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EXECUTIVE BOARD MEETING

SM/20/9
Correction 2

January 27, 2020

To:	Members of the Executive Board
From:	The Secretary
Subject:	**Austria—Financial System Stability Assessment**

Board Action:	The attached corrections to SM/20/9 (1/10/20), and Cor. 1 (1/23/20) have been provided by the staff:
Factual Errors Not Affecting the Presentation of Staff's Analysis or Views	**Pages 21 and 24**
Questions:	Ms. Melo, MCM (ext. 36485) Ms. Valderrama, MCM (ext. 37816)

Parliament. The government proposed, in May 2019, a reform of the supervisory framework for banking, which has been officially ~~put on hold~~ abandoned because the change in government (Box 1).

33. The FMSB plays a central role in terms of macroprudential oversight, benefitting from the support of OeNB's and FMA's work. The FMSB was established in 2014 to strengthen the cooperation in macroprudential supervision and to safeguard financial stability. The FMSB meets four times a year, and its members are the OeNB, the FMA, the Fiscal Advisory Council and the BMF, the latter also chairing the proceedings. The FMSB discusses facts relevant to financial market stability, and issues expert opinions, policy action recommendations and warnings about financial stability risks. The FMA is designated by law as the competent authority for applying macroprudential instruments, and it implements FMSB recommendations on a comply-or-explain basis. The OeNB is tasked with performing analysis for systemic risk identification, preparing preliminary recommendations to be voted by the FMSB, and providing the secretariat for the FMSB.

A. Macroprudential Policy Framework and Tools

34. The institutional framework for macroprudential policy is sound but could be strengthened to ensure effective and timely action. The framework encourages cooperation and coordination across different institutions. To benefit from OeNB's operational independence and the synergies offered by its role in monitoring and analyzing financial stability risks, the FMSB could be chaired by the OeNB, and its representation in the FMSB should be increased.[29] Adequate resources are needed to implement responsibilities related to European policy coordination.

35. The systemic risk monitoring framework is advanced but could be enhanced in some areas, including by closing data gaps. The analysis of real estate-related risks could be deepened and a more systematic analysis of interlinkages between different financial sector segments through common exposures is desirable. Several ongoing initiatives by the OeNB and FMA will increase the granularity of corporate and household lending data. However, data gaps remain. Authorities are encouraged to collect CRE data, gather detailed data on residential real estate exposures, enhance the granularity of CESEE exposures, and broaden the collection of NFC indicators, including on credit quality, profitability, debt and firm characteristics.

36. The expected weakening of credit demand and still negative credit-to-GDP gap justify the current countercyclical capital buffer (CCyB) of 0 percent (Figure 9). In terms of sectoral developments, growth of domestic bank credit to NFCs has picked up considerably over the last couple of years, driven primarily by real estate activities. If the strong credit growth in the NFC sector continues and credit in the real estate picks up, increasing the CCyB should be considered. Going forward, the planned introduction of *sectoral* macroprudential capital buffers to the European macroprudential framework may help address sector-specific risks stemming from credit growth.

[29] Currently OeNB and FMA are represented by two out of six voting FMSB members. The BMF, which also chairs the FMSB, has two representatives, and two members come from the Fiscal Advisory Council, which does not have a financial stability mandate.

Box 1. Institutional Reforms in Banking Oversight

In November 2018, the government announced the intention of consolidating banking supervision within the FMA. The stated aims of the reforms were to improve the efficiency of the supervisory system, reduce duplication, speed up decision making, establish clear points of contact for financial market participants, and strengthen "service orientation". Draft legislation released in April 2019 kept the main thrust of the reforms, but government changes have caused the reforms to be ~~reconsidered~~ abandoned.

The FMA would assume responsibility for on-site inspections and off-site analysis from the OeNB and would become the sole point of contact on day-to-day supervision, the FMA would have sole "ownership" of content of the supervisory reporting but the OeNB would retain responsibility for data collection, processing and quality assurance.

The FMA's Supervisory Board would be reduced from the ten members to six and would take on responsibilities for strategic planning and establishing priorities for supervision. Two of the members would be appointed by the OeNB, and the other four by the BMF, two of whom would be independent experts with no current affiliation with regulated entities. The two-person Executive Board would be reduced to one member, with termination of the OeNB appointee.

The FMA would also establish a Financial Market Advisory Board, composed of experts from relevant ministries, industry, academia, the stock exchange and the OeNB, to advise on matters related to financial markets, and draw up proposals on supervisory topics. The Board would be able to seek opinions and make its proposals public, including on priorities for regulation.

The reforms would increase the dependence of the FMA on government funding. Currently, the OeNB's costs for prudential supervision are largely borne by the OeNB itself; the FMA's costs are largely covered by supervisory levies. Since there is no intention to increase these levies, the increased costs incurred by the FMA from the absorption of OeNB responsibilities would need to be funded by the government budget. The FMA and the OeNB would be required to implement cost-efficiency programs, and the reforms included an increase in the OeNB's profit distribution to the government from 90 to 95 percent to help cover costs.

The OeNB would retain some involvement in supervision since the governor would continue as a member of the Governing Council of the ECB, and an OeNB representative would remain as a non-voting member on the ECB's Supervisory Board. The OeNB's responsibilities for financial market stability would be unchanged. The number of OeNB representatives on the FMSB would increase from one to two.

44. The prolonged low interest rate environment challenges the insurance sector. The duration gap between asset and liabilities is one of the highest among the European peers. The average guaranteed rates remain high, while the investment returns continue to be declining. In addition, Solvency II allows insurers to recognize expected profits in future premiums as part of their own funds, and these make up a substantial part of the own funds of the two largest insurance groups. The reliance on future profitability to meet capital requirements challenges the entities' business models over the medium term, especially that of composite insurers.[32] It is recommended that the FMA conducts more targeted stress testing on the segments/business lines for which future profitability is material. Moreover, supervisors should clearly communicate to higher risk insurers

[32] The average share of expected profits in future premiums relative to own funds is about 12 percent, which is close to the European average. While the largest Austrian insurance group' reliance on future profits reaches over 40 percent, this is not deemed to be systemic given the small size of the insurance sector.