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Financial Affairs Council  
Members of the Economic and Financial Affairs  
Council

**ECB-UNRESTRICTED**  
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**ESRB work on implications for the financial system of guarantee  
schemes and other fiscal measures to protect the real economy in  
response to the coronavirus**

14 May 2020

Dear President and Members of the Economic and Financial Affairs Council,

The outbreak of the coronavirus (COVID-19) pandemic and the subsequent enforcement of necessary containment measures are a severe shock to European economies. Guarantee schemes and fiscal measures for firms and households are being put into place in many Member States to tackle the current emergency situation. While these programmes target the non-financial sector, their effectiveness and design features have important implications for financial stability.

Within its mandate, the European Systemic Risk Board (ESRB) has started work on identifying financial stability implications of the newly introduced guarantee schemes and fiscal measures. The ESRB's work in this area has three main objectives:

- identifying the implications of these measures for financial stability;
- establishing minimum requirements for monitoring frameworks that help understand the effects these measures have on financial stability;
- outlining future work on cross-border and cross-sectoral effects of these measures and their implications for financial stability.

Given the pan-European nature of the crisis and the close integration of markets, a coordinated European approach is needed in order to preserve financial stability. This ESRB work will enhance the common understanding of the relevant issues, which will contribute to the improved monitoring of financial stability risks across EU Member States. The ESRB intends to complement, enhance and strengthen work being done at the national level.

This letter provides information about the content and process of the ESRB's work. It encourages fiscal authorities to engage in an intensified dialogue with national macroprudential and supervisory authorities. The ESRB invites you to share this letter with all relevant national authorities that should be involved in the monitoring of the financial stability implications of fiscal measures in response to the challenges posed by the coronavirus crisis.

## Features of guarantee schemes and fiscal measures relevant for financial stability

A key step towards reaching the objectives of this ESRB work is to identify the types of fiscal instruments and their features that might affect financial stability, as outlined in more detail below.

- **Instruments:** these include direct grants, subsidised loans, state guarantees, public moratoria, equity participations, tax deferrals, and other measures applicable to credit and surety insurance. Such instruments can be classified as those targeted at households and those targeted at firms. The distinction between instruments that affect liquidity and those that affect solvency is also relevant for financial stability. As the duration and effects of the lockdown persist, solvency might be at risk. In such a situation, the use of instruments that solely safeguard liquidity of firms or households increases the risk of excessive leverage of borrowers, ultimately endangering solvency.
- **Design:** the design of guarantee schemes and fiscal measures has implications for the incentives to access the schemes and for the allocation of risks between the financial sector and the real economy. Relevant features include the size and the expected take-up of the programmes, targeted beneficiaries, the pricing of loans and guarantees and the conditionality and safeguards attached. These parameters may be particularly important for an effective take-up of funds by small and medium-sized enterprises (SME).
- **Timing:** the speed at which support can reach the recipients in the real economy is an important factor in mitigating the impact of the coronavirus shock and, therefore, in limiting its impact on the financial system. Timing relates to, for example, the administrative capacity to allocate funds and the complexity of the programme design.
- **Duration:** if measures expire before firms and households are able to recover, this might lead to disruptions in trade and insolvencies with consequences for the financial system in the form of a build-up of non-performing loans. Similarly, the abrupt expiration of moratoria and guarantees schemes and their associated regulatory treatment could impair the lending capacity of financial institutions, and thus trigger a credit contraction. Avoiding such cliff effects, while ensuring that temporary fiscal support does not become permanent, requires consideration.

These features are important for assessing the effectiveness of fiscal measures in preserving financial stability at the national level. They also have important implications for cross-border and cross-sectoral effects, on which ESRB will focus future work. For example, some sectors of the real economy are hit harder by the shock than others, and may be more vulnerable to liquidity shocks. Therefore, the ESRB will also consider the financing structure of sectors; the exposure of different financial intermediaries to these sectors; financial vulnerabilities; and cross-border exposures.

### Process and timeline

By the end of May 2020, the ESRB will review the existing reporting systems and define minimum requirements for an EU framework for monitoring the implications of fiscal measures for financial stability. It will pay particular attention to minimising the cost of collecting information and will avoid duplicating work. The ESRB has already started collecting information on coronavirus-related fiscal measures; it encourages cooperation and would like to draw on relevant work carried out by other institutions.

The ESRB strongly encourages fiscal authorities to devote attention to a continuous dialogue with the macroprudential authorities for the purpose of monitoring the implications of fiscal measures on financial

stability. Cooperation between all relevant national authorities has mutual benefits, both in terms of collecting information and in assessing effects of fiscal measures. To this end, the ESRB intends to ask for information collected by national authorities to be shared with the ESRB, which will help to identify financial stability implications for the EU as a whole. In turn, the ESRB will provide feedback to national authorities concerning the monitoring framework, providing a broader view of financial stability implications.

Yours sincerely,

