Date: 13 September 2012
ESMA/2012/579

Written statement by Steven Maijoor, Chair of ESMA, to the ECON hearing on 19/9/2012

Madam Chair, Members of the Economic and Monetary Affairs Committee of the European Parliament,

Prior to making my presentation on ESMA's achievements and activities over the last 12 months, I want to present you with a short report on the important work of the Joint Committee (JC) of the European Supervisory Authorities (ESAs), which I have the honour of chairing this year.

I) Activities and achievements of the Joint Committee

The mission of the JC is to serve as a *forum* in which the ESAs – EBA, EIOPA and ESMA - "shall *cooperate* regularly and closely and *ensure cross-sectoral consistency* in a number of areas".

Through the joint efforts of the three ESAs over the past 18 months, we have now reached a point where the Authorities automatically use the JC to ensure the consistency of their views on topics of common interest, to develop common solutions, and to exchange information on their respective sectors.

1. A hub for cooperation, contributing to financial stability

The ESAs attach great importance to the objectives of the JC and all have made a significant commitment, in terms of dedicated staff resources and senior management involvement, to assisting the body in carrying out its tasks and in meeting its objectives. The JC work programme is supported by four sub-committees – Risk, Consumer Protection and Financial Innovation, Financial Conglomerates and Anti-Money Laundering.

In addition to the work of its sub-committees, regular bi-monthly meetings of the JC allow its members to have regular exchanges on market developments in their respective sectors and to assess any potential contagion effects of these developments. The JC takes a flexible approach to meeting its responsibilities and the Chairs have conferred frequently outside the confines of the regular meetings, at times daily, when confronted with adverse market developments in order to exchange information and to maintain a coherent cross-sectorial approach.

2. A catalyst for efficient cross-sectoral processes

As I have indicated, the JC carries out its work through a series of sub-committees dedicated to key areas of cross-sectoral concern. I will now go into further detail on what this work entails.

Risk Sub-Committee

This sub-committee is a key forum for the sharing of information and data on risks between the ESAs. This results in the development of the Report on Risks and Vulnerabilities in the EU Financial System. This Report, produced twice a year, contributes to a cross-sectoral approach to risk analysis and financial stability, and is shared with the European Systemic Risk Board (ESRB) and the Economic and Financial Committee (EFC). In addition, information is exchanged on specific topics, including for example the structure of the CDS market.

More recently, as a result of the LIBOR and Euribor cases, the ESAs have initiated work on reference rate issues, contributing to the coordination of investigations and the development of rapid policy responses.

Consumer Protection and Financial Innovation Sub-Committee

This sub-committee has begun work on product oversight and on the key measures proposed by the Commission in July 2012 in relation to Packaged Retail Investment Products (PRIPs). The three work-streams that are currently underway within this sub-committee are:

i. **Consumer protection**: Cross-selling and complaints handling are a first priority. The sub-committee is in particular assessing whether principles developed for complaints handling in the insurance sector can be re-used in the securities and banking sectors. In addition, the JC will consider the improvement of, and consistency between, the ESA templates for collecting, analysing and reporting on consumer trends based on lessons learned from the first data collection rounds from national securities markets regulators;

ii. **Product oversight and governance**: The JC is considering the development of a set of high-level principles for a product approval process based on the results of its September 2012 mapping exercise; and

iii. **Retail products (PRIPs)**: A sub-group of experts has initiated work on the development of proposals for the European Commission concerning delegated acts, and for the development of draft Regulatory Technical Standards (RTS) in the areas envisaged by the PRIPs legislative proposal.

   To reach out to financial services consumers, retail investors, and other stakeholders in financial consumer protection, the ESAs will organise their first Joint Consumer Day in the first half year of 2013.

Financial Conglomerates Sub-Committee (JCFC)
This group has dedicated a large part of its time and resources to developing its response to the call for advice from the Commission on the review of the Financial Conglomerates Directive (FICOD), the major instrument for supervision of financial conglomerates. The resulting report was presented as a JC public consultation and the final advice will be provided to the Commission later this year.

