Date: 9 December 2014
ESMA/2014/1474

Investor Protection and an integrated EU-Capital Market

Better Finance for All – International Investor's Conference 2014

"Shareholder Rights in Europe 2020"

Wiesbaden (Germany)

Steven Maijoor
Chair
European Securities and Markets Authority

Ladies and Gentlemen,

Let me first of all thank 'Better Finance for All' for organising this conference on "Shareholder Rights in Europe 2020".

I am very happy to have been invited to discuss "Investor Protection in the context of an integrated EU-Capital Market". This enables me to discuss two important and closely interlinked topics. Namely the enhancement of the level of protection offered to investors and the accelerated harmonisation and integration of EU capital markets. Investor protection is a key driver of EU financial legislation and the integration of European capital markets is a long-standing endeavour and has been set as a priority by President Juncker when taking office through the launch of an important initiative, the Capital Markets Union or CMU.

I believe that the two topics are and should be highly interlinked and today I would like to walk you through my thoughts on that.

The CMU has become the catalyst for developing the non-banking sector and in so doing diversifying the funding sources of our economy. A precise description is not yet available: the CMU is a concept under construction. However, the first sketches go in the direction of an accelerated integration of EU capital markets encompassing all 28 Member States. The clear objective set by President Juncker is that the CMU maximises the benefits of capital markets and non-bank financial institutions for the real economy.

I am convinced that this ambitious goal cannot be achieved without establishing a high level of confidence for all types of investors in the financial markets. Indeed, the CMU will not be successful if its design focuses solely on financial institutions' needs. It must also add value to investors. Diversifying the funding of our economy can only be achieved if investors have an incentive to take part in this initiative.

I am notably thinking about retail investors here. Their weight in our economies is way too important for the CMU to be built without them. On top of that it seems to make no sense to create a fully integrated capital market for professional investors and maintain a separate less efficient and less integrated financial market for retail investors.

The CMU initiative aims at taking a long standing European ambition to the next level. Indeed, developing an integrated EU capital market is an initiative which dates back to the 70s and the Directives harmonising company law and financial reporting requirements. This long-term process has recently accelerated with the implementation of the regulatory responses to the financial crisis.

However, despite the many efforts of the past four decades, and the good results achieved, the EU capital market is still fragmented and this limits its potential. So what is needed to achieve a strong and integrated capital market to increase capital availability and to support economic growth in all Member States?

In my view, there are four main building blocks to consider:

1. greater diversity in funding;
2. increasing the attractiveness of capital markets both for EU investors and for investors from outside the Union;
3. increasing the efficiency of capital markets; and
4. strengthening and harmonising financial supervision.

As I will further develop, investor protection is a key dimension of each of these four building blocks.

Let me now start with the first building block, which is greater diversity in financing.

Today about a third of EU non-financial companies' liabilities are bank loans. By contrast, in the United States (US), where companies turn more often to capital markets for their financing, they only account for about 7% of non-financial companies' liabilities[1].

European SMEs strongly depend on bank financing. This is detrimental for the EU economy. A more diversified financing system with an increased participation of institutional or non-bank investors, as well as a greater percentage of financing through the capital market are quite obvious remedies.

While policy makers and regulators should refrain from assuming the superiority of one channel over the other and let investors and market participants decide which channel best suits their investment and funding needs, I believe that the regulation of capital markets should be both robust and secured in order to create a trusting environment for investors. Setting-up a more transparent and harmonised framework is certainly one efficient way to create this environment. I will discuss this in a minute. But now I would like to discuss how investor protection should come into play.

My belief is that an enhanced level of investor protection will build-up investor confidence and will gradually lead more and more investors to consider the EU capital markets as a sound alternative to the solutions offered by the banking sector and a valuable option to diversify their portfolio.

Duly informed and protected investors will make more informed investment decisions out of a range of capital markets products more adequately suited for their needs. Having more confidence in the

[1] International Monetary Fund (2014) Euro Area Policies, Country Report No. 14/199

markets and understanding better the products they invest in, these investors will be less prone to react irrationally to market events or follow so called “sheep-like behaviours”.

The building of the CMU should therefore factor in that investor protection can also contribute to guarantee that this diversity of funding, once reached, is maintained overtime. Investor protection is both a factor facilitating the diversification of the source of funding of our economy but also one contributing to its stability.

As I mentioned before, I believe that legislative initiatives can be a way to incentivise different categories of investors to invest in the capital markets. Many legislative initiatives support the development of a wide variety of funding channels. Examples include the Alternative Investment Fund Managers Directive (AIFMD), the UCITS Directive and the Regulation on Venture Capital Funds which have set a trusted framework through which asset managers have been able to attract a growing number of investors. These pieces of legislation are major steps toward the harmonisation of capital markets and one should not underestimate the success already achieved.

One of the successful initiatives in terms of creating a single European capital market that I would like to emphasize is the UCITS Directive. As of September 2014, 72% of assets managed in an investment fund in Europe, roughly 7.8 trillion EUR[2], are managed through the UCITS regime. This regime offers a secured and trusted framework and delivers appropriately on investor protection. This strong framework has

[2] EFAMA – Investment fund industry fact sheet – September 2014.

contributed to successfully channel very substantive amounts – often retail savings – to the capital markets. Investing in the capital market allows investors to profit from returns they would have missed out on when they had invested their money merely in bank deposits which, although less risky, do not offer the possibility to benefit from the opportunities offered by the direct participation in capital markets.

