

## **ESMA's role in European and international regulatory cooperation**

International Council of Securities Associations, Copenhagen

Verena Ross, Executive Director of ESMA

Ladies and Gentlemen,

I am very pleased to be with you today and would like to thank ICSA for inviting me to address the 25<sup>th</sup> Annual General Meeting in front of this distinguished audience of international securities bodies, regulators and market participants.

Over the course of the conference so far, you have heard a variety of perspectives on the current position we find ourselves in in relation to global capital markets performance and their regulation – from international regulatory bodies such as IOSCO and the European Commission, local regulators and representatives of market participants, I would now like to take this opportunity to present the view from inside one of the newer arrivals to the milieu of securities regulation – the European Securities and Markets Authority.

I believe that the topics discussed so far set the scene well for what I want to talk about today. The world is changing quickly, particularly the world of financial markets, and financial regulation is part of this change. Since the financial crisis hit nearly four years ago, the change to the regulatory environment has been unprecedented and that has implications for all financial market participants, including investors, and their regulators. This has been especially true in Europe, where we have seen tumultuous events in markets but also an unprecedented response by the European system to these events.



## **Overview of ESMA**

Today, I will focus on the EU regulatory framework and the role of ESMA, on the priorities and challenges for 2012 and beyond and, finally, discuss the need for international convergence and cooperation.

In June 2009, the Heads of EU Member States and governments called for a move towards more harmonised regulation and integrated European supervision to tackle the effects of the crisis and to ensure a true level playing field for all actors at the EU level. This reflected not only our attempt to tackle the fallout from the financial crisis, but it also responded to failings in the areas of cooperation, coordination, consistent application of Union law and a lack of trust between national supervisors.

This political decision led to the establishment of the European System of Financial Supervision and the creation of the three new European Supervisory Authorities, or ESAs, for securities, banking and insurance in on 1 January 2011. This was a crucial political decision on the part of the European Union (EU) aimed at improving financial services regulation and supervision in Europe.

The new system's objective is not only to secure a more robust legal framework for financial markets and all its players, but also to provide benefits to investors and the wider economy. Moreover, the benefits of a single financial market are even more obvious when looking at the alternative: 27 separated and isolated financial systems functioning with their own rules.

ESMA, as one of the three ESAs, was given the mission of improving the protection of investors and promoting stable and well-functioning financial markets in the EU. As with the other ESAs, ESMA replaced an existing body, in our case this was CESR - the Committee of European Securities Regulators - which played an advisory role providing technical advice on a consensual basis to the European Commission.



While ESMA continues to provide technical advice to the European Commission it has a substantially expanded remit in comparison, which already includes supervisory powers over credit rating agencies and in the future trade repositories – in fact we are the only one of the new agencies with such direct supervisory powers.

We are also responsible for the enforcement of EU law, delivering opinions on legislation, resolving disputes between supervisors in cross-border situations and coordinating responses in emergency situations. ESMA now sits at the centre of a network of EU securities supervisors, with more muscle and more powers to coordinate than its predecessor CESR.

While ESMA has many new tasks and powers, the new framework is based on an already existing and effective network of national supervisory authorities. It is important for ESMA to have strong input from national authorities into ESMA's rule making process. In addition, we continue to rely on the national authorities to conduct the day to day supervision of their authorised firms and market infrastructure players, many of which are active across the whole of the Union.

In attempting to create a single set of rules and achieve an 'effective EU single market', ESMA needs input not only from national competent authorities, but also from the wider stakeholder community. This includes the key market players - buy side/sell-side, infrastructure, issuers, etc. - but also retail investors, small and medium size companies as well as the European institutions.

On the international side, we foster dialogue and cooperation with supervisors outside the EU. We are empowered to develop contacts and enter into administrative arrangements with the supervisory authorities and administrations of so-called 3<sup>rd</sup> countries and with international organisations. I will expand on this element of our work later in my speech.

