Date: 26 May 2011
ESMA/2011/157

Keynote speech of Steven Maijoor, Chair of ESMA, at the ICMA conference – 26 May 2011

Ladies and Gentlemen,

I am very pleased to have the opportunity to speak at your conference today. I would like to commend ICMA for organising this event and offering a program with distinguished speakers and panellists that will give their insights into a series of very important matters in the course of today and tomorrow.

In the first speeches I have given since I took up my position as the Chairman of ESMA, I have focused on the overall priorities that I see for ESMA. Given the ongoing discussions on certain major pieces of legislation that are expected to assign new tasks to ESMA, I would like to elaborate on the common objectives that I see underlying all these initiatives and how ESMA will aim at promoting them. Given the size and complexity of all the new regulatory initiatives, it is critical that we do not lose sight of their main objectives. In fact even the use of abbreviations like AIFMD, EMIR, MIFID and CRA2 further complicates matters and has reduced the transparency of these regulatory initiatives.

As I will discuss more extensively, important common objectives which are reflected in the new regulatory initiatives are more transparency, both for investors and other market participants and for regulators, contributing to stability, and improving the co-ordination of regulation and supervision with regions outside the Union. In short, it is all about **transparency**, **stability** and **international co-ordination**. In addition to talking about the underlying objectives of the new initiatives, I would like to discuss their impact on ESMA's organisation and the regulated financial firms concerned.

Let me now talk about the first common objective of more transparency for the public and regulators.

ESMA is very keen to promote increased transparency in financial markets both to the public and to regulators. Considering the various new transparency requirements, I will not touch upon all of them but select a few examples. One general observation that I would like to make is the relatively strong growth of information that needs to be shared with national regulators and ESMA so that they can exercise their duties, including ensuring stability, a subject that I will address later in my speech.

A first example of significantly expanded transparency concerns investment management. ESMA is currently conducting important work on the AIFMD to prepare technical advice to the European Commission, on which we will launch a consultation in July. One of the key elements of this advice will be proposals to ensure the availability of information to investors, including information that will allow investors to better assess the risk profile of the fund. It will be important to achieve a balance between increasing investor protection while avoiding imposing undue costs on fund managers. At the same time, regulators will need to be provided with sufficient information on the activities of alternative investment fund managers. As such, it can only be beneficial for competent authorities to have greater visibility of this sector. However, we should be careful not to require information just for the sake of it and should focus on those elements that help regulators carry out their supervisory tasks.

In post-trading, the role of trade repositories in promoting transparency of OTC derivatives markets is essential. ESMA will have a key role in determining how they will serve that role in practice, through the technical standards that we will draft. On the one hand ESMA will need to ensure that trade repositories receive the necessary information, on the other hand ESMA will need to detail what information different authorities should receive from trade repositories to exercise their tasks. As for the information to be disclosed to the public, ESMA will need to draw a careful balance to ensure that meaningful information will be available without disclosing commercially sensitive elements.

Although trade repositories are an important source of information, they are not the holy-grail for all transparency needs. There are financial instruments other than derivatives on which regulators need information. This is currently ensured through transaction reporting; ESMA supports the maintenance and further development of that mechanism. In its advice to the Commission last year, ESMA's predecessor CESR supported an increase in regulatory transparency by suggesting extending the scope of transaction reporting to include, among others, certain OTC derivatives. In this case, trade repositories could serve as one possible channel for firms to report transactions on OTC derivatives to regulators. This would avoid duplicating the reporting requirements for firms, whilst ensuring that regulators get transaction reports on all financial instruments in the same format providing greater comparability. We also proposed introducing mandatory client identifiers in transaction reports. Collecting this information will allow regulators to further improve market supervision, and client identifiers are much needed to be more successful in detecting market abuse cases.

As regards market transparency, MiFID already includes a regime for pre- and post-trade transparency for shares admitted to trading on a regulated market, wherever the trading takes place. When CESR advised the Commission on the MiFID review, we suggested measures to enhance the quality, timeliness and consolidation of post-trade transparency data. We also recommended introducing a similar regime for other financial instruments such as corporate and government bonds, certain structured finance products and all kinds of derivatives including CDS. The Commission followed our recommendations in its consultation on the MiFID review.

The Regulation on short selling and certain aspects of credit default swaps has been subject to intense negotiations in the past few weeks. If approved, it would improve transparency of short positions to the market through a requirement of public disclosure of short positions exceeding a particular threshold. The regulatory transparency would be enhanced by the requirement to report the same positions at a lower threshold to the national competent authorities. This model for transparency for short-selling, on which the Ecofin Council reached an agreement last week, is broadly consistent with CESR's advice to the European Commission. The key elements of CESR's advice "survived" the test of the difficult negotiations on the content of the regulation. While many EU Member States already have experience with transparency on short selling activities, the big achievement will be that we will have consistent rules across the Union. The topic of temporarily banning short-selling will be discussed in the following part of my contribution.