In parallel to that work-stream, the sub-committee prepared a proposal for draft RTS on the uniform conditions of application of the calculation methods of own funds under Article 6.2 of the FICOD, and this joint consultation was launched on 31 August 2012.

Finally, the JC published an updated list of identified Financial Conglomerates in July 2012.

Anti-Money Laundering Sub-Committee (AMLC)
The sub-committee has assessed the situation across EU Member States of the legal and regulatory provisions, as well as supervisory standards, in relation to the application of the Third Money Laundering Directive (3rd MLD), regarding beneficial ownership Customer Due Diligence requirements and Simplified Due Diligence requirements.

This resulted in two reports being published in April 2012 aimed at supporting the review process of the 3rd MLD by the Commission. Additionally, in August 2012, the AMLC published a Protocol on cooperation between home and host supervisors, to facilitate effective AML supervision of agents and branches of payment institutions in host Member States in accordance with the Payment Services Directive.

Other areas of activity
One of the key tasks in 2012 was the JC's work on EMIR, where the regulation requires that RTS are developed jointly by the three ESAs. In March 2012, the JC put forward its *Joint Discussion Paper on Draft RTS on Risk Mitigation Techniques for OTC Derivatives not cleared by a CCP under the EMIR Regulation*.

As the different work-streams on OTC derivatives regulation have progressed, both in Europe and globally, the JC recognised that the final version of the RTS could benefit from global initiatives currently being undertaken by international standard-setting bodies. However, these will not be finalised until the deadline for the final RTS has passed. In view of this situation the JC addressed a letter to the European Commission on 7 June 2012, suggesting the postponement of the deadline for the submission of these particular RTS, in order to take account of these international initiatives when finalised.

II) Activities and achievements of ESMA

ESMA's activities in the past twelve months have been driven by and focused on five areas:

1. the regulatory agenda;
2. financial stability and crisis management;
3. investor protection;
4. the implementation and execution of CRA supervision; and
5. developing the ESMA organisation.

1. The regulatory agenda

EU single rulebook

In relation to ESMA's statutory objective of building a single rulebook for the EU and ensuring its effective implementation across the EU, the Authority has undertaken the following work since September 2011:

- 40 Technical Standards were developed, involving significant work, for the implementation of the European Market Infrastructure Regulation (EMIR) which provides the framework for the regulation of OTC derivatives markets. Our work on this topic has included the publication of a Consultation Paper in June followed by an open public hearing in July. ESMA intends to deliver the final standards by the end of this month in order to meet the EU commitment to have rules in place for derivatives markets by January 2013;

- Four Technical Standards were developed for the new CRA supervisory regime;

- 7 Technical Standards were developed for the new short-selling and credit default swaps regime;

- 5 pieces of advice were provided to the European Commission on secondary legislation in areas such as prospectuses, alternative investment funds and short selling; and

- 6 sets of detailed guidance and recommendations for markets regulators and participants in areas such as automated trading, AIFM, ETFs, UCITS, suitability of advice and the investment firm compliance function.

In carrying out these tasks ESMA has ensured that all relevant stakeholders had the opportunity to provide input into our policy development process through open public consultations, interaction with various stakeholder associations – representing both investors and market participants - and by soliciting the views of the Securities Markets Stakeholders Group – which represents consumers, financial services users, small and medium-sized enterprises and financial services firms employees.

In addition, ESMA has provided advice and support on legislation currently being debated and adopted by the European Parliament and the Council, including MiFID 2 and MiFIR, the Market Abuse Directive (MAD) and Market Abuse Regulation (MAR), and the Central Securities Depositaries Directive (CSD).

Promoting supervisory convergence

Another statutory ESMA activity, which contributes to the effective implementation of a single rulebook and helps to reduce the risk of regulatory arbitrage, is the establishment of high quality common regulatory and supervisory standards and practices. In addition to developing the 51 draft regulatory and implementing standards and six sets of guidelines and recommendations already outlined, ESMA has supported supervisory convergence by:

- issuing opinions on the treatment of sovereign debt under IFRS and on a large number of pre-trade transparency waivers under MiFID;
- conducting four peer reviews in 2012 of national authorities' activities in order to assess the degree of convergence in the application and enforcement of EU law. ESMA has published the results of two peer reviews. The first concerns the regime for the issuance of prospectuses and the second report concerns the use of sanctions for market abuse across EU Member States.

