30 January 2023
ESMA22-106-4366

Summary of Conclusions

Securities and Markets Stakeholder Group

Date:	15 December 2022
Time:	10:00h – 16:00h
Location:	Online meeting
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No Item

1. Report from the Steering Committee

The SMSG Chair reported that the SMSG, since the last meeting, had finalised two pieces of advice: 1) The advice on depositary receipts and geopolitical risks; 2) The advice to the Call for evidence on the implementation of SRD II provisions on proxy advisors and the investment chain.

The SMSG Chair welcomed François Masquelier, as the new SMSG member.

2. Adoption of summary of conclusions from 5 October 2022

The summary of conclusions was adopted.

3. Recent market developments

3.1. Recent market developments

a) Barbara Alemanni (SMSG member) presented the results of a recent study on the financial and risk literacy of Italian households.

She explained that the investigation was largely inspired by behavioural economics and that advanced data analytics tools were employed to conduct semantic analysis of the answers to open questions, used to track experience and to measure the sentiment of Italian households with respect to financial and insurance matters. The survey was addressed to 3 500 Italian individuals in July 2022 and based upon OECD/INFE protocol on financial literacy (knowledge, behaviour, attitude).

It was explained that the Edufin index was used to analyse the answers to the questionnaire; it comprises two sub-indexes: the awareness index rates how much people appear to know about financial and insurance matters, the behavioural index, is a composite indicator of different elements such as how people perceive and appraise risk, and how they invest and protect themselves. In terms of the findings, Italian households are generally financially illiterate and women, generation Z, unemployed people, and people living in the South score lower than the average. She illustrated that the gender gap appears to be lower in terms of the behavioural index since women score above average in attitude and sentiment. Overall, the data are consistent with literature on the topic of financial literacy. She explained that awareness, more than knowledge, correlates with financial and insurance behaviour. Furthermore, risk literacy is very low and this seems to be a common pattern across European countries. Numeracy and risk numeracy appear strong predictors of financial and insurance behaviour.

SMSG members discussed the results of the study. ESMA staff thanked her for the interesting analysis carried out and highlighted the need to improve consumers' financial education and literacy at national and European level together with the importance of investor education and financial education initiatives.

b) Guillaume Prache (SMSG member) presented the Better Finance 2022 annual research report on the real returns long-term and pension savings in Europe, highlighting the impact of inflation on pension savings. He explained that the rise of inflation is not only due to short-term economic and political issues but is always a monetary phenomenon since the current upsurge of inflation has been enabled by the unprecedented increase in money supply by the ECB. Inflation is a fact for mid-and long-term savers. He also emphasised that for about the last ten years, the EU has entered an era of financial repression, which is reaching a historical high this year in 2022. He recommended the importance for the ESAs to account for the risk and negative impact of inflation in the annual cost and past performance reports by increasing awareness and education and providing, where relevant, both nominal and real returns of long-term saving and investment products. Finally, he concluded by presenting the following policy recommendations: 1) Harmonise and reinforce rules to curb conflicts of interest in the distribution of long-term and pension savings products; 2) Restore standardised relative past performance disclosure for all long-term and retirement savings products; 3) Provide simple, intelligible and comparable reporting on the long term and pension products across the EU; 4) Enable long-term equity investors to access collective enforcement tools; 5) Use tax to incentivise Pan-European long-term retirement savings and investments over consumption and short-term savings. In particular, it was highlighted that Member States must stop exploiting the "monetary illusion" to abuse pension savers and they must tax the real returns of long-term and pension savings.

SMSG members suggested that Better Finance may investigate further the role of defined contribution schemes for the sustainability and adequacy of the pension systems and the level of retirement income that one can expect from a defined benefit scheme as opposed to defined contribution scheme for equal contribution periods.

SMSG members discussed different aspects, including the differences amongst the Member States in relation to savings and investments in financial products. SMSG members also mentioned the decision taken by the Polish competent authority (which was partly found non-compliant by EIOPA) against insurance-based investment products that generate low or negative average returns to customers.

Finally, ESMA staff highlighted that the retail investment strategy will address some of the points mentioned in terms of transparency and costs and value for money, especially for some of these insurance products. Furthermore, ESMA staff thanked Better Finance for the interesting analysis provided and its contribution to investor protection, while ensuring its commitment to monitoring carefully the development of inflation risk and its impact from an investor protection and financial point of view.

