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PRESS RELEASE

CESR publishes its report on trends, risks and vulnerabilities in financial markets

CESR publishes today for the first time its report on trends risks, and vulnerabilities that are directly relevant to securities markets regulators (Ref. CESR/10-697). Previously, similar reports have been produced for the benefit of the Economic and Financial Committee (EFC) and the Financial Services Committee (FSC).

Over the last decades, financial markets have been transformed by the rapid development of new financial instruments, the rise of new categories of key market participants, and a supportive technological environment. More recently, fundamental areas of the financial sectors in Europe and elsewhere have experienced a severe crisis which is not yet over. Going forward, CESR would like to contribute more to the understanding of these trends and risks and communicate its insights to the general public through regular reports. These reports will focus mainly on the short and medium term without losing sight, however, of long-term developments. The analysis will naturally focus on the activity in European financial markets, but also take into full account the international dimension of the various markets and instruments analysed.

Carlos Tavares, elected Chair of CESR and Chair of the Portuguese Comissão do Mercado de Valores Mobiliários (CMMV), Chair of the Committee for Economic and Market Analysis that prepared the report, stated:

“Today’s publication shows CESR’s determination to contribute to the promotion of financial stability and the enhancement of consumer protection through regular reporting on trends and risks. CESR’s Committee for Economic and Markets Analysis (CEMA) has been put in place to fulfil this task. Its activity covers the pro-active identification, the monitoring, and the assessment from a micro-prudential perspective of key developments and risks in financial markets. This includes a cross-border and cross-sector dimension, as well as a thorough focus on financial innovations and incentives related to market practices both at the wholesale and retail level. Our first report stresses several trends and risks which should be taken seriously not only by regulators, but also market participants and investors to be better prepared for the future.”

At the current juncture, reporting on such risks, trends and vulnerabilities requires reference to the considerable uncertainties that are attached to the general economic and financial environment and their potential impact on markets. Therefore, this report covers developments in European securities markets both by considering broader trends and risks, and by looking into specific areas, such as activities in sovereign and corporate debt markets, securitisation in general, and the fund industry with a particular focus on the hedge fund sector and UCITS. It also considers in its analysis recent developments in mergers and acquisitions (M&A), and initial public offerings (IPOs).

Trends, risk and vulnerabilities identified

In its report, CESR has identified a range of key trends, risk and vulnerabilities. There are non negligible risks of a new deterioration in securities markets ahead: in particular uncertainties about the worldwide economic recovery, including the risk of a double-dip recession in some European countries, and rising and broadening of European sovereign risk. On derivatives markets, in particular in the sovereign CDS segment, it is likely that markets will continue to “test” countries in



difficulties in achieving the announced budget and debt goals. It is worth noting, however, that a sensible reduction in the perception of sovereign risk has been observed recently fuelled by the implementation of tough fiscal adjustment programmes in most European countries and the authorities' commitment to carry out and publish stress tests on the banking sector.

The financial crisis has triggered a process of financial dis-intermediation whereby banks play a diminished role in the financial system and direct finance becomes more important. Such a shift has implications in terms of the risk distribution within the financial system, including systemic risk.

The medium term

Going forward, it remains to be seen to what extent market and regulatory developments will be able to contribute both to developing the positive risk sharing functions and curtailing the possible negative effects of informational asymmetries of financial innovations.

Aside from high asset valuation, two signs which have been identified in the past as conducive to a bubble - rapid growth in private-sector credit and significant investment flows into particular asset classes - are not currently present. If a low interest rate environment were to persist, a close monitoring of the situation particularly in emerging and commodities markets on the one hand and, within Europe, some local markets (e.g. real estate) on the other, might well be needed.

The evolution of the boundaries between wholesale markets and retail markets need to be monitored with due attention because of an increasing tendency to shift risks to (possibly unaware) retail investors through new complex financial products.

The findings of this report will inform Europe's securities supervisors in their day-to-day analysis of supervisory priorities and will inform the emphasis and importance of factors as they are weighed in the regulatory development policy which seeks to take steps to protect investors and preserve well-functioning markets.



Notes for editors:

1. CESR is an independent Committee of European Securities Regulators. The role of the Committee is to improve co-ordination among securities regulators and act as an advisory group to assist the European Commission, in particular in its preparation of:
 - Draft implementing measures in the field of securities;
 - Work to ensure more consistent and timely day-to-day implementation of community legislation in the Member States.

The Committee was initially established under the terms of the European Commission's decision of 6 June 2001 (2001/527/EC) which was repealed and replaced by the Commission Decision of 23 January 2009 (2009/77/EC). CESR was one of the two Committees first envisaged in the Final Report of the Group of Wise Men on the regulation of European securities markets chaired by Alexandre Lamfalussy. The report itself was endorsed by the European Council and the European Parliament. The relevant documents are available on the CESR website.

2. Each Member State of the European Union has one Member in the Committee. The members are nominated by the Member States and are the heads of the national public authorities competent in the field of securities. The European Commission has nominated as its representative the Director General of the DG MARKT. Furthermore, the securities authorities of Norway and Iceland are also represented at a senior level as observers.

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