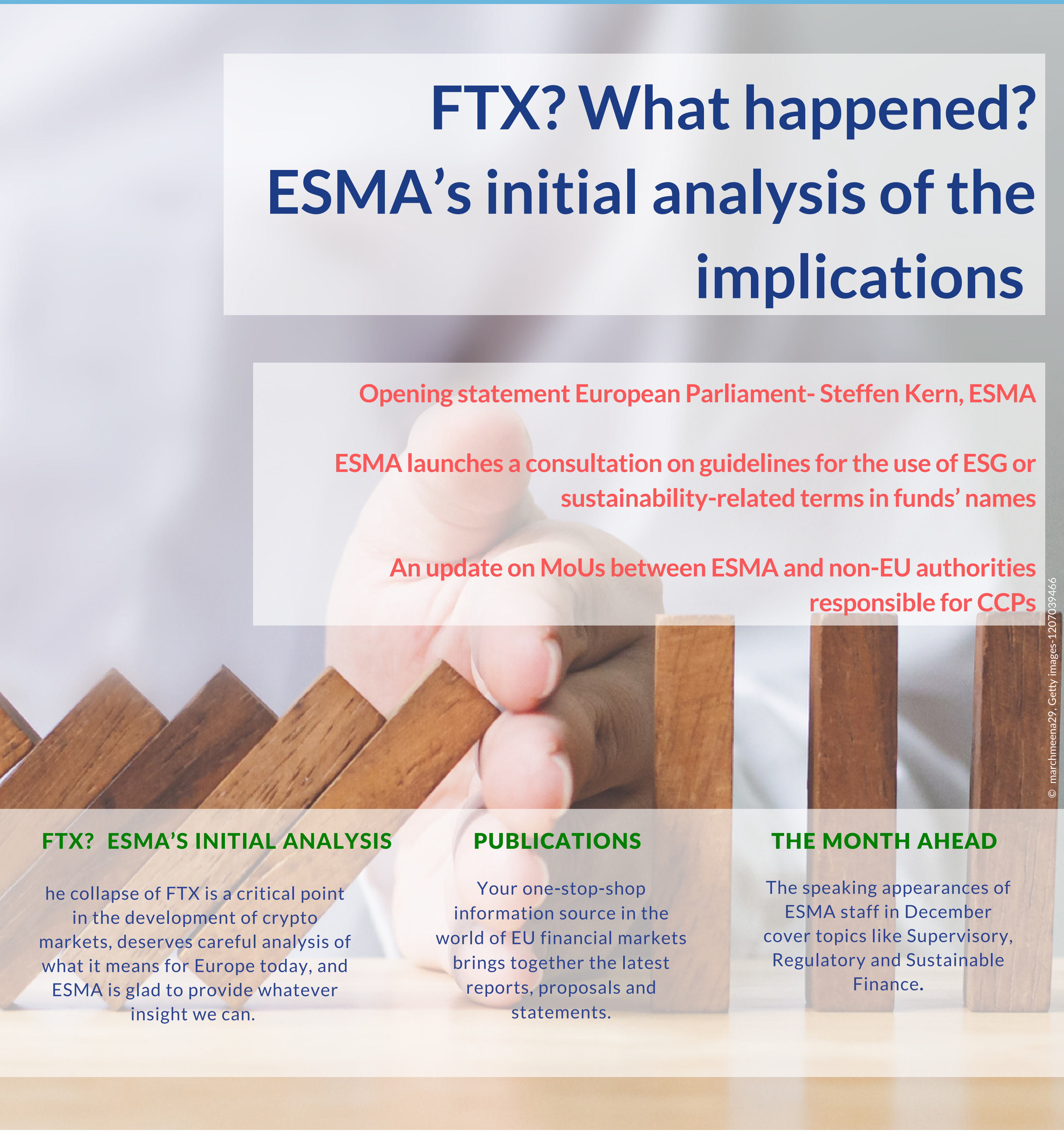
SPOTLIGHT ON MARKETS

NOVEMBER 2022 N°40



FTX? What happened? ESMA's initial analysis of the implications

Opening statement European Parliament- Steffen Kern, ESMA

ESMA launches a consultation on guidelines for the use of ESG or sustainability-related terms in funds' names

An update on MoUs between ESMA and non-EU authorities responsible for CCPs

FTX? ESMA'S INITIAL ANALYSIS

he collapse of FTX is a critical point in the development of crypto markets, deserves careful analysis of what it means for Europe today, and ESMA is glad to provide whatever insight we can.

