Ladies and Gentlemen,

I am very pleased to be in London for this event and I would like to thank Dan and his team for their kind invitation.

As we approach the end of 2017, now seems to be an appropriate moment to reflect on some of the key developments in the asset management sector over the past year. That will include our important work in the Brexit context as well as the package of measures that we delivered recently on money market funds. I would also like to take the opportunity to look ahead to a few of ESMA’s priorities in this area in 2018, notably on costs and charges of investment funds.

Supervisory convergence work on Brexit

I think it is fair to say that no speech at an event of this kind would be complete without a reference to Brexit. We know that the implications of the UK’s decision to withdraw from the EU are having a big impact on the industry in terms of contingency planning. You will probably not be surprised to hear that ESMA is also spending a lot of time on this topic and I would like to take a few moments to recall what we have done so far, and set out what we plan to do next.

So far our work on Brexit has focused on supervisory convergence. This is very much in line with the shift in ESMA’s focus more generally in recent years as we move away from the creation of the single rulebook towards achieving convergent application of those common rules. We took the view at an early stage that Brexit presented particular challenges to our objective of greater convergence. This is because the referendum results of last year and, in particular, the stated intention of the UK Government to withdraw not only from the EU but also the Single Market, created the potential for a significant shift of entities and activities from the UK to the EU27 as firms sought to secure their passporting rights.

As Steven Maijoor has stated publicly, including most recently at last month’s EFAMA conference, we saw a risk of regulatory arbitrage between the EU27 Member States seeking...
to attract this business. In other circumstances we might have had the luxury of more time to develop our supervisory convergence work, which would also have allowed us to engage more formally with stakeholders as part of that process. However, we recognised that we had to act swiftly as we knew that the industry would be drawing up contingency plans very soon. Indeed, as has been clear from recent media coverage, many firms are already taking steps to reorganise their activities and establish operations (or reinforce existing ones) in the EU27. I believe that this vindicates our decision to develop our guidance quickly. This consisted of the general Opinion that we issued in May followed by three sector-specific ones in July for investment firms, secondary markets and asset management.

There are three important points that I would like to emphasise in relation to our opinions. Steven already made these points at the EFAMA conference so I will not dwell on them here, but I think it is worth recalling them briefly in light of some of the market reaction that we have seen.

First, we consider the opinions to be fully in line with the existing Level 1 requirements. Secondly, the opinions in no way undermine the freedom of establishment that is provided by the relevant EU legislation. Thirdly, our opinions do not call into question the delegation model. That is not to say that we do not see scope for improvement in the way that certain of the existing EU requirements are applied in practice, but we do not believe there is anything in our opinions which would render delegation unworkable or make it unduly burdensome. Overall, I believe that the opinions achieve a good balance between elaborating on existing Level 1 and 2 requirements while recognising the merit of existing market practice.

As you may be aware, the opinions are not the end of the story when it comes to our efforts to achieve supervisory convergence in this context. The opinions are very useful tools on their own merits but we felt that it was necessary to take further steps. We therefore decided to set up a Supervisory Coordination Network, which I personally chair. This network is a forum that allows experts from the national competent authorities to discuss cases that they are facing involving UK entities looking to move to the EU27. I can personally testify to the added value that this network brings through information-sharing and promotion of convergent practices.

Turning briefly now to another aspect of our Brexit work, we are analysing carefully the possible cliff effects if the UK were to withdraw from the Union without any political agreement having been reached. This is naturally not the ideal outcome but securities regulators, and financial authorities more generally, have to plan for less-than-optimal situations. As well as assessing the amount of cross-border activity that could be affected by such a scenario, we are looking at how different types of cliff effect could be mitigated. In this context, I am aware that market participants are particularly concerned about the cooperation arrangements that have to be in place between regulators for certain types of activity. To take one obvious example, both the UCITS Directive and the AIFMD require cooperation arrangements to be in place in case portfolio or risk management is delegated to an entity in a third country. What I can tell you at this stage is that we are very aware of this issue and of the potential impact on activities – and ultimately investors – if cooperation arrangements were not put in place on time. I can also tell you that, as an EU authority, we have to take proper account of the political negotiations between the UK government and the EU27. One point on which I believe ESMA could certainly
add value in this context is to act as the facilitator of the agreements on behalf of the national regulators in the EU27, much as we did at the time of the entry into force of the AIFMD.

To summarise, therefore, Brexit is a key issue for us and is likely to remain so for the foreseeable future.

Money market funds

I will now move on to the significant work that we have been doing this year on money market funds (MMF).

