ESMA Risk Dashboard
No. 2, 2021

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ESMA risk assessment

Risk summary
EU financial markets continued to grow in 3Q21 but at a slower pace, with assets priced significantly above pre-crisis levels across all classes, reflecting growing investor risk-taking. While the macroeconomic outlook has brightened, uncertainty over the speed and resilience of the recovery persists. We see realistic scope for a reduction in risk levels within the market segments under our remit if the current improvements in the economic environment and the comparatively low volatilities in the market prove resilient. This resilience will critically depend, in particular, on the ability of markets to withstand a reduction in public policy support on the monetary or fiscal side without material disruptions. Market corrections and soaring volatility around the newsflow related to Chinese construction corporation Evergrande illustrate the sensitivity of markets. Corporate indebtedness persists, especially in HY where bond valuations climbed further. Uncertainty on the continuation of fiscal support measures, as well as expectations on monetary policy tapering, could weigh on pre-existing vulnerabilities in financial markets. Supply shortages in energy and commodities add to market nervousness, fuelling concerns on inflation expectations. Going forward, institutional and retail investors should be ready to sustain further, potentially significant market corrections as market risks remain very high.

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Note: Assessment of the main risks by risk categories for markets under ESMA’s remit since the last assessment, and outlook for the forthcoming quarter. Assessment of the main risks by risk categories and sources for markets under ESMA’s remit since the last assessment, and outlook for the forthcoming quarter. Risk assessment based on categorisation of the European SupervisoryAuthorities (ESA) Joint Committee. Colours indicate current risk intensity. Coding: green=potential risk, yellow=elevated risk, orange=high risk, red=very high risk. Upward arrows indicate an increase in risk intensities, downward arrows a decrease and horizontal arrows no change. Change is measured with respect to the previous quarter; the outlook refers to the forthcoming quarter. ESMA risk assessment based on quantitative indicators and analyst judgement.

Market assessment

Overall ESMA remit: Improved economic conditions over the summer offset concerns over the spreading COVID-19 Delta variant, before market sentiment slightly deteriorated in end-September. In 3Q21, asset valuations remained above pre-crisis levels with increased risk of price corrections and abrupt shifts in risk premia, as witnessed following the Evergrande newsflow. Looking ahead, the scars of the pandemic, its resurgence in 4Q21, and uncertainty around inflation and the continuation of fiscal and monetary policy support may exacerbate long-term vulnerabilities both for the financial and non-financial sectors. Market expectations on macroeconomic fundamentals will also play a key role in investor behaviour.

ESMA assesses the risks in its overall remit, securities markets, and in asset management as still very high. The same applies to liquidity and market risks. The outlook for the consumers segment is negative as well as that for credit and contagion risk. The most important risk drivers for the quarter are the economic outlook, inflation uncertainty, indebtedness in sovereign and private debt markets and political and event risks.

Securities markets: Equity markets continued to increase over the summer, with a contraction towards end-September linked to the events around the Chinese construction firm Evergrande and investor worries on rising inflation. The Eurostoxx ended the quarter flat (-0.7%), but still stood 6% above pre-crisis levels (R.1). The difference in performance across EU national equity indices persisted, with some still not fully recovering the losses occurred during the pandemic (FR +12%; ES -7%). Across sectors, financial services stocks continued to outperform, while bank shares caught up albeit still standing below pre-crisis levels (-2.5%). Price-earnings ratios continued to grow, pointing towards overvaluation concerns in equity markets. In fixed income markets, EA sovereign bond yields rose amid concerns over potential monetary policy tapering. Corporate bond valuations increased further with HY at 49% above pre-crisis levels (-2.5%). Price-earnings ratios continued to grow, pointing towards overvaluation concerns in equity markets. In fixed income markets, EA sovereign bond yields rose amid concerns over potential monetary policy tapering. Corporate bond valuations increased further with HY at 49% above pre-crisis levels. IG valuations have grown at a slower pace (+9% higher than pre-crisis), with growth mostly driven by BBB-rated bonds. Crypto assets grew and remained highly volatile.

