

Safeguarding investors is key to ensuring the Capital Markets Union's success

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Steven Maijor
Chair
European Securities and Markets Authority

Ladies and Gentlemen,

Let me first of all thank Börse Stuttgart for organising this conference.

I am delighted to have been invited to discuss the importance of safeguarding retail investors to ensure the success of the Capital Markets Union or CMU.

Last September, further to the State of the Union address, the Commission issued a communication entitled “CMU – Accelerating Reform”. To support this communication, Commission Vice-President Dombrovskis emphasised the need to “*finish the first building blocks of the CMU and move forward with new priorities*”. The purpose of the communication of the Commission was to emphasize a number of new initiatives aiming at contributing to the success of the completion of a CMU. This strong push to accelerate the pace of reforms on the CMU shows, if it was still necessary, that this is a key political priority for Commission.

The objective of CMU is to develop stronger and deeper capital markets in the EU to allow funds to flow to European companies to the benefit of the real economy, growth and investment.

This is a much needed initiative. Indeed, unlike their more diversely financed North-American counterparts, European SMEs still depend heavily upon bank financing. While the European



economy needs to be able to rely on the funding provided by the banking system, the current over-dependence is suboptimal for the development of our businesses and consequently the growth of our economy. This has been particularly apparent during the aftermath of the 2008 financial crisis. The recovery of the European economy was slowed down by the reluctance of banks to lend to European businesses while alternative sources of financing were not easily available to them.

To fight this, one crucial objective of the CMU is to diversify the source of funding available by promoting a shift of the destination of European household's savings from the banking sector to capital markets.

This is an ambitious goal which will require a change of mind-set. Indeed, European savers have historically shown reluctance to direct their savings to capital markets and steadily favoured the low risk profile of banking deposits. This preference for banking deposits is illustrated by the fact that the banking sector remains a destination of choice for European savings despite the gradual decrease of the return offered by this type of investment over the recent years.

The reasons of this preference are diverse and include cultural ones. I am convinced that European savers will not shift from the banking sector to capital markets unless they gain or re-gain confidence. Confidence must be established if we want to see European consumers direct a larger portion of their savings towards capital markets.

Of course, this will not be enough— other measures will be needed— but confidence is an absolute must. The CMU will not be a success if confidence is not re-established and I will explain in a minute why I firmly believe that enhancing investor protection is a key tool to do that. I will then discuss how past and future achievements in the field of investor protection will pave the way to the success of the CMU.

Why enhancing investor protection is crucial to regain confidence and how it must remain a high priority of the CMU

Some may think that further enhancing investor protection is not a push in the right direction and argue that it is not the role of policy makers and even less of regulators to rectify market failures. As you can imagine, I disagree with that. To explain how I built my view on this, I



would like to say some words about my background. I started my career in academia. I taught Economics for a number of years before taking up new challenges in the field of financial regulation. As many of you know, economic theories are typically based on the assumption that markets are self-correcting and that market participants are provided with information they need to assess products, prices and costs. These theories lead many to believe that no or little intervention is needed and that, over time, an 'invisible hand' always adjusts the market. And even when intervention would be considered to be justified, it would be limited to additional information disclosure.

Anyone who has experience on the ground knows that the assumptions on which these theories are based do not necessarily hold true in the real world. Market failures are real and most of them are not sufficiently self-corrected. Many of these failures impact investors. I think, for instance, of asymmetry of information, agency problems or detrimental conflicts of interest.

These market failures may affect the functioning of the market and contribute to the perception of capital markets as an unsafe environment. This is why I believe that rebuilding investor confidence can only be achieved through regulatory intervention. Policy makers and regulators should address the market failures which impact the level of protection of investors.

Investors will only shift from the safe yet not very rewarding banking sector to the riskier yet potentially more rewarding capital markets if they feel comfortable with the risk/reward balance offered by capital markets.

