Keynote address – CMU and current challenges

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Good afternoon Ladies and Gentlemen, Guten Nachmittag meine Damen und Herren.

I am delighted to be here with you today – even if virtually considering the current circumstances. Thank you to the Deutsche Schutzvereinigung für Wertpapierbesitz e.V. (DSW) and Better Finance for inviting me to the International Investors' Conference on the European Capital Markets' Union (CMU) and the new Green Deal and to speak about the current challenges of the CMU from the ESMA perspective.

The CMU project has been launched six years ago. While a lot has already been accomplished in its first phase, given the current economic circumstances, the importance and urgency of putting in place the necessary elements and achieve further progress on creating a deep and efficient European CMU have never been more pressing. Extraordinary circumstances can be the catalyst for transformational changes both in the economy and the society as a whole. In this way, I hope that, as one good thing coming out of the COVID-19 pandemic, the current situation could help EU capital markets to make a real step change and get closer to their potential.

Uncertainties about the medium- and long-term economic consequences of the COVID-19 pandemic are still very high, and this leads to a fragile market environment. What is clear that the economic impact of the COVID-19 pandemic results in an urgent need to support the recovery of the European economy. The European Green Deal and related need for transition to a more sustainable economic model require mobilisation of public and private financing. From the macro perspective, the current heavy dependence on the banking sector financing in Europe limits the funding channels available to companies and restricts capital for future innovative and transformative economic activities. While concerns about the level of indebtedness might be currently mitigated by the effect of the public policy response – and notably by monetary policy resulting in low interest rates - high level corporate indebtedness might make the recovery more fragile.

Consequently, deep capital markets offering diversified sources of funding are essential for the long-term financing of the recovery. Efficient capital markets encourage greater long-term investments in the economy, allow for more rapid recapitalisation of companies, help banks increase their capacity to finance the economy and can support the transformation to more sustainable economic growth. Through development of deep and efficient integrated capital markets, in my view the proportion of equity financing in the economy should be stimulated. The resulting decrease of the dependence on debt financing can contribute positively to future economic growth and financial stability.

The European Commission Action Plan on CMU published last September includes a large number of important initiatives to develop a deep and effective EU wide capital markets.

In my speech today I would like to focus on some of the initiatives within the CMU action plan that are of particular importance from an ESMA perspective.

For many, the success of the CMU would be primarily dependent on further harmonisation of regulation and reducing barriers for provision of services across EU Member States. I agree that this is a good starting point. Clear and harmonised regulation can facilitate market developments and a drive to a genuine European CMU. Initiatives in the first phase of the CMU were aimed at making a first step in fixing some of the specific issues across the regulatory spectrum and removing a number of barriers for the flow of capital across the Single Market (e.g. cross-border funds regulation).

However, I also believe that the removal of regulatory barriers alone would not be sufficient. Even more important is to acknowledge the low level of capital market activity across Europe. That needs to drastically change. If we want to see EU capital markets flourish, we need to engage far more with retail and household participants, both directly and indirectly, in this project. With this new impetus to the CMU, attention needs to be focused also on more complex underlying issues that prevent EU capital markets to operate closer to their potential – some outside of the scope of financial markets' regulation (e.g. initiatives that need to be taken at national government level, through removing tax biases towards debt financing or supporting more diversified pension arrangements).

As I said, in my speech I would like to focus on the priority areas that I consider particularly important from the view point of ESMA and financial markets regulators: (i) Developing retail investor participation in EU capital markets; (ii) Ensuring clear and sufficient information for the investors; (iii) Improving capital market access for EU SMEs and (iv) Reinforcing effective supervision / supervisory convergence across EU capital markets.

Retail investor participation

Let me first turn to the key ingredient of the Capital Markets Union, investor participation. In my view, a successful CMU cannot be achieved without a sufficiently large retail investor base. Only greater retail investor participation would enable to mobilise adequate resources for financing the economic recovery, and the long term-oriented investment supporting the digital and green transformation of the European economy.