PUBLICATIONS

Your one-stop-shop information source in the world of EU financial markets brings together the latest reports, proposals and statements.

THE MONTH AHEAD

The speaking appearances of ESMA staff in December cover topics like Supervisory, Regulatory and Sustainable Finance.

IN THIS ISSUE

At the end of November, ESMA Head of Risk Analysis and Chief Economist, Steffen Kern, during his opening statement to the European Parliament, described the collapse of FTX and its implications for the EU. The lack of safeguards in the cryptocurrency markets was one of the many factors that prompted ESMA to warn investors in 2018 and again this year about the serious risks associated with holding crypto-assets.

In fact, as part of the European System of Financial Supervision, ESMA aims to promote stable and orderly financial markets. In line with this objective, the ESMA Chair, Verena Ross, during her opening statement to the European Parliament, explained that ESMA will continue to cooperate closely with NCAs and ACER to ensure that potential market abuse is detected, investigated and prosecuted in the energy market. In addition, ESMA publishes the list of third country authorities that already signed an MoU with ESMA in order to receive quantitative and qualitative information from the TC-CCP and the home authority.

To ensure investor protection, ESMA launches a consultation on guidelines for the use of ESG or sustainability-related terms in funds' names.
In addition, the ESAs published a call for evidence on greenwashing to gather input from stakeholders on how to understand the key features, drivers and risks associated with greenwashing and to collect examples of potential greenwashing practices.

Furthermore, ESMA published a Final Report on the review of the regulatory technical standards (RTS) and a consultation on amendments to the RTS on the information that EU benchmark administrators need to provide in applications for authorisation and registration.

Other major publications in October include the new Q&A, the guidelines on resolvability and cooperation arrangements for central counterparties and the updates guidelines on stress tests for money market funds.

Last, but equally important, the Board of Supervisors of ESMA has appointed Vojtěch Belling as its Vice-Chair.

A full overview of all publications can be found in the newsletter, together with information on next month's speaking appearances of ESMA staff, consultations closing in January and vacancies.

For updates, follow us on Twitter and LinkedIn.

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IN THIS ISSUE

ESMA IN NOVEMBER

THE MONTH AHEAD: DECEMBER

FTX? What happened?
ESMA's initial analysis of the implications

Steffen Kern,
Head of Risk Analysis and
Chief Economist, ESMA

Dear Chairwoman,

Dear Members of the Economic and Monetary Affairs Committee,

Thank you for inviting ESMA to address you today regarding the collapse of FTX and its implications for the EU. The collapse of FTX is a critical point in the development of crypto markets, deserves careful analysis of what it means for Europe today, and we are glad to provide whatever insight we can.

ESMA's perspective

Let me point at the outset to some key aspects about our perspective as ESMA on this case: ESMA has neither regulated nor supervised FTX. We do not have access to any information on the company beyond what is in the public domain.

As a result, the observations we can make are based solely on public information about a rapidly developing situation. The collapse is still under investigation by authorities, especially in the US and elsewhere, and ultimately, we do not know the details of what happened.

Of course, we draw upon ESMA's wider experience of monitoring and analysing developments in this area in recent years. Our risk assessments are published widely on a semi-annual basis through our Trends, Risks, and Vulnerabilities reports. Following up on our risk assessment, and growing evidence of consumer detriment and aggressive marketing, we have issued Warnings to investors on the severe risks associated with crypto-assets.

Summary of current public information

As a starting point, let me briefly summarise what we know about the case at this stage, based on the available public information. As is typical of crypto asset providers and exchanges, FTX operated digitally and across borders, with a global client base. Created in 2018 and majorityowned by a US citizen, Sam Bankman-Fried, it is headquartered in the Bahamas and until recently was one of the top-five crypto-trading exchanges globally by volume of crypto asset transactions. According to its bankruptcy filings, FTX owns or is affiliated with a complex web of over a hundred entities across five continents, one of which, FTX (EU) Ltd, is domiciled in Cyprus, supervised by the Cyprus Securities and Exchange Commission and has been suspended by the Cyprus Securities and Exchange Commission on 11 November 2022.1 The company employed hundreds of staff and recently claimed to have over a million registered users, fewer than 10% of whom are understood to be based in the EU.