## **Role of ESMA in the EU framework**



I would now like to move on to speak about our role and work programme. ESMA has two key objectives as an organisation. The first being the building of a single rulebook for the regulation of the EU's financial markets and the second is achieving supervisory convergence and the consistent application and enforcement of the single rule book. The single rule book is important in ensuring that investors are receiving the same level of protection across the EU, while it also benefits the financial industry as it creates a level playing field and reduces the costs of providing services at a European level. In addition to these two objectives ESMA also contributes to the regulation of financial services firms with a pan-European reach, either through direct supervision or through the active coordination of national supervisory activity.

Now, let me focus on three key areas of work that have driven our activity over the last 18 months in pursuit of our mission, and will continue to do so again this year.

### Single rule book

One of ESMA's key activities is contributing to building a single rule book for the regulation of the EU's financial markets and ensuring its consistent application at national level.

ESMA has played its part in producing detailed requirements and standards by:

- producing the technical standards for credit rating agencies (CRAs) and short-selling;
- conducting significant work in order to prepare technical standards for the OTC derivatives regulation;
- providing advice to the Commission for secondary legislation in areas such as prospectuses and alternative investment funds; and
- providing more detailed guidance and recommendations in areas such as automated trading and ETFs.



Over the coming months this task of building the single rulebook for Europe will involve ESMA developing technical standards and advice that deal with markets (MiFID), their infrastructure (EMIR), transparency (TD) and orderly functioning (MAD), along with rules for financial market participants such as investment funds (UCITS, AIFMD).

### Supervisory convergence

The single rule book is a necessary tool to face the crisis and build a safer and more efficient financial market, but it is not sufficient. It needs to be complemented by supervisory convergence in order to be fully and efficiently implemented on the ground. This is core to ESMA's mission in achieving common approaches to regulation across the EU. Let me give you a few examples:

- ESMA has issued opinions on the treatment of sovereign debt under IFRS and on a number of pre-trade transparency waivers under MiFID;
- ESMA has coordinated bans on net short positions in Belgium, France, Greece, Italy and Spain last summer;
- During that period, we also coordinated the monitoring of market developments and market infrastructure resilience; and
- Finally, ESMA conducts peer reviews of national authorities' activities in order to assess the degree of convergence in the application and enforcement of EU law. We recently published the results of two of these peer reviews, one on prospectuses and the other on market abuse and the use of sanctions.

Part of ESMA's *raison d'être* is to foster supervisory convergence thereby reducing the risk of regulatory arbitrage which has the potential to undermine not only the integrity, efficiency and orderly functioning of markets but ultimately financial stability. While the single rulebook will contribute to this convergence, it is still very much a work in progress, and ultimately is about more than just black on white letters of law being the same.



## Direct supervision

Beyond the supervisory convergence agenda, legislators have gone further in some areas and have placed significant pan-EU market players under the direct supervision of ESMA, which is the case for CRAs at the moment.

ESMA is the only European Supervisory Authority currently exercising direct supervisory responsibilities over market participants. In July 2011 we took on the responsibility for the registration and supervision of CRAs wishing to conduct business in the EU. Bringing CRAs under the umbrella of EU supervision is a milestone achievement which will contribute to a sounder rating process and thus more resilient markets and improved investor protection. In this context, we have undertaken our first on-site inspections in December 2011, which will become a regular feature of our oversight, and published the findings last March. The report identified several shortcomings and areas for improvement which ESMA is now following-up on through risk mitigation plans for each individual CRA. These issues will also be addressed in the individual and thematic supervisory reviews, on-site inspections and off-site monitoring and risk analysis which we will conduct this year.

From 2013, ESMA will also take on direct supervisory responsibility for Trade Repositories (TRs) under the EMIR regulation - expanding the cross EU supervisory role – and will take responsibility for registration and supervision. Finally, ESMA will participate in the colleges that govern the registration and supervision of CCPs in order to ensure effective functioning and consistency of these colleges.

## **Investor Protection**

Investor protection is a core ESMA objective in our founding Regulation and informs many of our actions. There is a history in European securities markets of developing common approaches to the equal treatment and protection of investors. This has generally been done by setting standards for the harmonisation of conduct of business



rules across the European Union's Member States. As a result of lessons learned from the early experiences of this financial crisis, for example, CESR was vested with the responsibility of helping to ensure, and improve, the consistent implementation and application of the MiFID investor protection provisions.

