European Securities and Markets Authority

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Keynote Speech
The reform of financial markets: halfway there

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Ladies and gentlemen,

Thank you very much for inviting me to speak at this conference organised by the Association for Financial Markets in Europe (AFME) on the *New Post-Trade World*. It is a pleasure to see that so many stakeholders from both the public and private sector are here to share their views and to discuss what the post-trading environment should look like in the future – there is no doubt it will look nothing like it has done up until now.

The financial crisis triggered a wide regulatory and legislative overhaul, driven by G20 commitments, and is the biggest globally coordinated reform of financial services ever. Since the onset of the financial crisis the EU has introduced new pieces of legislation or made amendments to existing legislation covering almost all financial services areas. Just to mention a few examples in the securities markets area: the introduction of direct supervision of credit rating agencies, the European Market Infrastructure Regulation (EMIR), the Alternative Investment Fund Directive (AIFMD), the amendments to the Transparency Directive, the Market Abuse Directive, and MiFID.

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Today, the main principles have been agreed by the politicians and the results are becoming more tangible for financial markets. We are moving from legislation to implementation and the European Securities and Markets Authority (ESMA) is playing a key role in that respect. ESMA is the direct supervisor of 23 credit rating agencies and 6 trade repositories, has developed more than one thousand memoranda of understanding with regulators around the globe for the coordination of supervision of hedge funds and private equity (AIFMD) and has implemented measures for central counterparties (CCPs) and bi-lateral clearing, just to mention a few examples.

I do not want to sing our own praises too much, but the establishment of the European Supervisory Authorities (ESAs) in 2011 and the tools and powers they were granted are essential for creating a single rulebook for EU financial markets and have, in doing so, contributed to the Single Market. Just think how EU financial markets would have dealt with the regulatory reform if ESMA had not existed and that all the same coordination challenges we face at international level would have to be handled amongst the 28 EU Member States.

The reforms have been hard for many market participants but I believe that they were, and are, a necessary step towards economic growth. Or as the Stiglitz Report, commissioned by the United Nations, noted in 2009 "*the international community cannot focus exclusively on immediate measures to stimulate the economy if it wishes to achieve a robust and sustainable recovery. This crisis is, in part, a crisis of confidence, and confidence cannot be restored unless steps are taken to begin the more*

fundamental reforms required, for instance, through improved regulation of the financial system."[1]

So far a lot of the financial reform has focused on developing a single rulebook but the work is by no means over. We need to complete and implement the reforms and ensure the support for adequate supervision of financial markets. This is what I will focus on today. First, I will go into some of ESMA's work in completing the single rulebook relating to the area that is on today's conference agenda and to which I often like to refer to as the "back-office of securities markets": post-trading. As I genuinely believe that legislation is only half of the job of the reform of financial markets I will end my speech with three remaining important challenges for securities markets and illustrate them for the post-trade area.

Let me begin with the development of the single rulebook and our work on the Central Securities Depositories Regulation (CSDR) and EMIR.

CSDs

Central Securities Depositories (CSDs) form an important element of modern securities markets. While securities markets traditionally relied on the physical exchange of paper, CSDs now assume a critical role in guaranteeing a safe and efficient transfer of securities that exist largely only in book entry form. The CSD Regulation introduces an obligation of dematerialisation for most securities, harmonised settlement periods for most transactions in such securities, settlement discipline measures and common rules for

[1] United Nations, *Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System* (21 September 2009), p13

CSDs.

Together with the developments on Target 2 Securities (T2S), the CSDR plays a pivotal role in achieving a harmonised, integrated post-trade landscape in the EU. The CSDR provides one set of EU-wide legal rules while T2S ensures operational harmonisation. ESMA and EBA will have to develop draft technical standards covering a wide range of issues such as settlement discipline measures, CSD requirements, links and access requirements focusing on risks and data reporting, including on internalised settlement (i.e. securities transactions settled outside a securities settlement system).

We also expect to assist the European Commission by providing technical advice for the areas where the Commission can adopt delegated acts. This includes issues such as:

(i) the parameters for calculation of cash penalties for the participants that cause settlement fails;

(ii) the criteria under which the operations of a CSD in a host Member State should be considered of substantial importance for that Member State; and

(iii) measures to further specify the ancillary services provided by a CSD.

ESMA works closely with the European System of Central Banks (ESCB) on CSDs. We are involved in the T2S Advisory Group and perform T2S assessments together with the ESCB, and have established a cooperative framework with the ESCB in order to set an efficient and effective supervisory and oversight framework. This is currently under review for the operational phase of T2S.