Infrastructures and services: EU infrastructures were resilient overall in 3Q21. Trading volumes stabilised close to the 3M moving average of EUR 13bn per day and never exceeded excess capacity (R.57). Following the introduction of the share trading obligation (STO), the proportion of turnover volumes in EEA stocks moved away from UK lit markets, where they continued to be limited at 3%. Settlement fails at EU CSDs were stable for equities, but still above pre-crisis levels, while those for both corporate and sovereign bonds declined below their 1Y moving average by 0.2pp and 0.4pp respectively (R.7). In derivatives markets, outstanding amounts of interest rate swaps (IRS) referencing the new...
RFRs have increased since the beginning of the year (R.9). The emergence of new digital platforms with low barriers to opening accounts may pose risks to retail investors with little knowledge of trading in complex financial instruments.

Asset management: Global investment fund flows remained positive in 3Q21 (R.12) linked to positive performance, which reflected the trends of the underlying asset classes (R.13). Asset quality is a concern for bond funds, especially HY, which further increased their exposure to credit risk through lower quality portfolio holdings (R.18). Moreover, duration exposures could expose bond funds to interest rate shocks. However, bond fund maturity has slightly declined to 7Y (R.19). MMFs experienced outflows, possibly linked to increased investor risk appetite. (R.20). AuM of EU ETFs continued to grow linked to inflows and ETF performance, reaching a total size of EUR 1.2tn, and to experience positive returns (R.22).

Retail investors: Current investor sentiment increased further, but retail investors have started to be more cautious about future expectations (R.25). Retail participation in capital markets rose in 2021, driven by larger purchases of equity and investment funds shares, and other financial assets (R.24). The pandemic has also boosted the use of leveraged products (LPs) and LPs with knock-out features (R.18). The wide availability of technological tools drove increased retail trading, encouraged by new trading applications offering ‘zero-commission’ investing and gamified features. The large increase in retail trading and investing has been associated with large price increases in crypto assets and was also mirrored in the rising number of complaints reported to NCA, mostly concerning equities (R.26). Investor appetite for sustainable investment products increases greenwashing risk in the absence of disclosure requirements and labelling.

Risk drivers

Macroeconomic environment: The economic outlook improved overall in 3Q21 as COVID-19 vaccination campaigns accelerated and containment measures gradually eased across jurisdictions. EU GDP is now forecast to grow by +4.8% in 2021 and +4.5% in 2022, with the volume of output projected to return to its pre-crisis levels already by the end of 2021. However, the speed of the recovery differs across Member States. Uncertainty and risks remain high around the 4Q21 resurgence of COVID-19 in large parts of the EU. The outlook on inflation has also been revised upwards, amid rising energy and commodity prices, and supply chain shortages in some input components and raw materials. The 1Y-1Y break-even inflation forward rate rose sharply to 1.8% (R.39).

Interest-rate environment: The prolonged low-interest rate environment reinforced the risk-taking behaviour of investors in search for yield. This contributed to keep asset valuations at elevated levels, especially in the HY segment. Uncertainty over the monetary outlook may drive an increase in yields, leading to risks of market corrections.

Sovereign and private debt markets: Public indebtedness remained at elevated levels linked to fiscal support measures. As containment measures eased, corporate sector activity picked up in 3Q21 with increased profitability. However, debt levels for non-financial corporations remained high as market conditions continued to facilitate lower rated bonds issuance. The share of A and BBB-rated bonds was 60% of total outstanding rated debt (R.45). Corporate downgrades declined (R.51) and the share of ratings with negative outlook was lower, but still at 40% for HY (R.52). Debt sustainability concerns remain high, and any potential future phasing out of public support measures may result in a further deterioration of credit risk. Foreign credit risk exposures came to the forefront in September, when Evergrande warned investors that it could default on its debt, with limited spillovers into European markets.

Infrastructure disruptions: There were no major incidents on EU trading venues or CCPs, except for a minor outage in derivative trading reported at the end of June, and few circuit breakers were triggered in 3Q21 (R.56). Continued digital transformation is one key concern for financial infrastructures as, across the digital economy, cyber-criminals are developing new techniques to exploit vulnerabilities. Cyber incidents may threaten financial stability, given their potential to disrupt critical financial services and damage confidence in the system.

Political and event risk: Market reactions to the issues related to Evergrande have shown the continued importance of event risks, the reactivity of markets to such events, and the continued potential impact on investors and financial stability going forward. Regarding political risk, negotiations on a long-term extension of the US debt ceiling could also contribute to shaping the trends in financial markets. Moreover, sources of geopolitical instability still exist both in neighbouring and more distant regions.