FTX is a centralised crypto trading platform. It allowed users to buy and sell crypto coins and tokens. Products available for trading on FTX also included futures, options, and leveraged tokens.

The business model of FTX has been highly complex.

- Next to crypto asset trading, it is understood to, first, involve dealer and custodian services, including margin lending to clients and safekeeping of crypto assets. On its website, FTX offered clients up to 20x leverage for various trades.

- Second, FTX is understood to have been lending to Alameda Research. Alameda has been referred to as an investment firm or proprietary trading firm founded and owned by Mr Bankman-Fried, though precise details of the business model of Alameda, its role in the conglomerate of firms around FTX and its lending arrangements with FTX remain unknown. Alameda appears to have been launched to carry out arbitrage trades, profiting from differences in crypto asset prices.

In 2019, FTX launched a native token, known as FTT, which gave holders the right to reduced trading fees on the platform. FTT had a total market capitalisation of EUR 3bn prior to the FTX collapse. FTT is reported to have made up over a third of the value of the assets on Alameda's books.

There are also questions around accounting practices in this regard. Alameda had stated that FTT was valued at half its USD market price on the company books, but the book value in fact reportedly exceeded the market value at the time.

FTX's collapse was rapid. On 2 November, Coindesk, a crypto news website, published an article questioning its financial soundness. On 6 November, the CEO of crypto exchange Binance announced via Twitter his intention to sell all FTX tokens held on Binance's books. Binance stated on 8 November that it intended to acquire FTX, but a day later announced that, after first due diligence, it had abandoned the rescue deal. On 11 November, FTX and dozens of its subsidiaries filed for bankruptcy.

The bankruptcy proceedings in the US are expected to take time, and many of the details of the case are yet to emerge.

First considerations on implications

At this early stage, certain features of the reported situation deserve consideration from a regulatory perspective.

First, in traditional finance, segregation of client assets is a crucial safeguard. FTX's clients – including EU-based investors – stand to lose much or all of the value of their assets deposited with the company, depending on the extent to which FTX may or may not have pooled their holdings with other capital. The governance in place at FTX has been described by observers closer to the matter as highly suspect.

The lack of safeguards in place at many entities active in crypto markets such as client asset segregation was one among many factors that prompted ESMA and the other ESAs to issue warnings to investors – in 2018, and again this year –about the severe risks involved in holding crypto-assets.

Second, crypto assets carry with them extreme market risk, with huge volatility seen in prices. The price of Bitcoin, for example, is around two-thirds down from its peak around a year ago. Liquidity and operational risks – including the risk of hacks and exploits – mean that investors holding assets on crypto exchanges may find their assets are inaccessible, either temporarily or permanently. Crypto assets have long raised concerns around market manipulation and the potential for money laundering and the financing of criminal activities.

Third, despite these fundamental risks from crypto assets, we continue to see widespread and often aggressive marketing to the mass market. Consumers may be persuaded to put their money into crypto assets without being made aware of the extreme risks involved.

In addition to investor risks, we have been monitoring crypto asset markets from a financial stability perspective and have published our assessment in a dedicated report earlier this year[3]. Within the crypto asset sector, there remains potential for contagion from the FTX episode, as well as the risk that other entities in the sector have flawed business models or inadequate governance and controls. That said, at present ESMA does not see significant risks of major spill-overs into the wider financial sector, given that crypto assets represent less than one percent of total market capitalisation across traditional asset classes, and the fact that interlinkages across the crypto and traditional financial markets have remained comparatively limited.

Importance of regulatory action

The concerns we have publicly expressed on the risks around crypto assets are at the heart of the rationale for the EU's MiCA regulation. The collapse of FTX is likely to cause major detriment to retail investors, including in the EU. The specific facts of the case, as they emerge, may provide evidence relevant to policymakers in future in this area. Notably, the collapse of FTX is understood to corroborate existing evidence that corporate governance and controls in the crypto asset space at large may be very weak.