The second common key objective that is visible throughout the new regulatory framework is ESMA's role in contributing to <u>financial stability</u>.

As you are probably aware, the regulation founding ESMA gives us an important role in stability and requires us to monitor, assess and measure systemic risk. The objective of financial stability is now included in many individual regulations and directives which will provide national regulators, ESMA and the European Systemic Risk Board (ESRB) with the practical toolkit to meet their mandates in this area.

In the AIFMD, for example, there are specific provisions on the exchange of information relating to the potentially systemic consequences of activities of alternative investment fund managers. The home competent authority of the manager will have to inform other regulators, as well as the ESRB and ESMA, whenever a fund manager's activities could have implications for financial stability and the orderly functioning of markets. ESMA will also have an important role to play in helping define what this information should be and how it should be exchanged.

There has also been much debate in recent months on Exchange Traded Funds (ETFs), where CESR was initially focusing on investor protection issues and possible additional disclosure. The scope of the work has since been enlarged to cover ETFs' practices as regards collateral and securities lending. As described in the recent report by the Financial Stability Board (FSB), these practices – if not properly managed– can potentially give rise to systemic risk. However, in the discussions on ETFs we also have to bear in mind that we are not working in a vacuum – indeed, ETFs structured as UCITS are subject to a comprehensive framework of requirements on risk and liquidity management, investment limits, and disclosure to investors. We will be publishing our views on possible policy options in this area in the next few months.

In EMIR, the main objective of the clearing obligation is the reduction of systemic risk that ESMA will need to aim at when assessing the types of derivatives that will be subject to the clearing obligation. Strict prudential requirements on CCPs are also essential in this respect. The obligation proposed by the European Commission to require all derivatives which are eligible for clearing and sufficiently liquid to be traded on organised trading platforms also intends to complement these efforts and to further the G20 commitments. ESMA is expected to have a major role also in determining the scope of the trading obligation.

With regards to short selling, the Council's general approach adopted last week would implement for the first time the power assigned to ESMA in the ESMA Regulation to temporarily prohibit or restrict certain financial activities, in this case short selling and CDS transactions regarding sovereigns. The precondition for the use of this power is that the activity threatens the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system. We welcome this power that in my view is essential going forward to ensure that there is a mechanism in place at the European level to address situations with cross-border implications.

Whatever the final details of the short selling regulation will be, it is important that the end result can avoid the possibility of regulatory arbitrage. For example, such a possibility could emerge if in one Member State short selling in a sovereign bond would be allowed, while short selling in that same sovereign bond, or sovereign bonds in a very similar situation, would be banned in other European markets. The financial markets in sovereign bonds are European, if not world-wide, and asymmetric treatment of similar situations would undermine the credibility of regulatory interventions. Further, it is important to avoid complex and unclear accountabilities. This would risk slowing down the decision making while a decision to ban will typically require speed to be effective.

To conclude the issue of stability, I would like to share with you an observation going beyond the various regulatory initiatives. While we are now used to discussing stability issues, that was clearly not the case before this financial crisis. Securities regulators were very much focussed on transparency and investor protection issues, and stability per se was not a typical topic on their agenda. This has now changed, and I now witness securities regulators talking passionately about stability issues. Whilst this obviously does not mean the job is finished, it is a very good starting point for the early recognition and analysis of risks building up in securities markets that might have stability implications.

Last but not least, I would like to discuss the third common key objective of the regulatory initiatives, which is improved international co-ordination of regulation and supervision.

Probably one of the most important lessons of this financial crisis concerns the enormous risks various regions have taken as a result of regulatory competition. We have learned the hard way that attempting to attract or stimulate financial activities with favourable regulation and supervision can be a very costly strategy. Effective regulation and supervision requires the avoidance of gaps across regions, and to strive for a world-wide level playing field. The most tangible commitment to this world-wide level playing field is the G-20 roadmap and the monitoring performed by the FSB.

In this context, all new regulatory initiatives also address so-called third country issues, and by that I mean issues related to regions or countries outside the EU. A very important element here is to ensure that there is an effective and efficient regulatory framework in place in Europe for the recognition of third country service providers. ESMA is willing to contribute to ensuring the appropriate design and implementation of the third country regimes.

I would like to expand on this point by taking the example of the AIFMD. During 2013 to 2015 there will be a passport for sales of EU alternative investment funds to professional investors within the EU. For non-EU funds and managers, national private placement regimes will continue to operate. However, for these regimes to be used, appropriate co-operation arrangements will have to be put in place between the EU regulator concerned and the authority of the third country. The Commission has asked us to provide advice on the establishment of these co-operation arrangements and encouraged us to consider how ESMA could assist EU regulators in putting in place the co-operation arrangements. It would certainly seem more efficient for a single MoU to be negotiated by ESMA rather than obliging non-EU authorities to have separate discussions with up to 27 different EU regulators.