You will recall that the European Commission published its proposal for a Regulation on MMF more than four years ago. That proposal followed extensive work at EU and international level in this area, including the ESRB Recommendation of 2012 and the IOSCO document of the same year. Looking even further back, ESMA’s predecessor, CESR, had already issued guidelines on MMF in 2010. At ESMA we followed the progress of the political negotiations with interest and stood ready to provide our input once an agreement on the Level 1 text had been reached. It is fair to say that we expected to be called upon at an earlier stage but it became clear over time that a political agreement would not be immediately forthcoming. We were pleased, therefore, when a compromise was found between the co-legislators last year allowing the Level 1 text to be finalised.

There were three main deliverables for us in the final MMF Regulation: technical advice on Level 2 measures, implementing technical standards on the reporting requirements and guidelines on stress testing. I would like to spend a few minutes outlining the key aspects of each of these deliverables. I will also touch on the issue of share cancellation, which I know has been generating some concern among managers of constant net asset value (CNAV) MMF in particular.

Turning to the technical advice first of all, this concerned two key aspects: eligibility of assets for reverse repurchase agreements and the assessment of credit quality. For the advice on reverse repo we felt it important to recognise the extensive requirements that were already in the Regulation itself, particularly on credit quality, so decided to focus on developing the liquidity requirements further. The approach that we finally adopted, and on which stakeholders provided generally positive feedback, set out a number of quantitative and qualitative factors for MMF managers to take into account. These included the time to maturity of the assets and their price volatility. We also specified that, depending on the outcome of the assessment of the liquidity factors, appropriate haircuts should be applied. In this context, it is important to note that we maintained our view – despite some pushback – that some minimum haircuts should be in place.

The second aspect of the technical advice dealt with the assessment of credit quality. Here we were able to take inspiration from a range of existing rules and requirements, including ESMA’s own work. For example, for the advice on the validation of the credit quality assessment methodology, we benefited from similar work that had already been done in the context of credit rating agencies and the related ESMA guidelines on the validation and review of Credit
Rating Agencies’ methodologies. It was nevertheless important not simply to copy and paste those provisions but to adapt them to the specific circumstances of the MMF sector.

Moving on now to the implementing technical standards (ITS) on reporting, I recognise that we included a very broad set of information in the proposals in our consultation of May this year. Some stakeholders felt that we had gone too far and that we were imposing unnecessary burdens. However, as we pointed out at the time, the idea was to test views of market participants on as broad a set of information as possible so that we would get precise feedback on each aspect, and we always had in mind that the final set of reporting requirements would be more targeted. In developing our proposals we also tried to ensure that there was as much consistency with the AIFMD reporting requirements as possible. That is not to say that we simply assumed that information that was relevant in the AIFMD context would also be appropriate for MMF. Rather, for data that we felt MMF managers should report, we tried to ensure that it would be reported in the same way and in the same format as under the AIFMD.

The last deliverable to mention are the guidelines on stress testing. The MMF Regulation obliges each MMF to have in place sound stress testing processes that allow the identification of possible events or future changes in economic conditions which could have unfavourable effects on the MMF. The manager of the fund has to assess the potential impact that those events or changes could have, and must conduct regular stress tests in order to do so. The Regulation obliges ESMA to issue guidelines with a view to establishing common reference parameters of the scenarios to be used in the stress tests. The Level 1 text is already quite specific about the factors that need to be taken into account but it is not exhaustive, so we have been able to develop what we believe to be useful guidance on each of these factors. Stakeholders broadly welcomed the approach that we had set out for consultation but noted the difficulties in giving precise figures on the calibration of the different criteria given the constant changes in market conditions and the diversity of participants in the sector.

Therefore, in the final guidelines we decided not to specify the reference parameters at this stage but we will aim to make progress on this when we issue the next iteration of the guidelines. Indeed, the Regulation specifies that the guidelines have to be updated every year taking into account the latest market developments, so we have already started work with the objective of issuing updated guidelines by the end of next year. We will consult stakeholders as part of the process of updating the guidelines.

The final point that I would like to mention in relation to MMF is share cancellation. As we set out in our final report, we are liaising with the European Commission on this issue since the practice raises issues of interpretation of the MMF Regulation itself. In light of the output of the Commission’s assessment, we will decide what action we should take. I know that the industry is keen for clarity on this matter and we hope that it will be resolved soon.

Costs and charges

Moving on from MMF, I would like to touch briefly on the issue of costs and charges of investment funds. This has been a theme that Steven Maijoor in particular has addressed consistently in several of his recent speeches, and I do not intend to repeat his remarks here.
However, I believe this work is sufficiently important to merit a brief overview of the key ESMA workstreams.

The first workstream falls under the banner of the European Commission’s Capital Markets Union (CMU) initiative, one goal of which is to increase the attractiveness of long-term savings products for retail investors. Since investors are unlikely to be attracted to a product offering where the costs and performance lack transparency, the Commission has asked ESMA, together with the other ESAs, to issue recurring reports on the cost and past performance of the main categories of retail investment, insurance and pension products. We published first findings of this work in the latest edition of ESMA’s semi-annual report on Trends, Risks and Vulnerabilities (TRV No. 2 / 2017). We are now moving to a more in-depth analysis of UCITS with a view to issuing the first edition of the reporting by the end of next year. At a later stage we plan to extend our analysis to EU alternative investment funds (AIFs) and structured products, such as structured deposits and structured notes.

