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Speech by Steven Maijoor, Chair of ESMA,

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"How to restore European household's confidence in long term savings & investments"

Ladies and Gentlemen,

Let me thank EuroFinUse for inviting me to this conference on "Better Finance". I believe this event is touching on a crucial aspect of the on-going policy and regulatory work, and I am delighted to speak as part of such a distinguished and representative line-up of speakers.

Allow me to begin my thoughts by summarising the current situation of the European financial sector: The effects of the financial crisis and the subsequent EU sovereign debt problems still linger on. There are

— expectations for further bank deleveraging,
— a reluctance in the private sector towards raising capital on equity and debt markets,
— and only slowly receding doubts among investors about the stability of financial markets.

But the situation is improving: The progress on implementing the post-crisis regulatory reform agenda as well as addressing the sovereign-bank nexus are vital building blocks for fostering confidence in the markets. In addition, the recent economic stabilization – reflected by an expected

growth rate of 1.5% for 2014 in the EU – is already starting to lift the spirits of entrepreneurs and their appetite to engage in additional investment.

This newly revived appetite requires new funding, either intermediated by banks or from securities markets. As our banking systems are going through an important phase of transformation, markets and policy makers increasingly look to securities markets for fresh impulses. And I very much concur that we need to explore what funding opportunities we can develop through capital market financing.

Let me first take a look at the potential funding sources. From a birds-eye view, capital sources include direct investments in securities by private investors, or indirect investments through institutional investors, such as asset managers, pension funds and insurance companies.

The potential of these investments is considerable: In 2013, EU household savings brought to the financial markets either directly by private investors or through institutional investors amounted to roughly 260 billion euros. This compares to 140 billion euros which were invested in bank deposits in that same year.

Despite this very substantial supply of funds in the EU, a look at the demand side shows that the appetite for funding is much larger. The gross new issuance by sovereign borrowers alone amounted to more than one trillion last year, and on top came 800 billion euros worth of issuances by corporates. While net issuances in that period were at 150 billion euros significantly lower, it is clear that the appetite for funding in the EU is very strong, with sovereign and corporate issuers strongly competing for investor attention.

Based on these very rough figures, it emerges that one important question we may need to consider is how to further encourage investments in the EU securities markets. In particular, this brings us back to the perennial question of how direct investments in securities markets can be made more attractive. And also, institutional investors have to consider what their role can be in providing long-term funding via corporate debt and equity markets.

The solution to the first question is inherently related to the trust of retail investors in financial markets. Indeed, trust is the necessary pre-condition to convince investors to transfer some of their carefully saved income to another entity, which they may not know in detail and which then goes on to use their funds to undertake a productive activity. With investor sentiment indicators remaining below zero since 2011, this trust has recently been moderate at best. And, while losing trust can happen quickly, restoring it is difficult and can take time. With the implementation of the post-crisis reform agenda, policy makers have already laid important foundations for safer securities markets and a return of investor confidence, and I will give you more details on that in a minute. And, indeed, supported by the economic recovery, we currently witness a return of investor optimism, in particular also illustrated by markedly improved expectations for the future.

In structural terms, however, the relative conservatism of European private investors persists – in the last 10 years they reduced their securities holdings from 27 to 23% in their portfolios. This compares with almost 40% in the US. Of course, this structural difference between the EU and US goes

back a long way in history; and strong cultural forces are at play. Also, we should not forget that the EU itself is very heterogeneous in that respect.

Nevertheless, additional opportunities seem to exist for enhancing financial proficiency by promoting transparency and investor protection through adequate legislative and regulatory measures. In addition, highlighting the relative long-run outperformance of yields on equity and debt securities compared to deposit interest rates can offer an appropriate way to create additional incentives in this area. Of course, it is important to acknowledge in this context both private investors' risk aversion and potential temporary deviations of returns from their long-term pattern.

Concerning the second question, recent changes in regulation and supervision – which, I should stress, were necessary changes – generated positive as well as negative incentives for the asset management industry's involvement in securities markets and direct lending. On the one hand, those measures definitely helped to sustain financial stability and to decrease the amount of systemic risks perceived by investors, which is also reflected in improving risk metrics observed by macro- and micro-prudential supervisors through the Union. On the other hand, we should be willing to admit that certain adverse side effects, such as low yields due to persistent liquidity support, put, at least temporarily, pressure on the business models of some asset managers.