3.2. Recent market developments

c) Christian Stiefmueller gave a presentation on the crypto exchange FTX. He explained that the latter was a global operator of exchanges for crypto assets and was established in 2018 in Hong Kong, and then moved to the Bahamas. The company operated globally through a network of more than 100 subsidiaries and associated companies. While the network was very poorly documented, the global customer base was estimated to be around 1 million. It operated in the European Union through a licensed subsidiary in Cyprus. The company was a crypto conglomerate, operating, on the one hand, as an exchange trading platform and as a broker-dealer. Furthermore, it was acting as a market maker in crypto assets, particularly active in the derivatives markets, and it provided custodial services. FTX was associated to Alameda Research. There was a clear transfer of assets between FTX and Alameda Research, but the relationship with Alameda Research was not properly documented and is still unclear. FTX and its related companies filed for bankruptcy under Chapter 11 in the US and respective jurisdictions. The total assets and liabilities of the company are still unknown, but the estimates go from 10 billion to 50 billion. There was no consolidated oversight of the corporate structure and no transparency of the corporate relationships. No fit and proper tests applied and it appears that the main shareholder and CEO of the company had very little oversight on a day-to-day basis. There was no asset segregation, and client assets were misappropriated. The structure was decentralised, and this feature highlighted huge jurisdictional issues. The operations in the US were legally run on an entirely separate basis. The company owned or controlled a capital markets entity, a broker-dealer entity, which had been fined in 2016 for manipulation and manipulating penny stocks trading. It was also explained that it owned a derivative entity that was supervised by the CFTC and became the European operation for FTX. As part of the bankruptcy procedures, there are extensive issues between EU and US regulators about establishing jurisdiction between the CySEC and the CFTC and between authorities in the US and the Bahamas for control of the assets. It was highlighted that there are communication and cooperation issues on the supervisory side, investor protection and prudential issues. Another issue that is specific to crypto assets is the problem of classification of these assets and efficient trading, with particular regard to FTX tokens because these can be classified as hybrid tokens. The speaker concluded by asking what impact FTX has on the EU and EU clients and investors, what is the actual exposure, who is affected and how EU investors can actually recoup potentially some of their assets, and how this episode affects the wider financial markets. Finally, he suggested a reflection on whether MICA will provide adequate safeguards since many of the critical issues have been passed from level one to level two of the legislation.

Emilios Avgouleas (SMSG Member) presented a paper in relation to the biggest challenges facing policymakers with respect to crypto markets and the treatment of crypto lending.

SMSG members discussed the presentations, highlighting the resemblance to the Wirecard case (fraud, lack of oversight), pointing out that there is no investor compensation scheme for crypto assets, and questioning whether MICA will be sufficient to remedy the current shortcomings.

ESMA staff highlighted that some of the issues of FTX are related to the corporate and managerial sides with all its facets and are not fundamentally or at least inherently related to crypto assets. Overall, it was noted that the questions regard the impact of FTX on clients and the adequacy of MICA. Exposures in the EU based on 1 million users globally, of which just under 10% are meant to be in the European Union and mainly in a small number of Member States. In relation to the potential forward risks, ESMA staff remarked that MICA will provide requirements across key areas such as registration, supervision, transparency, and conduct of business. At the same time, the FTX case seems to have involved criminal activity, which in general cannot be prevented by regulation and supervision. It was highlighted that, in the crypto space, incidents like this may happen again, especially in light of weaknesses and corporate controls such as those at FTX. ESMA loss scenarios illustrate the limited size of the crypto asset markets, when looking at the grand scheme of things of traditional markets. However, the high crypto-asset exposure to individual traditional investors and creditors could lead to a massive impact on the entity level in the traditional world. The scale of the total loss scenario on progressive markets is not systemic, but given the current time, market fragility and volatility, and EU global finance, downward spirals in case of a critical event in crypto assets could not be excluded. ESMA staff highlighted that the adoption and implementation of MICA are a priority and that ESMA remains also vigilant through the internal crypto-asset taskforce evidence.

3. Mandate to ESMA on SRD II

Christiane Hölz and Florence Bindelle (SMSG members), co-rapporteurs of the working group, presented the Group's advice on the mandate to ESMA on the review of SRD II, which had been adopted in written procedure in between SMSG meetings. Overall, the SMSG considers that the transmission of information along the intermediaries' chain remains not fully satisfactory. In fact, it was highlighted that in only 37% of cross-border voting attempts, the information flow between issuer and investor through the intermediaries chain works properly. In all the other cases, the investors had to search themselves the information about a general meeting for example, in 63% of all cases, the shareholder did not receive the information from the product bank. When shareholders tried to vote in another member state, in 45% of all of these attempts, they did not succeed to exercise the basic rights to vote their shares in another member state. One of the main problems is the delayed implementation of SDRII and its implementing regulation, for example, in Spain or in Croatia, which was problematic for intermediaries. Also, on the intermediary side, there is still a lack of the same language format. Furthermore, there are problems regarding general meetings for retail investors on cost and charges such as in Denmark and Luxembourg. It was highlighted that retail investors had to pay sometimes more than 250 euros to get an admission ticket for a general meeting in another member state which deprives retail investors of exercising their rights. It was found that neobrokers do not always support investors in exercising their voting rights in another member state and even publicly stated in the terms and conditions that they are not obliged to do so. It was also highlighted that there is a complete duopoly in the market of proxy advisors.

ESMA staff thanked the SMSG for the advice which is very detailed and covers several of the main issues touched upon by the ESMA call for evidence, both in the area of proxy advisors and the investment chain. ESMA will duly take into account the input received, together with that collected via the call for evidence.