When talking about confidence, I am obviously thinking more specifically about retail investors. The weight of retail investors in our economy is tremendous and European retail investors only have a small portion of their savings directly invested in capital markets. While it must remain up to investors to determine which sector best fits their investment and funding needs, the CMU should be designed to increase retail investor participation and an enhanced level of consumer protection is a very powerful tool to this end.

I also think that investor protection is a means to guarantee the sustainability of the CMU. Indeed, enhanced investor protection is also likely to ensure lasting success for the CMU.

Better protected investors will make more informed investment decisions. These investors will be more likely to consider their investment with an investment horizon in mind and as such they will be less prone to react irrationally to market events or follow so called "sheep-like behaviours" which are very disruptive for financial markets and the economy as a whole.



Investor protection could therefore be seen as both a factor facilitating the diversification of the source of funding of our economy but also one contributing to its stability.

Here, I would like to clarify that when referring to investor protection, I mean more than just information and transparency which are important but not sufficient. The information asymmetry between sellers of financial products or services and consumers often simply cannot be overcome with some additional disclosures. More substantive requirements need to apply to ensure a full protection of investors.

This approach emerges clearly in the EU securities legislation, notably in MiFID I already and even more so in MiFID II, which set substantive requirements in the field of investor protection. I will discuss how achievements in the area of investor protection will contribute to its success.

But before that, I would like to talk about a selection of new initiatives announced by Vice-President Dombrovskis which are particularly interesting from an investor protection point of view.

The first one is the Commission's consultation on a potential EU personal pension framework. While this is a topic which sees a very important role for EIOPA, ESMA is also following it closely given the possible link between the potential future framework and certain aspects at the core of ESMA's activity, such as the asset management, PRIIPs or MiFID rules.

Personal pensions products are key in the capital markets because they are a means to match long-term savings with long-term investment opportunities. This workstream is still at an early stage but key issues have been identified in the consultation document and ESMA has responded on a number of aspects which have relevance from our perspective.

ESMA is notably suggesting that some mechanisms developed in the context of the asset management sector or MiFID be used as a clear basis when designing this personal pension framework. ESMA is also getting involved in the discussion in relation to the information to be provided to investors in this sector. It is indeed crucial that investors receive the clearest information possible when it comes to what would often be the more important investment decision of their lives.

The second example I would like to mention also refers to long term investments. As I said earlier, the CMU will be considered a success not only if it reaches its goal but also if this goal is met on a long-term basis. This is why I believe an assessment of the performance and fees



of long term retail investment products is an important piece of work. ESMA stands ready to work on an initiative which would strengthen transparency around the net performance of long term retail and personal pension products. Providing European investors with a better basis for comparison of investment alternatives could be greatly useful for investors, as well as for supervisors, notably to identify areas of weaknesses across the Union.

A third and last aspect I would like to discuss is Fintech. Fintech is truly revolutionising the way investors access the capital markets. It is creating tremendous opportunities for investors and is a game-changer for the industry. I believe that the success of the CMU also depends upon the ability of policy makers and regulators to ensure that the level of protection reached in the non-digital world is maintained in the new digital environment.

Assessing under a regulatory and supervisory point of view what Fintech brings to us is a challenging task. The European lawmakers and regulators are used to operate with a moving target. But, with Fintech, the target is moving at a fast pace and in many different directions.

The CMU Action Plan mentions the importance of changes associated with the transition to online distribution of investments. ESMA supports this approach and is currently involved in several workstreams, the outcome of which should inform not only ESMA's possible future actions but also contribute to the reflections in the context of the completion of the CMU.

Let me name a few.

The Joint Committee, the body under which EBA, EIOPA and ESMA collaborate, is about to finalise a report on automation in financial advice. The report will draw conclusions on potential benefits and risks of robot advice, having also in mind that the existing EU regulatory framework is technology neutral.

Further, ESMA is leading the work of the Joint Committee on opportunities and challenges related to the use of Big Data by financial institutions. A Discussion Paper should be published by year end.