However, with the creation of ESMA and the other two European Supervisory Authorities (ESAs), this work has the potential to be greatly enhanced. All three ESAs have been tasked with an explicit investor protection responsibility. ESMA has set out to deliver a variety of tasks related to consumer protection and financial activities.

Ingraining investor protection responsibility into the EU regulatory framework in this way is a significant step forward, it moves investor protection onto another plane. What is significant about our new powers, and this explicit responsibility, is that we can now change the way we do things. In particular, we can take a much more pro-active, and effective, approach towards investor protection

One example of this more proactive approach was ESMA's first investor warning in December 2011 to retail investors against dealing with unauthorised firms and individuals offering foreign exchange investments, while also alerting them to the main risks involved in forex trading. We will not stop here: working with the national competent authorities, ESMA is prepared to issue further investor warnings as and when the need arises.

### **Key priorities for 2012-13**

The introduction of new, and the overhaul of, existing legislation will be a key challenge for ESMA this year. ESMA will work on establishing harmonised binding implementing measures in different areas such as: OTC derivatives (EMIR), investment funds (UCITS), alternative fund managers (AIFMD) and issuers (Prospectus directive). EMIR in particular will dominate our agenda for the next months, with a consultation paper in June, an open hearing in July and with final standards due to be delivered by end



September.

In addition, ESMA will provide advice and support on legislation being introduced and debated by Council and Parliament, including MiFID/MiFIR, MAD/MAR, CSD, Venture capital etc. We will need to start conducting some preparatory work in many of these areas, as the issues ESMA is likely to have to work on, once the Level 1 legislative process is completed, are not only numerous but often technically complex and difficult. ESMA will want to collect information and data, for example to support its future work in areas such as non-equity transparency under MiFID/MiFIR.

On the supervision side, 2012 will mark the first year in which ESMA will fully exercise its duties on CRAs and - as I already mentioned - needs to prepare itself to take on supervisory responsibilities for Trade Repositories. ESMA will also be preparing for the work on supervisory colleges which will be established in 2013 for the regulation of cross-border central counter parties under the OTC derivatives legislation. The reach and impact of these institutions operating in one country could dramatically affect investors and intermediaries of other countries. ESMA will play, in this framework, a co-ordination and a mediation role if needed.

### **ESMA's role in international cooperation**

Moving now to speak about ESMA's role in the field of international cooperation, which I hope will be of particular interest to this audience. International cooperation and convergence is difficult but absolutely necessary. In coordination with the European Commission, but also in close cooperation with national regulators, ESMA plays a central role in ensuring that Europe speaks with one single voice vis-à-vis regulators outside the European Union.

In 2009, the heads of EU Member States and governments called for harmonised regulation and integrated supervision to ensure a true level playing field for all actors at EU level. With the establishment, and good start, of the ESAs and the ESRB, I think we

are making good progress in this direction. However, the financial market is global both for participants and investors. It goes beyond Europe, and therefore the greater harmonisation within the EU needs to be complemented with international convergence and cooperation. I strongly believe that Europe can lead by example here, to show how convergence and good cooperation between different national member states and their regulators provide more effective and efficient regulation of cross-border entities and markets.

Let me now move on to explore more deeply ESMA's role on the global stage. Why is it so important to aim for broadly common regulation of financial markets at world-wide level? In the middle of this on-going worldwide financial crisis it would be foolish not to support broadly common regulation of international financial markets. Still, I would like to give you my views on the main reasons for common regulation as we need to continuously keep them in mind when reforming international financial markets.

### **The rationales for broadly common regulation of international financial markets**

First, many market participants, both on the investor side and the industry side, operate on a global level. Therefore, to achieve the same level of investor protection and to minimise the extra costs of doing business at the international level, common regulation is desirable.

Second, financial markets are very sensitive and responsive to regulatory differences, and this holds especially for wholesale financial markets. Differences in regulation will affect where financial activities are conducted. To avoid regulatory competition, where regions are undercutting each other with laxer but also more risky regulation, we need to cooperate to achieve the same level of robust regulation. Competition is the right model for markets, not for regulation and supervision. Common regulation also increases the acceptance by the financial industry in our local markets of the far-reaching consequences of regulatory reforms. The additional costs of new regulations are more



palatable when the industry knows that their international competitors are confronted with the same costs. I should also mention here that the committee that laid the foundations for the establishment of ESMA, the de Larosière committee, considered regulatory competition to be one of the most important causes of this financial crisis.