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1 LPs with knock-out features are options that cease to exist if the underlying asset’s price exceeds or falls below a specified price.
2 Summer 2021 Economic Forecast: Reopening fuels recovery
3 The 1 y-1y and 5y,5y inflation swap rates are used as a proxy for short- and long-term inflation expectations.
Key indicators

Markets

Securities markets

R.1
Market performance
Above pre-crisis levels for EQ

R.2
Market volatilities
Volatilities down

R.3
Corporate bond yields by ratings
Reduced yields across ratings

R.4
Equity prices
Banks catching up

Note: Return indices on EA equities (Datastream regional index), global commodities (S&P GSCI) converted to EUR, EA corporate and sovereign bonds (iBoxx EUR, all maturities). 01/09/2019=100.
Sources: Refinitiv Datastream, ESMA.

Note: Annualised 40D volatility of return indices on EA equities (Datastream regional index), global commodities (S&P GSCI) converted to EUR, EA corporate and sovereign bonds (iBoxx EUR, all maturities), in %.
Sources: Refinitiv Datastream, ESMA.

Note: ICE BofAML EA corporate bond redemption yields by rating, in %. 1Y-MA=one-year moving average of all indices.
Sources: Refinitiv Datastream, ESMA.

Note: STOXX Europe 600 sectoral return indices. 01/09/2019=100.
Sources: Refinitiv Datastream, ESMA.
Markets
Infrastructures and services

R.5
Sovereign 10Y yields
Pick up in September

Note: Yields on 10Y sovereign bonds, selected countries, in %, 1Y-MA: one-year moving average of EA 10Y bond indices computed by Datastream.
Sources: Refinitiv Datastream, ESMA.

R.6
Price earning ratios
Elevated valuations

Note: Price earning ratios based on average inflation-adjusted earnings from the previous 10 years (cyclically adjusted price earning ratios). Averages computed from the most recent data point up to 10 years before.
Sources: Refinitiv Datastream, ESMA.

R.7
Settlement fails
Stable at high level for EQ

Note: Share of failed settlement instructions in the EEA30, in % of value, one-week moving averages. Missing data for some CSDs prior to mid-March 2020. Dotted lines represent one-year moving averages of the respective asset classes.
Sources: NCAs, ESMA.

R.8
€STR rate and volumes
Continuing smooth transition

Note: €STR rates at 25th, 50th and 75th percentile of volume, in %, and monthly volumes, EUR tn, before trimming. Pre-€STR rates and volumes prior to 01/10/2019.
Sources: ECB, ESMA.
R.9
IRS referencing EONIA and Euribor by maturity

Increase of IRS referencing RFRs

![Graph showing increase of IRS referencing RFRs](image)

Note: Gross notional amount of IRD outstanding referencing benchmarks, EUR bn.
Sources: TRs, ESMA

R.10
Initial Margins held at EU CCPs

Stable and higher than pre-crisis levels

![Graph showing initial margins held at EU CCPs](image)

Note: Initial margin required as well as additional margin posted by EU and UK CCPs, in EUR bn.
Sources: Clarus Financial Technology, CPMI-IOSCO PQD, ESMA

R.11
CCP Margin breaches

Breaches below 1%

![Graph showing CCP Margin breaches below 1%](image)

Note: Average and maximum margin breach size over the past 12 month at selected EU CCPs, as a percentage of the total margin held, as of 30 June 2021.
Sources: Clarus Financial Technology, PQD, ESMA.
Markets

Asset management

R.12
Global investment funds
Inflows across types and regional focus

R.13
Fund performance
EQ and commodities outperform

R.14
Assets by fund type
Growth across types

R.15
Rate of return volatilities by fund type
Back to low levels, slightly up for commodities

Note: Bond and equity funds (BF and EF) flows over time since September 2019 by regional investment focus, in % of NAV.
Sources: REFINITIV Lipper, ESMA.

Note: EU27 domiciled investment funds’ annual average monthly returns, asset weighted, in %.
Sources: Thomson Reuters Lipper, ESMA.

Note: AuM of EA funds by fund type, EUR tn.
Sources: ECB, ESMA.