Finally, ESMA published a Discussion Paper on distributed ledger technologies, also known as DLT, in order to assess the opportunities and challenges posed by DLT, even if the technology is still in its early days. We look at DLT from a regulatory standpoint to assess whether a specific regulatory response to the use of this technology in securities markets is needed.



As I said earlier, the success of the initiatives I just mentioned, together with the other initiatives promoted in the context of the CMU, will be judged on both short and long terms results.

The CMU must be designed, developed and enforced bearing in mind that the overall goal - diversifying the source of funding of our economy by strengthening capital markets – will only be achieved through the re-establishment of investors' confidence which itself requires, as I mentioned earlier, to maintain a high level of investor protection.

I now would like to walk you through my thoughts on another important aspect that I mentioned, the interaction between already existing measures to protect investors and the potential success of the CMU.

Indeed, over the last few years significant progress has been made in the field of investor protection and I am convinced that this should greatly contribute to the success of the CMU.

In response to the 2008 financial crisis, the EU policy makers have adopted an unprecedented amount of financial legislation. This post financial crisis regulatory package intervenes on a large spectrum of aspects. However, the bulk of this regulatory response is still in the course of being implemented by Member States since a few very important pieces of legislation have not yet entered into application. An example is MiFID II, which will enter into application on January 2018.

MiFID is arguably the cornerstone Directive in the field of investor protection. Based on the lessons learnt from the financial crisis, it has been reviewed and MiFID II sets higher standards for the provision of services to investors, especially retail.

I now would like to spend a few minutes discussing some of these aspects which I feel are relevant in the context of contributing to the success of the CMU.

Let me start by corporate governance. MiFID II improves the corporate governance of financial firms by setting strengthened requirements for board members as well as new requirements imposing minimum knowledge and experience levels for certain categories of client facing staff, notably those providing investment advices or information about financial instruments or investment services. These requirements should prevent investors from being advised or informed by someone who does not have a minimum qualification to do so.



MiFID II also sets new requirements on product governance. It will be required to both manufacturers and distributors of financial instruments to determine and consider the “target market” of the products they are manufacturing or selling.

As most of you know, MiFID II also significantly changes the way investment firms will be able to receive third parties’ payments – or inducements - when they are providing an investment service. The legal framework set by MiFID II on inducements has been extensively discussed so I will not go into too much details and focus on the key achievements. MiFID II provides for a general prohibition for investment firms providing portfolio management and investment advice on an independent basis to accept and retain fees, commissions or any monetary or non-monetary benefits, with the exception of minor non-monetary benefits. As you know, the EC delegated directive has indicated, broadly in line with advice received from ESMA, the conditions and the requirements under which portfolio managers may receive research. MiFID II also regulates the reception of inducements for other investment services and it puts special emphasis on the enhancement of the quality of services to relevant clients to whom inducements refer, in addition to a disclosure regime for inducements. Inducements must be justified by the enhancement of the quality of services provided to each client and the inducement needs to be proportionate to the quality enhancement achieved.

With respect to financial advice, MiFID II sets disclosure requirements aiming at ensuring that investors are informed whether the adviser they are dealing with is “independent” or not. To this end, MiFID II sets strict requirements an adviser must meet in order to be able to label itself “independent”.

One last MiFID II measure with investor protection added-value I would like to mention is the new product intervention powers that MiFIR grants to ESMA and national supervisors. These new provisions introduce the possibility for national authorities to restrict or prohibit certain financial products, activities or practices. ESMA will be entrusted with the same powers, on a temporary basis, and will perform a facilitation and co-ordination role in relation to actions taken by national supervisors. This will enable supervisors to address significant investor protection concerns.

On many of these and on other topics, ESMA has worked hard in the last three years to support and promote this push for more and better investor protection in legislation; we have done so through our technical advice and technical standards to the Commission in relation to the



elaboration of Level 2 measures on MIFID II. I'm pleased that our work has been turned into European legislation which will soon be implemented into national systems.

Once MIFID is implemented across the Union, together with the rest of the post financial crisis package, things should improve on the ground for retail investors. I am convinced that this will create a powerful positive momentum for the success of the initiatives adopted in the context of the CMU.