Outside of the CMU context, we are planning to tackle cost issues on several other fronts:

- The first relates to closet indexing. As a follow-up to our statement of last year, we will now collect information from national regulators in order to get a clearer overview of what has been done at national level.

- We intend to carry out more detailed analysis of the performance of active and passive funds. The precise outcome of this work will depend on the results of the analysis but there could also be scope for further guidance on the relevant legal requirements given some differences of practice we have seen with regard to benchmark disclosure.

- Another aspect that we will look into is performance fees. We have become aware of different approaches across the Member States as to what constitutes a permissible performance fee so we will consider scope for supervisory convergence work in this area.

I hope this overview, albeit a brief one, gives you a sense of the importance we attach to these issues.

MiFID II

I said earlier that no speech in the current regulatory and political environment would be complete without a reference to Brexit – the same could equally be said of MiFID II, especially since we are now less than a month away from the application date. I would like to address two specific issues in this context: investment research and the Legal Entity Identifier (LEI).

In accordance with MiFID II, inducements are banned for independent advice and portfolio management. For other services, inducements are permitted if they (amongst other things) improve services provided to individual clients. With regard to research, the legislation clarifies that the receipt of research by portfolio managers from any third-party entities (and in particular brokers) would not constitute an inducement provided that portfolio managers pay for research
in one of two ways: they can either pay directly from their own resources, or from a separate research payment account controlled by the portfolio manager and funded by a specific research charge to the client. Some issues have been raised by market participants regarding the implementation of these new measures and ESMA has provided guidance in order to facilitate a common understanding and convergent supervision on the main aspects of the new framework.

We believe that the new model of payments for research (versus payments for execution) will push portfolio managers to identify more clearly the research they need and the value it adds in informing their investment decisions. This should help ensure better use of the research budget instead of firms (and ultimately their clients) paying for low-quality, duplicative research. Managers will thus be able to use more efficiently and wisely the funds allocated to research. Also, the new rules should provide better opportunities for independent research providers to compete on the quality of the research provided and should prompt portfolio managers to acquire research from a wider variety of research providers.

I would also like to mention one issue that emerged recently on the application of MiFID II rules by EU portfolio managers dealing with third-country broker-dealers and sub-advisors. The US Securities and Exchange Commission, the European Commission and ESMA have been involved in some positive discussions on this topic and I was pleased to see that the SEC was able to adopt some no-action letters on this topic a few weeks ago, which should address industry concerns in this area.

Still on the subject of MiFID II, we know that one of the key reforms relates to Legal Entity Identifiers (LEI). The new rules have an impact on all clients of EU investment firms and any entity issuing financial instruments traded on European trading venues. These are not only financial entities, but corporates too. EU investment firms and trading venues are obliged to report the LEI of these entities regardless of where they are based and regardless of whether the entity is subject to LEI requirements in its own jurisdiction.

In particular, the LEI rule for clients includes a prohibition for EU firms to act on the instructions of a client who does not have an LEI. This means that the LEI code becomes a precondition for clients wishing to access the EU markets.

The LEI plays a key role under the new MiFID data-reporting regime as well as being essential in supporting regulators' work on transparency and market surveillance, including detection of market abuse. It is vital that investment firms and trading venues make the necessary efforts to obtain the LEI in good time. For these reasons, we expect market participants to take all necessary steps to ensure full compliance with the LEI requirements under MiFID II.

Based on previous experience with EMIR reporting, we urge reporting entities not to delay in addressing this important matter, as advance preparation will help in avoiding backlogs and ensuring that all market participants are ready for the new regime.

It is worth recalling that the LEI requirements are not new. The obligation for EU investment firms to identify their clients with the LEI is enshrined in the MiFIR Level 1 framework, which
was published in May 2014. With respect to the lead-time allowed for the implementation, the final requirements were made public already in September 2015, when we submitted our regulatory technical standards (RTS) to the European Commission. On top of that, the EU co-legislators granted an additional one-year delay of the MiFID II requirements to enable market participants to finalise the technical implementation work. Finally, I would like to highlight that national regulators have already organised their data surveillance systems and processes in view of the new framework.

On a more positive note, LEI issuance is growing dramatically as the MiFID II deadline approaches with average daily volumes increasing each week. Indeed, the average daily volume of LEI issuances by week has doubled since the beginning of October. Let us hope that this positive momentum will continue.

I have covered a broad range of topics in my remarks today but with a focus on Brexit, MMF and some key aspects of MiFID II. I hope that we can continue to count on good cooperation with the stakeholders assembled here today as we face these and other challenges in the year ahead.

Thank you for your attention.