Concerning new funding channels, we observe with great interest the emergence and growth of market practices associated with shadow banking, such as loan origination by funds, securities financing transactions, a responsible revival of securitization and even more recent funding forms,

such as crowd funding, to name but a few. We recognise that these markets can yield benefits for market participants, but we are aware of the various risks involved, which we are mandated to identify, monitor, and manage, if needed. Nevertheless, these activities can help to fill in for traditional funding channels that are temporarily hampered and may contribute to two objectives: first, a successful transformation of the EU financial sector towards a more diversified structure, which is less dominated by intermediation through the banking sector; and secondly, to the channelling of more funding to Europe's real economy.

As I mentioned earlier, there seems to be a sufficient level of household savings available. What remains is to steer this funding – either through direct markets or via institutional investors – to the financing of the real economy. If we can unlock Europe's lending bottleneck in this way, we will help foster the green shoots of economic growth in Europe that we have seen recently.

Turning to the field of policy, the first reaction to the crisis by policy makers at EU and international level has been, understandably, a wave of regulatory initiatives in the prudential area, in order to provide the conditions for financial stability at micro and macro prudential level. We have to recognize that the focus on the protection of investors has come rather late, at global level, in comparison with the reaction in the prudential area.

This is also true at EU level. On one hand, it should certainly be noted that the EU seized the opportunity to focus on the protection of investors when drawing the lines of the new EU supervisory architecture; indeed,

enhancing customer protection and specific tasks in the area of consumer protection are part of the regulations establishing the three European Supervisory Authorities (ESAs), including ESMA. On the other hand, the legislative process for specific pieces of legislation aimed at strengthening the protection of investors started with significant delay. It is sufficient to mention the review of MiFID, the regulation on Packed Retail Investment Products (so-called PRIPs) and the review of the Insurance Mediation Directive to confirm this perception. In all these cases, the final picture of the respective frameworks will be clear only in the years to come. For instance, just to mention the MiFID review, the "Level 2" legislation will need to complement the "Level 1" and the full package will only be applicable 30 months after entry into force.

That said, it should be clear that restoring investors' confidence is a basic yet crucial objective of any regulatory and supervisory intervention aimed at increasing households' appetite for long-term investments. With this objective in mind, I think we can identify three key building blocks for a stronger investor protection framework:

1) disclosure

2) advice

3) supervision.

Strengthening disclosure is the traditional regulatory response when regulating investments. It is clear, however, that in the context of increasingly complex markets, disclosing information to clients is not sufficient. The idea of well informed and self-confident investors has shown

some limits, arising from the inability of the average investor to understand the intricacies of complex and innovative instruments. Furthermore, in a number of cases, intermediaries have interpreted disclosure as a formalistic process in which compliance with information requirements has been delivered through the collection of clients' signatures on disclosure documents.

Notwithstanding these limitations, well-designed information requirements remain important and we welcome the regulatory efforts to improve the quality of disclosures and increase the relevance of information provided to clients. I would like to stress, in this context, the merits of the initiative on PRIPs, which seeks to achieve two main objectives:

1) providing clients with short, clear and standalone Key Investor Information Documents building on the UCITS experience; and

2) overcoming the traditional silo approach (banking, securities, and insurance), knowing that the average investor is not concerned about the legal form or label that applies to a product but rather on the economic features it offers.

We are therefore worried, by the apparent lack of political agreement in the PRIPs negotiations. Despite this delay we will maintain our level of readiness to work, together with the other European Supervisory Authorities, on developing detailed rules on format and content of the new PRIPs KID as well as on the methodologies for the calculation of the disclosures of risk and costs.

Again on disclosure, we also appreciate the new requirements in MiFID2 that aim at aggregating all costs and charges of products and services in order to allow clients to understand the overall cost of their investment as well as the cumulative effect on return of the investment.

In the wider context of improved information I would like to mention another achievement of MiFID2, which is the extension of the EU regime for pre- and post-trade transparency beyond equities. The new regime is designed to help investors to remain informed over time about the market value of their investments, including in the non-equity space. This should also be of help to retail participants investing directly in the bond market which can benefit from overall more, more standardised and more consolidated information from secondary markets trading in bonds. ESMA is in charge of designing the implementing measures for this new and highly complex non-equity transparency regime and, of course, happy to receive proposals from retail investor organisations in making this regime useful for them.

