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Keynote Address

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Verena Ross
Executive Director

Ladies and gentlemen,

I am very pleased to be with you today and to have been invited to address this distinguished audience of international securities bodies, regulators and market participants in Hong Kong.

Financial markets today are a global game between a variety of highly interconnected players. Financial regulation sets out the rules of this game.

The post-crisis financial world has seen a strong international response to improving the macroeconomic environment, promoting financial market stability, and advancing structural repair. Over the course of the conference so far you have heard about the importance of maintaining resilience and robust governance in financial institutions, increasingly intense and data driven supervision, and the need to manage the impact of technological innovation.

Against the background of the new regulatory world post-crisis, strong co-operation between regulators is crucial. Not only to identify common trends, risks and vulnerabilities and ways to deal with them, but also to better address supervisory matters affecting firms in multiple jurisdictions.

Today, I would like to give you a view from Europe on a few topics that I hope will be of interest to you. I will be focusing my remarks on:

(i) the EU regulatory framework, and within that, the role of ESMA;
(ii) the work carried out by ESMA in the context of what we call third country frameworks and how I believe this can be further strengthened;
(iii) some of the implications of the EU regulation on Asian firms, using the topic of MiFID II/ MiFIR as an example.

ESMA within the EU Regulatory Framework

In June 2009, the Heads of EU Member States and governments called for a move towards more harmonised regulation and integrated European supervision to tackle the effects of the crisis and to ensure a true level playing field for all actors at the EU level. This reflected not only the attempt to tackle the fallout from the financial crisis, but it also responded to failings in the areas of cooperation, coordination, consistent application of Union law and a lack of trust between national supervisors.

ESMA is part of the wider European System of Financial Supervision that was established in 2011. Like its sister organisations EBA and EIOPA, and together with the ESRB it was given the mission of improving the protection of investors and promoting stable and well-functioning financial markets in the EU.

As an independent institution, ESMA achieves this aim by building a single rulebook for EU financial markets and ensuring its consistent application across the EU. ESMA also contributes to the regulation of financial services firms with a pan-European reach, either through direct supervision (currently of CRAs and TRs) or through the active coordination of national supervisory activity.

In attempting to create a single set of rules and achieve an 'effective EU single market', ESMA relies on input not only from national competent authorities, but also from the wider stakeholder community. This includes the key market players - buy side/sell-side, infrastructure, issuers, etc. - but also retail investors, and small and medium size companies. We also have close relationships with the European institutions, the European Commission, the European Parliament and the Council of Member States, the latter two we are formally accountable to.

On the international side, we foster dialogue and cooperation with supervisors outside the EU. We develop contacts, enter into administrative arrangements and regulatory interact with the supervisory authorities of so-called ‘third countries’ and with international organisations (being for example an increasingly active observer of the IOSCO Board). I will expand on this in the next section of my speech.

ESMA and Third Country Frameworks

When looking at the financial services legislation in place at EU level, one can notice a third-country framework present in key texts. It is important to clarify here that the term “third country” refers to jurisdictions outside the EU and “third country firms” refers to entities incorporated outside the EU, whether they do, or seek to do, business in the EU.

The EU framework tries to achieve consistent regulation and supervision of global financial markets, and to strengthen the EU as a stable global financial region where it is possible to conduct financial activities in orderly and efficient markets and where investors are protected.

Perhaps it would be useful to elaborate further with examples:

- Under the **European Market Infrastructure Regulation** ('EMIR') an equivalence decision by the European Commission allows a central counterparty ('CCP') or trade repository ("TR") established in a non-EU country to provide their services in the EU.

  The Directive was originally adopted by the European legislators in 2012. Last June, the EU Commission (EC) presented a proposal for strengthening the supervision of the EU and third-country CCPs operating in the EU in the context of the EMIR review, recognising the need to carefully look at the systemic importance of some of these market infrastructures.

- The **Markets in Financial Instruments Directive** ('MiFID') is the EU legislation that regulates firms who provide services to clients linked to 'financial instruments' (shares, bonds, units in collective investment schemes and derivatives), and the venues where those instruments are traded.

  The second iteration of the Directive, MIFID II, agreed by the co-legislators in 2014 and coming into force on 3 January, now creates for the first time a harmonised regime for granting access to EU markets for firms in third countries when they provide certain services into or conduct certain activities in the EU for professional clients and eligible counterparties. As regards the third country regime for retail clients, Member States' national rules continue to apply. I will say more about MiFID later on.