Note: Annualised 40D historical return volatility of EU domiciled mutual funds, in %.
Sources: Thomson Reuters Lipper, ESMA.
R.16
Leverage by fund type
Slightly declining

Note: Leverage of EA investment funds by fund type computed as the AuM/NAV ratio. Sources: ECB, ESMA.

R.17
EU bond fund net flows
Slightly positive across all types of bond funds

Note: Two-month cumulative net flows for bond funds, EUR bn. Funds investing in corporate and government bonds that qualify for another category are only reported once e.g. funds investing in emerging government bonds reported as Emerging; funds investing in HY corporate bonds reported as HY).
Sources: Thomson Reuters Lipper, ESMA.

R.18
Bond funds credit risks
Increased credit risk

Note: Average credit quality (S&P ratings; 1 = AAA; 4 = BBB; 10 = D).
Sources: Refinitiv Lipper, ESMA.

R.19
Bond funds’ maturity and liquidity profile
Increase in HY

Note: Effective average maturity of fund assets in years; ESMA liquidity ratio (rhs, in reverse order).
Sources: Refinitiv Lipper, ESMA.

R.20
MMF assets and leverage
Slightly declining in 2Q21

Note: NAV and AuM of EA MMFs, EUR bn. Leverage computed as the AuM/NAV ratio. 5Y-MA=five-year moving average of the leverage ratio.
Sources: ECB, ESMA.

R.21
MMF liquidity and maturity
Increasing MMF liquidity

Note: Daily and weekly liquidity includes all assets maturing overnight and shows by AAA MMFs, securities issued by highly rated sovereigns with a maturity of less than one year, in % of total assets (rhs). Weighted average maturity (WAM) of European domiciled MMFs, in days (rhs).
Sources: Fitch Ratings, ESMA.
**Markets**

**Consumers**

R.24  
EA households’ net acquisition of financial assets  
*Increased acquisition of financial assets in 1H21*

R.25  
Investor sentiment  
*Less optimism in the long-term*

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**ESMA Risk Dashboard**

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R.22  
ETF NAV by asset type  
*NAV increasing for all types of ETFs*

Note: NAV of EU27 ETFs by asset type, EUR bn.
Sources: Refinitiv Lipper, ESMA.

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R.23  
ETF net flows by domicile  
*Inflows in EU and US*

Note: ETF net flows by domicile, in % of NAV.
Sources: Refinitiv Lipper, ESMA.

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**Note:** Net acquisition of financial assets and net incurrence of liabilities for EA households as a share of their gross disposable income adjusted for changes in pension entitlements, based on a one-year rolling period, in %, IF shares=investment fund shares. Other financial assets=insurance technical reserves, financial derivatives, loans granted and other accounts receivable. Net financial flows=Net household lending (positive values) or borrowing (negative values) to/from sectoral financial accounts. Liabilities multiplied by -1 to present as outflows.
Sources: ECB, ESMA.

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**Note:** Sentix Sentiment Indicators for the EA retail and institutional investors on a ten-year horizon. The zero benchmark is a risk-neutral position.
Sources: Refinitiv Datastream, ESMA.
### R.26

**Complaints by cause**

**Increase in fees related complaints**

![Graph showing increase in fees related complaints](image)

- Withdrawals
- Unauth. bus.
- General admin
- Fees/terms
- Appr/suit
- Info quality

Total with cause reported

**Note:** Share of complaints for quarterly-reporting NCAs (n=14) received direct from consumers and via firms by underlying cause, excluding complaints with no cause recorded. 'Unauth. bus.'=Unauthorised business. 'Appr/suit'=(In)appropriateness or suitability assessment. 'Info quality'=Quality or lack of information. 'Total with cause reported'=Number of complaints via these reporting channels including those with none of the listed causes recorded.

Sources: ESMA complaints database

### R.27

**Complaints by financial instruments**

**More complaints on EQ**

![Graph showing more complaints on EQ](image)

- Equities
- CFDs
- Options/futures/swaps
- UCITS/AIFs
- Structured securities
- Debt securities
- Total with instrument cited

**Note:** Share of complaints from quarterly-reporting NCAs (n=14) received direct from consumer and via firms by type of financial instrument, where none of the instruments listed was reported. 'Total with instrument cited'=Number of complaints via these reporting channels excluding those with instrument type not reported or reported as 'other' or 'N/A'. 'Total complaints'=Number of complaints via these reporting channel whether or not further categorisation possible. 'CFDs'=Contracts for Differences.

