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A bout of birthday reflection

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Introduction

Firstly I would like to thank Financial News for inviting me, this evening, to join you in this wonderful building to celebrate its 20th birthday. I want to congratulate Financial News on reaching this significant milestone which in this day and age, given the disruptive impact of technology we are now seeing in all walks of life but especially in the media, is a substantial achievement and I wish you continued success.

You may not know this but 2016 is also a milestone year for ESMA because we celebrated our fifth anniversary in January. Like Financial News I think a birthday is always a chance to celebrate but also a time to reflect – what have we done with our lives, where are we going, and do we have more wrinkles than last year?

So, I would like to spend the next few minutes to reflect: where ESMA came from, why that represented such a big change from the status quo, and where are we heading in the next five years? I know that most, if not all of you are affected by the rules drafted by ESMA so I will focus in particular on our role as a standard setter and how that process works, something, I think, which will interest Financial News at least, given the cover story in March which mapped out the entire process with the evocative heading “Europe’s Rulemaking Tangle”.

The Past

I would like to start by briefly looking back to the past. As some of you will remember, ESMA, along with its sister organisations, the European Banking Authority here in London, and the

European Insurance and Occupational Pensions Authority, was born out of the 2008 financial crisis. This was a crisis on a scale none of us had seen in our life time and the shockwaves from it are still affecting us today, almost a decade later.

In the immediate aftermath, the crisis laid bare two major regulatory shortfalls: there was no overview of systemic risks in the financial system and no coordination of national responses to problems which arose in interconnected, international markets. Different countries responded differently to the same issues. No one had the big picture and so the consequences of actions taken in one area on another area were not thought through. The lack of coordination also entailed risks of regulatory competition, or arbitrage, because it enabled national financial centres to create favourable rules in order to attract business but which might create risks to the financial system as a whole. These problems occurred at a global level and the G20 worked hard to agree a global response. At the EU level – and of course hindsight is always 20/20 – we can see that what was in place at the time could never have dealt with such a crisis.

So what was in place?

At the time of the crisis, it was ESMA's predecessor, the Committee of European Securities Regulators known as CESR. This was an advisory committee to the European Commission, made up of European securities regulators and supported by a small secretariat in Paris. Principally, it was a means of bringing together regulators and helping them prepare guidance to bring some consistency to EU rules where it was most needed.

However, what CESR did not have – and this is the crucial point - was any meaningful powers. It was 'a soft' approach to regulation, done on a voluntary basis by national regulators and when the crisis broke, it was an approach that proved insufficient.

ESMA, in contrast to CESR, has been cast from a very different mould: it is an independent, specialised EU authority with rule-making powers, supervision powers and powers to respond to stability risks. In short, the crisis led to the creation of EU financial bodies with teeth, independence and - highly important - staff to carry out their new roles. Since 2011 our headcount has increased from about 40 staff to over 200 staff today.

Our rule-making powers are used in developing rules that contribute to what we call the EU Single Rulebook. The purpose of the Single Rulebook is to harmonise technical details where it matters so that there are single standards, critical if the EU is to have a truly single

market in financial services. Also, the Single Rulebook is a requirement to avoid regulatory competition.

Creating ESMA and the other European Supervisory Authorities in 2011 was a real paradigm shift: something, I think, that could only have been achieved on the back of a major crisis when everyone saw there was a need for change and the arguments against a more robust framework no longer stacked up.

The Present

So now to the present.

In our first 5 years, ESMA has developed rules which cover the whole range of legislation under our remit including OTC derivatives, CRAs and asset management which are just a few of the areas: I will refrain from mentioning the many well-known acronyms, which is a hallmark of EU financial legislation. These first years have been hectic ones - I describe it as a time where we have had to build our shop at the same time as running it - and principally have been about designing harmonised rules. But, we are now at the point where most of the rules we needed to prepare are final and in place, or have been submitted for approval to the European Commission and this takes me to where we are today with MiFID II. As it is probably our star-attraction at the moment and the recent developments around it have been much discussed in the media, I would like to spend a moment explaining what can be a very complex process.

We submitted our draft MiFID II technical rules, 42 in total, to the Commission in 2015 who have asked us to amend three standards: those covering transparency for trades in bond and derivatives, position limits for commodity derivatives, and the ancillary activity exemption which is about how to quantify whether a non-financial firm is doing so much financial activity it should be authorised as a financial firm.

The first point I would like to make is that this is a process set down in law: the timelines and parameters on who should do what by when. Once we have submitted draft regulatory technical standards for endorsement, the Commission has three months to decide whether to endorse, amend or reject them. However, what it cannot do is revise a standard unilaterally. This process was set up with the intention that non-endorsement would be rare and demonstrates the independence ESMA has, which I spoke of earlier.

The preamble to the law actually says [I quote] that our draft standards "*should be subject to amendment only in very restricted and extraordinary circumstances"*. The ability to depart from our proposed standards, or refuse the standards we propose, is carefully limited. If the Commission decides not to endorse the standards or request an amendment, as it has done for MiFID II, it must send the standards back to us, along with the reasons why any changes are needed. We then have six weeks from the date of the Commission's notification to resubmit the standards with the changes that we consider to be necessary.

You might be wondering why I am spending so much time on the legal arrangements regarding rule making, especially as you may know I am an economist, not a lawyer. The reason is this: these detailed arrangements reflect the philosophy, which is embedded in ESMA's founding regulation, that technical rules for capital markets should be developed by independent technical experts. Why? Because to ensure well-functioning capital markets it is important that the technical realities are understood and are reflected in the applicable implementing rules.