As you can see, there is a role for ESMA to play in the establishment of a framework for third country alternative investment funds and managers. It remains to be seen how that role will develop in practice in the complex regime of the AIFMD, which naturally reflects the particular challenges faced during the negotiations on it. ESMA is keen to fulfil in the most efficient manner possible the role that it has been assigned in the AIFMD, in fostering co-operation and co-ordination among regulators globally.

Third country regimes are in the process of being introduced also in other important pieces of legislation. The one in EMIR relating to third country CCPs is currently under negotiation. In the framework of the MiFID review, the European Commission has also proposed to develop at EU level a regime for the access of third country investment firms and market operators to EU financial markets.

When designing the respective third country regimes, it is in my view essential to consider the nature of the services to be provided across the border from third countries. The model introduced in the AIFMD was specifically designed for the alternative investment management industry. However, it will need to be carefully considered before importing some of its elements to other directives or regulations. For example, it would seem natural to centralise the decision making on the mutual recognition of important third country market infrastructures.

To conclude the international co-ordination issue I would like to briefly mention an actual decision that ESMA has taken last week in the CRA area. As you are aware, a substantial share of the activities of the largest CRAs occurs outside the EU our financial markets are heavy users of these ratings. ESMA has therefore decided that in principle ratings used in the EU, but issued outside the EU, need to meet the same regulatory requirements as those within the EU. Some interested parties suggested that a voluntary regime, based on the commitments of the CRAs themselves would be sufficient. However, I strongly believe that in this area we should not return to the pre-crisis model of self-regulation. Of course, when assessing the legal requirements outside the EU, we will need to be flexible. It will be essential that the third country system has the same regulatory effects and meets the same objectives as envisaged by the EU Regulation on CRAs. CESR had already applied that thinking earlier in the area of accounting standards with respect to prospectus and transparency requirements in its advice to the Commission.

Let me now move on to the consequences of all the regulatory changes for the ESMA organisation.

The new roles of ESMA are fundamentally different compared to the roles of its predecessor CESR. This has various implications for the ESMA organisation. First of all, we have restructured the internal organisation of ESMA and tasks like policy making, direct supervision of CRAs and research on financial market trends and stability issues are now clearly reflected in new divisions and units. As you can see on our website, we are recruiting very actively and we are looking for a human resource mix with backgrounds in policy making, supervision and practical market experience. On the latter, many of you have valuable market experience, and I would like to encourage you to visit our website to see whether there is anything of your interest.

The expansion of human resources brings me to a closely related topic, the financial resources of ESMA. While the financial resources as planned for the medium term seem reasonable for the current tasks of ESMA, this will change when we are awarded with new tasks. Discharging the supervisory responsibilities for new entities, building an IT system to be able to centralise reporting at the European Union level or drafting a significant amount of technical standards within sometimes very tight deadlines needs sufficient resources. It is therefore very important that any new piece of legislation with additional tasks for ESMA includes also an assessment of the financial resources needed to execute that new task. Additional tasks without the necessary resources will undermine the credibility of ESMA and the regulatory initiatives.

When it comes to our regulatory role, as discussed, the key change is naturally the mandates that are being introduced in the new pieces of legislation for ESMA to draft technical standards. We are very pleased to be assigned with these important responsibilities, but it also implies a different role in the legislative process, which should be reflected in the institutional framework for the negotiation of the proposals. ESMA should in my view have the possibility to provide its views already in the negotiation phase, or at least observe the negotiations. This is essential in order to ensure consistency between Directives and Regulations and any technical standards and advice that ESMA is expected to draft. I am optimistic that the various parties involved fully understand ESMA's wish on this point.

Let me conclude with some words on the consequences of all the regulatory initiatives for the firms involved.

I understand that most of the future requirements that I just illustrated to you will translate into higher costs for financial firms in the short term. However, I would like to encourage you to consider the benefits that will be achieved through increased transparency and stability, and the ability to prevent future crises. These benefits are difficult to measure in a precise way but they need very high weights in cost-benefit analyses.

In assessing the costs, we need your help in providing comprehensive and reliable material for us to work on – keeping in mind that we are committed to the goals of increased transparency and financial stability and better international co-ordination.

Finally, in one of ICMA's recent publications the current state of affairs in financial markets was strikingly described as "from intensive care to rehabilitation". As the odds of fatal outcomes in the intensive care are substantial, we should avoid at all costs that financial markets ever end up again in that situation!

Thank you for your attention.