

Opening statement: Steven Maijoor, Chair of ESMA

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Ladies and gentlemen,

The European investor protection framework for the provision of services to retail clients is getting stronger all the time.

With the establishment of the European System of Financial Supervision (ESFS), as a direct response to the financial crisis, and the creation of the three new European Supervisory Authorities (ESAs), the legal framework for financial markets and all its participants has become much more robust.

ESMA's investor protection role

From a European perspective, investor protection is a core part of ESMA's activities and necessarily informs many of our actions.

ESMA continues the work of its predecessor, the Committee of European Securities Regulators (CESR), by

- (i) setting standards for the harmonisation of conduct of business rules across the European Union's Member States, to ensure the consistent and improved implementation and convergence of European securities legislation; and
- (ii) (ii) providing Technical Advice to the European Commission.

However, with the creation of ESMA and the other ESAs, this work has the potential to be greatly enhanced. ESMA now has a much wider remit and stronger powers – also with regard to investor protection. In particular, we contribute to the development of the single rulebook in the EU through draft Technical Standards.

More specifically, within the legislative framework of the EU and by using the available ESMA *tools*, we have sought to enhance investor protection through output relating to:

- Markets in Financial Instruments Directive (MiFID): Article 16 guidelines to promote greater convergence in the interpretation of, and supervisory approaches to, the MiFID suitability and

compliance requirements; and draft guidelines on remuneration based on the MiFID obligations on investment firms in respect of conflicts of interest and conduct of business when providing investment services;

- Exchange-traded funds and other UCITS issues: Article 16 guidelines introduce significant additional safeguards for investors in UCITS funds, for example by strengthening the rules on collateral and clarifying the types of financial index to which a UCITS may gain exposure. With respect to ETFs in particular, the guidelines make clear that in certain circumstances, investors should be able to redeem their units directly from the ETF provider. Finally, disclosure requirements are strengthened in a number of areas, such as with respect to the methodology used by funds when tracking indices and the possible additional risks involved from activities such as securities lending;
- Article 9(3) investor warnings: on dealing with unauthorised firms offering foreign exchange investment, the main risks involved in forex trading, and on the internet distribution of financial products generally;
- Prospectus Directive: Technical Advice on proportionate disclosure to make access by SMEs to capital markets easier and less costly; and
- International Financial Reporting Standards (IFRS): To ensure that the information investors receive is clear, understandable and useful in their decision-making, the proper enforcement of IFRS is crucial and ESMA has started to play a very active role in ensuring the consistency of the enforcement of these rules by the various EU competent authorities. Consistent application of IFRS needs pan-EU coordination: in this regard, ESMA has recently published a set of common enforcement priorities in the EU. This is the first time EU enforcers have agreed on common enforcement priorities highlighting the areas on which all EU enforcers will focus when reviewing 2012's financial statements.

By helping to ensure that firms comply with regulatory standards, and by helping to develop regulatory standards at European and international levels, not only are we anticipating a corresponding strengthening of investor protection – one of ESMA's main objectives – but we are demonstrating our commitment to pursuing improved consumer outcomes at EU level.

MiFID – a key investor protection directive

The current MiFID is widely regarded as having been fairly effective in raising standards of investor protection across the EU. Nevertheless, ESMA welcomes many of the elements identified in the MiFID review to improve on the current MiFID. The revised MiFID proposals clearly seek to strengthen investor protection through an even stronger framework for the provision of investment services to retail clients. It is, however, important to note here that we should not only focus on changing the regulation. We should also ensure that the current MiFID is properly implemented, effectively supervised and enforced in a similar way across the EU - even while the MiFID 2/MiFIR debates continue.

ESMA (and CESR) played key roles in supporting the work to develop and implement MiFID 1 and the Level 2 Implementing text. We expect to make good use of all this work as the basis for updated conduct of business requirements in MiFID 2 and the related Level 2 text, as well as to contribute to the issuing of any required Technical Standards.

The MiFID 2/MiFIR powers include product intervention in order to protect investors from inappropriate products or services by banning products. These proposals have been developed in the context of the new world we live in: rapid innovation, the ever increasing complexity of financial markets and products, as well as increasing retail investor participation in these financial markets.

The proposed approach allows both national action and co-ordinated EU responses. The key challenge for ESMA here is the co-ordination of any action taken by national competent authorities. ESMA will need to take account of the fact that some national initiatives may be appropriate to address specific national risks - but other market failures will raise common concerns across the EU. This means that ESMA will have to manage the inevitable differences and co-ordinate accordingly – as we should avoid *national action* creating fragmentation in the market and possibly creating consumer confusion.

The real issue here for ESMA, though, is the extent and practicability of these intervention powers. We fully appreciate the need for limiting the scope for intervention, but we need also to ensure that there is the real possibility for ESMA to take swift action, where necessary.

We have also seen that inducements provided to advisers are an important factor leading to unsuitable products being recommended to clients. And we all know that this problem cannot be solved by yet more transparency. As you are probably aware, I fully support the ban on inducements in certain situations as included in the proposal by the European Commission for MiFID. At a minimum we need to ban inducements in the case of discretionary portfolio management and when an advisor wants to use the independent label. Should this proposed *finesse* to MiFID (banning inducements) in order to prevent potential conflicts of interest not make the final cut, ESMA and national regulators will need to use all of their available powers to effectively address the bias, and mitigate the acknowledged risks, that arises in this area of inducements. However, it is clear that tackling poor incentives via a corrective measure like external supervision adds costs and will too often fail to achieve the desired outcome.

