European Securities and Markets Authority

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PRESS RELEASE

ESMA sees high risk for investors in non-regulated crypto assets

The European Securities and Markets Authority (ESMA), the EU securities markets regulator, today publishes its first Trends, Risks and Vulnerabilities (TRV) Report of 2021. The Report analyses the impact of COVID-19 on financial markets during the second half of 2020 and highlights the increasing credit risks linked to significant corporate and public debt overhang, as well as the risks linked with investments in non-regulated crypto-assets.

Continued high risk across financial markets

Globally, risks in markets under ESMA's remit remain very high. The significant rebound of equity markets and the valuation of debt indices which reached pre-pandemic levels, contrast with weak economic fundamentals. The main risk for European Union's (EU) financial markets is that this ongoing decoupling leads to a reversal in investor risk assessment and a sudden market correction.

Crypto-assets: ESAs remind consumers about risks

As crypto-assets, including so-called virtual currencies such as Bitcoin, continue to attract public attention, the European Supervisory Authorities (EBA, EIOPA and ESMA – together the 'ESAs') recall the continued relevance of their previous warnings.

The ESAs remind consumers that some crypto-assets are highly risky and speculative and, as stated in the ESAs' February 2018 joint warning, consumers must be alert to the high risks of buying and/or holding these instruments, including the possibility of losing all their money.

Additionally, crypto-assets come in many forms but the majority of them remain unregulated in the EU. This means that consumers buying and/or holding these instruments do not benefit from the guarantees and safeguards associated with regulated financial services.

In September 2020, the European Commission presented a legislative proposal for a regulation on markets in crypto-assets. Consumers are reminded that the proposal remains subject to the outcome of the co-legislative process and so consumers do not currently benefit from any of the safeguards foreseen in that proposal because it is not yet EU law.

Brexit is changing the trading landscape

The preparedness of market participants ensured that the end of the UK transition period had no discernible stability impact on securities markets. However, the implementation of the EU share trading obligation (STO) is changing the European trading landscape. In 2020 43% of shares with a legal entity in the EEA were traded on UK venues, and a large part of them fall under the STO. ESMA has analysed the evolution of trading between December 2020 and January 2021, and sees that the expected shift in trading domicile occurred in January. Most on-exchange trading moved to EU venues, with the share of lit trading on EU venues increasing to 96% in January, and auction trading to 93%.

Focus on risks for financial stability and investors

In its risk analysis, ESMA provides five in-depth articles looking at sustainable finance and particular market vulnerabilities during the Covid-19 crises:

- **Vulnerabilities in money market funds:** This article uses evidence from the market stress during March 2020 to provide insights on EU money market fund vulnerability to liquidity risk and the impact of regulatory requirements;

- **Fund portfolio network, a climate risk perspective:** Within the European financial sector, investment funds are considered to have the largest exposure to climate sensitive economic sectors such as utilities, transport, and fossil fuels extraction. This article is a first attempt at a climate-related financial risk assessment of EU funds;

- **Stress simulation in the context of COVID-19:** During March 2020 investment funds faced a combination of significant deterioration in liquidity in some segments of the fixed income markets, combined with large-scale investment outflows from investors. Based on data from these events ESMA assesses fund preparedness to future liquidity shocks, involving a Stress Simulation exercise (STRESI);

- **54,000 PRIIPs KIDs - How to read them (all):** European retail investors now receive more information than ever, and it can be challenging both for investors and supervisors to properly exploit and assess all this information. This article —an application of *SupTech*— aims to illustrate how these techniques can produce useful measures for European supervisors, policymakers, and risk analysts; and

- **ESG ratings:** As sustainable investing gains traction, environmental, social and governance (ESG) ratings are growing in importance for investors and issuers. This article describes the market for ESG ratings, including types of ratings and key providers, and presents several use cases.

Notes for editors

1. ESMA's Trends, Risks and Vulnerabilities report No 1 2021

2. Joint ESA's warning on virtual currencies

3. Digital Finance proposal

4. Involving the Council and European Parliament in accordance with the ordinary legislative procedure

5. ESMA is the European Union's securities markets regulator. Its mission is to enhance investor protection and promote stable and orderly financial markets.

   It achieves these objectives through four activities:

   i. assessing risks to investors, markets and financial stability;

   ii. completing a single rulebook for EU financial markets;

   iii. promoting supervisory convergence; and

   iv. directly supervising specific financial entities.

6. ESMA achieves its mission within the European System of Financial Supervision (ESFS) through active cooperation with the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), the European Systemic Risk Board, and with national authorities with competencies in securities markets (NCAs).

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