ESMA Financial Innovation Day

Closing comments

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I would like to begin by thanking the panellists for sharing with us their thoughts and analysis. Today we covered a wide range of topics which has taken us far and wide in the innovation space.

The way in which ESMA tracks innovation is a challenge. The financial markets across our 28 Member States differ from one another in terms of breadth, depth, volume and sophistication of market participants. In turn, the innovation framework we employ must be a principles based one, needing to remain flexible as the underlying markets are dynamic. We look to a wide range of sources, both quantitative and qualitative, in monitoring innovations. However, a primary source of knowledge for us is events such as todays. We believe the dialogue between regulators such as ourselves and NCAs and market practitioners and academic observers such as those individuals gathered here is instrumental to our work.

We began the day with a discussion on investment-based crowdfunding. The discussion confirmed that the challenges that we identified in our Opinion and Advice, for the crowdfunding sector to move out of the ‘start-up’ phase and to find its place as a sustainable part of the business financing ecosystem, are still relevant. In particular, access to investors and projects cross-border and the emergence of a pan-EU crowdfunding sector are needed for the sector to meet its full potential. Clearly, for the sector to be sustainable there will also need to be paths to exit which are attractive to investors. The development of secondary markets which would provide some shorter-term exit mechanism could provide one such path and so help crowdfunded securities to become a more ‘mainstream’ choice for investors. Yet, those developments are and will remain difficult as long as the regulatory framework remains fragmented. We await with interest the Commission’s reflections on the evolution of the sector and on ways to support its development. Meanwhile, here at ESMA we will to continue our work on those issues, including through our Supervisory Crowdfunding Forum with NCAs, with a view to fostering supervisory convergence in the EU as far as we can within the existing regulatory framework.

We then turned to the topic of trading innovations. Investment banks, buy-side and investors that are faced with lower liquidity levels are looking for innovative ways to transact corporate bonds. Indeed initiatives by market participants and technology providers to develop new trading technologies and electronic platforms multiply. The objectives are simple, i.e., improving connectivity between potential buyers and sellers and facilitating trade execution, but the means differ. While some initiatives, like 'all-to-all' trading platforms focus on reducing the role of the middleman, i.e., the bank, others, like Honeycomb, aim at improving pre-trade information. These developments are interesting as they may help re-introduce liquidity in the market. Yet, more time and scrutiny might be needed before they can effectively be considered as a replacement to the traditional Request for Quote trading model.

We followed this with a discussion on the Distributed Ledger Technology (DLT). The DLT certainly is THE innovation of the moment. It is amazing how much interest the technology has attracted from banks, brokers and infrastructure providers in just a few months. The Bank of England recently called it the 'first attempt at an Internet of finance'. We at ESMA launched a call for evidence to collect feedback from the market on its development a few months back. Beyond the hype, our panel looked into the technology to understand what it is all about and how it could be applied to financial markets. Based on our discussion, we believe that the technology may well help with streamlining post-trading services, reducing costs and increasing security and transparency in the financial system. Yet, for this to happen, a number of challenges, including around privacy and governance issues, will need to be addressed. The transition to the new system may also prove complex and resource intensive. We as regulators should prepare for those changes to come.

We completed the day with a discussion of Leveraged Loan funds. We discussed the unique risks of leveraged loans, notably the lengthy settlement cycle, which investors need to understand. We then discussed differences across the two sides of the Atlantic, the market being less mature and therefore exposed to certain risks to a greater degree in Europe than in the US. Yet if the European market were to mature further, we feel that it would offer an appealing investment choice for certain investor profiles. The increased presence of loan origination and participation vehicles across the Union would help in that regard. The topic of alternative sources of lending, including through asset management, to complement traditional bank lending is a timely one within the EU, as we heard from Jean-Paul Servais this morning.

I hope that today we have provided you with an insight into the way that ESMA approaches financial innovation with the aim of having a balanced view that is both protective to investors and markets and at the same time supportive when we feel that there are potential benefits.

Finally, I would like to thank you the audience for your attendance and sharing your insights.