments, the Secretariat should publish background documents explaining the methodology used in the risk assessments.

4 Access to all relevant and necessary information

To meet its objective, the ESRB requires access to all relevant and necessary information. In practical terms, this means access to data. And, to provide a holistic evaluation of the systemic risks facing the entire EU financial system, this means access to comprehensive, granular data on financial institutions, non-financial corporations, households and governments. That is, the ESRB needs to develop a map of the financial system. We discussed this in Chapter 2, as such a map is an essential starting point for any risk assessment. Here, we focus on the information, i.e., the data, required to construct such a map.

4.1 Current status

Currently, the ESRB benefits from access to a wide range of data. Some data are available immediately and automatically as soon as they are processed, while other data are only available with a lag and upon request. Table 4 summarises what is currently available to the ESRB.[23] The availability of these data is constrained – in legal terms – only by reporting frequency and lag and – in technical terms – by the availability of appropriate data infrastructures and skillsets to analyse the data. Importantly, immediate and automatic access makes it possible to perform systemic risk assessments through comprehensive analyses before risks materialise and without the need to determine in advance where, and in what specific ways, such risks could emerge.

[23] The ESRB's access to information is defined under both the ESRB Regulation – adopted in 2010 and not amended significantly in this regard since – and specific EU legislative acts. The ESRB Regulation sets out the general rules for information sharing, including between the ESCB and the ESRB, as well as a detailed – and rather complex – procedure regulating the ESRB's access to information available to the ESAs. Furthermore, specific EU legislative acts grant the ESRB direct or indirect access to defined datasets on various activities or sectors.

Table 4
Immediate and automatic access for the ESRB to specific datasets

Legal basis		Dataset
Specific EU legislative acts	EMIR	Derivatives
	SFTR	Securities financing transactions
	AIFMD	Alternative investment funds
	STS	Securitisation
Data available via ECB	AnaCredit	Credit instruments
	SHS	Securities holdings
	AnaCredit	Securities database

Source: ESRB Secretariat.
Note: EMIR – Regulation (EU) 648/2012 on OTC derivatives, central counterparties and trade repositories; SFTR – Regulation (EU) 2015/2365 on transparency of securities financing transactions and of reuse, AIFMD – Directive (EU) 2011/61/EU on alternative investment fund managers; STS – Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation; AnaCredit – Regulation (EU) 2016/867 of the ECB on the collection of granular credit and credit risk data (ECB/2016/13); SHS – Securities Holdings Statistics; CSDB – Centralised Securities Database.

Some key datasets are only available from various authorities in response to justified ad hoc requests. In other words, there is only lagged access rather than immediate and automatic access. Importantly, the ESRB only having lagged access applies to granular data collected by the ESAs within structured, regular supervisory reporting frameworks such as (i) COREP/FINREP data reported under CRD/CRR,[24] (ii) data reported under Solvency II,[25] and (iii) data reported under MiFID II[26] and MiFIR.

The current procedure for obtaining data from the ESAs is as follows. First, the ESRB needs to explain the systemic relevance and necessity for obtaining data on the individual financial institution concerned. If the ESRB requests information that is not in summary or aggregate form, the request should explain why data on the individual financial institution concerned is deemed to be systemically relevant, and necessary, considering the prevailing market situation. As evidenced by

[24] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ, L 176, 27.6.2013); Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ, L 176, 27.6.2013).

[25] Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ, L 335, 17.12.2009).

[26] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ, L 173, 12.6.2014).

the 2023 banking turmoil, distress can be triggered by a single institution. Consequently, the need to explain the relevance of data on individual financial institutions seems to be redundant. Second, to ensure that the request is justified and proportionate, the ESRB is required to consult on each request for information of a supervisory nature which is not in summary or aggregate form. If the ESA does not consider the request to be justified and proportionate, it might ask for additional justification. But once such additional justification is provided, the information should be transmitted to the ESRB. As emphasised in the ESRB Regulation, the interconnectedness of financial institutions and markets implies that the monitoring and assessment of potential systemic risks should be based on a broad set of relevant macroeconomic and micro-financial data and indicators, including balance sheet data. Consequently, the obligation to justify each request seems to be unnecessary. Finally, as an ultimate safeguard, if the requested information is not available or not made available in a timely manner by the ESAs, the ESRB can directly address the request to Member State authorities, but this has never been necessary. According to the ESRB Regulation, if the information is not available or not provided in a timely manner, the ESRB may request the information from the ESCB, the national supervisory authorities or the national statistics offices. The co-legislators essentially included safeguards in the legislation to ensure that the requests for individual supervisory data would be justified and – at the same time – safeguards to ensure that – ultimately – the ESRB would receive the data, if necessary, directly from the Member States.