However, in order to manage expectations, it was highlighted that certain requests to ESMA included in the SMSG advice, such as "an in-depth analysis on general meeting-related costs and charges invoked by intermediaries" or an analysis of "the de facto duopoly" in the proxy advisory market or "whether the intermediated systems currently in place and current CSDR framework needs to be reassessed" may go beyond the mandate received from the Commission.

In view of the fact that this topic is also highly relevant for EBA, the SMSG decided to send its advice also to EBA.

4. EU Sanctions

Christiane Hölz and Rainer Riess (SMSG members) presented the Group's own-initiative advice on depositary receipts (DRs) and geopolitical risks, which had been adopted in written procedure in between SMSG meetings. They provided an introduction to DRs, including the different types, and described some of the advantages and disadvantages of them. They then detailed issues experienced in the DR market for Russian entities following the sanctions against Russia due to their invasion of Ukraine in February 2022. They concluded that there are strong investor protection concerns and more general questions on the regulation of DR programmes in the European Union, in particular how to ensure that the asset rights of EU investors in Russian DRs are maintained to the largest extent possible. In addition, the Russian example has shown that investors are not fully aware of the risk inherent to DRs. The advice describes the need for an EU DR regulation.

ESMA staff thanked the Group for the advice. They pointed out that, while sanctions and any considerations of a DR regulation are in the remit of the European Commission, ESMA had facilitated understanding of the impacts of sanctions between the European Commission and NCAs.

The SMSG Chair suggested that the advice should be sent to the European Commission which was approved by the Group.

5. Greenwashing and Fund names

ESMA staff presented the consultation papers on the call for evidence on greenwashing and on the guidelines on funds' names with ESG or sustainability-related terms. They described, in particular, the dimensions that characterise greenwashing and the threshold mechanism of the guidelines. They noted the risk to investor protection of greenwashing.

Urban Funered and Adina Gurau-Audibert (SMSG members) described the ongoing work of the working group on the two consultation papers and provided some first feedback of their discussions. They brought up several topics that the working group was considering including the importance of reliable data, the phenomenon of green bleaching, the need to make use of existing legislation such as MiFID and CSRD, consumer frustration, and financial (non-)literacy inter alia. They asked the Group for any examples of greenwashing. They asked ESMA about the links between the two consultations and what their next steps will be once the consultation responses have been received.

When reacting to the presentations, SMSG members noted the negative impact of allegations of greenwashing on retail investor confidence but also the lack of a framework for issuers. They noted that some allegations of greenwashing could come from differing expectations or misunderstanding of the product by investors.

ESMA staff clarified that the political drive to green investment coupled with investor demand could mean that the risk of greenwashing is high. ESMA therefore wishes to provide advice on the greenwashing issue and also to provide concrete help to the market, for example on funds' names.

6. 2021 CCP Peer Review

ESMA staff presented the results of the annual peer review of NCAs' supervisory activities in relation to CCPs. The reporting period covered January 2020 to June 2021 and was focussed on business continuity in remote access situations. The review observed that NCAs and CCPs could better clarify how remote access operational risks are addressed and business continuity plans could be improved by taking into account other extreme scenarios where remote working could be used. The review also identified ten best practices.

7. Prospectus Peer Review

ESMA staff presented the results of the peer review into the scrutiny and approval procedures of prospectuses by all competent authorities (CAs) in the EEA zone. Overall the review found that CAs were meeting expectations; it sets out recommendations including that ESMA could consider developing a framework for a risk-based approach to prospectus scrutiny, as well as guidance in the area of prospectus comprehensibility, and could undertake further harmonisation of NCAs' enforcement of the Guidelines on risk factors. The review invites the European Commission to consider undertaking a behavioural study on the use of prospectuses and to consider aligning timelines for the refusal of a prospectus at EU level.

SMSG members discussed the results of the peer review.

8. AOB

The SMSG Chair reminded the Group of the importance of attending working group meetings in order to take part in discussions prior to drafting.

In response to a question from the SMSG Chair, ESMA staff clarified that ESMA does not do competition monitoring and it should not be part of ESMA's role. While ESMA's strategy emphasises the importance of having competitive EU markets, it engages with other regulators on an international level with the aim of informing itself of developments rather than monitoring for competition purposes.

ESMA staff informed SMSG members that they would be receiving a request to contribute individually to a survey on divergence from EU rules in order to assist ESMA with its risk-based prioritisation of supervisory convergence activity. If desired, feedback could be provided on how the information received impacted on the prioritisation.

Christiane Hölz (SMSG Vice-Chair) requested that ESMA reinstate the process whereby the SMSG receives copies of the agendas of CWGs. ESMA staff thanked her for the reminder and noted ESMA was in the process of reorganising its group structure and so could take the opportunity to look at how CWG agendas were sent to the SMSG.

The SMSG Chair suggested that the advice on depository receipts and geopolitical risks and on SRD II should be sent respectively to the European Commission and to the EBA which was approved by the Group.