So where does this process leave us in relation to MiFID II?

While there is a lot of focus, by us, but also in the media, on the three standards which the Commission wants us to amend I want to emphasise that this is only about 3 out of 42 standards. While we have not seen the final endorsements, I expect that the Commission will endorse the overwhelming majority without amendment which, given the complexity and breadth of MiFID II, is a great achievement. In addition, let me also emphasise that the Commission followed our technical advice to a very large extent when producing its delegated acts which were published recently.

Still, there have been a couple of anomalies to the process. The clock for an endorsement decision should have stopped at the end of December, three months after we sent most rules to the Commission. However, we only received the official notification on 20 April that three of our MiFID II standards required amendment. I use the word 'official' because we initially received letters from the Commission requesting amendments to three technical standards in March and it was unclear to us at the time whether these formed part of the process. We sought clarification from the Commission which resulted in the official letters in April**.** Our six week period to respond started on 20 April which means we have to revert to the Commission on these three standards by 2 June.

We have already provided our reactions, or so-called Opinions, regarding the proposed amendments to two of the standards – those on bond transparency and position limits - and we have changed them in line with the proposed amendments by the Commission, also taking into account the views of the European Parliament and Council.

However, we have deviated on one point from the Commission's proposal regarding bond transparency: how the phase-in of the transparency requirements should work.

The Commission proposed the standards should set the liquidity criteria for the first year only and ESMA should then conduct an annual assessment to determine whether and what adjustment should be made. This annual assessment is now included considering the general concerns about bond market liquidity. In the case of a favourable assessment, meaning the criteria could be tightened so that more bonds are captured by the transparency requirements, ESMA would have to amend the existing standard and so the whole regular legislative procedure for changing the rules would kick in.

I want to stress that overall, my Board supports the more cautious transparency regime suggested by the Commission. However, we have proposed that the phase-in, including the intended annual assessment of liquidity, should be included in the technical standard itself from the outset, rather than after an annual assessment and, in the case of a positive outcome, a request to change the technical standard. We believe our approach gives clarity to all involved, and implements the wishes of the co-legislators to bring meaningful transparency to the bond market. Equally, the liquidity assessments are of a technical nature, and going through multiple legislative processes will imply bigger resource implications for all involved.

Our Opinion on the final standard which we have been asked to amend – on the ancillary activity exemption - will be issued shortly.

There are challenges to the rule-making process. What we have learned over the first five years is that it is difficult to specify something at a technical level when the overarching direction, the political intention, is unclear or contentious in the basic law. Political problems cannot be solved with technical solutions.

It is to try to help smooth this process in the future that ESMA, along with EBA and EIOPA, has raised the possibility of introducing measures which would allow us to obtain a better insight into the intentions of the European Parliament and Council when the laws are being

made. At the moment, we are not present in these discussions and this has made it more challenging at times to fully understand the intentions behind the final agreed law and our own empowerments. Throughout my tenure, I have emphasised our willingness to work as transparently as possible with the EU institutions and I will continue to pursue that course.

The Future

And so this takes me to the future.

We have almost completed the main part of the Single Rulebook and we are moving to what we call 'supervisory convergence' or more prosaically, the 'implementation stage'. Having written the rules, we want to look at the actual practices of supervisors in the EU and ensure that those practices meet a minimum standard and are consistent throughout the EU. This matters in avoiding situations where some participants look to exploit regulatory arbitrage between national markets. I intend to see ESMA play an important role in ensuring there is consistency in how regulation is implemented, supervised and enforced on the ground across the EU.

We will also closely monitor the impact of our rules on the market and because they are more flexible than the legislation they come from, we will amend them when needed, as we have already done in the past.

Finally, looking to the very near future there is of course the UK referendum, now less than a month away. I am often asked for ESMA's view on the referendum because, after all, we are the EU authority for securities markets and the UK is the EU's largest capital market, as well as being a key international player, it also possesses large amounts of expertise and experience which is of enormous value to us.

Like everyone else, I am awaiting the result of the referendum and that decision rests with the UK voters. As part of our remit on financial stability, we are monitoring securities markets for any potential impacts related to the upcoming referendum and as a public authority we are engaged in scenario planning related to the referendum's potential outcome.

Let me make one additional remark from a securities markets perspective, while fully recognising that the referendum is about much more than that. The Capital Markets Union is all about creating size, and the benefits this will bring, like more competition and more choice. Needless to say, that we need all 28 national capital markets, and especially the

biggest one, to make the CMU a success. Beyond this, all I can say is that I will be watching the news with great interest on 23 June as the results come in. I dare say so will you.

Conclusion

So with that quick tour from the past to the present to the future I will conclude my bout of birthday reflection.

I decided to check before I came here, out of curiosity, what gifts are appropriate for a 20th anniversary and apparently it is traditionally China although in the modern era, platinum is also acceptable. For a five year anniversary it is wood or silverware. Admittedly this is for weddings, no such list having been created for financial journals or EU regulatory authorities. Paper, I suppose, would probably be the most appropriate for both of us but returning to where I started, the pace and impact of technology we are seeing is phenomenal. We at ESMA see it in constant financial innovations as much as you in the markets and media are experiencing it.

Thank you again to Financial News, and I wish you all a very pleasant evening.