While cooperation with the ESAs is excellent and the ESRB's data requests have always been fulfilled, the process is cumbersome and slow. We note that the 2013 High-Level Group on the ESRB Review highlighted that, over time, there would be a case for streamlining these arrangements.

Lagged access to data clearly hampers the ESRB's ability to monitor and identify systemic risks in a timely manner. The limitations of the cumbersome framework that make timely monitoring harder are becoming increasingly evident. Two examples serve to illustrate this point: the market turmoil in March 2020 and March 2023, and the developments in the energy market following the Russian invasion of Ukraine. In the first case, the lack of immediate and automatic access to bank and insurer balance sheet data meant that the ESRB was unable to gauge the interplay between asset-side and liability-side risks both during the March 2020 market turmoil and, more recently, following the interest rate hikes and subsequent instability in March 2023. In the second case, the lack of immediate and automatic access to pre-trade data (reported under MiFIR) during the energy crisis in the winter and spring of 2022 meant that the ESRB was unable to analyse developments, including possible deficiencies in financial market infrastructure.

It is essential that both the ESRB and the ESAs quickly analyse risks from all types of external shock. During critical periods, when resources are scarce, there is little time to build a bureaucracy for data access. Additionally, access to data on individual institutions is crucial. While one financial entity may not be systemically important, a group of institutions that are sufficiently similar can collectively pose significant financial stability risks, as the 2023 US banking sector turbulence demonstrated. Furthermore, the growing importance of NBFIs, along with their connections to the banking sector, underscores the need for improved visibility into this set of institutions. The transparency of data from NBFIs needs to be enhanced if we are to have a sufficiently deep and thorough understanding of risks to the financial system.

Finally, we note the continuing advances in the analytical skills of ESRB member institutions, especially related to their ability to process large quantities of data. Numerous institutions are developing advanced capabilities and cutting-edge tools, while others have unique, in-depth knowledge of specific market segments and sectors. By fostering greater data and knowledge sharing across its member institutions, the ESRB can develop a more cohesive, system-wide understanding of financial stability risks.

4.2 Enhancing data and knowledge sharing

For macroprudential policy authorities to successfully meet their financial stability objective, they need a monitoring system that provides an accurate and timely assessment of systemic risk. This, in turn, means having immediate and automatic access to the data they need to map the interdependencies between financial intermediaries as well as between these intermediaries and the non-financial sector. As discussed in Chapter 2, such a map makes it possible to monitor risks and spillovers and quantify the sensitivity of these interdependencies with developments in markets or after specific exogenous or endogenous shocks. This is not possible without continuous access to granular data. Consequently, we put forward the following recommendations:

Recommendation 5: The ESRB Regulation should be amended to introduce the immediate and automatic sharing of granular data between the ESAs and the ESRB. The ESRB's analytical work and monitoring of an increasingly complex, interconnected and evolving financial system requires timely and continuous ex ante access to granular data by the ESRB and its member institutions. Access that is immediate, automatic and continuous, as soon as the data are collected and processed, is crucial for analysing the financial system effectively and identifying risks and vulnerabilities as they materialise.

Consequently, we support the position of the General Board as expressed in the letters of 19 August 2024 from the ESRB to the EU co-legislators regarding the ongoing legislative process on certain reporting requirements in the fields of financial services and investment support.[27] In particular, we support the European Parliament's proposal to introduce the principle of data sharing by default for all the ESAs.[28] Under the Parliament's proposal, the ESRB would have access to the information it requires without undue delay.