Sources: ESMA complaints database

### R.28

**Structured retail products**

**Pandemic boosted LPs**

![Graph showing pandemic boosted LPs](image)

- SRP
- LP
- LP with KO
- LP as % of SRP
- LP with KO as % of SRP

**Note:** Exchange turnover of Structured Retail Products (SRPs), Leveraged Products (LP), and LP with Knock-Out feature, EUR bn. EUSIPA data for AT, BE, FR, DE, IT, NL, SE (CH excluded). % shares on right scale.

Sources: EUSIPA, ESMA
Risk categories

Liquidity risk

R.29
Composite equity illiquidity index

Small peak in 3Q21

Note: Composite indicator of illiquidity in the equity market for the current STOXX Europe Large 200 constituents, computed by applying the principal component methodology to six input liquidity measures (Amihud illiquidity coefficient, bid-ask spread, Hui-Heubel ratio, turnover value, inverse turnover ratio and market efficiency coefficient). The indicator range is between 0 (higher liquidity) and 1 (lower liquidity). Sources: Refinitiv Datastream, ESMA.

R.30
Sovereign bond liquidity dispersion

Liquidity improved

Note: Dispersion of liquidity measured as median across countries of the bid-ask yields difference for 10Y sovereign bonds, in bps. Lower figures mean more liquidity and vice-versa. 22 EEA30 countries are included. Sources: Refinitiv EIKON, ESMA.

R.31
Corporate bond illiquidity index

Improvement in liquidity

Note: Markit iBoxx EUR Corporate bond index bid-ask spread, in %. computed as a one-month moving average of the iBoxx components in the current composition. 1Y-MA=one-year moving average of the bid-ask spread. Amihud liquidity coefficient index between 0 and 1. Highest value indicates less liquidity. Sources: IHS Markit, ESMA.

R.32
Bond futures illiquidity indicator

Stable at low levels

Note: One-month moving averages of the Hui-Heubel illiquidity indicator for selected 10Y sovereign bond futures, in %. Lower figures mean more liquidity and vice-versa. Sources: Refinitiv Datastream, ESMA.
R.33
Sovereign repo volumes
Stable around yearly average

R.34
Repo market specialness
Slight increase

 Risk categories
Market risk

R.35
Economic policy uncertainty
Decrease in uncertainty

R.36
Financial instrument volatilities
Still above pre-crisis levels, but stable
R.37
Exchange rates
**EUR slightly depreciated over summer**

Note: Spot exchange rates to EUR. Emerging is an average of spot exchange rates for CNY, BRL, RUB, INR, MXN, IDR and TRY weighted by GDP as of start date year 01/06/2019=100. Increases in value represent an appreciation of EUR. 1Y-MA USD=one-year moving average of the USD exchange rate.
Sources: ECB, IMF, ESMA.

R.38
Exchange rate volatilities
**Below yearly averages**

Note: Implied volatilities for 3M options on exchange rates, in %. 1Y-MA USD (resp. 1Y-MA GBP) is the one-year moving average of the implied volatility for 3M options on EUR-USD (resp. EUR-GBP) exchange rate.
Sources: Refinitiv EIKON, ESMA.

R.39
Inflation swap rates
**Increased inflation expectations**

Note: 1-year-1-year and 5-year-5-year inflation-linked swap rates.
Sources: Refinitiv Datastream, ESMA.
Risk categories

Contagion risk

R.40
Composite systemic stress indicator
Back to pre-crisis levels

R.41
Sectoral equity indices correlation
Differentiation across sectors

R.42
Equity market concentration
Slightly lower concentration

R.43
Dispersion in sovereign yield correlation
Increased dispersion across countries

Note: ESMA version of the ECB-CISS indicator measuring systemic stress in securities markets. It focuses on three financial market segments: equity, bond and money markets, aggregated through standard portfolio theory. It is based on securities market indicators such as volatilities and risk spreads.
Sources: ECB, ESMA.
R.44
Financial market interconnectedness

Increased for MMFs

![Graph showing increased interconnectedness for MMFs]

Note: EA loan and debt securities vis-à-vis MFI counterparts, as a share of total assets, investment funds and MMFs, in %. Total funds includes: bond funds, equity funds, mixed funds, real estate funds, hedge funds, MMFs and other non-MMF investment funds.
Sources: ECB, ESMA.