Let me now move to the second building block of the CMU that is to increase the attractiveness of the EU capital markets for investors. Here again, investor protection is clearly a key angle.

As I just discussed, only when investors feel sufficiently protected will they be willing to enter the capital markets and participate. At this stage, trust in the financial sector is low among European investors, so a lot of work remains to be done. This has gradually been improving. Still, in 2013 only 35% of retail investors trusted investment services providers to respect consumer protection rules[3].

This lack of trust is especially problematic in the European environment where there is a preference to save via deposits.

Restoring investors' trust is primarily the responsibility of the financial sector. However, regulation and supervision should strongly support this process. While the early phase of the regulatory response to the financial crisis focused on stability and prudential objectives, a certain number of recent regulatory measures will help rebuilding investor's confidence in the financial markets.

---

[3] European Commission (2013), Market Monitoring Survey, 2010-2013.

For instance, PRIIPS will contribute greatly and visibly to enhance the level of investor protection. The introduction of the Key Information Document (KID) is a great step in the right direction. Great opportunities lie ahead with this new legislation which covers a broad range of investment products marketed to retail investors, a market worth up to €10 trillion in the EU according to European Commission estimates.

MiFID II is obviously also a major step forward to better protect investors and restore investors' trust in capital markets. New or reinforced rules on a wide range of important topics such as product governance, conflict of interests, safeguarding of client assets or inducements will significantly improve the fair treatment of investors. Furthermore, MiFID II is improving the level of protection offered to all type of investors. As I said earlier, I strongly favour the building of a CMU which has added value for all type of investors. This is the direction in which MiFID II is heading and I strongly believe it is the right one. Here I would like to seize the opportunity to question the common view that there should be limits in the harmonisation of rules protecting investors and especially retail investors. Certainly, there are national specificities in the domestic retail markets. Some of them are quite strong. I nevertheless believe that, while these differences should be considered, the mere fact that these differences exist should not constitute an obstacle to harmonisation. If we truly want to create an integrated Capital Markets Union and overcome the 'home bias' that may lead investors not to look beyond their own national borders when making investment decisions, we need not to overestimate these differences and avoid that they may unduly affect the building of the CMU.

Let me know quickly discuss the third of the four building blocks. Policies that aim at increasing the efficiency of EU capital markets are needed to increase capital market financing with deep, liquid and well-functioning markets. This is affected by many factors, including accounting standards, corporate governance, transparency around pricing and the legal arrangements regarding the various stages of a financial instrument's life-cycle.

The CMU is a large scale and ambitious project. It will have to overcome the many remaining barriers. This leads me to believe that when building the CMU concept, we need to assess which changes will have the biggest impact on EU capital market efficiency and many questions need to be answered in that respect.

MIFID II should again be mentioned here. Indeed, MiFID II will contribute to the CMU by increasing the deepness and liquidity of capital markets. The increase should be the result of a large number of measures, including for example improving pre- and post-trade transparency, limiting dark trading and moving OTC derivatives on-exchange. However, all the benefits of MIFID II/MIFIR are at this stage still only on paper. The success of this important piece of legislation will also depend on its implementation and require a major effort by all parties involved in the upcoming years, including from industry, investors, national regulators and ESMA.

This brings me to the fourth and last building block that concerns harmonising and strengthening supervision. It is a key dimension. This is necessary to ensure that the same basic technical rules are applied, supervised and enforced consistently, to identify risks in the system at an early stage, to be able to act together effectively in emergency situations and in resolving disagreements among supervisors. Without converged supervision all of the regulatory responses I mentioned earlier and the CMU itself will be of limited impact.

Converged supervision, by which I mean consistent application of the same rules and using similar approaches across the 28 Member States, is needed to ensure that the single rulebook on paper becomes a single market in practice. Given the breadth and complexity of the single rulebook, regulators need to make many choices regarding their supervision, including the interpretation of the rules and the intensity of supervision. Diversity in these choices will have the result that the single rulebook will not in fact be seen as such by investors and market participants. ESMA is ready to take up an important role in this process and is already working very hard towards this much needed goal.

An example of ESMA's involvement in this field is the peer review work coordinated by ESMA. Peer review consists of the critical review of the supervisory procedures that are put in place by national competent authorities on a specific topic. ESMA coordinates these year-long reviews and include on-site visits by experts from ESMA and other national competent authorities. A recent example of ESMA's work in this field is an ESMA peer review report on MiFID – Conduct of Business, fair, clear and not misleading information, which we expect to publish shortly. The results clearly show that there is still a lot of convergence work ahead of us.

A significant addition of the supervisory power brought by the MIFID II package I would like to mention here is the harmonisation across the

Union of intervention powers by National competent authorities as well as the creation of similar powers for ESMA. These powers will enable National competent authorities and ESMA, whenever it deems that there is *inter alia* a ‘significant investor protection concern’, to permanently or temporarily prohibit the marketing or sale of certain financial instrument or certain financial activities or practices.

***

Running through these four building blocks shows that building a better integrated capital market is much needed and that it requires considering carefully the protection of investors.

Ladies and gentlemen, the CMU is an ambitious initiative which we all need to support. Actions need to be taken to build this much needed union which is an appropriate response to build a strong, safe and integrated EU capital market which will allow the EU economy to flourish again.

The end goal should be a CMU based on an accelerated integration of the capital markets of the 28 Member States. This CMU should be competitive, efficient and provide a wide range of funding channels and the protection of investors should play a major role in building it. Because the CMU will only be successful if it is and remains trusted by investors.

Thank you for your attention.