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Keynote address of Steven Maijoor, Chair of ESMA, to the ISDA AGM – 13 April 2011

Ladies and Gentlemen,

I am very pleased to have the opportunity to speak at this very important event for the financial industry and introduce the role of ESMA in the new European System of Financial Supervision and notably with respect to the reform of derivatives markets. The fact that my first public speech as Chair of ESMA is at an ISDA conference illustrates the importance of the derivatives area for our work in the upcoming period.

Now let me start by talking about ESMA before discussing the regulation of derivatives markets. In my view, the establishment of ESMA and the overall European System of Financial Supervision is one of the few positive results of this financial crisis. ESMA is here to address – together with the two other European Supervisory Authorities and the European Systemic Risk Board – the causes of the crisis, and to prevent similar crises going forward. Together these institutions will work to prevent regulatory competition, inadequate risk management, inappropriate remuneration practices, and insufficient transparency, which have been some of the main causes behind the crisis that we have been – and still are - going through.

As you know, ESMA has been given significant new powers. I will not go through all of them. However, one thing is clear to me. Since the current status of EU financial markets is still fragile, ESMA needs to be ready to act in emergency situations, if needed. We have taken steps to ensure that we have had that capability from 1 January 2011.

In terms of our supervisory powers, with the notable exception of credit rating agencies, day-to-day supervision of financial market participants will in general continue to be at the national level; ESMA will focus on coordination, facilitating cooperation of national authorities and ensuring consistency of supervisory approaches. In the case of market infrastructure, ESMA will have a somewhat wider role – I will come back to that in the second part of my address to you.

When it comes to our regulatory role, the key change is naturally the power given to ESMA to draft technical standards and issue guidelines and recommendations that are subject to a stronger comply and explain principle than during the CESR era. One element is however unchanged: a key part of our rule-making process will continue to be stakeholder consultation. This is a priority for us; in fact one of the first documents that we published was our public statement on consultation practices.

I want to share with you briefly my view of the priorities of ESMA for the first years:

1. Firstly, it is essential for us to build effective supervision of credit rating agencies (CRAs). At this stage, CRAs are the only financial institutions that are directly supervised by a European Supervisory Authority and we will therefore set the benchmark for the future. It is also foreseen that ESMA will have this direct supervisory responsibility regarding trade repositories.

2. Secondly, ESMA has a major role in contributing to the European single rule book. We will strive to deliver high quality technical standards, respecting the sometimes extremely challenging deadlines.

3. Thirdly, ESMA has been entrusted with new innovative powers in the area of consumer protection in order to promote transparency, simplicity and fairness in the markets for consumer financial products and services. We have a new set of tools at our disposal, ranging from warnings to prohibitions and restrictions. The latter will be exceptional and will only apply when a financial activity threatens financial stability or the orderly functioning and integrity of financial markets. We are conducting work at the moment to form our future policies and procedures in this important area.

4. Fourthly, ESMA has a key role in contributing to financial stability by monitoring, assessing and measuring systemic risk; this role is discharged in cooperation with the European Systemic Risk Board and the two other European Supervisory Authorities for banking and insurance.

5. The last point that I want to emphasise is ESMA's role in ensuring a level playing field in financial supervision. It is essential to avoid regulatory competition in the future; in this area ESMA has also been granted with powers of intervention, including the possibility to address cases where it considers that Union law has been breached.

Now let's move on to the derivatives area. The financial crisis we have faced and whose effects are still felt very seriously, has no single cause. However, the structure and functioning of the OTC derivatives markets played a major role in amplifying and spreading the risks entrenched in the financial market by creating an opaque web of interdependencies difficult to understand and disentangle. This is nicely illustrated in the book "Too Big to Fail" by Andrew Ross Sorkin, which many of you probably have read. I really enjoyed reading it during my last Summer holiday. Sorkin describes how AIG and banks entered into many credit default swap agreements. Banks used them to increase the rating of risky assets allowing them to take on even more leverage. In the middle of the planning of the various rescue operations, and when AIG appeared to be at risk, the US financial authorities needed more information on the exposures of counterparties to AIG. The US financial authorities created ad hoc a list of counterparties exposed to AIG and to my surprise, and I guess to the surprise of many, the Dutch bank ABN-AMRO appeared at the top of the list. As you know, ABN-AMRO did not fare well during the crisis and had to be bailed out by the Dutch tax payer.

