



TOPICS:

Liquidity Risk, NBFIs

SOURCE

European Systemic Risk Board

ESRB Publishes Report on a Monitoring Framework for Systemic Liquidity Risks in Financial System

- The European Systemic Risk Board (ESRB) report outlines a **comprehensive monitoring framework for systemic liquidity risks** in the EU financial system. It highlights the **importance of interconnectedness** across institutions and markets and the role of non-banks (NBFIs) in financial stability.
- **Definition of Systemic Liquidity Risk**
Risk of liquidity shortages affecting multiple institutions and key markets.
Stresses in **funding liquidity (availability of financing)** and **market liquidity (ease of trading assets)** can amplify each other. Interconnected financial entities and markets can escalate localized stress into a system-wide crisis.
- **Entities & Markets in Scope**
Key entities: Banks, insurance firms, pension funds, and investment funds (including MMFs).
Key markets: Sovereign bonds, repo markets, covered bonds (e.g., Danish mortgage bonds), corporate bonds, unsecured money markets, and FX/interest rate derivatives.
Country-specific applications: Netherlands (pension funds) and Finland (investment funds).

Indicators for Systemic Liquidity Risk

Funding liquidity risk: Measures of rollover risk (refinancing constraints), redemption risk (investor withdrawals), and margining risk (collateral demands).

Market liquidity risk: Metrics for **tightness (cost of trading), depth, breadth, immediacy, and resilience** across key markets.

Contagion & amplification risks: Includes **financial conditions, volatility, leverage, and interconnectedness** (e.g., portfolio overlap between banks and NBFIs).

- **Policy Implications & Future Enhancements**

Early Warning Indicators: Needed to **predict liquidity stress**, as current indicators are reactive.

System-wide Liquidity Stress Testing: To **complement and refine** the framework.

Global Dimension Expansion: Monitoring of cross-border liquidity risks, particularly for **funds investing outside the EU**.

Real-time Liquidity Monitoring: Lessons from past crises (e.g., **pandemic liquidity shock**) should be **integrated into surveillance**.

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