European Securities and Markets Authority

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Keynote address of Steven Maijoor, Chair of ESMA, at the AFME Market and Liquidity Conference – London 8 February 2012

Ladies and Gentlemen,

I am very pleased to have the opportunity to speak at this important conference in front of an audience full of high level representatives of the financial industry.

In the past year I usually started my speeches with a general introduction about ESMA. However, I assume that the amount of work that ESMA has carried out in 2011 allows you to have a good idea of our mission and tasks. A few examples of our work include the guidelines that we published regarding high frequency trading, the extensive and detailed advice for the European Commission on the regulation and supervision of private equity and the hedge fund industry (AIFMD), our opinion on the valuation of sovereign debt, and draft guidelines for ETFs. These examples illustrate our contributions to the mission of investor protection and the financial markets' integrity and stability.

Given the very dense agenda that ESMA has for 2012, I suggest we get straight to business and I will not spend any further time to promote ESMA's central role in the regulation and supervision of European financial markets. In view of the topics of the conference I will start with EMIR.

EMIR

As you know, EMIR is the European response to the G20 commitment to make derivatives markets safer and transparent. The indications are that we are very close to a political agreement on EMIR. However, it has not been finalised yet and therefore the ball for developing the implementing measures has not yet been passed to us. Our hope is that with this ball, we can play to shape the long list of complex technical standards that we need to draft in the best possible way. While making technical standards regarding CCPs, trade repositories and central clearing will not be easy, we will do our utmost to avoid that the ball will become a hot potato.

Now abandoning the metaphors, we are very conscious and strong believers in the benefits of open public consultations and accurate cost-benefit analyses, but if we face unreasonable deadlines, there is not much we can do. I must say that the deadlines for ESMA to deliver standards and advice in the recently agreed Short Selling Regulation are too short. My team at ESMA is working night and day to meet the end of March deadline and we will make sure that most of the work will be done on time. However, the whole process is compressed including a very short time for consultation of stakeholders on the standards and advice. It is important to note that the quality of a regulation also depends on its technical implementation and for that a proper consultation process is important. I therefore understand the explicit concerns expressed regarding the tight deadlines by various stakeholders. The deadlines on EMIR are, to say the least, challenging considering that we need to meet the G20 deadlines. However, I hope and expect that for the technical standards regarding EMIR we will receive the time needed, and substantially more than in the case of the Short Selling Regulation.

To give you a flavour of the complex issues that are related to this piece of legislation, I will touch base on some of them which are more closely related to the subject of this conference and I will start with FX derivatives.

FX derivatives

Many industry representatives have always battled for having an exemption from the clearing obligation for FX derivatives, arguing that the risk associated with those derivatives is only settlement risk. I will not discuss whether the clearing obligation should or should not apply to FX derivatives. Any conclusion on that is simply too premature considering the many aspects that ESMA needs to take into account before applying the clearing obligation to any class of derivatives.

The real issue on FX derivatives that only a few have spotted is not the clearing obligation, but the bilateral collateralisation. The problem of international inconsistency and regulatory arbitrage is much more serious on margins for contracts that are not centrally cleared than on the clearing obligation. As you all know, in the US FX derivatives are fully exempted from the application of the Dodd-Frank Act. Therefore, the margin requirements for non-centrally cleared transactions would not apply. However, they will apply in the European Union.

Let me be absolutely clear, I am not calling for a similar exemption. I believe that the European approach is consistent because it looks at the overall risks of derivatives markets and at all the market players. However, it should be recalled that we have a common objective established by the G20 and the introduction of significant local exceptions risk compromising the global picture. This leads me to the second point I would like to make: international consistency in the regulation and supervision of the derivatives market.

International consistency

ESMA is working closely with international regulators both bilaterally and within international forums. We believe that if all the work that is conducted at international level results in equivalent regimes, than third country regimes should be recognised. Equivalent regimes and mutual recognition is important to ensure that we not only avoid regulatory gaps, but also regulatory overlap.

