ESAs highlight risks in phasing out of crisis measures and call on financial institutions to adapt to increasing cyber risks

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The three European Supervisory Authorities (EBA, EIOPA and ESMA - ESAs) issued today their second joint risk assessment report for 2021. The report highlights the increasing vulnerabilities across the financial sector, the rise seen in terms of cyber risk and the materialisation of event-driven risks.

As the recovery begins, the appropriate phasing out of exceptional crisis measures plays a key role. Despite the positive outlook, the expectations for economic recovery remain uncertain and uneven across member states. Vulnerabilities in the financial sector are increasing, not least because of side effects of the crisis measures, such as increasing debt levels and upward pressure on asset prices. Expectations of inflation- and yield growth, as well as increased investor risk-taking and financial interconnectedness issues, might put additional pressure on the financial system.

The financial sector is also increasingly exposed to cyber risk. The financial sector has been hit by cyber-attacks more often than other sectors, while across the digital economy, cyber-criminals are developing new techniques to exploit vulnerabilities. Financial institutions will have to rapidly adapt their technical infrastructure in response to the pandemic, and the crisis has acted as a catalyst for digital transformation more generally.

Finally, the materialisation of event-driven risks (such as GameStop, Archegos, Greensill), as well as rising prices and volumes traded on crypto-assets, raise questions about increased risk-taking behaviour and possible market exuberance.

Concerns about the sustainability of current market valuations remain, and current trends need to show resilience over an extended period of time for a more positive risk assessment.

In light of the above-mentioned risks and uncertainties, the ESAs advise national competent authorities, financial institutions and market participants to take the following policy actions:

- financial institutions and supervisors should continue to be prepared for a possible deterioration of asset quality in the financial sector, notwithstanding the improved economic outlook;
- as the economic environment gradually improves, the focus should shift to allow a proper assessment of the consequences of the pandemic on banks' lending books, and banks should adequately manage the transition towards the recovery phase;
- disorderly increases in yields and sudden reversals of risk premia should be closely monitored in terms of their impacts for financial institutions as well as for investors;
- financial institutions and supervisors should continue to carefully manage their ICT and cyber risks.

The ESAs also consider that policymakers, regulators, financial institutions and supervisors can start reflecting on lessons learnt from the COVID-19 crisis.

Download the report