

## **Keynote speech - FESE Convention 2013**

Berlin

Steven Maijoor

Chair

European Securities and Markets Authority

Ladies and gentlemen,

Good morning. It is a privilege to address the FESE annual convention today, together with such distinguished speakers.

Being a Dutchman let me go straight to the core topic of my contribution: “making markets safe”, which is also one of the topics of this conference. Safe markets are an essential element of ESMA’s mission, relating both to investor protection and to the stability of markets.

However, making markets safe cannot be viewed in isolation, it goes hand in hand with the goal of promoting markets' efficiency, in order to maximise the efficient funding of the real economy and to provide investment opportunities.

ESMA is currently pursuing the goals mentioned above on a number of fronts. A key element in this is the revision of MiFID, where significant progress has recently been made by the European Council.

The further development and deepening of the single market for financial instruments is the means to promote an efficient market that will help in financing the real economy and European growth.

However, it is necessary to ensure the proper development of the market. In this regard, three new and important pieces of regulation come together to form a new regulatory environment that keeps all of us very busy:



1. New MiFID/MiFIR on the trading side;
2. EMIR and the CSDR on the post-trading side; and
3. The Short-selling Regulation and new MAD/MAR on market integrity.

MiFID I introduced competition between trading venues across the EU and it is well-known that fragmentation was the other side of that coin. The new MiFID, rather than a radical change, is largely an improvement of the already existing legal realities: whilst retaining competition, MiFID II sets out a better response to fragmentation and levels the playing field. The revision of MiFID aims precisely at mandating more transparency, maintaining and deepening competition, and ensuring that there are sufficient means for regulators and investors to check the quality of the services provided.

### Transparency

As far as transparency is concerned, I would like to point out the extension of the pre-trade transparency regime to non-equities and a revision of the pre-trade transparency waiver regime, as well as the creation of Approved Publication Arrangements (APAs) and Consolidated Tape Providers (CTPs). This aggregation of market data will allow market players and regulators to acquire a unified view. I do not know if the new rules will effectively bring at least one truly, full consolidated tape; but I think that it would be a lost opportunity if, as some say, they did not.

Putting in place a consolidated tape would bring many benefits, not only in terms of improved transparency and accessibility of data, but also to enable intermediaries' duty of best execution to gain significance as it will be easier to compare the actual execution of orders with other available options. It will also enhance the surveillance function of trading venues, which would for the first time have a consolidated source of all trading in all venues and OTC.

The envisaged transparency regime requires ESMA to determine liquidity estimates and thresholds, in order to define the actual scope of the regime in terms of instruments and the key parameters of the transparency provided to the market. The impact of the measure and the need to adequately calibrate the system should not be underestimated, as it is necessary to set meaningful thresholds around a vast array of financial products, with trading patterns very different to equities, and we need to do that without damaging liquidity. We could say that in the area of markets this is possibly the most substantial and demanding single task left for the Level



2 of the whole MIFID/MIFIR framework. Producing a robust regime will require sufficient time and ESMA will need to engage with market participants for information and views.

### Surveillance

Let me comment briefly on the topic of surveillance of market abuse. Market integrity is a top priority for ESMA. We have been paying a great deal of attention to the issue of whether the surveillance framework of our markets needs a substantial revamp due to market interconnection and prevalence of high frequency trading. We think it does not, but it does indeed need some adjustments that are on the way. An effective surveillance system needs to be based on four pillars: 1) information for regulators; 2) resources dedicated by trading venues; 3) investment firms that detect misconduct and cooperate with regulators; and 4) a fully-fledged enforcement system. Significant progress has been made, and is being proposed, in all four areas: from the expansion of transaction reporting to cover OTC derivatives and include client ID, to the possibility for regulators to access order book data, to reinforcement of the market abuse directive to include manipulation of benchmarks and related instruments and attempts at manipulation.

We believe that, with robust consolidated post trade information, almost all misconduct can be detected either at firm, venue or market level. A true minority, like cross-market layering, will still be hard, but not impossible to detect. Overall, I think that the EU does not need an overhaul of the system, but the continuation of the efforts by all the gatekeepers to act together, including firms, venues and supervisors.

