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Towards an EU-Securities Market: Challenges for Banks

European Banking Federation Conference – National Bank of Belgium

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Good morning Ladies and Gentlemen,

It is a pleasure to be here in Brussels at the conference of the European Banking Federation and Febelfin on the challenges faced by banks in the creation of pan-European securities markets. I am delighted that the EBF has chosen this important topic for its conference. Banks are key players for securities markets and play a central role in the European financial system.

Today I will speak about why, against the current macro-economic situation, it is important to create a single rulebook for the European Union, and ESMA's role in that endeavour. In line with the conference agenda I will then touch upon some issues in relation to trading and post-trading activities.

Let me start with the current economic situation and the single rulebook. The EU is undoubtedly still facing a weak macro-economic outlook – the IMF forecasts a slowdown of 0.3% in 2013 and a growth of 1.1% in 2014 for the Euro area - affecting the financial positions of governments and private sector borrowers, and the outlook for property markets, which may lead to further deterioration in the profitability and asset quality of some banks. The announcements by European leaders, like the Outright Monetary Transactions (OMT) and the Single Supervisory Mechanism (SSM), have helped to reduce market perceptions of tail risks and led to a narrowing of bank and sovereign credit spreads. However, breaking the bank-sovereign link and creating sustainable macro-economic growth will require continued progress on implementation of announced policies.

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Since the outset of the crisis there has been some risk of fragmentation of the EU Single Market. In the banking sector we have noted an increased home bias and reduced cross-border financial activity. Interestingly, securities markets do not follow this trend and, though some market clustering is seen, with diverging returns and credit spreads increasingly correlated between some member states, we see an overall increase in integration of securities markets at EU level.

Financial integration is important for banks and benefits them. Research has shown that banks operating in systems with larger (i.e. deeper and more efficient) capital markets face relatively lower costs of risk absorption than banks operating in smaller capital markets. Access to larger capital markets reduces bank's costs by providing them with more efficient instruments of risk management.

Enhancing the EU Single Market with a single rulebook for financial markets is one of the core objectives of the three European Supervisory Authorities (ESAs) established in 2011. The financial crisis has shown that the Single Market cannot function properly if national rules and regulations are significantly different from one Member State to another. It leads to competitive distortions among financial market participants and encourages regulatory arbitrage. As part of achieving its mission to reinforce stable and well-functioning markets and to enhance investor protection, ESMA contributes to the creation of an EU single rulebook by developing technical standards and guidelines, and as the logical next phase, by enduring its consistent application across the EU.

I fully appreciate that all this regulatory activity to achieve a single rulebook not only keeps ESMA busy, but also results in implementation costs for the financial sector, at least in the short term. However, for the reason explained earlier, I am convinced that the standardisation of regulatory and supervisory practices across the Union will have major benefits for the financial services industry as it reduces the costs of doing business across borders and helps to exploit economies of scale. I am sure that EBF members will benefit from that and will be supportive of the long-term objective.

We have progressed a lot on the European dimension of implementing the G20 agreements. Today I specifically want to mention the more than 40 technical standards that were developed for the implementation of EMIR. On 15 March 2013, just over one month ago, an important milestone was passed in the regulation and supervision of OTC derivatives in the EU, when the

EMIR technical standards drafted by ESMA and agreed by the legislators entered into force. Now the standards are developed they need to be implemented. A significant task for the industry, but also for us at ESMA. Two EMIR standards were not delivered by ESMA last year, as, in order to take international discussions and standards into consideration, it was decided to delay the work on (i) the standards defining which OTC derivatives contracts have a direct, substantial and foreseeable effect within the EU and (ii) the standards on bilateral margining. ESMA is engaged in discussions with the main regulators around the world, and follows the progress of the joint working group on bilateral margins of the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO).

As promised, I will provide a bit more detail now on two issues that might be of particular interest to you: next steps on bilateral margining and the preparation for MiFID 2.

Bilateral margining

The financial crisis provided some evidence that counterparty risk was not properly addressed in many market activities, especially in OTC derivatives. As a result the G20 agreed that derivatives should be centrally cleared. When this is not possible, the counterparty risk shall be mitigated by the exchange of collateral. With the crisis, confidence changes in wholesale markets and the new regulatory regime, have led market participants to be increasingly reliant on collateral as a way to mitigate counterparty risk, resulting in an increased demand for collateral. We have not yet completed the work on non-centrally cleared derivatives and the related margin requirements. We believe that, the derivatives market being global, any approach should be coordinated at global level as much as possible in order to prevent gaps, and thus risks, to arise. We therefore strongly support and closely follow the global work of the international joint BCBS/IOSCO working group will allow.

As you might know, the group has recently consulted the market and is currently preparing a report on the margin requirements for non-centrally cleared derivatives. We are following the activities of the joint BCBS/IOSCO working group closely so that we can build European legislation based on international agreements. We hope to consult market participants on our preferred approach soon after the finalisation of the global discussions.

MiFID / CSDR

I have talked a lot about post-trading so far as it is a key theme today. However, EMIR is not the only piece of European legislation where ESMA is contributing to a single rulebook in the area of trading. There are many proposals out for discussion. The European Commission is going to evaluate the short-selling regulation, which entered into force in November 2012, and ESMA is assisting the Commission with that exercise. We are currently considering the responses we received on the call for evidence issued, with regards to the review of the requirements and powers related to short selling and credit default swaps.

The European Parliament and Council are also discussing the Commission's proposals on how to improve securities settlement and central securities depositories (CSDs) as well as improving MiFID. Again, ESMA will have an important role to play under MiFID by providing technical advice or preparing technical standards. The MiFID negotiations are creating passionate debates on issues such as market structure and transparency – often between banks and trading venues. No doubt, some of these will also be part of the agenda later today.

ESMA is not involved in the level 1 discussions but it seems, from the texts published by the different parties, that a big, and in some cases, challenging job is coming our way. We have already set up internal working groups, and liaison with national and international authorities, to discuss this further. Before finalising any advice or proposing standards to the Commission, we will consult market participants on our proposed approach. Your contributions and input are extremely valuable for ESMA in that process and I would like to use the opportunity to invite you all to participate in this process.

In the meantime, I want to emphasise that ESMA already takes account of market developments and takes action under MiFID 1, whether that is by issuing pre-trade transparency waivers or by ensuring supervisory convergence between European national supervisors and, for example, to ensure that new phenomena like automated trading are properly controlled.

On this note, I would like to finish my presentation and thank you very much for your attention. I wish you a good conference and would be happy to answer a few questions.