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The major challenges facing securities regulators

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Good morning, ladies and gentlemen,

I am delighted to be here today, back again at Eurofi in person. After almost two years of virtual engagement, it is great to once again see so many faces, both new and old, here in Paris for this important event.

The pandemic posed new challenges for society. The health crisis has caused considerable suffering that will remain with us for some time. The economic crisis linked to the pandemic led to historic levels of economic contraction, both in the EU and worldwide.

The world of finance was not immune to this systemic shock, and its resilience was severely tested during that period. Thankfully, the system, and in particular market infrastructures, held firm. To me this was a confirmation of the importance of the post-financial crisis regulatory reforms. However, the events also illustrated that the resilience of some parts of the financial system needs to be further enhanced.

Alongside our regulator counterparts in banking and insurance, we as securities regulators have a fundamental role to play in ensuring the resiliency and integrity of the financial system. Securities regulators oversee the functioning of capital markets, and in a system that relies heavily on investor confidence and market integrity, we must always be on the front foot. Even if the challenges faced by capital markets are wide ranging, society relies on us as securities markets regulators and supervisors to manage and mitigate the risks that could threaten the functioning of the market.

Being on the front foot means that we must operate with foresight and tenacity, adapting to the challenges presented in an ever-changing world.

The twin transitions towards a more digital and sustainable economy are two such challenges, which I will address today.

Both digitalisation and sustainability are rapidly transforming the way in which the financial sector operates. In doing so, new and exciting opportunities for investors are arising. But as securities regulators, we must also remain conscious of the risks that investors face while navigating these new environments.

Besides digitalisation and sustainability, there is a third topic I would like to touch on today, the need to safeguard financial stability. At such a critical time for the financial services sector, and the economy as a whole, securities regulators must also remain focused on our duties to monitor, understand, and assess the risks not only to investors, but also to markets and financial stability that may lie ahead.

Protecting investors during the digital transition

Innovation drives progress, and financial markets are no exception to this. New technologies, such as blockchain and cloud technology, combined with new FinTech entrants and new digital distribution models, are changing the traditional value chain of financial services. This can deliver cost reduction and efficiencies for firms, as well as optimise choice and accessibility for investors.

The digital transition in financial services has been underway for some time, but the pandemic accelerated it to new levels. Managing personal finance is continuously being made easier and more intuitive though customer friendly digital apps. Stocks or investment products can be purchased in just a few clicks, while you sip your morning coffee (that you just bought by tapping your phone). Convenience is key.

This financial revolution also brings capital markets within reach of new parts of society, changing the demography and behaviours of investors. Trends during the pandemic showed that younger, more tech savvy people were investing more in stocks or other financial instruments, such as crypto assets. This was driven by a spike in savings rates, while at the same time people spent more and more time online during the lockdowns.

Attracting more retail investors to participate in financial markets is a good thing and is one of the key objectives in building the Capital Markets Union in the EU. However, this trend also presents new risks, which securities regulators must address. ESMA has observed an increasing level of consumer complaints in relation to financial instruments over the past couple of years, which correlates with the large increases in retail investor trading. We have also seen the influential power of social media in promoting questionable investment strategies and driving market volatility to extreme levels, for example, during the Gamestop event in the US.

Celebrities and online influencers are increasingly promoting complex and risky products, like crypto assets, while anonymous online chat forums peddle dubious investment tips. Fear-Of-Missing-Out (or FOMO for those more au fait with modern lingo), can then pressure individuals to invest in products they may know little about. Some products or platforms do not have appropriate disclosures for investors to make informed decisions. At the same time, many of these new digital platforms take advantage of the fact that trading feels just like a simple game. And just like gambling, this can be addictive and have dire consequences.

Finance at our fingertips brings clear benefits – but opportunity and risk are finely balanced. [As Thomas Edison said, “the value of an idea lies in the using of it”.] The litmus test for many new digital innovations in finance will be whether they can enhance the consumer experience. But equally, can they also provide the level of protection and security that must be afforded to investors in the modern digital age?

Regulation should not stifle innovation, but regulators should play a key role in reigning in bad behaviour and improper practices. Our combined efforts are needed to raise wider societal awareness on the risks in modern financial markets. We need to uphold strong standards of investor protection, while encouraging learning and participation. As an example, we need to ensure that the information provided to investors is adapted to the digital age, giving them easy access to compare products, find helpful information and not be swamped by legalistic documents. We also need to remain ready to react where there are signs of potential consumer detriment and will continue to issue warnings where relevant.

Ensuring green choices for green investors

The digital transformation and broadening of the investor base also help facilitate another challenging, but important, global initiative – supporting the flow of finance towards helping to tackle climate change.

The urgency in building the sustainable finance framework has resulted in a flurry of legislative, regulatory and international standard setting activity. Of course, a clear legal framework is vital in order to oblige both non-financial and financial firms to disclose the information necessary for investors to make sustainable investment choices. The challenge for securities regulators is to ensure effective, timely and clear implementation of these rules, and then to supervise and enforce them effectively. In parallel, as the importance of ESG ratings and data continues to grow, we must enhance our oversight of these providers to increase trust in their services.