The proposed inclusion within MiFID's scope of structured deposits as part of the drive for greater consistency in selling practices for competing Packaged Retail Investment Products (PRIPs) is welcome. ESMA supports delivering consistent investor protection regardless of the legal form of products, and will work together with the other ESAs in the Joint Committee to support investor and consumer protection, including by reducing the scope for regulatory arbitrage.

Complex products

The financial crisis that started in 2007/8 is still with us, and the markets are still under the effect of quantitative easing measures taken by central banks to keep interest rates low. Low interest rates help households and businesses, and help support the prices of many other assets, such as stocks and houses. However, as market regulators, we are also aware that the search for higher returns by investors in a historical period of low interest rates leads retail consumers to increase their demand for innovative forms of investments, such as complex structured products. This heightens the risk of mis-selling.

ESMA is not against complexity per se - there will be cases where a more complex structure will render a product more suitable for an investor, such as through the inclusion of capital protection. However, it is clear that there are circumstances in which retail investors struggle to understand the complexity of a particular investment product, the intrinsic value of the product at time of purchase, and the expected returns of the product.

Increasingly, ESMA will need to continue its work with a view to achieving a coordinated approach to the regulatory and supervisory treatment of new or innovative financial activities and providing advice to the European Parliament, the Council and the Commission.

ESMA's current initiatives in relation to complex products are in response to the *mainstreaming* of complex products which, as we have seen, increases the risk that retail investors do not understand the risks attached to their investments and the drivers of risks and returns. It is an important investor protection area in which we can improve supervisory convergence (by re-enforcing MiFID conduct rules) especially in an era of:

- (i) growing complexity in financial instruments; and
- (ii) increasing use of the internet (both by providers to approach investors, and by investors to access products).

In this regard, it seems likely that we will need to remind both supervisors and firms about selling practices, and ESMA's expectations, to be observed when selling complex products including, for example, the sale of structured products to retail investors, and platforms giving access to complex products.

On the distribution of complex products, we are mapping national regulatory and supervisory initiatives to get a better understanding of the rationale for those initiatives, and to identify existing problems and issues. The aim is to consider what we could do at European level to improve investor protection in relation to the distribution of complex structured products, by establishing common ground where possible for distribution frameworks of complex structured products across the Union.

Behavioural finance

The complexities and risks of developing appropriate and effective retail market regulatory intervention are exacerbated by a fundamental difficulty: identifying the typical EU retail investor and his or her approach to investment decisions.

Under neo-classical economic theory, investor protection is only necessary where market failures, primarily related to information asymmetries, arise. Disclosure often forms a central element of current retail market policy internationally, reflecting the assumption that disclosure can support better decision-making and stronger market-based investing.

Academic research in recent years has underlined the numerous behavioural biases that undermine the financial decisions of individuals and their ability to manage information. Effective disclosure design for the retail market, and particularly for the expanding universe of complex investment products, represents, and remains, one of the most problematic issues for the retail market. Behavioural finance suggests that biases and competence failures are unlikely to be dealt with through disclosure. And the problem of information overload has also been well documented.

Disclosure has considerable attractions as a retail market tool, but the challenge for regulators is to resist the temptation to make disclosure the panacea for investor protection.

Behavioural finance is essential in helping us to understand how retail investors make their decisions – by highlighting the flaws and weaknesses inherent in the behaviour of financial markets' participants – and this may help us understand how to improve the effectiveness of our regulatory intervention.

The debate on the characterisation of investor protection continues: should retail market regulation encourage the empowered investor or shield the irrational or uninformed investor?

ESMA: European contender in global arena

From a more international perspective, the ESMA Regulation foresees a more active role for ESMA in international relations by developing contacts and entering into administrative arrangements with supervisory authorities, international organisations and the administrations of third countries.

Developments in the markets and the related regulatory initiatives taken by the G20, for example, require enhanced co-ordination between regional and national legislators, regulators and standard setters.

The G20 *high-level principles on financial consumer protection* (endorsed by the G20 Finance Ministers and Central Bank Governors at their meeting on 14-15 October 2011) were developed by the Task Force on Financial Consumer Protection of the OECD Committee on Financial Markets, in close co-operation with the FSB and its Consultative Group, other international organisations, standard setter bodies and

consumer and industry associations. The principles are designed to assist G20 countries and other interested economies to enhance financial consumer protection, and they apply across all financial services sectors. ESMA uses these high-level principles as a reference for building on its investor protection work – especially its work (i) to promote the consistent application of the MiFID conduct of business rules, (ii) in the area of financial education and awareness, and (iii) in complaints handling.

Beyond the many bilateral contacts already established, and gathering strength, with some non-EU competent authorities (with the OECD, and with FINRA in the US, for example), ESMA has already been involved in some important recent IOSCO initiatives. IOSCO will play an increasing role in the global co-ordination and convergence of these efforts (including G20 commitments). Because of the importance of structuring our co-operation with IOSCO on more stable and institutional grounds, we have sought strengthened membership of IOSCO and, in May 2012, we were upgraded to Associate member of IOSCO - in line with our regulatory and supervisory powers. We firmly believe we will be able to bring the pan-European view of securities regulators to the IOSCO table, including from the perspective of investor protection.

Thank you for your attention