European Securities and Markets Authority | EBA European Banking Authority | EIOPA European Insurance and Occupational Pensions Authority | JOINT COMMITTEE OF THE EUROPEAN SUPERVISORY AUTHORITIES

PRESS RELEASE

ESAs highlight main risks for the EU financial system

The Joint Committee of the European Supervisory Authorities (EBA, EIOPA and ESMA - ESAs) has published its spring 2017 Report on risks and vulnerabilities in the European Union's financial system. The Report highlights the risks to the stability of the European financial sector in an environment subject to political and economic uncertainties. In particular, the protracted period of low profitability of banks and the difficulties faced by insurers to generate adequate returns to meet long-term liabilities in a low growth and low-yield environment remains a major challenge. In addition, the steepening of the yield curve may benefit earnings across all sectors but it also raises valuation concerns and, in the short term, may not be sufficient to alleviate the low profitability concerns. The Report also highlights the high valuation risk linked to search for yield strategies and repricing of risk premia. Rising operational risks related to information and communication technologies are increasingly requiring supervisory attention.

Low profitability of financial institutions

High levels of non-performing loans (NPLs), continuously high litigation costs, overcapacity, and lack of focus in strategies to return to sustained profitability affect the banking sector, notwithstanding a further steady strengthening of the capital ratios. Addressing NPL challenges requires a comprehensive and coordinated European response, including stepping up supervisory action, making progress in structural reforms, and improving the efficiency of secondary markets. Insurers face substantial challenges arising from prolonged low interest rates, especially those with material exposures to life insurance contracts with interest rate guarantees. In the European Union's fund industry, rates of returns are subdued and remained mostly negative.

Valuation risks around search for yield and repricing of risk premia

Increased asset price volatility coupled with lingering liquidity concerns has heightened risks around the adequate valuation of asset prices. Risks are exacerbated by political uncertainties. As a matter of fact, the recently observed steepening of the yield curve, while benefitting the profitability of banks, insurers and pension funds, poses additional valuation concerns. For the insurance sector, a sudden substantial increase of the interest rate might expose companies to an increasing probability of lapses.

Interconnectedness within the financial system

Interconnectedness, in particular via asset price contagion and direct financial exposure, adds to financial sector risks. Highly correlated equity price movements for insurers and banks, and high exposures of EU insurers to EU banks indicate risk concentration within those two sectors. Persistent search for yield intensifies the potential of price contagion among risky asset classes and reinforces valuation risk. Interconnectedness with the wider financial system is also on the rise, as cross-sectoral exposures, asset price commonalities and the interdependency of business processes increase.

Cyber risks and IT-related operational risks

Fast technological change is expected to have a significant impact on the existing business models of financial institutions over time. Many financial intermediaries have to deal with ageing core IT systems, hence the need for extensive IT investments, which further aggravate profitability. In addition, cyber risk threatens data integrity and business continuity in an interconnected financial system. Against this background, the demand for cyber insurance is expected to grow while cyber coverage products are still relatively new in the market, with limited underwriting experiences. Unlike other types of insurance, there is a severe lack of historical data that can be used for pricing purposes. The ESAs are responding to cyber and IT-related risks by, e.g., drafting Guidelines on ICT risk assessment for supervisors, assessing cyber security capabilities of central counterparties (CCPs) and assessing the potential accumulation of risk at insurers deriving from newly developed cyber security coverages.

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).

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