This being said, I think that establishing an ambitious single rule book is not enough for the CMU to be and remain a success. These new set of rules must be enforced by the national competent authority and, in an open and integrated market like the European retail financial services market, the supervision of firms must be harmonised to prevent firms from taking advantage of regulatory arbitrage which can be beneficial for some firms but detrimental to investors.

This is why ESMA has decided on a strategic direction towards **supervisory convergence**. I am convinced that promoting an investor protection oriented approach in the supervision of financial regulation is necessary to contribute to ensure that rules do not remain on paper and that actual improvements are noticed by investors.

At a time where the cross-border provision of services is made easy by on-line marketing, supervisory convergence is also very needed to ensure that the rules on pass-porting of services are consistently enforced across the Union. Such harmonisation is crucial for investors. Indeed, in the context of an integrated CMU, it is important that investors are able to rely on the services of European firms irrespective of which Member State such firm originates from. Likewise, investors should be able to trust the European supervision framework enough to consider buying their financial services and products in another Member State than their own.

To illustrate ESMA's action in the field of supervisory convergence on investor protection issues I would like to give you one concrete example.

The proliferation of the offer of CFDs and other speculative products to retail clients and the aggressive way in which they are often marketed has raised ESMA's concern. Supervisory convergence issues were identified.



As a response, ESMA develops and publishes Q&As on CFDs and other speculative products as a first step to tackling this serious investor protection issue.

In addition, ESMA has been coordinating the activities of a group comprising a number of host national Competent Authorities and CySEC, the Cyprus Securities and Exchange Commission, in its capacity as home Competent Authority. The work of this group has focussed on issues arising in relation to a number of Cyprus-based investment firms offering CFDs and other speculative products that are operating on a cross-border basis. In this context, CySEC has so far imposed administrative fines or reached settlement agreements in excess of €2,000,000 with a number of investment firms that are active in the CFD market.

ESMA's work on supervisory convergence is not just only about harmonisation but also encompasses the resolution of divergence between two or more national competent authorities on a specific case. I am happy to mention that ESMA has recently completed a confidential mediation between two national competent authorities in relation to a matter involving the suspension of redemptions of an investment fund decided by its management. The mediation has enabled to contribute to safeguarding the interests of investors of this investment fund.

Our work on MiFID II also concerns supervisory convergence in order to ensure that as many aspects as possible of this crucial new piece of legislation is applied consistently across the Union from Day 1.

In this context, ESMA recently issued guidelines on some of the new topics I mentioned earlier. I would like to just mention the guidelines on the assessment of knowledge and competence of staff finalised a few months ago, and the draft guidelines on product governance, a key addition from an investor protection standpoint, on which our consultation is still on-going. The draft guidelines suggest guidance regarding the assessment of the target market. We hope this will bring clarity for supervisors and market participants alike. Together with the EBA we are also running a consultation on suitability requirements for management bodies and key function holders.

I would strongly encourage you to participate in our consultations in order to be sure that we will be able to consider all relevant comments when finalising the work on these important areas.

Last, but still not least, I will mention ESMA's work on product intervention. The task of monitoring the financial market across the Member States and multiple asset classes is highly



complex. ESMA is working with national competent authorities to develop appropriate tools to monitor markets and to coordinate the use of our intervention powers. ESMA will be legally entitled to use its intervention powers starting 3 January 2018 and intends to be ready to use them on that date.

Ladies and gentlemen, the Capital Markets Union is an ambitious initiative which pushes in the right direction. It should contribute to accelerating the integration of European financial markets and bring the diversity of funding the European businesses need to sustain the growth of the European economy.

As any ambitious initiative, the Capital Markets Union faces a number of challenges. As I have explained, the main one in my view relates to investor protection.

The Capital Market Union will only be a success if it manages to inspire trust and investors will only feel confident if they feel they are sufficiently protected.

Thank you very much for your attention.