Joint training sessions for staff of national securities market regulators are also a vital element in promoting supervisory convergence. ESMA is particularly active in this field and has delivered 15 training courses since September 2011, on topics such as risk measurement for UCITS, the principles for the calculation and application of financial penalties, and investigation techniques for insider trading. Furthermore, a dedicated website is now available to national authorities supporting E-Learning courses.

ESMA's role in the field of international cooperation

As part of pursuing supervisory convergence, ESMA has been actively engaged in the work at the international level on the reform of financial markets. Examples include the participation in the international coordination of OTC derivatives reform, and the conclusion of Memoranda of Understanding on CRA supervision with a number of jurisdictions including the United States, Canada, Australia, Hong Kong, Japan, Brazil, Singapore, Mexico and Argentina. Moreover, ESMA is participating in work-streams of the Financial Stability Board[1] and has recently become an Associate Member of the International Organization of Securities Commissions. The continued involvement of ESMA in worldwide coordination is of vital importance given the interconnectedness of financial markets.

---

[1] Development of an international Legal Entity Identifier (LEI) mechanism.

2. Financial stability and crisis management

ESMA's regulatory obligations include contributing to the assessment of systemic risks and financial stability within the EU. To this end we co-operate closeley with, and participate in, the European Systemic Risk Board (ESRB) and other European institutions. We also address the issue through regular monitoring exercises as well as in individual in-depth analyses of specific market segments.

ESMA, in meeting this obligation over the last 12 months, has contributed to the two JC Reports on *Risks and Vulnerabilities in the EU Financial System*. In addition we have participated in several ESRB Working Groups on financial stability topics.

ESMA's work on financial stability is a mix of specific projects and regular risk reporting. We have completed specific work on the risks associated with the current industry trend towards structured and complex retail products. In addition, we have conducted a first assessment of the size of the shadow banking system in Europe. Current work-streams include an analysis of CDS markets and the contribution of the hedge fund sector to systemic risks in financial markets.

Coordination

I would also like to highlight key aspects of ESMA's coordination activities over recent months in the context of "adverse market developments". The Board of Supervisors of ESMA held several conference calls during the summer to discuss the significant worsening of financial market conditions in the EU. The objective of these calls was to exchange information on current key financial market developments in the EU, (planned) responses to those developments by national competent authorities and to assess where, and what type of coordination, was needed.

As a result of these coordination initiatives ESMA has for example undertaken further work on:

- Establishing information sharing between national competent authorities on planned changes by CCPs that might have wider markets implications;
- developing a framework for the adoption of any possible restriction of short positions by one or more national competent authorities; and
- updating crisis management scenarios like the coordination of cross-border trading suspensions, and monitoring and addressing settlement fails on an EU wide basis.

3. Investor protection

Since September 2011, ESMA has reinforced the European framework for investor protection through a series of concrete initiatives. In July 2012, ESMA published two sets of guidelines aimed at enhancing the protection of investors. The aim of the guidelines is to promote greater convergence in the interpretation of, and supervisory approaches to the suitability of advice under MiFID[2] and investment firms' requirements regarding the compliance function.

Also in July, we published *Guidelines on ETFs and other UCITS issues* which are aimed at strengthening investor protection and harmonising regulatory practices across this important EU fund sector, through increasing the level and the quality of information provided by UCITS to their investors.

This month, September 2012, ESMA published for consultation, *Guidelines on remuneration based on the MiFID obligations for investment firms* in respect of conflicts of interest and conduct of business when providing investment services. They address the alignment of remuneration with the overarching obligation on firms to act honestly, fairly and professionally in accordance with the best interests of its clients.