- A third country framework is also found under the **Alternative Investment Fund Managers Directive** ('AIFMD') which regulates the management and marketing of alternative investment funds (such as hedge funds, private equity and real estate funds) in the EU. It provides for a 'passport' which allows funds managers (AIFMs) to manage and/or market these funds (AIFs) across the EU, on the basis of a single authorisation by their local regulator.

  Currently, only EU authorised AIFMs managing and/or marketing EU registered funds can avail themselves of the passport and third-country funds can be managed or marketed in the EU only on the basis of a number of national private placement conditions, that is to say, if and how Member States allow it. However, the AIFMD, envisages the extension of this passport by the Commission subject to a number of conditions.

- ESMA's direct supervisory role to date is currently limited to credit rating agencies and trade repositories. Endorsement and equivalence are two regimes provided under the **CRA Regulation** (CRAR) that allow credit ratings issued in a third country to be used for regulatory purposes in the EU. The equivalence regime is made available for CRAs from non-EU countries with no presence or affiliation in the EU, provided they are not systemically important for the financial stability or integrity of the EU financial markets. The endorsement regime is made available for CRAs that are affiliated or work closely with EU-registered CRAs and is used extensively.

- The **Benchmarks Regulation** introduced a regime for benchmark administrators that will ensure the accuracy and integrity of benchmarks. Under this regime, there are three ways for a non-EU benchmark to be used by EU-supervised entity; equivalence, recognition and endorsement. The Benchmark Regulation will also be implemented from January onwards, but, contrary to MiFID II, there are transitional regimes envisaged for existing benchmarks.

Under each of the third country frameworks ESMA has contributed or will in future provide technical advice to the Commission on the regulatory and supervisory regime in a variety of third countries. In each case, this has also resulted in a greater, formalised focus on cooperation agreements between the EU and third country regulators. In fact, ESMA has negotiated co-operation arrangements with various third country national competent authorities which, among other things, relate to the exchange of information and co-ordination of supervisory activities. In some instances, such as the AIFMD, ESMA has also supported the finalisation of the necessary cooperation agreements between EU national regulators and their third country counterparts, by providing a single template which simplified the process.

Having described some of the third country regimes in the current legislative framework, I believe that the EU approach on how to account for the activity of third country firms in the EU needs to be improved further.

First, there is no generic third country framework: it is a set of arrangements varying across the different pieces of legislation. No arrangement is identical and they are mixtures of equivalence, endorsement, recognition, third country passporting or no arrangement at all. While some differentiation seems inevitable to respond to the different nature of various financial market activities, based on the experience of the past few years it would be beneficial to create greater consistency.

The point of departure should however stay the same; achieving consistent regulation and supervision of global financial markets, and strengthening the EU as a stable global financial region where business can be carried out. The EU should be open and play an active part of the global financial system.

Another important element to consider in such a new system is ensuring that risks posed by the activities of third country entities in the EU can be adequately assessed and addressed. For Europe, this is even more relevant considering the impact of the UK's withdrawal from the EU and the associated emergence of certain third country entities with potentially a significant impact on Europe's financial stability and investor protection.

I believe that to ensure a common approach to third country entities active across the EU financial markets, the supervisory and enforcement powers should be conducted at EU level by ESMA for third country entities such as: Credit Rating Agencies (CRAs), Trade Repositories (TRs), Central Counterparties (CCPs) and benchmarks. In the context of CCPs, the Commission has already put forward an extensive EU-wide third country regime in a proposal to amend the EMIR legislation.

In my personal view ESMA should play such a central role also regarding third country trading venues, and potentially other important market players.

A step to centralise the third country supervision would not only bring a number of benefits for the Union as a whole, but also allow third country firms to have a single point of reference in relation to the regulatory issues in the EU.

MiFID II/ MiFIR Implications for Asian Firms

Having talked about the direct access of third country entities to the European markets, I want to move on to the indirect impact of EU legislation that many Asian firms currently experience.

I would like to refer again here to one very current and important legislative framework that has taken up significant portion of ESMA's resources over the last few years and whose implications are far-reaching; MiFID II/ MiFIR.

Asian-headquartered firms with branches or subsidiaries providing investment services in the EU will be directly subject to the new MiFID requirements. But MiFID II obligations for Asia-based institutions are often indirect, arising by virtue of them dealing with European firms or counterparties on a cross border basis for example.

These Asia-based institutions may have to meet certain requirements to comply with MiFID II. For a start, Asia-based institutions will be asked to get a Legal Entity Identifier (LEI); a 20-digit, alpha-numeric code that enables clear and unique identification of legal entities participating in financial transactions.

