

## **Vítor Constâncio: The establishment of the European Systemic Risk Board – challenges and opportunities**

Introductory remarks by Mr Vítor Constâncio, Vice-President of the European Central Bank, at the Eurofi Financial Forum plenary session 14 on “Implementing the de Larosière Agenda”, Brussels, 29 September 2010.

\* \* \*

The European Systemic Risk Board (ESRB) will be established in January 2011 as the body responsible for the macro-prudential oversight of the EU financial system. It is mandated to actively monitor the various sources of risk to financial stability in the EU – across Member States and financial sectors – with due consideration of also global developments. It should identify the risks and assess how they could impact the financial system so as to prioritise them. In this context, systemic risk is defined in legislation on the ESRB as “a risk of disruption in the financial system with the potential to have negative consequences for the internal market and the real economy.” The ESRB should issue warnings on significant systemic risks and issue recommendations for policy action to address such risks.

The creation of the ESRB is a response to one of the key lessons of the financial crisis regarding the need for an enhanced macro-prudential oversight of the financial system as a new policy function. The value added of a macro-prudential function to safeguard financial stability is its focus on detecting, assessing and addressing vulnerabilities that arise from the interconnections between financial institutions and markets, as well as from macroeconomic and structural developments, including financial innovation. It will thus take a system-wide perspective, which will complement micro-prudential supervision, whose purpose is to assess the soundness of individual financial institutions.

The design of a framework for the conduct of macro-prudential oversight as new policy function involves significant challenges, but also represents a unique opportunity for reinforcing the arrangements to safeguard financial stability. In particular, the following three main components should underpin a macro-prudential framework:

- first, the necessary conditions for an enhanced monitoring of the financial system as a whole, in order to identify potential threats to financial stability;
- second, the instruments for translating financial stability assessments into concrete policy action aimed at enhancing the resilience of the financial system; and
- third, appropriate governance structures, including mechanisms for ensuring an effective interplay between, and coordination of, macro and micro-prudential responsibilities.

As regards the first, one of the basic prerequisites for an effective macro-prudential function is the availability of a comprehensive set of information on the financial system that can be used for the detection and assessment of systemic risk. This implies the attribution of specific tasks to the macro-prudential authority with respect to accessing and collecting such information, which may include macro-economic and macro-financial data and indicators, as well as market intelligence.

In this regard, the European Supervisory Authorities (ESAs), the European System of Central Banks, the Commission, the national supervisors and the national statistical authorities have the obligation to cooperate closely with the ESRB and to provide all the information necessary for the fulfilment of its tasks. In addition, the ESRB may request the ESAs to supply information also on individual institutions on the basis of a reasoned request.

The ESRB will therefore have access to ample sources of information on risks. The development of the appropriate infrastructure for pooling such information on an EU-wide

basis will be a major step forward in the assessment of financial stability in the single market, but this will require substantial analytical and data-related expertise, as well as market knowledge. Work is already under way to set up efficient procedures for regular information-sharing between the ESRB and the ESAs.

The second component relates to the instruments available to the ESRB, which should be geared to mitigating systemic risk on the basis of the outcome of the monitoring of the financial system. As mentioned earlier, they include the issuance of risk warnings and policy recommendations, as well as the monitoring of the follow-up by the respective addressees on the basis of an “act or explain” mechanism.

One of the challenges in this respect is ensuring the effectiveness of the ESRB’s instruments. From the very outset, this will require the development of analytical tools and models that underpin the macro-prudential policy process, including reliable systemic risk indicators that support the issuance of warnings or recommendations on the calibration of prudential measures. Such measures may include specific capital and liquidity requirements to take account of financial cycles, or of the systemic relevance of financial institutions. Furthermore, the effectiveness will also depend on close cooperation between the members the ESRB and, in particular, the ESAs, which are expected to play an important role in the implementation of the ESRB’s recommendations.

Macro-prudential governance, as a third component, is decisive for the functioning of the overall financial stability architecture. Central banks should play a major role, given their interest in, and responsibility for, the stability of the financial system, as well as their analytical expertise and the information they have on the real economy, financial markets and market infrastructures.

The participation of the governors of all EU central banks in the General Board of the ESRB, as well as the attribution of the Chair to the ECB’s President, shows that the importance of this role has been recognised. The ECB has also been requested to provide the Secretariat and the necessary analytical, statistical, logistical and administrative support. For this purpose, the ECB will optimise its existing capabilities and infrastructure in the areas of financial stability monitoring, macro-economic analysis and the collection of statistical information, to the benefit of the ESRB.

Supervisory authorities should be involved in, and contribute to, the macro-prudential function with information, analysis and regulatory advice. The conduct of macro-prudential policies will to a large extent also depend on supervisory measures. Accordingly, the macro-prudential framework should provide for coordination mechanisms between macro and micro-prudential responsibilities, which should also avoid any potential overlaps or conflicts of interest.

The legislation contains a number of provisions that provide the basis for a close institutional collaboration between the ESRB and the ESAs. The provisions range from the mutual participation in the boards of the ESRB and the ESAs – including the chair of the Joint Committee of the ESAs as second Vice-Chair of the ESRB – to cooperative duties in the monitoring and assessment of systemic risk, the conduct of stress-tests and the sharing of information, as mentioned earlier. National supervisors will also participate in the ESRB’s General Board and will, as is important, be members of the Advisory Technical Committee. This committee will be one of the main support structures of the ESRB, together with the Advisory Scientific Committee of independent experts.

In conclusion, the establishment of the ESRB will introduce a new policy function at the EU level, which has a great potential for enhancing the ability of European and national authorities to safeguard the stability of the EU’s financial system as a whole. The challenges of designing and implementing this new EU-wide macro-prudential policy function are considerable. However, with appropriate preparations, which are already ongoing in close cooperation with all the parties involved, a smooth start of the ESRB may be envisaged in 2011.