While we all still recognise the importance of OTC derivatives, we have also become more aware of their limitations and risks. Collective efforts are under way to make these markets safer.

The industry, in particular ISDA and the major market participants involved in its activities, have worked to improve the resilience of the OTC derivatives markets by signing and delivering upon important commitments. The fact that we now have CCPs clearing OTC derivatives and trade repositories recording the majority of transactions in certain asset classes is largely due to the efforts of the industry - although the supervisors have also played a role in guiding those developments.

However, in a global market with the presence of a multitude of players, industry commitments, although important, are not sufficient. To achieve the key objective of reducing counterparty and systemic risk and increase transparency to both market participants and regulators, global financial reforms are needed. This is why the G-20 agreed to embark on a comprehensive reform of the OTC derivatives market, the results of which will need to be delivered by the end of 2012. These regulatory changes will have a fundamental impact on the industry.

Regulators around the globe are now working in a coordinated fashion to implement this reform. Indeed differences exist in terms of timing and in certain approaches to tackle similar issues, but the end goal and the final deadline are common. ESMA is very committed to contribute to the achievement of the ambitious agenda of G-20. This is important to avoid the possibility for regulatory arbitrage. In the path towards that end goal we will continue working together with the CFTC, SEC and other international partners within IOSCO to ensure that our markets will be safer and stronger.

One key element that we have promoted in the discussions with our foreign counterparts is the concept of mutual recognition which is essential to avoid a duplication of regulation and supervision from different jurisdictions. ESMA, for example, wrote two letters to the SEC and CFTC to recommend an approach that avoids regulatory overlap regarding trade repositories and foreign boards of trade. This approach based on equivalence and mutual recognition should in our view apply also to investment firms.

<u>Post-trading</u>

Centralised market infrastructures have proved their value and resilience to shocks during the crisis. This is the reason why the reform in the European Union started from them. EMIR will assign a lot of responsibility to CCPs and trade repositories to achieve the key objectives that I mentioned before.

CCPs will need to reduce risks in the system by clearing contracts previously managed at bilateral level. This will imply new challenges for CCPs. They will face risks to which they were not exposed in the past and these risks must be appropriately managed. We cannot accept that the risk passes from one party to another without control. This is why CCPs will be subject to new and strict requirements.

Trade repositories will play a major role in improving transparency, mainly for regulators, but also for the public. They are not simple databases of information, but essential elements of the OTC derivatives market. They, therefore, need to be appropriately regulated, supervised and monitored.

Here ESMA comes into play. Market infrastructures are by definition European, if not global, in nature. Purely local supervision would not be an effective approach. Even where there might be fiscal implications, a common supervisory approach must be ensured.

The current version of EMIR not only assigns a significant role to market infrastructures, but also to ESMA and we are very committed to fulfil our planned new responsibilities:

1. First, in the drafting of technical standards, where our preliminary analysis has already started. However, we can only move on to the next stage when the text of the EMIR regulation is more or less definitive. ESMA's intention is to launch a call for evidence on the technical standards as soon as we will have a stable text of EMIR and to consult at a later stage on the actual legal provisions to be included in the draft technical standards.

2. Second, in the identification of the classes of derivatives eligible for mandatory clearing. Here we expect that in the final negotiations any changes in the scope and in the procedure will take into account the practical consequences of those changes both to the regulators in charge and to the market players.

3. Third, in the direct supervisory role of trade repositories and in the co-ordinatory role in the colleges of competent authorities for CCPs.

On the first point, I would like to add that ESMA has established three task forces, one on OTC derivatives, one on CCP requirements and one on trade repositories to develop the technical standards. We are also trying to ensure that - when needed - efficient arrangements for the close cooperation with the European System of Central Banks (ESCB) are put in place for the development of the technical standards. At the same time, we are fully conscious of the fact that the final responsibility on the content of the draft technical standards will be on us.