From 3 January, under MiFID II/ MiFIR, no LEI means no trade.

The LEI will become applicable to:

- investment firms that execute transactions in financial instruments;
- the clients (buyer, seller) on whose behalf the investment firm executes transactions, when the client is a legal entity;
- the client of the firm on whose behalf the trading venue is reporting, when the client is a legal entity;
- the person who makes the decision to acquire the financial instrument, when this person is a legal entity
- the firm transmitting the order;
- the entity submitting a transaction report (i.e. trading venue, ARM, investment firm); and
- the issuer of any financial instrument listed and/or traded on a trading venue

The LEIs, are needed by firms to fulfil their reporting obligations under financial regulations and directives. LEIs are also key for matching and aggregating market data, both for transparency and regulatory purposes. Many have voiced concerns about the rigorous implementation of LEIs in the EU and complained about the difficulty of getting an LEI.

However, I want to counter here some myths around this topic. In effect it is a matter of several days to get assigned an LEI at an average cost of a 100 Euro.

The LEI data is registered and regularly verified according to protocols and procedures established by the LEI Regulatory Oversight Committee (LEI ROC). The LEI constitutes an example of where we have genuinely achieved a common global data standard. We are happy to see that the use of the LEI is required or is in the process of being implemented by regulators such as the Hong Kong Monetary Authority (HKMA) and Securities and Futures Commission (SFC) here in Hong Kong and the Monetary Authority of Singapore, that have mandated the use of LEIs in the activity of OTC derivative trades[1].

The LEI global success story should encourage us to move ahead with the specification and global agreement around other key data standards – such as the Unique Product Identifier.

With only a few weeks before the MiFID II rules come into effect, I would encourage all of you to take the time to understand fully the implications on your specific business. I accept it is not always easy to fully understand how a foreign regulatory act, as complex as MiFID II/MiFIR, will impact on your firm's business, but we have tried over the last few months to provide guidance and additional information through Q&As.

While we published extensive guidance on MiFID II/MiFIR covering all various aspects that may be of interest of you (investor protection, transparency, market data, market microstructure and commodity derivatives), I'd like to highlight in particular our guidance on MiFID II/MiFIR requirements with a third country dimension.

Earlier in May we published two opinions clarifying under which circumstances transactions on third country trading venues are subject to the post-trade transparency requirements for investment firms and/or are considered to be economically equivalent over-the-counter (EEOTC) contracts for the purpose of the position limit regime. The two opinions set out a number of objective criteria that, if met by a third country trading venue, exempt transactions on those trading venues from the MiFID II/ MiFIR post-trade transparency requirements and the position limit regime.

We are now in the process of assessing more than 200 third-country trading venues for which we have received requests. Given the high numbers, this will take us some time. I can ensure you that we'll treat all third country trading venues in the same manner. Furthermore, we are working on an interim solution that should ensure that, pending an assessment of the criteria listed in the two opinions, transactions on third country trading venues do not have to be made post-trade transparent and/or are not considered to be EEOTC contracts. Furthermore, the ESMA Q&As on transparency issues have a dedicated third country section.

[1] https://www.gleif.org/en/about-lei/regulatory-use-of-the-lei

In November we published an extensive Q&A providing detailed guidance on the treatment of transactions with a third country dimension for the purpose of the MiFIR transparency requirements and the determination of systematic internalisers.

Finally, I know that you're particularly concerned about the application of the trading obligation for shares to shares which have their primary pool of liquidity outside the EU. I hope that our recently issued guidance together with the European Commission provided you with some comfort that, in the absence of an equivalence decision, transactions in shares would not be considered to be of a systematic, regular and frequent nature and therefore not subject to the trading obligation for shares.

Conclusion

In concluding, I want to emphasise again my belief that while international convergence is difficult it is absolutely necessary. In coordination with the Commission, but also in close cooperation with national regulators, ESMA plays and will continue to play a central role in ensuring that Europe speaks with one single voice vis-à-vis regulators outside the European Union.

ESMA continues its strong commitment to international relations and aims to further intensify regulatory cooperation at the global and regional level. As part of this, I am here to participate tomorrow, alongside the EU Commission, at the second IOSCO EU-Asia Pacific Forum and I look forward to further exchanges with our Asian regulatory counterparts through this and other fora and to continue building trust and day-to-day cooperation.

Thank you for your attention. I look forward to our panel discussion that will no doubt explore some of the issues around global regulatory standards and cooperation further.