Retail investor participation cannot be achieved without measures that inspire trust and confidence in the efficiency and integrity of the capital markets. The main reasons for relatively scarce retail investor participation in capital markets in the EU are lack of trust in distributors, also in light of several mis-selling cases, and limited financial literacy. International comparisons show that confidence in financial markets remains relatively low. Moreover many European retail investors are not able to assess appropriately risks of even simple financial instruments. Further initiatives to develop financial education and improve financial literacy are thus indispensable to enable retail investors to benefit from the financial markets.

While many of the required changes to encourage greater investor participation are outside of the remit of market supervisors (such as changes to the tax legislation or state pension regimes), some changes to certain pieces of legislation and, in particular, further harmonisation of the supervisory framework and focus on investor protection will be needed to facilitate the development of an effective and efficient integrated "Investor Union". While there is no silver bullet measure to build a CMU from the investor perspective, let me now focus on a couple of specific topics that I consider particularly important:

Studies show that retail investment products in the EU are characterised by high costs that have a significant effect on investors' long-term returns.[1] To enable retail investors to make an informed investment decision, the MiFID II and the PRIIPs frameworks were designed to ensure that all costs and charges, explicit and implicit, are disclosed to the client in a clear and understandable way. Here I believe further alignment and simplification of these frameworks is essential to facilitating appropriate, clear and understandable disclosure for retail investors.

Closely related is the issue of inducements, due to the potential conflicts of interest they bring between the firm being paid by the product provider and its clients seeking suitable and low-cost products. Distribution in most Member States is dominated by non-independent investment advisors that almost exclusively recommend in-house products. As experiences of some European countries show, further restricting the

[1] See ESMA (2019), Report on performance and cost of retail investment products in the EU

acceptance of inducements can be one effective tool to enable access to higher-quality services and lower-cost products. Therefore, I fully support the Commission in its intention to assesses the role of inducements in the distribution of investment products in the EU. I strongly believe that such assessment should be broad and fundamental and should carefully analyse and consider the experiences and market structures of different countries.

A similarly careful assessment should be devoted to the ideas to reform the MiFID II client categories. Without re-opening the questions currently discussed as part of the negotiations on the capital markets recovery package, I'm of the view that adding another category could increase the complexity of the framework. MiFID II already provides for the possibility for the most experienced retail clients to opt-up to a professional client status and waive some of the protections from which retail investors benefit. As part of the comprehensive review of MiFID II, I believe that the calibration of the criteria for such opt-out could be further re-assessed and maybe made more flexible.

Finally, another key pre-requisite of retail participation and more broadly of development of the CMU is a high-level of transparency and availability of comprehensive and reliable information.

Access to information

I welcome the focus of the Action Plan to reinforce the work on two important projects of the CMU that can help to address this demand – the European Single Access Point (ESAP) for corporate disclosure and the Consolidated Tape for market data.

Easy access to comparable and reliable information on all listed companies in the EU is indispensable for the development of an integrated capital market. The creation of a single access point to financial and non-financial regulated information based on a harmonised format would facilitate investment, also on a cross-border basis. In this respect, Europe is lagging behind the developments in the United States, where a similar system known as EDGAR is in operation for more than a decade.

I consider that a single access point that would facilitate investors' access to company data is of crucial importance to building a genuine CMU. Such access point needs to provide, over time, comprehensive coverage of financial and non-financial information of all listed companies. To be realistic such system needs to be set up, in my view, in a progressive way (e.g. starting with companies listed on regulated market). While setting up such a system will not be easy, the data hub hosted by ESMA should be as simple as possible to use for both issuers and investors and where possible built on the current filing systems at national level, so as to minimise the additional cost and reporting burden for issuers.

Previous ESMA work highlighted that users of the current systems, where information is held in the repositories of what are called Officially Appointed Mechanism's (OAMs) in each country, are mainly professional advisors, lawyers and researchers, who use them to source the original, historical and secured version of regulated information. On the other hand, individual investors tend not to access financial information through these existing systems, but use commercial information services or issuers' web sites. Most of them seem not to be aware of the OAM databases - where the information is currently scattered across Europe. Consequently, the main problem today seems not so much the availability of data, but rather its accessibility and findability. This is because there is no centralised search function allowing investors to find out where the financial information is if they do not know in advance. Furthermore, for users of commercial information services, small companies would be particularly "invisible" because data aggregators do not include information on those in their platforms. A single EU-wide digital access platform, with ESMA setting data fields and formats, and overseeing data collection and data quality as proposed in the report of the High-Level Forum on the CMU[2], would in my view help to address these issues.