Over the course of the last 10 months ESMA has also exercised its **power to issue warnings** in the event that a financial activity poses a serious threat to investors. In December 2011, ESMA issued a warning on dealing with unauthorised firms offering foreign exchange investments and on the main risks involved in forex trading. This action was taken in light of the size of the forex market and the growing retail investor participation. In September 2012, ESMA issued another investor warning regarding the pitfalls facing investors when using the internet for investment purposes, following an observed rise in complaints reported by national authorities.

4. Implementation and execution of CRA supervision

This is the first year in which ESMA has exercised its supervisory powers regarding CRAs. Currently, 17 CRAs have been registered and a Japanese CRA has been certified. Amongst the 17 registered CRAs, three operate under a group structure, totalling 16 legal entities in the EU, which means that the total number of CRA entities registered in the EU is now 30, and ESMA continues to receive further applications for registration.

Supervisory role

In executing our supervisory responsibilities, ESMA's CRA Unit has undertaken two on-site inspections at the three largest registered entities. The first inspections were carried out in December 2011 and the findings were published last March, while a second on-

[2] For suitability: to improve, amongst other things, due diligence on gathering information on the client's background when providing suitable investment advice; and to ensure firms have in place appropriate arrangements to enable them to meet the suitability requirements on an on-going and consistent basis for any client, and irrespective of the distribution channel used.

site inspection has been completed earlier this month. In keeping with our risk-based approach to supervision we have so far focused our supervisory activity on the three main CRAs given their collective share of the market.

The March report identified several shortcomings and areas for improvement[3] which ESMA is now following-up through risk mitigation plans for each individual CRA. These issues will also be addressed in the individual and thematic supervisory reviews, on-site inspections and off-site monitoring and risk analysis which we will conduct this year.

On the basis of the second round of inspections this month on bank rating methodologies we are now examining the evidence in preparation of our supervisory findings.

As required under the CRA Regulation, and in support of its supervisory functions, ESMA has this year established a central repository (CEREP) to make long-term information on ratings available to the public.

Trade Repository and Central Counter Parties Supervision
ESMA's supervisory remit will expand in the coming year, under EMIR, as it will take on supervisory responsibility for Trade Repositories from January 2013 and we are currently preparing internally for these supervisory tasks. ESMA is also preparing for the work on supervisory colleges, which will be established in 2013 for the supervision of cross-border Central Counter Parties under the OTC derivatives legislation.

5. Developing the ESMA organisation

In addition to focusing on its role in policy and supervision, ESMA has also devoted much of this year to developing its internal organisation so it can carry out its mandate while remaining sufficiently flexible to respond to any further responsibilities it may receive.

This included designing and implementing internal rules and organisational procedures in order to facilitate ESMA's governance. We have ensured that our rules and procedures are in line with EU requirements, especially in the key areas of procurement, payments and recruitment. With regard to the latter area, I would like to stress that we are pleased with the calibre of our recruits over the last 12 months and ESMA posts continue to attract applications from high quality candidates from both the public and private sectors. We are growing from 45 staff in September 2011 to an expected 100 staff at the end of 2012.

---

3 As specified in our report published last March, the main areas covered included: transparency of rating methodologies, disclosure and presentation of ratings; adequacy of controls over IT systems; recording of core internal processes and decisions; and adequacy of resources devoted to internal control functions and analytical business lines.

In order to accommodate this growth in staff numbers, resulting from our increased responsibilities, the Authority has identified the need to expand its current premises and we have recently submitted our proposals in this regard to the EU Parliament and the European Council.

Budget and future funding

Finally, I warmly welcome the provisions of the recently adopted Opinion by ECON on the general budget of the European Union with regard to the ESA funding.

I would again emphasise that when the ESAs are given additional tasks a detailed cost assessment should be included in the legislative process, and adequate funding for the ESAs factored into the planning of new tasks.

Secondly, using the current 60/40 weighting contribution to ESMA's budget (between National Competent Authorities and EU institutions), any increase in ESMA's budget will automatically increase the financial contribution of national authorities, which may be problematic for several of them, especially in the current circumstances.

In terms of resolving these potential conflicts regarding ESMA's funding, I believe that a move to either 100% EU funding, an industry fee based mechanism or a combination of both should be considered to ensure a sustainable funding model for ESMA.