MiCA is tackling the right issues for market participants to introduce vital protections for investors through a common EU regime. I and important rules. Implementing and applying protections and rules, resources, as well as equipping regulators and supervisors with adequate appears to us a matter of utmost urgency.

Service providers domiciled outside the EU play the dominant role in crypto markets. They should be expected to do so even after the implementation of a regulatory framework in the EU . EU authorities will internationally, therefore, need to continue to cooperate closely with counterparts internationally on such matters.

ESMA stands ready to assist the EU institutions in providing technical advice and input whenever it is required.

Thank you again for the opportunity to appear before the Committee today.

Steffen Kern,
European Parliament 30 Nov 2022

VERENA ROSS, ESMA CHAIR
ECONOMIC AND MONETARY AFFAIRS COMMITTEE

Verena Ross, ESMA Chair

Dear Chairwoman,

Dear Members of the Economic and Monetary Affairs Committee,

Thank you for the invitation to address you this morning.

It is clear that the energy crisis directly affects many European citizens and companies. While its root causes are geopolitical, we all observe the consequences in our daily lives as the price of energy has increased.

To start, I would like to clarify that ESMA's role as a securities market regulator does not cover all aspects related to developments in energy markets. We play a role in derivative markets, as part of the European System of Financial Supervision, in support of the ESMA objectives of promoting stable and orderly financial markets. Market surveillance and enforcement against market abuse breaches remain the remit of National Competent Authorities, while we, as ESMA, facilitate cooperation and information sharing. In addition, ESMA has a leading role when it comes to CCP supervision. Spot markets for energy trading on the other hand are supervised by the Agency for the Cooperation of Energy Regulators (ACER) and national energy regulatory authorities (NRAs).

I would also like to highlight that, as of early September, we have regularly convened Board of Supervisors' discussions to assess and closely monitor developments in the energy derivatives markets and to take mitigating actions where necessary.

An important distinction between financial speculation and market manipulation

Applicable regulatory framework regarding market manipulation

ESMA's policy work in relation to recent developments in energy derivative markets

An important distinction between financial speculation and market manipulation

Generally speaking, volatile market conditions tend to attract more participants trading, or some would say, 'speculating' [in the markets]. It is important to distinguish between speculation and market manipulation. While speculators may exacerbate price movements, they are part of free markets dynamics and play a role in the provision of liquidity. [Doing this, speculators could risk big losses if their predictions do not pan out.] Market manipulation, on the other hand, constitutes abusive behaviour that is a threat to the integrity and the orderly functioning of the markets themselves. It means rigging the system to your own profit, rather than taking a position that may or may not deliver to your benefit. This is what financial regulators are there to police to ensure market integrity, transparency and efficiency.

Applicable regulatory framework regarding market manipulation

As mentioned earlier, under the Market Abuse Regulation, responsibilities for fighting market manipulation lie with National Competent Authorities. ESMA has a coordinating role and will continue to cooperate closely with NCAs and ACER to ensure that potential market abuse is detected, investigated and prosecuted. On 18 October, ESMA and ACER informed the public of our intention to strengthen our cooperation, to further improve information exchange and work with our respective national authorities to enhance the surveillance of Europe's spot and derivative markets.

ESMA's policy work in relation to recent developments in energy derivative markets

Looking at the energy crisis more widely, I would like to briefly touch on the policy measures we have put forward in this space. In September, at the request of the European Commission (EC), we drew up a set of proposals aimed at taming some of the adverse consequences observed in energy markets, such as slightly widening the pool of eligible collateral in CCPs, suggesting improvement to circuit breakers, raising the clearing threshold and bringing energy firms' significant financial market activity under the same regime as financial firms. In doing so, our work focused on assessing possible avenues to alleviate the strain some financial markets have been experiencing, without transferring undesirable levels of risks from the energy markets into the EU financial system. We are happy to see that many of the proposals were taken forward by the EC. I was also pleased to see that the European Parliament treated the suggested Delegated Acts with urgency and that these provisions will now hopefully bring some relief to market participants.

