European Securities and Markets Authority | EBA European Banking Authority | EIOPA European Insurance and Occupational Pensions Authority | Joint Committee of the European Supervisory Authorities

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PRESS RELEASE

ESAs highlight main risks for the EU financial system

The Joint Committee of the European Supervisory Authorities (ESAs) published today its September 2016 Report on Risks and Vulnerabilities in the EU Financial System.

This Report focuses on recent developments concerning the **low growth and low yield environment** and its potential effects on **financial institutions' profitability and asset quality**, and highlights concerns related to **the interconnectedness in the EU financial system**. These risks have persisted for some time and can be related to lasting effects of the 2007 financial crisis. However, the EU financial system is also vulnerable to more immediate risks such as the result of the UK referendum on EU membership which has added political and legal uncertainties to those already affecting the financial system.

Gabriel Bernardino, Chairman of EIOPA and the current Chair of the Joint Committee, said:

"*The Joint Committee proactively considers key risks to financial stability and assesses risk mitigation policies in cooperation with national and European institutions. We are considering the possibilities for further enhancing monitoring of financial industries, reinforcing adequate capital or risk buffers as well as ensuring adequate resolution arrangements for affected sectors.*

The Joint Committee is committed to providing a strong and streamlined supervisory response both on a micro- and macro prudential level, which is required by the challenging economic environment."

Low growth and low yield environment

Low growth and low yields affect the financial services industry through various channels. Interest rates and growth expectations have decreased further and are posing new challenges to the entire financial sector. Low interest margins significantly constrain banks’ profitability, while life insurers’ and pension funds’ liabilities increase as it becomes more difficult to generate high investment returns. This environment may lead banks, insurers, pension funds and other investors to engage in risky search-for-yield behaviour, adding to already elevated risks around asset valuation and adjacent concerns about market liquidity.

The Joint Committee considers it essential to further develop effective recovery and resolution schemes in all relevant sectors, to employ adequate stress testing procedures and to enhance the monitoring of relevant risk drivers.

Profitability of financial institutions

Low quality of assets in many countries, conduct costs and growing competition from non-bank and non-insurance financial institutions negatively affect the profitability of banks and insurers. Subdued returns, further lowered by fees and charges, reduce the attractiveness of investment funds. While the EU-wide bank stress test results have demonstrated the importance of a better capitalised banking system, the high levels of non-performing lands (NPLs) exacerbate concerns about medium-terms sustainability. Addressing NPLs as a major driver of uncertainties in the financial system has become a key challenge, and further NPL resolution requires comprehensive and proactive action among all relevant stakeholders. Following the UK referendum, profitability risks may be further intensified. Expectations of weaker macroeconomic conditions are amplified by growing political risks within the EU and globally. In addition, traditional financial service providers are facing increasing competition from Fintech providers which will further challenge the sustainability of their business models.

Responding to this risk, supervisors need to encourage steps to adjust business models in search for sustainable income, to address excess capacities as well as to monitor and assess the impact of emerging innovative technologies and market practices.

Interconnectedness within the financial system

The interconnectedness between the financial sector outside of the banking, insurance and pension fund industries with the wider financial system is increasing, as cross-sectoral exposures, asset price commonalities and the interdependency of business processes augment.

The Joint Committee considers that related stability risks should be assessed thoroughly to mitigate the increasing risk exposure outside the traditional financial system.

Joint Committee September 2016 Report on Risks and Vulnerabilities to the EU Financial System: http://goo.gl/qLGBwm

Notes for Editors

The Joint Committee is a forum for cooperation that was established on 1 January 2011, with the goal of strengthening cooperation between the European Banking Authority (EBA), European Securities and Markets Authority (ESMA) and European Insurance and Occupational Pensions Authority (EIOPA), collectively known as the three European Supervisory Authorities (ESAs).

Through the Joint Committee, the three ESAs cooperate regularly and closely to ensure consistency in their practices. In particular, the Joint Committee works in the areas of supervision of financial conglomerates, accounting and auditing, micro-prudential analyses of cross-sectoral developments, risks and vulnerabilities for financial stability, retail investment products and measures combating money laundering. In addition, the Joint Committee also plays an important role in the exchange of information with the European Systemic Risk Board (ESRB).

Further information:

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