Let me focus, briefly also on the inclusion of the non-financial information in the European Single Access Point (ESAP). In light of all the EU Green Deal, efforts of the EU institutions and ESAs in developing a comprehensive framework for the sustainability disclosures in the financial sector and the upcoming revision of the Non-

[2] A New Vision for Europe's Capital Markets, Final Report of the High-Level Forum on the Capital Markets Union, June 2020

Financial Reporting Directive (NFRD), sustainability related information required by NFRD should I believe be included in the ESAP. It is extremely important that consistent, comparable, reliable and understandable non-financial information is readily available to investors so that they can take it into account in the investment decision making process. High-quality reliable information will foster the efforts to transform the European economy. However, accessibility and comparability of non-financial information would also require additional efforts in harmonisation of the non-financial disclosure framework.

Finally, let me discuss also the market side of transparency and highlight the importance of the consolidated tape for investors. Accessibility and transparency of market data is important to ensure that markets are fair, sound and efficient. In our recent review report, ESMA found that to date, MiFID II has not delivered on its objective to reduce the cost of market data. The fact that the cost of data has not improved was also compounded by the fact that no consolidated tape has emerged, which would provide live information on the price and size of equity trades. While MiFID II designed the requirements that would be applicable for consolidated tape providers, it did not mandate the establishment of such an EU consolidated tape. Instead, it left its creation open to a voluntary market-led initiative, which did not materialise. For ESMA, the main reasons why this did not happen are the limited incentives and commercial rewards to potential providers within the current regulatory framework, as well as possible competition by non-regulated entities such as data vendors.

Nonetheless, I strongly believe that the creation of a real-time consolidated tape for equities would counter concerns about the fragmented access to market data. I therefore welcome the intention of the Commission to propose the creation of a comprehensive post-trade consolidated tape for equity and equity like instruments as part of the CMU Action Plan. In my view, there are a number of key factors that would be indispensable to the successful establishment of the consolidated tape. These include the mandatory contribution of high-quality data by trading venues and Approved Publication Arrangements (APAs), the sharing of revenues with contributing entities and a strong governance framework. Ultimately, this is a task which will require a substantial investment of both time and resources by all parties involved, but one which will greatly benefit all market players and users (including investors) by providing a single source for price comparison.

Access of SME to finance

Let me now turn away from the pure investor perspective and focus on how we could boost EU capital markets by improving market access for SMEs. It is well known that SMEs in Europe tend to rely mainly on banking finance and – when they access capital markets – they tend to privilege local markets due to easier access and lower information asymmetries for investors. The ecosystem clearly plays a decisive role in this regard. For example, while venture capital funds can support the path towards IPOs, their presence is uneven across member states.

At the same time, it is fair to recognise that SMEs may pose increased risks for investors and it is challenging to develop rules that are appropriate for all types of SMEs in different stages of their development.

Coming from a regulatory and supervisory perspective, it is important that the applicable regulatory requirements and listing rules are applied in a proportionate way, while safeguarding investor protection and market integrity. Some measures have already been taken in this area over the last years, for example with the creation of SME Growth Markets. While it might be too early to comprehensively evaluate their impact – and especially of the elements that have been implemented only recently as e.g. SME listing package – ESMA is currently considering the functioning of the regime for SME Growth Markets under MiFID II. Our recent consultation provides some encouraging figures on the number of SME Growth markets set up in the Union (20) and of SME issuers admitted to trading on those SME Growth markets (almost 1000) (or otherwise traded on MTFs that seek to attract SME issuers without qualifying as SME Growth markets).

The Action Plan on the CMU and the recommendations of the High-Level Forum include a number of suggestions to adjust the regulatory regime in order to further facilitate access of SMEs to financing – including changes in listing rules, prudential rules and fund legislation. While I support further measures that can make the regulatory regime more proportionate to the characteristics of the SME and their risks to investors, I'm of the view that we need to acknowledge that it is unlikely that changes to regulation alone would be able to achieve a decisive breakthrough in this issue.