Consultation of stakeholders is an essential element of our *production process* of implementing measures. We very much value stakeholder feedback and we want as much data and empirical evidence as possible to identify and use best practice models in terms of safety and efficiency. Therefore, we have decided to consult stakeholders twice on our CSDR work. At this moment we are seeking your views on the strategic directions through a discussion paper and later this year we will consult on the draft technical standards. We will also consider the work of the CPSS-IOSCO Principles on Financial Market Infrastructures (PFMIs) in order to ensure international consistency.

Turning to the content of our standards, it is no surprise that the more challenging standards are the ones on settlement discipline. This is due to the complexity of the issues that have to be taken into account, the different processing models currently in use across the EU and the need to develop coherent and complementary measures whilst carefully balancing the potential impact on market liquidity.

Another important subject covered by the technical standards refers to data reporting. Transparency is important in ensuring that authorities and all market actors concerned get an appropriate understanding of how the markets work and the nature and magnitude of any potential risks. In this context, increased transparency will provide us with the information necessary to develop effective and efficient policy tools to prevent systemic risks. The reporting requirements under CSDR will complement those under MiFID and EMIR and when setting requirements we will balance supervisory needs and reporting costs.

It is therefore important when commenting on our discussion paper to not only focus on the controversial policy options but to also consider future implementation issues. The work on EMIR has for example taught us that a mundane issue like the definition of reporting fields is an essential element for a reporting regime to work properly. If we do not address sufficiently such issues now, subsequent changes after the standards are into force are lengthy and difficult. In any case, ESMA will endeavour to align the various data reporting requirements, by also taking into account the work done in connection to EMIR, MIFIR and MAR.

EMIR

Let me say a few words on EMIR before moving to the challenges I see for the regulatory reform and securities markets. For many people the lack of transparency – and by consequence, of understanding on what was going on – in relation to over-the-counter (OTC) derivatives was a symbol of the urgent need for more adequate regulation after the financial crisis. The EU's response to that concern, EMIR, quickly became an important backbone of European financial markets regulation and for ESMA. EMIR mandated ESMA to develop almost forty technical standards and a wide range of different pieces of advice to the European Commission. Most of those standards have by now been adopted by the European Commission including the ones on risk mitigation techniques and on trade reporting. Today only two sets of technical standards are missing from the EMIR single rulebook for derivatives:

1. the technical standards determining the clearing obligation; and
2. the technical standards on bilateral margins for uncleared trades.

As for the first set of missing standards, nobody will disagree that the clearing obligation ensuring that OTC derivatives move to central clearing is an essential tool to increase the transparency, and stability, of OTC derivatives markets. However, CCPs should be safe and sound before counterparties can be required to clear their derivatives with them. This means that CCPs should follow the EMIR requirements and be authorised by the competent authority (the national authority for EU CCPs, ESMA for the non-EU-CCPs). Today four out of the twenty European CCPs that have applied are authorised and more authorisations are expected in the near future.

Not all products are fit for the clearing obligation and EMIR defines criteria to be taken into account before a clearing obligation can be imposed on counterparties, in particular the level of standardisation and liquidity. ESMA plays a pivotal role by conducting the assessment and developing technical standards defining the classes of OTC derivatives to be subject to the clearing obligation.

We will consult on technical standards the coming months. In that respect we have already published a discussion paper in 2013 to better understand the classes that are suitable for clearing obligations. Given the fact that some jurisdictions already require central clearing of interest rate and credit derivatives, and given the global nature of the industry we were not surprised by the almost unanimous request and support from stakeholders for international convergence in this area.

Some stakeholders also expressed concerns on the relative rigidity of the process. They provided examples of situations in which the clearing obligation would need to be

suspended or removed as a matter of urgency but where this might be difficult, not to say impossible. As you well-know, the clearing obligation will be defined through technical standards, and lifting this obligation needs to follow the same democratic, but lengthy procedure. We are discussing this issue with the European institutions, like we are also discussing the way forward on some other challenges introduced by the clearing obligation such as the frontloading requirement and the special case of covered bond derivatives.

Regarding the technical standards on bilateral margins for uncleared trades which aim to ensure an appropriate level of collateralisation for non-cleared transactions alongside central clearing for the mandated classes, I am sure that you will have seen the consultation paper we issued together with the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA). As widely known the reason for the delay on this standard was to ensure global consistency by awaiting the finalisation of the joint work of the Basel Committee and the International Organisation of Securities Commissions (IOSCO). International co-operation, as we have seen in this area, is important and though I believe that we even could have gone further, for example on the models for calculation of margins and the acceptable list of collateral, the process should set a standard for future reforms of globally connected markets.

