EUROPEAN CENTRAL BANK

EUROSYSTEM

2nd Chief Risk Officer Roundtable

Frankfurt am Main, Wednesday, 18 January 2023

Meeting summary

The ECB's Vice-President, Mr de Guindos, welcomed the Chief Risk Officers (CROs) of eight financial institutions (see Annex) to the virtual Roundtable, which was also attended by senior staff from the ECB's Directorate General Macroprudential Policy and Financial Stability and Directorate Risk Management, and its Chief Compliance and Governance Officer. The Roundtable aims to bring together CROs in a diverse composition, complementing the ECB's regular monitoring of systemic threats to the euro area financial system with targeted feedback.

1. Key threats to euro area financial stability

The session opened with a tour de table during which the CROs outlined what they currently perceived to be their five greatest threats to euro area financial stability. Most CROs considered the possibility of higher and persistent inflation as a key driver of risks as interest rates could increase more than expected. Several CROs mentioned geopolitical tensions and some CROs linked them to cyber-risks, in particular highlighting risks related to cyber-attacks on critical infrastructures. Investments into energy security and long-term energy independence, combined with the need to transition to a low carbon economy, represent a major challenge for the corporate sector, and euro area competitiveness could be challenged, in the view of some CROs. A few CROs highlighted risks related to both market and funding liquidity, whereby high market volatility and margin pressures were seen as key drivers. Others considered private equity and private credit markets as vulnerable, also in light of the higher interest rate environment. Some CROs flagged that certain financial market activities have migrated to less transparent and less regulated venues and jurisdictions. Finally, a few CROs argued that economic divergences between EU member states and uncoordinated policy responses could risk renewed fragmentation and sovereign debt sustainability concerns.

2. Model risk in a changing environment

Two CROs provided introductory presentations on the topic of model risk, from the perspective of the banking and insurance sector, respectively. All CROs agreed that 2022 was a challenging year for the performance of risk models, since models may not have been adequately calibrated to reflect higher inflation and interest rates after a long period of accommodative financial conditions. Several CROs noted that models for stress tests, e.g. of liquidity, proved useful, but interest rate changes significantly surpassed previously made model assumptions. Nevertheless, the CROs emphasised that the use of risk models continued to provide better incentives than simple non-risk-based approaches and could help to identify important risks even if the models were not accurate. CROs agreed that the increased model risk required prudence, but their views differed on whether it was better addressed via post-model adjustments ("overlays") or via a more conservative risk appetite. Several CROs highlighted that the extraordinary period of the COVID-19 pandemic, with significant policy support for businesses, puts the representativeness of the most recent data into question, as these measures have changed the relationship between economic fundamentals and market pricing as well as credit risk. Going forward, several CROs expected that the strong governance frameworks set up after the Global Financial Crisis in 2008 – as often required by regulation – would support the required model improvements.

Annex: List of participating institutions

Aegon

Amundi

AXA

Deutsche Bank

European Commodity Clearing

ING

Munich Re

Tikehau Capital