On the second point, I would like to clarify that at this stage I cannot say for which classes of derivatives the clearing obligation will apply. A careful analysis will be required and the fulfilment of a number of criteria will need to be ensured. In addition, most likely for each new class of derivatives a cost-benefit analysis will need to be performed and certainly a public consultation will need to be carried out. Therefore, giving my views on this now would be premature, but you will have a number of occasions to express your opinion. Regarding the clearing obligation I fully understand the wishes of the industry for flexibility. However, flexibility should not result in risks to the stability of financial markets.

On the third point, I would like to mention that for the effectiveness of supervision, a clear determination of roles of various bodies in the authorisation and supervision of trade repositories is essential. This is particularly important when such a responsibility is given to a newly established authority that will be held accountable for the authorisation of and ongoing supervision of these important entities.

We expect the Regulation to be soon adopted by the European Parliament and Council. This will officially start our process that will inevitably require some time, taking also into account the fact that after ESMA will have finalised the draft technical standards, the Commission, Council and Parliament will have their role to play in the process. However, I'm confident that with the joint European efforts we will be able to meet the approaching G-20 deadline.

<u>Trading</u>

At the trading side, we are a bit less advanced compared with the post-trading side. As you know, the Commission recently published its consultation on the MiFID review where it proposed that all trading in derivatives which are eligible for clearing and sufficiently liquid should move to regulated markets, MTFs or other organised trading facilities. I think we all share the view that there are limits to what can actually be traded on these types of organised platforms and there are also differences in the way in which derivatives can be traded compared to equities trading.

Despite the differences, it is evident that certain features of the equities market structure need to be brought to derivatives trading; notably transparency, liquidity, operational efficiency and equal market access are the most obvious objectives. However, it seems also clear that a "copy-paste" approach cannot be taken, given the unique features of derivatives markets.

According to the Commission's consultation, ESMA can be expected to play several key roles in this area in the future:

1. Providing advice to the Commission on MiFID Level 2 measures;

2. Drafting technical standards for the practical implementation of the revised MiFID; and

3. Determining when a derivative would be sufficiently liquid so as to be traded on organised platforms.

If the Commission's proposals are taken on board, ESMA will have to face a number of challenges in developing our thinking. The main challenge is likely to relate to striking the right balance between the need to align global regulatory outcomes and the need to respect the specific characteristics of European markets.

On the more technical side, defining the right parameters to determine which derivatives are sufficiently liquid to be traded on organised trading platforms will form a key part of the future work. We will also need to continue our work to develop an appropriate pre- and post-trade transparency regime for each class of derivatives, which will naturally require – as in the equity markets side - certain exemptions from the general principle of transparency in particular for large transactions in order to avoid a negative impact on liquidity. It will also be important to take into account the differences in OTC and organised platform trading.

Let me conclude. I believe that EMIR will mark an essential step in the European reform of derivatives markets by making them less risky and more transparent. ESMA is committed to fulfil its role and meet the deadlines, but a reasonable time is necessary to develop the huge set of technical standards required. In addition, ESMA will need to put in place the appropriate resources to assume the new responsibilities. The basis for this will need to be set in the legislation.

International coordination is essential in a global market. To ensure safe and sound markets, regulatory arbitrage has to be avoided. However, from an international perspective we not only need to avoid regulatory gaps, we also need to avoid overlap by taking into account the regulations and supervisory systems in other jurisdictions. ESMA is working towards these objectives bilaterally and by increasing its participation in the international fora.

Finally, an essential element of good regulation is stakeholder consultation. This is why ESMA established in its Board of Supervisors meeting of yesterday its Securities and Markets Stakeholder Group. Stakeholders from the derivatives markets are represented in this group. We are looking forward to an intensive dialogue with this important group, without underestimating the contribution of the consultative working groups that we have set up to support various technical committees, including in the field of trading and post-trading. In addition, ESMA will publicly consult in every step of its regulatory process. This will ensure that all the different views of market participants will be taken in due consideration to the benefit of a sound single rulebook.

Thank you for your attention.