Three challenges

Ladies and gentlemen, so far so good about the completion of the legislation to meet our G20 commitments and developing a single rulebook for financial services. Let me now turn to the three main challenges I see in the current phase of regulatory reform. My main message is that while the legislative phase nears completion, it does not imply the

completion of the regulatory reform programme. Let me explain that further by identifying three commitments for the next phase of regulatory reform.

Firstly, commitment to the financial reform, its implementation and to adequate supervision. Legislation needs to be accompanied by good implementing measures, to ensure the legislation works in practice, and credible supervision. Secondly, a commitment to supervisory convergence in order to establish a truly internal market and to prevent regulatory arbitrage within the EU. Agreeing at EU level on a single rule book for all 28 Member States is a big step. However, ensuring that this single rule book is supervised consistently across the 28 Member States is an even bigger step. Thirdly, in order to prevent crises we need commitment to the lessons learned from the crisis regarding risk analysis and the availability of high quality data on financial markets.

We need more information on securities markets. Since the beginning of the financial crisis securities regulators have learned a lot about how to deal with financial stability – an area that was beforehand mainly reserved for central bankers and banking regulators. Information on financial markets is key to achieve the financial stability objective. It is therefore no surprise that many pieces of recently introduced legislation already include data requirements. Securities regulators however also need to step up their role on this and need more resources to collect and analyse data. It goes without saying that more data and analysis will also support our other important objective of investor protection.

Let me illustrate these three commitments with current developments in the post-trade area.

Direct Supervision of Trade Repositories

Let me start with the first commitment: implementing the financial reforms and the need for adequate supervision. Following the implementation of EMIR, ESMA is now supervising the six trade repositories it registered in November and December 2013. Notwithstanding that all trade repositories, except one, are registered for the five asset classes, the industry is very heterogeneous: some entities focus on regional markets others focus on certain asset classes and the rest has a wider offering.

Trade repositories went through a very intensive period of arranging their systems that needed to connect to parties all over the EU. As a supervisor ESMA focused on the operational functions such as the deployment of IT-systems, data reconciliation between trade repositories, the transparency of commercial offerings to market participants and repositories' progress in getting counterparties as well as regulatory authorities on board.

Since 12 February 2014, for almost three months now, derivatives are reported to trade repositories. Regulators now have access, or are in the process of setting up their access, to derivatives data which should help to have a clearer picture on the risks associated to those markets. So far, I believe that the reporting has gone quite well given the framework and the complexity of the project. As in many Member States different authorities need to connect to the repositories and one should consider that across the EU there are at least 60 authorities that need to be connected and that reporting is required from both sides of the trade. This reporting requirement covers also exchange

traded derivatives (ETD) and non-financials that are counterparty to an OTC derivative or ETD.

On average on a weekly basis all the repositories receive more than 120 million reports. As some firms seem not to have made the starting deadline of 12 February, we expect the number of new reporting entities and of trades reported to repositories to increase over the next months.

In line with the requirement of the Regulation to publish aggregate positions by class of derivatives on the reported contracts on a regular basis and in an easily accessible way, trade repositories are providing figures on their website on a weekly, or in some cases, even daily basis. Having said that I believe that the information made public can be further improved. ESMA from its side is constantly monitoring the data in order to improve its reliability.

Though I know that the benefits of trade repositories have been widely acknowledged I would like to reiterate that their set-up should finally enable surveillance of EU derivatives markets and contribute to risk monitoring. The data gathered can help regulators with identifying and reducing the risks associated with derivative markets and, by doing so, lead towards the objective of more transparent, stable and fairer financial markets.

It goes without saying that, taking into account the scale and complexity of trade repositories and the data flows, there is still a lot to come. Trade repositories have just

started a new business and experience some *growing pains*, which is not unnatural. I would expect the functioning of portals to improve over time and that data will become more and more accurate.

Let me now remind you of the first commitment that I mentioned: a commitment to adequate implementation and supervision. As the developments regarding trade repositories show, implementation and supervision are as important as legislation to ensure that the regulatory reform achieves its objectives. From that perspective we are only half-way. Primary legislation needs high quality technical measures and credible supervision. As a direct supervisor we will ensure that the trade repositories will become reliable market infrastructures and provide the long awaited transparency on derivatives markets. I am confident that ESMA will prove itself a credible supervisor in this area as it has done for credit rating agencies.