The second building block that I mentioned is advice. We cannot deny that average investors often rely on recommendations from banks and investment firms when deciding how they allocate their investments. MiFID2 will strengthen the regulatory treatment of advice by introducing the distinction between independent and non-independent advice. MiFID2 will also intervene on one of the root causes of unsuitable advice by regulating already at Level 1 the conditions for the receipt by intermediaries of payments from third parties (inducements), including by banning such payments in certain cases (portfolio management and independent advice) and by requiring such payments to be designed to enhance the quality of the

service to the client in the other cases. In the same context, MiFID2 also emphasizes the importance of the remuneration of staff as a potential source of conflicts of interest.

Other important measures aimed at improving the quality of investment products reaching the market in the years to come are about product governance. MiFID2 will bring forward and broaden the area of regulatory intervention by focusing on the process for the "manufacturing" of financial instruments before they are marketed or distributed to clients. New requirements will include the identification and the review of the target market for each financial instrument as well as the assessment of the consistency of distribution strategies with the identified target market. I am confident that these measures will also help improve the quality of advice provided to clients.

From our side, ESMA has made use of its powers since its establishment in order to lay the groundwork, to the extent possible, for the regulatory evolution that I have just described. On advice and remuneration, ESMA published detailed guidelines concerning the application of MiFID suitability requirements and remuneration policies and practices. On product governance, after adopting, together with the other ESAs, high level principles on manufacturers' product oversight and governance processes, ESMA has published yesterday an opinion on the governance of structured retail products.

Furthermore, in the context of MiFID2, ESMA is preparing its consultation concerning the detailed measures that will implement the new MiFID2 requirements.

I would like to mention that we will publish two different documents depending on the nature of the deliverables expected from ESMA and the ESMA deadline for delivery. A discussion paper will cover areas for which ESMA will be in charge of proposing technical standards while a consultation paper will cover areas for which Commission delegated acts are required and the role of ESMA will be to provide a technical advice to the Commission. Most consumer protection issues will be dealt with in the consultation paper.

Due to the importance of this consultation to shape the details of the MiFID2 provisions in the coming years, we strongly encourage stakeholders, including retail investors and consumers associations, to take active part in the consultation that will start in the coming months. It will touch upon topics across the full cycle of the provision of investment services to clients, ranging from the authorisation of investment firms via their organisational requirements through to point-of-sale obligations.

The third building block I would like to focus on is supervision. I would like to mention two aspects: strengthened supervisory powers and supervisory convergence. MiFID2 will introduce powers for supervisors at EU and national level to restrict products, activities and practices which are potentially detrimental for investors. Although we very much appreciate these new powers, in order to avoid overestimating their potential impact I should stress that several conditions and limitations will make these powers an option of last resort rather than an ordinary tool available to supervisors on a day-to-day basis. In parallel with the development of technical advice for the future implementing measures, ESMA is also deploying significant

efforts to improve its ability to monitor the markets and to identify products deserving attention in the context of the new powers.

On supervisory convergence, I consider that ensuring the actual application of the rules on the ground is a crucial area for ESMA and the other ESAs. ESMA has recently released an opinion to remind national supervisors and firms about the importance of MiFID requirements for the sale of complex financial products. This opinion, together with the guidelines on suitability and remuneration mentioned above, already pursue the objective of promoting convergence. We will intensify our efforts on supervisory convergence in the coming years.

In addition to the three key areas I mentioned, please allow me to spend few words on financial education. Investors around the world display limited knowledge and understanding of financial products and concepts. Low levels of financial literacy among the majority of the population are prompting governments at global level to take action. Financial education, while not being a panacea, can improve the ability of individuals to use financial products and services and participate in financial and economic activities. As recognized in the G20 context, such measures can also help in promoting economic recovery and growth, supporting small and medium enterprises and boosting the creation of new jobs.

Financial education can therefore be a factor contributing to change a cultural approach that has kept households at EU level far from long-term investments.

At the end of my intervention the question arises whether all of this will be enough to revitalize and increase the interest of households in increasing

their exposure, directly or through asset managers and other institutional investors, to long-term investments. While this is unlikely to be an objective fully achievable in the short-term, I am confident that the intervention in the areas described above will provide an important contribution to restore investors' trust.

That trust is seriously undermined due to the crisis and because of a poor service culture among intermediaries, which resulted in serious lack of transparency, promises of unrealistic returns and unexpected hidden costs. In turn, I am convinced that regaining the trust of investors and financial consumers will provide a real boost to investors' confidence in long-term investments.

Thank you for your attention.