Finally, we believe that it is important to foster additional knowledge sharing among ESRB member institutions. Since a timely holistic view of the system is crucial for identifying and modelling potential contagion channels effectively, there needs to be investment into both analytical capacity and data. Further improvements in knowledge sharing would underpin the use of state-of-the-art

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[27] **ESRB letter to the European Commission**, **ESRB Letter to the Council of the European Union**, **ESRB letter to the European Parliament**.

[28] See Recital 5c and Article 1(1a) of the **draft European Parliament legislative resolution on the proposal for a regulation of the European Parliament and of the Council amending Regulations (EU) No 1092/2010, (EU) No 1093/2010, (EU) No 1094/2010, (EU) No 1095/2010 and (EU) 2021/523 as regards certain reporting requirements in the fields of financial services and investment support** (Report - A9-0026/2024), which amend Article 15 of 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.

analytical tools to provide a comprehensive view of systemic risk. With this in mind, we make the following recommendation:

Recommendation 6: The ESRB should establish a dedicated forum for knowledge sharing among member institutions. In collaboration with the Advisory Scientific Committee, this forum should facilitate the exchange of insights and best practices, as well as the development of new analytical tools for the construction of systemic risk indicators.

5 Further issues

We turn now to a few additional issues where we believe further improvements are possible.

We begin with governance. The Group believes that ESRB decision-making – and governance in general – is well regulated and does not require legislative changes. In this regard, the tasks of the head of the ESRB Secretariat are also well defined.[29] At the same time, the Group noted that most high-level officials have fixed terms of office and in many cases are subject to term limits. This is an essential element of good governance, providing regular opportunities for fresh perspectives and enhanced accountability. Looking at the voting members of the ESRB, for example, virtually all have fixed terms. Similarly, the heads of the secretariats of the standard-setting bodies such as the Financial Stability Board and the Basel Committee on Banking Supervision also have fixed terms of office. Furthermore, the heads of such secretariats generally have the title "Secretary General". It is our view that turnover in this position, as well as an appropriate title, are important elements in the success of these bodies.

With that in mind, we recommend:

Recommendation 7: The ESRB Secretariat should be led by the (re-titled) Secretary General appointed by the General Board for a fixed term of five years, renewable once. The Group notes that such a structure is consistent with current practices in international standard-setting bodies, including the Financial Stability Board and the Basel Committee on Banking Supervision. It is also consistent with the practice whereby all members of the General Board are subject to term limits. These changes should be recognised in the revised ESRB Regulation and in a revised Council Regulation conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board.[30]

Finally, our recommendations aimed at enhancing the financial stability framework in the EU may have resource implications for the ESRB. The objectives set by the Group can be achieved using various approaches and over different timeframes. Ultimately, the decision on the implementation plan rests with the ESRB General Board, while legislative changes would require decisions by the European Commission and the EU co-legislators. With this in mind, we make the following recommendation:

Recommendation 8: The ESRB Secretariat should undertake a comprehensive screening of resource needs against our recommendations, with a view to shifting resources to tasks associated with risk assessment. This assessment should determine whether reallocating existing resources can achieve the objectives set by the Group or whether additional resources are necessary. The findings from this exercise should be presented to the ESRB's Steering Committee.

[29] According to Article 4 of Regulation EU 1096/2010, the ESRB's Chair and its Steering Committee shall give directions to the head of the Secretariat on behalf of the ESRB. According to Article 3a of Regulation 1092/2010, such directions may refer to (a) the day-to-day management of the Secretariat, (b) any administrative and budgetary issues related to the Secretariat, (c) the coordination and preparation of the work and decision-making of the General Board, (d) the preparation of the annual ESRB programme proposal and its implementation, and (e) the preparation of the annual report on the ESRB's activities and the reporting to the General Board on the implementation of the annual programme.

[30] **Council Regulation (EU) No 1096/2010 of 17 November 2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board**, Article 3(2).

Based on these findings, the Steering Committee should prepare a detailed master plan for the approval of the General Board in the first half of 2025. The Secretariat should also screen all instances where EU legislation requires the ESRB to provide opinions, offer consultations or engage in some other capacity, including in its reciprocation framework. It should assess the importance of these capacities with a view to the ESRB recommending to the European Commission and the co-legislators possible legislative changes that could in turn streamline procedures and reduce the burden on the ESRB.

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For specific terminology please refer to the **ESRB glossary** (available in English only).

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