Supervisory Convergence

Secondly, commitment to supervisory convergence. The crisis has shown that the absence of what we today call the *single rulebook* and supervisory convergence formed a dangerous cocktail whereby some Member States adopted a less strict approach to financial regulation and less stringent supervision to attract business. We need to continue preventing regulatory arbitrage and keep on ensuring supervisory convergence in the EU. Let me illustrate that with the CCP authorisation process and the functioning of the CCP colleges. Colleges, composed of national authorities and ESMA, discuss the authorisation and supervision of individual CCPs and the common yardstick across all colleges is EMIR. A decision that all colleges have to take is whether the CCP meets the

EMIR requirements: this is done in the form of an opinion which, when positive, can trigger the registration decision. ESMA safeguards a level playing field for CCPs and avoids regulatory arbitrage by ensuring that all EU CCPs are authorised according to the same standards. We do this through active participation in the colleges and by continuously updating the Q&As on EMIR that we publish on our website.

Some have suggested that they had expected some of the colleges to take a registration decision at an earlier point in time and that the delays illustrate that national interests had entered the discussion in the colleges. Being a participant to all colleges, I can tell you that the discussions in the colleges are on substance; the application of EMIR to the specific CCP. This is a complex and time-consuming process, involving complicated underlying issues and many different actors. The colleges bring to light potential differences between supervisory practices but the very same colleges ensure the convergence of these practices.

Over the last few months the colleges have authorised four CCPs within the Union and others will follow shortly. Where ESMA is playing an active role in the colleges for CCPs within the EU, it is in the driver's seat for the recognition of CCPs located outside the EU. Since the start of the process in September 2013 we have received around forty applications. When processing these, supervisory convergence will again be essential. We will assess whether these 3rd country CCPs are subject to requirements similar to EMIR. Of course, the equivalence decisions of the European Commission will set the framework for this assessment, and we will apply that subsequently to the specific application by a 3rd country CCP.

Data on securities markets

Thirdly and lastly, I believe that in order to prevent future crises we need more information on securities markets. This applies to all levels: national, European as well as at international level.

The fact that firms regulated by securities markets supervisors tend to be smaller and seem less *systemic* than those under the supervision of banking regulators might partly explain why less data is available. The crisis has however shown that we need better data and high-quality analyses on securities markets. There is not only insufficient data on EU securities markets, moreover there is hardly any data available in a consistent format at EU level. If we are exploring alternatives for bank financing, by for example stimulating capital markets, capital markets will grow making such data and analyses only more important.

Let me take the example of collateral. Collateral plays an increasingly important role in financial markets and can become relatively scarce at certain times. Regulations designed to allow better infrastructures for the collateral cycle (like CSDR) and the European Commission's proposal requiring the reporting of Securities Financing Transactions (SFT) to trade repositories should allow regulators to have a clearer picture of the market. The regulatory community, including the European Systemic Risk Board, might however need to think about which requirements, policies, and safety mechanisms should be in place to ensure that collateral can play its important role in financial markets but does not pose a risk to its functioning. Considering that many practices

around collateral increase the interconectedness of financial markets, collateral issues can be systemically relevant. And therefore we need data.

EU legislation rightly gives ESMA an increased role not only in setting rules but also in monitoring activity in European securities markets. Securities regulators have in the past had a strong focus on investor protection and transparency towards investors, but much less of a tradition of collecting data and looking at risks in financial markets, and this holds particularly for stability risks. It is fair to say that banking regulators have much longer track-record in collecting data in banking and looking at stability risks than securities regulators. We are still behind though we are much ahead of where we were three years ago. Securities market regulators need to increase their collection of data in a broad range of areas.

Permanent monitoring of financial markets is essential to spotting new developments and to prevent future crises. But in order to do so we need to devote more staff on economic analyses and identifying financial risks to meet our objectives regarding investor protection and stability. However, ESMA also feels like our national colleagues, understandably, the austerity measures put in place across Europe. Let me assure you that ESMA will at no point compromise on the quality of the legislative acts it develops, and the single rule book more generally. Our track record in the past years regarding technical measures in all areas of securities markets provide evidence on this. However, ensuring adequate risk analyses of financial markets and supervisory convergence requires a clear commitment to sufficient resources to ESMA and our national colleagues.

Conclusion

To conclude I would say that the EU is on its way to fulfilling the G20 commitments and is progressing towards more transparent, stable and fairer securities markets. However, it is not because the legislative phase nears completion that the regulatory reform is over. We should remain committed to the lessons we have learned from the last crisis. ESMA from its side will work hard and I am convinced that you share our objective to ensure we establish well-functioning and stable financial markets across the EU.

Thank you.