We cannot force global players, being either CCPs, trade repositories or banks, to be subject to multiple jurisdictions, multiple registrations and multiple supervisors. This would not only result in the inefficient use of resources, it would also undermine the credibility of regulation and supervision.

It is our responsibility as regulators to work toward equivalent regimes to maintain derivatives markets globally. ESMA is working hard to achieve this objective together with global regulators. However, whilst different approaches cannot always be aligned, we absolutely need to ensure that this does not end up in a higher risk for the entire financial system. We should avoid the risks related to legal complexities and uncertainties arising from market participants being subject to multiple regulatory regimes.

Legal Entity Identifier (LEI)

To further stress the importance of global initiatives, I want to spend a couple of words on an essential project: the establishment of a unique legal entity identifier for every single legal entity concluding financial transactions. This is important not only for derivative trade reporting, but also for many of the other regulatory reporting, like transaction reporting, short positions reporting and alike.

Given that such an identifier needs to be globally unique to serve its purpose, the foundations for the establishment of the Idnetifier should be right. This includes a proper governance model for the fulfilment of regulatory objectives. Again, attempts to extend local requirements at global level will not be useful in this respect. A global solution should be defined and agreed at global level with the appropriate level of ESMA participation.

Central Counterparties (CCPs)

I will now turn to one of the main issues covered by EMIR: the regulation of CCPs. Given that the main subject of this conference is liquidity, I will spend some words on that.

Also in this case, I will not focus on the obvious topic: the access to central bank liquidity. That is not an issue on which I would like to comment here. However, I would like to stress our extensive collaboration with central banks on issues related to CCPs and we are working together in the drafting of technical standards.

The aspects of liquidity I would like to focus on are related to the liquidity collected by CCPs mainly in the form of cash. Given the systemic role played by CCPs and the greater role they will play in view of the clearing obligation, we cannot allow that such liquidity could be put at risk.
CCPs need to be safer than banks, and for this reason they fully collateralise their exposures. Now, all this collateral cannot be returned to banks through unsecured arrangements, otherwise we will be back to square one. We will therefore need to establish strict rules on CCPs' investment policies.

MIFID II

After having touched on some important post-trading aspects, I will now turn to trading. On this, we all know the traditional struggle between transparency and liquidity which will be at the top of ESMA's list for the near future.

As you are aware, the Commission's proposal for MiFID was made public on 20 November 2011. Despite this, there might be a long way before the final version is approved, but looking at the current version of the text we can already make a few points.

The Commission proposal extends the MiFID transparency framework to bonds, structured finance products, emission allowances and derivatives. From the previous CESR experience, it became clear that the calibration of transparency regimes has to be undertaken *per asset class* and in many cases *per type of instrument* within each asset class so as to *avoid that transparency harms liquidity*. Hence, we should not opt for a mechanical extension of the MiFID equity transparency requirements to non-equity financial instruments.

On derivatives: one of the pillars of the comprehensive reform of the OTC derivatives market agreed by the G-20 is moving all trading in derivatives, that are eligible for clearing and sufficiently liquid, into regulated markets, MTFs or other organised trading facilities. In that regard, it seems clear 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. However, 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. Again, it seems clear that a "copy-paste" approach cannot be taken, given the unique features of derivatives markets.

In case the Commission proposal is passed as it is, ESMA will have to advise the Commission for the adoption of the delegated acts. I can assure you that, as always, we will organize intensive consultation practices: ESMA is supported by a Securities and Markets Stakeholder Group, which would add to the contribution of the Secondary Markets consultative working group. In addition, ESMA will publicly consult in every step of its regulatory process. This will ensure that all the different views of market participants and the latest market conditions will be taken in due consideration in any future ESMA proposal.

Securitisation

I would also like to spend a couple of words on a very important market that deserves to repair its damaged reputation and restore investor confidence: the securitization market.

Once again the link between liquidity and transparency is very strong. In this case the liquidity has completely dried up because of a combination of investors being confronted with much higher risks than expected and a lack of transparency. Therefore, the rebuilding of the securitization market cannot be achieved without seeking more transparency and greater accountability. In that context I would like to mention the Prime Collateralised Securities (PCS) initiative which aims to restart the securitization market.