Previous CMU initiatives have already created a framework to reduce regulatory barriers, both for the regulated markets and the MTFs. Further relaxation is proposed in the Capital Markets Recovery Package currently being discussed by the co-legislators. However, further progress for delivering smooth financing for SMEs on the capital markets also depends on the broader ecosystem of actors. In various European countries we see that the ecosystem uses the existing regulatory framework to its full potential (e.g. Nordics region), while in other countries further measures are needed to support development of the SMEs ecosystem. This, however, might require intervention which goes beyond the EU regulatory possibilities and that is in the remit of the national governments - either because it relates to national competences (such as taxation and insolvency regimes, as well as national fiscal or regulatory measures how to support SME listings) or it touches on underlying cultural and societal aspects of individual members states (such as design of the pension systems and their propensity to invest into SMEs on the capital markets).

Supervisory convergence

The development of harmonised European legislation for Capital Markets is a first significant step to the CMU. But only a consistent interpretation and application of those rules and alignment of supervisory practices and outcomes can ensure that in practice the goal of CMU is achieved.

Increased focus on consistent supervision is likely to bring more material benefits to the CMU project than further expanding the single rule book itself and its level of detail. Consistent supervision (and enforcement) is needed to ensure that investors receive the same level of protection across the EU independently of the location of the firm. Only then will we create the confidence and the incentives to enter into cross-border investments. I fundamentally believe that consistent and effective supervision is a key contributor to well-functioning pan-European capital markets. It equally contributes to simplifying the business environment and reducing compliance costs, that are currently resulting for example from divergent implementation or supervision of rules for firms operating on a cross-border basis. Therefore, it also enables companies to access funding in a wider and deeper market.

Integrated capital markets require an efficient supervision system that ensures harmonised application of the rules in a manner proportionate to their risks. Consequently, development of an integrated capital markets requires further progress in harmonising supervisory practices as well as ensuring sufficient resources and focus on proactive supervision and enforcement.

Over the last years, ESMA has done a lot in developing novel and effective supervisory convergence tools. Supervisory convergence is a project for the long term - some of the results will be seen only after some years. But we will continue to develop the tools suitable to drive forward greater convergence in line with the ESMA mandate.

Before I end, I wanted to finally come to some current activity of ESMA that has particular relevance to the German audience. As I said earlier, ESMA has been actively using, in close cooperation with NCAs, a broad variety of tools to increase supervisory convergence. These tools range from public statements coordinating supervisory approaches, via common supervisory priorities, to peer reviews. I would like to spend a bit of time on the recent peer review on Wirecard that ESMA has concluded last month and that is relevant to the CMU discussion.

The Wirecard case has once again highlighted that high-quality, robust and sound financial reporting is essential for the effective functioning and integrity of the financial markets and for maintaining investor trust. It also highlighted the need for effective supervision and enforcement of financial reporting across the EU, in particular if our objective is to support retail participation in the capital markets. Achieving similar supervisory outcomes in this area are indispensable for the development of an efficient CMU. While I want to be careful in generalising conclusions from a single specific case at this stage, ESMA will assess the implications of the case for the Transparency Directive and consider how various supervisory authorities can cooperate better and more efficiently.

Conclusion

Ladies and Gentlemen, thank you again to DSW and Better Finance for their invitation today. I do not think I have to convince anyone listening to the conference right now that we need an effective Capital Markets Union in the EU. We need to foster investor participation and greater cross-border investment, thereby boosting the productive use of capital and diversifying the sources of funding needed for financing the recovery and the transformation into a greener and more sustainable economic model.

ESMA is a strong supporter of the CMU, as we trust that CMU can unlock the value in the European financial system and thus allow all investor to benefit from wider economic and investment opportunities. Brexit and the fall-out from the COVID-19 outbreak have made the case for creation of deep and effective CMU even more acute. The CMU is a long-term policy goal that requires further and continuous progress on a number of initiatives at European and national level. I hope I gave you today some insight into the CMU actions that we at ESMA believe are particularly important to focus on.

Thank you for your attention.