Risk categories

Credit risk

R.45
Sovereign risk premia

Low risk premia

![Graph showing low risk premia]

Note: Selected 10Y EA sovereign bond risk premia (vs. DE Bunds), in %.
Sources: Refinitiv Datastream, ESMA.

R.46
Sovereign CDS spreads

Continued decline

![Graph showing continued decline in CDS spreads]

Note: Datastream CDS sovereign indices (5 years, mid-spread), in bps.
Sources: Refinitiv Datastream, ESMA.
**Corporate bond spreads**

**Compressed levels**

Note: ICE BofAML EA corporate bond option-adjusted spreads by rating, in bps. 1Y-MA=one-year moving average of all indices.
Sources: Refinitiv Datastream, ESMA.

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**Covered bond spreads**

**Stable at higher levels in September**

Note: iBoxx EUR covered bond option-adjusted spreads by rating, in bps. 1Y-MA=one-year moving average of all indices.
Sources: Refinitiv Datastream, ESMA.

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**Long term corporate debt outstanding**

**Large share of A and BBB**

Note: Outstanding amount of corporate bonds in the EEA30 as of issuance date by rating category, in % of the total. Maturities < 12 months are excluded.
Sources: Refinitiv EIKON, ESMA.

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**Net sovereign debt issuance**

**Positive net sovereign issuance**

Note: Quarterly net issuance of EEA30 sovereign debt by country, EUR bn. Net issuance calculated as the difference between new issuance over the quarter and outstanding debt maturing over the quarter. Highest and lowest quarterly net issuance in the past year are reported. EEA30 total on right-hand scale. All maturities are included.
Sources: Refinitiv EIKON, ESMA.

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**Debt redemption profile**

**Current financing need for financials**

Note: Quarterly redemptions over 5Y-horizon by EEA30 private financial and non-financial corporates, EUR bn. 1Y-change=change between the sum of this year’s (four last quarters) and last year’s (8th to 5th last quarters) redemptions. Maturities < 12 months are excluded.
Sources: Refinitiv EIKON, ESMA.
**Corporate issuer downgrades**

**Downgrades slow down**

Note: Number of EU27+UK corporate issuers with at least one bond downgraded and ratio of downgraded corporate issuers over upgrades and downgrades (3-week moving average). Issuers with same reported parent treated as one issuer.

Sources: ESMA, P&O

**Ratings outlook by rating**

**Corporate ratings’ outlook slightly improved**

Note: Distribution of outlooks for corporate non-financial instruments (ISINs) with outlook rated by the Big Five (Fitch, Moody’s, S&P, Scope and DBRS) by (r.h.s) credit value over the total ratings per category-value. Cutoff date 30/9/2021.

Sources: P&O, ESMA

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**Operational risk**

**Circuit-breaker trigger events by sector**

**High share of health care**

Note: Percentage of circuit-breaker trigger events by economic sector registered on 29 EEA30 trading venues for all constituents of the STOXX Europe LargeMidSmall 200 and a large sample of ETFs tracking these indices or some of their subindices. Results displayed as weekly aggregates.

Sources: Morningstar Real-Time Data, ESMA

**Circuit-breaker trigger events by market capitalisation**

**Back to pre-crisis levels**

Note: Number of daily circuit-breaker trigger events by type of financial instrument and by market cap registered on 29 EEA30 trading venues for all constituents of the STOXX Europe LargeMidSmall 200 and a large sample of ETFs tracking these indices or some of their subindices. Results displayed as weekly aggregates.

Sources: Morningstar Real-Time Data, ESMA.
R.57
Trading system capacity proxy

Slight increase in September

Note: Daily and 3M-MA of trading volumes on 29 EEA/30 trading venues for all constituents of the STOXX Europe Large/Mid/Small 200 and a large sample of ETFs tracking these indices or some of their subindices, in EUR bn. Capacity computed as the average across trading venues of the ratio of daily trading volume over maximum volume observed since 31/03/2016, in %.
Sources: Morningstar Real-Time Data, ESMA.