### ETD reporting

Let me make a side-step with an illustration of the importance of transparency for ESMA. I would like to give you an example that does not originate from the MiFID review but rather from EMIR. As many of you are aware, the regulatory technical standards that we drafted on derivatives reporting were published and finalized in March this year. However, we have come to the conclusion that more work is needed in the reporting area. ESMA is about to launch the development of guidelines on how trades in Exchange Traded Derivatives are to be reported to Trade Repositories, since we recognise that more clarity is needed on this type of transactions.

### Regulators' tool box

Earlier in my contribution, I summed up the major regulatory changes in trading, post-trading

and market integrity. This regulatory reform not only results in new requirements for financial markets, it also adds new instruments to the toolbox of the regulator. Are these tools the right ones? To answer this question, a well-known English idiom comes to mind: the proof of the pudding is in the eating.

The EU has taken a big leap towards a single market by enshrining the bulk of the new rules in European regulations, directly applicable and identical in all Member States. The Commission and the co-legislators have to be credited for that. However, in a project of the combined dimension and depth of EMIR and MIFIR, many matters will need adjustment, fine-tuning, the adaptation of rules to market circumstances and, even temporarily, suspending their effect when exceptional circumstances arise. This is what regulators do all the time at national level or in third countries, however we do not have those supervisory instruments at EU level.

Certain matters can be adjusted at national level, some others can be harmonised through guidelines, but others, being set in Regulations, cannot be tackled via supervisory measures. The main instrument to modify the application of the Regulations, the technical standards, remains a rulemaking process, subject to full legislative oversight and requiring several months to come into force.

MiFIR, EMIR and the Short Selling Regulation, will certainly test the effectiveness of the new rulemaking process, the one based on technical standards. Let me explain that a bit more.

The trading obligation, like the clearing obligation to which it is related, is an act of general application, meaning it binds all EU counterparties, that the EU legal framework requires to be enshrined in a piece of EU law. Hence, a trading obligation will be achieved with a regulatory technical standard developed by ESMA, adopted by the Commission and non-objected by Parliament and Council. However, we need to be aware that it is a decision based on the liquidity of a financial instrument over time, which can change very rapidly, sometimes in a matter of weeks. If a product ceases to be liquid enough, forcing trading and clearing will increase the risks, not reduce them. In other jurisdictions, this is more of a supervisory type of decision, but we do not have EU-wide supervision for this at the present time for securities markets.

Let me be clear, ESMA is very happy with the new instruments in its toolbox, and we will fully respect the conditions and instructions that come with these new instruments, however, we need



to be aware that where we use technical standards, many other regulators are using supervisory measures. Hence, the swiftness with which we will be able to adopt, review and even reverse those standards in the EU, depending on market changes, will determine the effectiveness of the new instruments in the tool box.

### Investor protection and securities markets funding

Let me in the remaining part of my contribution return to the topic of securities markets and the funding of the real economy. With the banking sector in difficult territory, many have expressed the hope that securities markets will become a more important source of funding. For me, this hope can only become a reality when we improve the protection of investors, and especially the protection of retail investors. Let me explain that briefly.

The frequently used example of a better balance between bank funding and markets funding is the US. In that context, a statistic that I would like to share with you is the strongly increased participation of households in US securities markets in the past 30 years: an increase from about 45% to about 65% of all households. The Harvard professors Greenwood and Scharstein convincingly argue in a recent article<sup>1</sup> that this development played a key-role in lowering the cost of capital for listed companies, and has especially benefitted young entrepreneurial firms.

It is obvious for me that we can only increase the participation of the retail investor in securities markets when he feels he is sufficiently protected. While a lot has been achieved with the regulatory reform, it is fair to say that there has been a strong focus on stability-prudential concerns. Completed pieces of legislation like CRA, CRD4, EMIR, and AIFMD illustrate this point. Of course, investors indirectly benefit from stable financial markets, but more is needed to convince them to accept risk when investing in securities. Pieces of legislation that will directly improve the protection of investors are still in the pipeline: MIFID/MIFIR, MAR, and PRIIPS. I sincerely hope that these will be completed as soon as possible, and with the strongest possible investor protection measures. Now is the time to restore the balance between stability-prudential concerns and investor protection concerns at EU level. This is needed for successfully growing securities markets and a better funding balance of the real economy.

Thank you for your attention.

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<sup>1</sup> Robin Greenwood and David Scharfstein, "The Growth of Finance", *Journal of Economic Perspectives*, Spring 2013.