Securities regulators are very mindful of the challenges that persist during this transition. Inconsistent application or interpretation of rules, inadequate transparency and comparability, and the lack of suitable data are all challenges which we must confront. [Pardon the non-sustainable pun, but regulators must remain firmly at the coalface in driving forward and completing this work.] And a global problem requires a global solution, underpinning the need for international cooperation at bodies such as IOSCO.

The resulting opportunity for businesses is clear. They can tailor investment products to match a growing investor demand to make green choices, while also contributing to the global environmental, social and governance (ESG) agenda. On the flipside, if firms seek to exploit the opportunity in a way that does not reflect a real commitment to ESG outcomes and investor preferences, this will have a detrimental impact for the entire sustainable finance project and threaten investor trust and confidence.

Investors therefore need to be safeguarded and firms held accountable, to ensure goals are aligned. Earlier this month, ESMA published its sustainable finance roadmap where we prioritised tackling greenwashing and promoting transparency in advancing the sustainability agenda in the EU. Greenwashing occurs when a firm or investment product misrepresents its sustainability characteristics or profile. As a result, investors may be given the impression that what they are investing in is green, while the reality is different. Regulators are determined to tackle this. Transparent and reliable disclosure rules and standards are the first important step - coming fast at both EU and international level; the skills and capacity of supervisors are continuously being improved to enhance scrutiny; and investors are being empowered to hold companies accountable for their sustainability commitments.

Our ESMA roadmap also underlines the importance of monitoring and analysing ESG markets and identifying trends and risks. This will be key in helping national authorities and firms build ESG factors into their own risk analysis work, for example, climate scenario analysis for investment funds.

Building the sustainable finance framework in the EU is both urgent and essential. It is complex and multifaceted, and thus presents numerous challenges for all of us - policy makers, regulators, companies, and investors. It is nonetheless an imperative task as the EU strives to meet its commitments on tackling climate change.

Understanding risks and building resiliency

Finally, I want to reaffirm the need to be prepared for new and evolving challenges by continuously improving our monitoring of risks and vulnerabilities that threaten the stability of the financial system. Securities regulators, alongside our prudential siblings, have an important role to play in this regard.

In a world that runs on data, good quality data is also the essential ingredient to effective risk analysis. Detailed reporting requirements now constitute a key component of financial sector legislation. I know many firms complain about the burden of these reporting requirements, but - let me assure you - this data allows ESMA and national regulators to better understand risks and scrutinise market activity. In this context, it is vital that we continue to streamline data reporting and enhance our data capabilities, to ensure the timely detection and mitigation of those risks, based on robust and accessible high-quality data. ESMA is therefore putting every effort into enhancing data-driven risk analysis, policy making and supervision in the EU.

However, knowing where the risks are is not enough. This insight, and our experiences from crises of the past, must be used to instigate relevant policy action to prevent those risks materialising in the future.

The ‘dash for cash’ during March 2020 highlighted shortcomings in some parts of the financial system, such as short-term funding markets and money market funds. We witnessed how this sector could amplify shocks and could pose risks to financial stability in stress situations. The vulnerabilities of certain investment funds, combined with the interconnectedness with other parts of the financial sector, reinforces the need for reform, for example, to improve resilience and liquidity risk management for money market funds and open-ended funds. On the back of FSB policy proposals for money market funds last year, ESMA has recently published its views on how to implement these reforms at EU level.

On the other hand, CCPs continued to play an important role in cushioning rather than exacerbating shocks in the financial markets. During the stress period in March 2020 they dealt successfully with record volumes of clearing and settlement activity. It is nonetheless necessary to continue reinforcing the resilience of market infrastructures, for example, by putting in place a suitable recovery and resolution regime or by reviewing the adequacy of anti-procyclicality measures. Likewise, in view of the systemic importance of CCPs for the EU as a whole, we must continue to think about the risks stemming from our reliance on CCPs outside the Union as well as the appropriateness of the current supervisory framework within.

Conclusion

Ladies and Gentlemen, being here in Paris, the home of ESMA, during the French presidency of the Council, I cannot resist embracing the words of French Nobel laureate Albert Camus, when he said “La vraie générosité envers l’avenir consiste à tout donner au present” - “The true generosity towards the future is to give everything to the present”.

ESMA, together with securities regulators in both the EU and globally, is ambitiously confronting today's challenges, in order to ensure safe, reliable, efficient and open financial markets for the future.

Harnessing the forces of digital and sustainable finance in a safe and trustworthy way can I believe truly lead to a more inclusive and socially conscious financial market.

Some of the challenges we face may be new, but our resolve to learn and adapt is not. After all, smooth seas do not make skilful sailors. We remain vigilant, agile, and passionate in pursuit of our goals of enhancing investor protection and promoting stable and orderly financial markets.

Thank you.