Third and most importantly in my view, the performance of financial markets in countries and regions across the world is strongly linked. No financial market can isolate itself from the performance of other markets across the world. Hence, the value of a well-regulated home market is constrained by the potential risks of lax regulated markets abroad. Therefore, we all have a strong interest that not only our own financial market is well-regulated, but also all other foreign markets to which our home market is exposed.

### **The international regulatory reform agenda**

Much of ESMA's work is conducted in the context of international agreements on the reform of financial markets. These are the G20 Commitments and they have been essential in achieving, as much as possible, comparable regulatory reforms across the various financial markets. This worldwide coordination is obviously very important considering the interconnectedness of financial markets. Concrete examples of current ESMA work which is driven by these G20 commitments are the regulation and supervision of CRAs, private equity, hedge funds, and the far reaching reforms of the OTC derivatives market.

### **Achieving common international regulation**

Let me now move on to how we can achieve broadly common regulation of financial markets across the world. That achieving this objective is difficult and hard work needs no further explanation at this event. I would like to comment on two specific issues relating to achieving broadly common regulation of international financial markets. The first issue concerns the regulation of internationally active market players by various

national regulators. The second issue concerns the relationship between securities markets regulators and our governments who decide on the core regulation with which we have to work.

### *International market participants and national regulators*

When regulating national or, in the case of the EU, regional financial markets, the issue needs to be addressed of how international market players are regulated. To illustrate this with the European perspective, and also the European terminology: How do we for example regulate market players like CRAs, hedge funds, private equity firms, and CCPs from 3<sup>rd</sup> countries doing business in the EU? To provide EU investors with the same level of protection, and to create a level playing field with EU market players, these 3<sup>rd</sup> country market players need to meet the same EU requirements. This automatically raises the potential problem of market players becoming subject to multiple regulatory regimes. These potential problems can be controlled under two conditions. The first one is that the regulatory requirements of the 3<sup>rd</sup> country and EU are broadly similar. More common regulations between home and host countries obviously limit the potential problems facing cross-border entities and activities. I will discuss achieving broadly common regulation later in my contribution. Secondly, we must avoid circumstances where market players are subject to two, or even more, sets of day to day regulatory demands.

In this context, I believe that the easiest and most efficient option is a system based on equivalence and relying on mutual recognition. Without mutual recognition, entities operating on a cross-border basis would be subject to different requirements and to the jurisdiction of different authorities. This exposes them to potentially conflicting requirements and to higher compliance costs. Of course, I fully understand that before you rely on a foreign regulatory system its robustness needs to be assessed. Hence, the equivalence needs to be assessed of the home country's regulation and supervision of the foreign market player. However, when the home country regulation and supervision achieve similar outcomes, we will need to rely on mutual recognition and co-operation



with the home country regulator. This cooperation with the home country regulator is essential to ensure that when needed and in response to specific risks you can supervise the 3<sup>rd</sup> country market participant in the same way as domestic market participants.

### *Governments and securities regulators*

Much of the regulation with which we have to work as securities regulators depends on decisions by our governments. As we are all aware, there is no governance mechanism at worldwide level which ensures that governments take coordinated decisions regarding the regulation of financial markets. The EU has developed such a mechanism after many decades: the European Commission, Council, and EU Parliament can decide on Directives and Regulations, and ESMA now has the powers to write technical standards.

While we respect the sovereignty of governments, I have already made clear what the benefits are of broadly common regulation of international financial markets. Not achieving broadly common regulation will inevitably lead to different levels of investor protection, as well as an uneven playing field and the potential to spread risks. While, sovereign governments can obviously deviate locally, such deviations come at a high price.

I would like to qualify my statement that there is no governance mechanism at world-wide level ensuring that governments take coordinated action regarding financial market regulation. One of the positive results of the financial crisis has been the G20 Commitments on financial market reform and the new role of the Financial Stability Board. As a result of these G20 Commitments, the regulatory developments in the main financial centres of the world are broadly similar on such issues as CRAs, hedge funds and OTC derivatives. Of course, we all know this does not mean that there are no differences in regulation across the world. While we should not deny these differences and be complacent, I would like to be positive on what the G20 Commitments have achieved.