I note that there is now a debate on a possible price cap mechanism in the gas market. This is essentially a political debate. ESMA is nonetheless very attentive to the concrete design of the price cap mechanism in view of its potential implications for the functioning of markets in terms of price formation and in particular CCPs' ability to manage risk in accordance with applicable regulatory requirements.

Thank you for your attention and I now stand ready to take your questions.

Verena Ross

European Parliament 1 Dec 2022

An update on MoUs between ESMA and non-EU authorities responsible for CCPs

Why does ESMA require MoUs with third-country (i.e. non-EU) authorities responsible for central counterparties (CCPs)?

A third-country CCP (TC-CCP) that wishes to provide services to EU Clearing Members or EU trading venues needs to obtain a recognition from ESMA under Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, known as EMIR.

The reason for this requirement is the potential impact a TC-CCP may have on the financial stability of the EU or any of its Member States, given the systemic nature of CCPs. In order to assess and address such potential impact, ESMA needs to be able to understand and monitor the EU specific risk profile of the TC-CCP, including exposures by EU entities to that TC-CCP or products denominated in EU currencies cleared by the TC-CCP.

For ESMA to be able to perform this function whilst relying on the home authority of the TC-CCP, ESMA needs to effectively cooperate with the home supervisory authority and receive quantitative and qualitative information from the TC-CCP and the home authority.

EMIR therefore requires the establishment of cooperation arrangements ('MoUs') between ESMA and the home authority of the TC-CCP as one of the conditions for ESMA to recognise TC-CCPs and to this aim specifies the necessary minimum content of the cooperation arrangements.

The purpose of these MoUs is thus to establish a framework for information sharing related to TC-CCPs, to assess the risks the TC-CCPs pose to the EU or any of its Member States including during crises and emergency situations, as well as to be informed on regulatory and supervisory developments in the third country. It also needs to provide ESMA with adequate tools to assess and monitor the ongoing compliance by the recognised TC-CCPs with the recognition conditions.

Following the review of EMIR ('EMIR 2.2'), which enhanced the EU framework for recognition and supervision of third-country CCPs by introducing a proportionality regime based on the systemic importance and risks posed by TC-CCPs and enhancing ESMA's role and powers, revised versions of MoUs previously concluded between third-country authorities and ESMA had to be concluded.

Who are the third country authorities who already signed an MoU with ESMA?

As of today, 22 authorities from 19 third-countries have signed such revised cooperation arrangements with ESMA. Negotiations normally take between 3 and 7 months before an agreement is reached between the third-country authority and ESMA on the content of the MoU.

ESMA provides on its website the MoUs signed with third-country authorities.

The list of countries whose CCP supervisory authorities have signed a revised MoU is:

- Australia
- Brazil
- Canada (authorities from Quebec, Ontario and Alberta)
- Chile
- China
- Dubai International Financial Centre
- Hong Kong
- Japan (JFSA and MAFF/METI)
- Malaysia
- Mexico
- New Zealand
- Republic of Korea
- Singapore
- South Africa
- Switzerland
- Taiwan
- United Kingdom
- United Arab Emirates
- USA (CFTC and SEC)

ESMA LAUNCHES A CONSULTATION ON GUIDELINES FOR THE USE OF ESG OR SUSTAINABILITY-RELATED TERMS IN FUNDS' NAMES

The European Securities and Markets Authority (ESMA), the EU's financial markets regulator and supervisor, is seeking input on draft guidelines on the use in funds' names of ESG or sustainability-related terms.

Funds' names are a powerful marketing tool. In order not to mislead investors, ESMA believes that ESG- and sustainability-related terms in funds' names should be supported in a material way by evidence of sustainability characteristics or objectives that are reflected fairly and consistently in the fund's investment objectives and policy. ESMA is particularly seeking stakeholders' feedback on the introduction of quantitative thresholds for the minimum proportion of investments sufficient to support the ESG or sustainability-related terms in funds' names.

