European Securities and Markets Authority

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Financial markets and the new normal monetary policy

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Steven Maijoor
Chair
European Securities and Markets Authority

Ladies and Gentlemen,

It is a pleasure for me to again be part of the Asian Financial Forum. When I spoke here last year, the Policy Dialogue focused on how we could progress the implementation of the global regulatory agenda together. At that time, I think it's fair to say that most of us would have expected the level of interest rates to remain extremely low for quite a while and so formulated our arguments accordingly.

However, times are changing and today we are here to talk about the first steps towards 'interest rate normalisation'. Indeed, I find the expression 'normalisation' appropriate, if not catchy, in this context because the persistence of such low interest rates is not normal in the economy although it is easy to forget that given recent years. I am not a central banker therefore I will not judge the monetary policy of respective jurisdictions. Rather, I want to concentrate on the impact which these years of abnormally low interest rates have had on financial markets and talk about the potential consequences of a change in this area. In particular, I will speak about the impact of low rates on investor behaviour, liquidity and the role of the non-banking sector in general. These are the three key issues linked to the current exceptional monetary policy that we have observed from the perspective of securities regulators.

Firstly, let me touch on what we see regarding how investors value assets in this environment. The low interest rates – also simply called 'cheap money' – incentivise search for yield behaviour. What is of particular concern to me as a regulator is that they tend to

have the effect of reducing investor discipline in undertaking appropriate assessments of the risks to their investments, and to increase investors' appetite for leverage in the hope of greater returns. We are also seeing traditionally conservative investors move towards less liquid investments which promise higher returns than they could otherwise receive. Consequently, a low rate environment does risk creating bubbles, which is consistent with some of the corrections we have seen recently. We are all well aware of the big hits that the Asian and world-wide equity markets have taken in recent weeks after an earlier similar large sell-off in Asian equity markets in August last year.

Secondly, the current monetary policy has had a significant impact on liquidity in financial markets. However, structural changes to market liquidity are not only due to monetary policy but also to changes in technology, competition and, indeed, regulation over the past decade. There are strong concerns about the current levels of liquidity and I would underline that liquidity remains a complex issue for regulators to address. I am very much of the view that regulators' assessments of liquidity should be based on evidence and take into account the specificities of different market segments, given the difference between asset classes such as equities and bonds and even within asset classes, such as sovereign bonds and corporate bonds. I am well aware that there are critical voices around the impact of regulation on liquidity but it is too early at this stage to state, in the securities area at least, whether a new approach is needed.

Thirdly, low interest rates, combined with the scarce supply of bank funding, have boosted the expansion of the non-banking sector. For example, Eurozone non-financial companies increased their recourse to debt securities by 42% over the last 5 years[1] compared to a much lower increase of 7% from bank funding. This rise in outstanding debt has led in part to a 54% growth in the EU asset management sector over 5 years[2].

Let me now look to the near future. Changes to monetary policy are around the corner. For securities regulators, that brings hope that this will ease some of the pressure on capital markets and, therefore, reduce the risks I mentioned. Having said that, I would not want a rise in interest rates to mean that the EU reverts to a bank-centric funding model and we lose all the opportunities and benefits that come with having stronger capital markets.

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[1] Statistics Bulletin, ECB, December 2015

[2] Asset Management in Europe, 8th Annual Review, EFAMA, April 2015

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Europe and Asia need strong market-based funding for their economies. The increasing role of capital markets is the cornerstone of the European Commission's Capital Markets Union initiative, as presented a few minutes ago by Olivier Guersent, and I strongly support these policy objectives: a more balanced financial system as a whole should prove to be a more stable one. Furthermore, if investors have access to good, market-based funding, the pressure on credit supply should ease, and the level of equity capital in EU economies increase.

As you may have guessed, I am a *capital markets optimist* about a future of normalised interest rates but I do believe it is necessary to have in place a few conditions that, in my opinion, are crucial for achieving strong, sustainable and safe financial markets. The magic word is, it won't surprise you to hear, transparency.

I would start with unlocking the private capital of Small and Medium-sized Enterprises (SMEs), which are the backbone of the real economy. On the one hand, such companies need a comprehensive overview of the financing means available to them, including innovative sources like crowdfunding. On the other hand, potential investors require transparency on the financial health and performance of an enterprise, either through a prospectus or through an SME credit score. I consider the biggest challenge for regulators in this area is striking the right balance between disclosure and cost-efficiency, taking into account the different size and nature of businesses, however, I believe it is a goal worth striving for.

Capital markets must continue to be attractive for wholesale market participants too and bond markets in particular already play an increasingly important role in EU capital markets, partly, as I mentioned earlier, due to the low interest rate environment. I'd like to see this greater role become a permanent feature and therefore it should be supported with policy measures where needed. To this end, ESMA submitted its proposed rules on transparency and liquidity for the bond market under MiFID II to the European Commission in September and they are attracting attention from a wide range of stakeholders. I want to emphasise that protecting liquidity is of paramount importance and when I say transparency is the magic word, I am fully aware that transparency applied indiscriminately to illiquid instruments can be extremely damaging. However, we have carefully calibrated the liquidity thresholds and exemptions, based on extensive evidence using large data sets. This should provide investors with the right balance between transparency and protection which, I believe, will contribute to fostering liquidity.

Finally, I believe we should continue to promote the participation of retail investors in the financial markets – even as savings accounts become more attractive again. It is one of our key tasks as regulators to ensure robust investor protection, part of which means ensuring both performance and fee structures of investment products are transparent allowing choice and competition. The EU Regulation on Packaged Retail Investment and Insurance-based Products (PRIIPs) which is currently being implemented serves as a good example of this.

Last but not least, let me underline the importance of supervisory cooperation. Bigger and more interconnected – or if you wish global – capital markets require effective coordination and cooperation between the various authorities around the world. In Europe, we go very far on this: convergence of supervisory practices among European regulators will be an essential part of the Capital Markets Union, and also become ESMA's key activity.

I would like to conclude by recalling again last year's Policy Dialogue: we need to continue to work together on the common regulatory agenda to let capital markets flourish, whatever the monetary policy of the time. As I have said before, we are living in changing times which brings challenges and requires regulators to stay alert. But it also brings opportunities to us all and I believe the rewards will be greater if we step forward and continue to explore them.

Thank you for your attention.