The key of the success of the G20 commitments is that they have driven the law making activity by governments and has resulted in relatively common laws with which we have to work as securities regulators. While it is clear that the financial crisis has provided the catalyst for the G20 commitments, we should not need a crisis to let this system work. How can we help as the international community of securities regulators to ensure that the process operates smoothly? We should not only cooperate after our governments have taken decisions on financial market regulation, we also should influence policy making by governments at the international level at an early stage.

ESMA is very much in favour of a strong international community of securities markets regulators driving the international policy debate on financial market regulation. In popular words “we need to be ahead of the curve”, and need to identify possible future areas of regulation and offer possible regulatory frameworks. For example, an area where this has worked well is CRAs where IOSCO published its first principles in 2003. The actual IOSCO Code of Conduct Fundamentals for Credit Rating Agencies has been largely incorporated in legislation in many countries in response to the financial crisis.

An additional argument for a more active role of securities regulators in the international policy debates is that the interest in many of the current important topics are shared with other regulators and specifically banking regulators. The latter group has strongly influenced the current regulatory reforms in response to the crisis. While this is to some extent logical considering that the current crisis is in essence a banking crisis, we need to ensure that for topics that have the joint interest of banking and securities regulators, our respective perspective gets the right attention.

The initiatives related to OTC derivatives are a good example of this need for convergence and cooperation at a global level. In Europe, the result from the G20 commitments has been EMIR, and to a degree the provisions on derivatives transparency in MiFID 2. But the same issues are occupying our counterparts in the US, Asia and other parts of the world.



Regulators have set up a number of international groups aiming at achieving international consistency of the different regimes, and ESMA plays a full role in this global dialogue.

As no single regulator can seek to regulate global financial markets from one location, we will need to rely on equivalence, mutual recognition and cooperation in order to make progress. There is no alternative to close international cooperation, both in the setting of standards and in the execution of day to day supervision, if we want to achieve an efficient system for the global financial markets.

### **Practical supervisory cooperation and how we can do this, mutual recognition**

Turning finally to mutual recognition as a means to enhancing supervisory co-operation I would like to provide some concrete examples of where ESMA has successfully applied or is in the process of applying this principle.

One of the areas where we have applied this model of mutual recognition concerns the endorsement assessment of 3<sup>rd</sup> countries for CRAs and this has been one of the international areas receiving a lot of attention from ESMA. The essence of the assessment is whether ratings from 3<sup>rd</sup> countries used in the EU meet EU requirements. While the banking industry in particular was understandably concerned about sufficient 3<sup>rd</sup> countries being endorsed before the 30 April deadline, we can now see that the most important 3<sup>rd</sup> countries have been endorsed. Looking back at the whole assessment process, I am quite positive about the current 3<sup>rd</sup> country regime for CRAs. It ensures a level playing field between the EU and other regions, and investors can expect the same quality of endorsed non-EU ratings as EU-ratings.

## Conclusion

In summary:

- The crisis has led to an unprecedented number of legislative initiatives in Europe at Level 1 and 2 aimed at enhancing transparency and creating safer and more efficient markets;
- The way regulation is prepared and supervision is performed is changing and it needs to maintain its focus on more international convergence and cooperation. Although the path is difficult, progress is being made; and
- We recognise it requires adaptation by market participants and also their contribution to the dialogue between regulators and markets – to ensure we, as regulators, understand the risks and can effectively monitor and respond to them.

Let me conclude by stating the obvious: regulating international and interconnected financial markets from a national perspective is a mismatch. However, despite this difficult starting point, the community of international securities regulators should do its utmost to achieve broadly common regulation of international financial markets. Important ingredients to achieve this are cooperation both before and after our governments decide on the regulation of financial markets. It is essential that we drive the international policy debates on future areas of financial market regulation and possible solutions. Once regulation is in place which is broadly similar, we need to move to a model of equivalence, mutual recognition, and strong cooperation in day to day supervision between regulators.