> *With this consultation, ESMA continues to prioritise promoting transparency and tackling the risk of greenwashing as identified in the ESMA Strategy and Sustainable Finance Roadmap.*
> *This consultation seeks the views of stakeholders on a proposal to promote supervisory convergence in the assessment by NCAs of the use of ESG or sustainability-related terms in funds' names.*
> *The objective is to ensure that investors are protected against unsubstantiated or exaggerated sustainability claims while providing both NCAs and asset managers with clear and measurable criteria to assess names of funds including ESG or sustainability-related terms.*

Verena Ross, ESMA Chair

The main elements of the consultation paper on draft guidelines for the use of ESG or sustainability-related terms in funds' names on which ESMA is seeking stakeholders' feedback are:

- a quantitative threshold (80%) for the use of ESG related words;
- an additional threshold (50%) for the use of "sustainable" or any sustainability-related term only, as part of the 80% threshold;
- application of minimum safeguards to all investments for funds using such terms (exclusion criteria);
- additional consideration for specific types of funds (index and impact funds).

ESMA proposes that the draft guidelines would become applicable from 3 months after the publication of their translation on the ESMA website. Furthermore, a transitional period of 6 months is suggested for those funds launched prior the application date, in order to comply with the Guidelines.

Next steps

ESMA will consider the feedback it receives to this consultation after it closes on 20 February 2023 with a view to finalising the guidance afterwards.

ESAs LAUNCH JOINT CALL FOR EVIDENCE ON GREENWASHING

The three European Supervisory Authorities (EBA, EIOPA and ESMA – ESAs) published a Call for Evidence on greenwashing to gather input from stakeholders on how to understand the key features, drivers and risks associated with greenwashing and to collect examples of potential greenwashing practices.

Due to the growing demand for sustainability-related products and the rapidly evolving regulatory regimes and sustainability-related product offerings, the call is also motivated by the need to better understand which areas may become more prone to greenwashing risks. In addition, the call seeks input on potential greenwashing practices relevant to various segments of the sustainable investment value chain and of the financial product lifecycle.

Obtaining a more granular understanding of greenwashing will help inform policy making and supervision and will help foster the reliability of sustainability-related claims. In the context of this call, the term "greenwashing" is broadly used, recognising that sustainability-related claims can be linked to all aspects of the ESG spectrum.

All interested parties are welcome to contribute to the survey, including financial institutions under the remit of the three ESAs and other stakeholders ranging from retail investors and consumers' associations to NGOs and academia. Contributions should focus on greenwashing risks and occurrences arising in the financial sector and affecting financial products or services, which are under the scope of the ESAs.

We draw attention to the fact that the survey contains a section common to the three Authorities, which includes cross-sectoral questions on greenwashing and separate sections relevant to each ESA.

This Call for Evidence was issued in the context of the mandates received from the European Commission in May 2022.

Next steps

Respondents are invited to submit their responses by 10 January 2023. Contributions will feed into the ESAs' findings for their progress reports due in May 2023, and final reports due in May 2024.

ESMA AMENDS AND CONSULTS ON STANDARDS FOR BENCHMARK ADMINISTRATOR APPLICATIONS

The European Securities and Markets Authority (ESMA), the EU's financial markets regulator and supervisor, published a Final Report on the review of the regulatory technical standards (RTS) on the form and content of applications for recognition by non-EU benchmark administrators, and a consultation on amendments to the RTS on the information that EU benchmark administrators need to provide in applications for authorisation and registration.

Amended standards for applications for recognition

The Final Report includes draft RTS that aim at aligning the information provided in a recognition application with the amended BMR following the transfer of direct supervisory responsibilities to ESMA. This is to ensure that these applications include all necessary information in order for ESMA to assess whether the applicant meets BMR requirements.

Third country benchmark administrators who wish to apply for recognition, are encouraged to contact ESMA at Supervision-BMR@esma.europa.eu.

Input sought on standards for applications for authorisation and registration

In the consultation also published today, ESMA is seeking stakeholder views on proposed changes to the RTS on authorisation and registration. The objective is to safeguard equal treatment between EU and non-EU Benchmarks administrators by aligning the information requested in applications from EU administrators with the information requested in recognition applications from non-EU administrators.

Next steps

The draft RTS on recognition are sent to the European Commission (EC) for endorsement in the form of a Commission Delegated Regulation. Following the endorsement by the EC, the Commission Delegated Regulation will then be subject to the non-objection of the European Parliament and of the Council.