The PCS initiative is built upon three pillars: 1) granting a label for ABS securities which meet certain criteria, 2) developing a market convention with agreeable market standards, and 3) providing credible verification to assure continued compliance.

I see these elements as constituting the steps for increasing transparency, and thus contributing to the overall enhancement of investor protection. The standardization process will help to ensure that securitization is safer and does not jeopardize the stability of the overall financial system.

This will facilitate the development of more liquid secondary markets and could allow for better comparison between products to the benefit of investors.

I am confident that the implementation of such an initiative will be done consistently and will contribute to the better operation of the securitization market.

Credit Rating Agencies

Let me now say a few words on credit rating agencies. All CRAs active in the EU are now under supervision of ESMA. We have completed our first inspections of the largest CRAs and we expect to report on these inspections in April. While we can inspect such issues as the CRAs' internal controls, transparency and independence arrangements, we cannot interfere with their ratings. The European regulation establishing the supervision of CRAs rightly requires that neither ESMA, nor any other European public authority interferes with the ratings issued by CRAs. I fully understand the deep concerns about CRAs considering their performance in the structured finance area and the role they have played in starting this financial crisis. However, to make the new regulatory framework function it is important to respect the principle of non-interference by public authorities. Like all ratings, sovereign debt ratings can only be credible and play their proper role in financial markets when they are issued independently from the rated entity.

I also want to comment on the so-called third country issues of CRAs. As you know, many of the ratings that we use are issued outside the European Union and we need to ensure that these ratings meet the same requirements as "our" ratings. We are currently performing the assessment of the regulatory framework of several non-EU countries and agreeing suitable cooperation arrangements with the respective supervisors

- something that will ensure the endorsement of the overwhelming majority of third-country ratings currently used for regulatory purposes in the Union.

Last December, ESMA decided to extend until 30 April 2012 the initial transitional period of three months for credit ratings issued outside the European Union. This decision allows the use in the EU of credit ratings issued in third countries while the convergence process with the EU requirements and the endorsement process of third countries continue. The assessment requires that the regulatory framework in the third country is "as stringent as" the European CRA Regulation. This requirement ensures a level playing field between ratings issued in- and outside the European Union.

Let me make an important specification in this respect, namely that the wording of the provisions in the non-EU countries concerned do not need to be identical to those set out in the CRA Regulation. A global and holistic view should be applied in assessing to what extent the third country legal framework achieves similar adequate regulatory effects and meets the same objectives as the EU Regulation.

In December, following a careful assessment of its regulatory framework, ESMA also decided to endorse Australia's regulatory regime on credit ratings. Having also assessed as endorsable Japan in June 2011, ESMA is in an advanced state of its assessment for several other non-EU countries, namely Argentina, Canada, Hong Kong, Singapore, and the US. ESMA is also currently examining the regulatory frameworks of Brazil and Mexico.

Final observations

Let me move to some final observations. All the topics that I have addressed in my contribution are the result of the regulatory reform in response to the financial crisis. This firstly shows that the regulatory reform is far-reaching and will fundamentally change financial markets. I think that is consistent with how serious this crisis is. Second, the fact that a substantial part of the regulatory reform is in the implementation phase, and some of its results can already be used to respond to the day-to-day issues of this crisis, indicates that governments have taken timely action but also, and maybe more cynically, that this crisis is taking a long time.

The coordination by ESMA of the responses to the financial crisis by National Authorities is such an example of the result of the regulatory reform. The regulation establishing ESMA gives us an explicit mandate in this area. In practical terms this includes activities like coordinating the information exchange between national authorities, and collecting and analyzing information on European financial markets, for example on settlement failures and on the developments in CDS markets.

To conclude I want to highlight that our focus now on regulatory reform should not distract us from the fact that the application of the new regulations by financial market participants, and consistent supervision and enforcement will be at least as crucial to get the right outcomes from the regulatory reform. The combination of regulation, application, supervision and enforcement is needed to achieve the expected benefits to investor protection and the stability of financial markets.

Thank you for your attention.