

PRESS RELEASE

ESMA issues first risk report on EU securities markets

The European Securities and Markets Authority (ESMA) has published today its first report on trends, risks and vulnerabilities in European Union (EU) securities markets and a risk dashboard for the 4th Quarter 2012. The report looks at the performance of securities markets in 2012, assessing both trends and risks in order to develop a comprehensive picture of systemic and macro-prudential risks in the EU that can serve both national and EU bodies in their risk assessments. By regularly looking into cross-border and cross-sector trends and risks both at the wholesale and retail level, ESMA's report will contribute to promoting financial stability and enhancing consumer protection.

The report finds that EU securities markets and investment conditions in the EU improved in 2012, especially in the second half of the year; while systemic risk in EU securities markets decreased in the fourth quarter. The recovery can be linked to the ECB's announcement of Outright Monetary Transactions (OMT) in early August, which alleviated pressure on euro area sovereign bond markets and reduced uncertainty among market participants. However, risk indicators remained at high levels: amongst other factors, this was due to the on-going sovereign debt and banking crisis, the realignment of risk assessments by investors, funding risk, potential long-term implications of low interest rates and obstacles to orderly market functioning.

Steven Maijoor, ESMA Chair, said:

“ESMA's risk analysis points to important first signs of easing in EU financial markets, but risks remain high and regulators, market participants and investors should remain vigilant about risks in the financial markets.

“This report provides a guide for securities regulators on those areas requiring regulatory focus in order to build on recent improvements in financial markets and to foster financial stability in the EU.”

The report identifies the following key trends in EU securities markets:

- **Securities markets:** after a volatile first semester, financial market conditions in 2012 improved due to the ECB's OMT announcement. However, sovereign bond markets continue to struggle;
- **Collective investments:** asset managers benefited from easing markets (with total net asset values up to € 8tn, compared to € 7.4tn in 2011). Main beneficiaries were bond, hedge, real estate and exchange-traded funds. Overall however, fund inflows remained volatile.
- **Market infrastructures:** trading on EU venues significantly decreased in 2012. The use of Central Counterparties (CCPs) however, increased: 60% of worldwide interest rate swaps are now centrally cleared, and 10% of CDSs.

In addition to market trends and risks, ESMA monitors on an on-going basis market developments which may be considered as representing possible vulnerabilities. ESMA's 2012 report focuses on:

- **Collateral concerns in financial markets:** the collapse of unsecured markets during the financial crisis, as well as regulatory initiatives, have led market participants to rely increasingly on collateral as a means of mitigating counterparty risk, stimulating the demand for collateral. Additional demand for collateral will exceed the additional supply of collateral in 2013-2014, making collateral comparatively scarcer.
- **Hedge funds and prime brokers:** financial intermediation provided by hedge funds and prime brokers may be vulnerable to any negative impacts on the price of assets pledged as collateral, which may lead to scarcer collateral, reducing liquidity and ultimately hamper repo financing.

Quarterly Risk Dashboard

Complementary to the Report on Trends, Risks and Vulnerabilities, ESMA will publish its Quarterly Risk Dashboard. The Risk Dashboard for Q4 2012 analyses the following developments:

- **Liquidity risk:** in 2012, liquidity risk started to disperse across market segments and Member States. Recent policy measures reduced liquidity risk in some segments while others such as money market funds faced tightening liquidity. Within the sovereign bond market however, liquidity risk remains significant;

- **Credit risk:** overall EU issuance increased but was focused on high-risk assets. Banks and sovereigns exposed to high risk premia concentrated on shorter maturities. Should market conditions worsen, those issuers may face funding difficulties and substantial credit and rollover risks remain.
- **Market risk:** equity and bond markets showed signs of easing in 2012, starting from in Q3 2012. In particular, investors appeared to be less averse to risky bonds;
- **Contagion risk:** EU sovereign bond markets remained mixed in 2012. Lower CDS exposures and increased risk perceptions by investors helped in mitigating market risks. Contagion risks remain high for those countries still facing high sovereign yields.

Next steps

As part of its on-going market surveillance, ESMA will update its report semi-annually, complemented by its quarterly Risk Dashboard.



Notes for editors

1. ESMA is an independent EU Authority that was established on 1 January 2011 and works closely with the other European Supervisory Authorities responsible for banking (EBA), and insurance and occupational pensions (EIOPA), and the European Systemic Risk Board (ESRB).
2. ESMA's mission is to enhance the protection of investors and promote stable and well-functioning financial markets in the European Union (EU). As an independent institution, ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. ESMA contributes to the regulation of financial services firms with a pan-European reach, either through direct supervision or through the active co-ordination of national supervisory activity.

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