ESMA will consider the responses to its consultation before submitting the draft RTS on authorisation and registration to the European Commission for adoption. The closing date for responses from stakeholders is 31 January 2023.

PUBLICATIONS

Click to read the news items

1 Dec OPENING STATEMENT VERENA ROSS, ESMA CHAIR ECONOMIC AND MONETARY AFFAIR COMMITTEE EUROPEAN PARLIAMENT

30 Nov OPENING STATEMENT STEFFEN KERN, HEAD OF RISK ANALYSIS AND CHIEF ECONOMIST, ESMA ECONOMIC AND MONETARY AFFAIR COMMITTEE EUROPEAN PARLIAMENT

30 Nov ESMA UPDATES GUIDELINES ON STRESS TESTS FOR MONEY MARKET FUNDS

28 Nov ESMA AMENDS AND CONSULTS ON STANDARDS FOR BENCHMARK ADMINISTRATOR APPLICATIONS

25 Nov NEW Q&AS AVAILABLE

18 Nov ESMA LAUNCHES A CONSULTATION ON GUIDELINES FOR THE USE OF ESG OR SUSTAINABILITY-RELATED TERMS IN FUNDS' NAMES

17 Nov ESMA PUBLISHES GUIDELINES ON RESOLVABILITY AND COOPERATION ARRANGEMENTS FOR CENTRAL COUNTERPARTIES

15 Nov ESAS LAUNCH JOINT CALL FOR EVIDENCE ON GREENWASHING

15 Nov VOJTĚCH BELLING APPOINTED VICE-CHAIR OF ESMA

SPEAKING APPEARANCES

by ESMA staff in December

	EVENT	ORGANISER	SPEAKER
1 Dec	ERA Annual Conference on EU Financial Regulation and Supervision 2022	ERA	Antonio Barattelli Elena Brannetti
2 Dec	6° SIII Conference	La Sapienza University	Claudia Guagliano
2 Dec	FBF Online MasterClass 'Crypto Assets: Developments and Supervisory Challenges'	EUI Florence School of Banking and Finance	Clement Luzeau
6 Dec	International Investors' Conference	DSW	Verena Ross, Chair
6 Dec	Global Regulatory Forum	Bloomberg	Jakub Michalik
7 Dec	EFRAG Conference	EFRAG	Verena Ross, Chair

by ESMA staff in December

Date	EVENT	ORGANISER	SPEAKER
8 Dec	EUCI's annual event	EUCI	Claudia Guagliano
14 Dec	Training Initiative for Financial Supervision (TIFS) Seminar	KNF	Evert van Walsum
14 Dec	High Level Expert Forum for Sustainable Finance (HLEF)	Better Finance	Patrik Karlsson
14 Dec	27th Eurofiling Workshop	Bank of Spain, Spanish Business Registry, CNMV	Eduardo-Javier Moral Prieto
15 Dec	ESEF 2022	Bank of Spain, Spanish Business Registry, CNMV	Eduardo-Javier Moral Prieto
16 Dec	Italian Cooperative Banks MiFID II/ESG)	Italian Cooperative Banks	Matteo Rava
30 Dec	Shaping transition by regulation	ISS ESG	Guilain Cals

CONSULTATIONS

Closing

16/12/22	Consultation Paper on Market Outages
10/01/23	ESAs Call for Evidence on greenwashing
31/01/23	Consultation Paper on review of RTS on authorisation and registration
17/02/23	Consultation on Review of the technical standards under Article 34 of MiFID II
20/02/23	Consultation on Guidelines on funds' names using ESG or sustainability-related terms

The full list of consultations and reply forms can be found on the ESMA consultations page

OPEN VACANCIES

POSITION	DEADLINE
Seconded National Experts (multiple profiles)	31/12/23
Head of Department (Investor Protection and Sustainable Finance)	03/01/23
Traineeship notice – Legal profile (F/M)	Open call (without a specific deadline)
Traineeship notice – Transversal profile (F/M)	Open call (without a specific deadline)
Traineeship notice - Financial Markets Profile (F/M)	Open call (without a specific deadline)

All open vacancies can be found on ESMA's recruitment portal

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