

Preparing ourselves for the next storm

Cooperation in financial markets supervision in Europe

EMCI Annual Conference, November 22 2017, Paris

By: Merel van Vroonhoven, AFM

(12 minutes, 1330 words)

Ladies and Gentlemen,

We live in an era in which we have to find solutions to immense challenges.

Global warming and rising sea levels. Hurricanes and floods in one part of the earth, increasing temperatures and long periods of drought in other parts.

Climate is getting more extreme and we all realize that international cooperation is the only way to deal with the situation.

The Dutch have learned over the centuries that the defense against water is a challenge we could only take on if we share responsibilities and join forces to win. On a local, regional, national and international level. Floods don't stop at borders.

We solved the problem by investing in innovation, technology and knowledge. And in governance models to coordinate these efforts. In The Netherlands we are convinced that cross-border operating financial markets need supervision with similar levels of coordination, convergence and dedication for now and in the future.

It's not my intention to scare you by comparing man-made financial markets with the forces of nature. But we operate in a time of a rapidly changing playing field with strong forces.

As you all know, a strong force in the financial markets are the technological developments and digitalization. We see the use of big data, huge quantities of data that are stored in systems and subsequently exchanged over the internet, we see potential efficiency gains of blockchain technology in market infrastructures. On top of this we see robots marching into our world, juggling with data and algorithms. High Frequency trading and Initial Coin Offerings are impacting the capital markets. They are getting bigger and more differentiated.

The role of stock exchanges has drastically changed due to globalization and technological developments. Electronic trading makes high demands on the robustness of the trading. The possibility of placing orders based on algorithms is becoming available on a much broader scale.

Innovation also leads to new players and new earnings models, both locally in the Netherlands but also doing business from across our borders. New platforms create new – sometimes disruptive – opportunities. Companies like Apple, Amazon or Google might very well become the market leaders in the sector of the future.

So, it's clear that the financial sector is changing radically. This brings about a lot of opportunities but also imminent risks. As the ecosystem is changing, the challenges and risks become more and more overwhelming. And I am not only talking about the traditional capital market risks, but also about competition-related risks and data protection risks. Supervision on a national level is insufficient as violations and fraud often are taking place in multiple markets. Supervisors need to invest in data-driven supervision and strengthen their research methods, we need to be able to analyze huge quantities of market data.

Having said all this, I am truly convinced that individual supervisors will not be able to deal with the challenges just by themselves.

With this in mind, I think the Commission proposals on enhancing ESMA's role in the area of supervisory convergence is much needed. As are the proposals for centralization of tasks like direct supervision on certain prospectuses, data Reporting Service Providers and benchmarks. A well-integrated Capital Markets Union needs a Single Capital Markets Supervisor, and ESMA is best equipped to take up this role. I also believe that a stronger ESMA needs a different governance structure, in order to be able to deal with its tasks in a more independent way. I think it is important that ESMA has all the tools available to contribute to a joint supervisory culture. One of those tools should be the possibility to initiate Breach of Union Law procedures and to conduct independent reviews. Introducing an Executive Board, as the Commission proposes, would be very helpful to support an independent role for ESMA.

Of course, the devil will be in the details of the regulation, and I know that the proposals so far have been received with mixed levels of enthusiasm, but it is important that we do not limit our policy-debates to all kinds of legal discussions, although I do acknowledge the importance of European principles such as subsidiarity and proportionality.

In my view it is not a question IF supervision should be centralized, but HOW it should be done. For me it is evident that in the future supervision will move into the direction of more centralization. To me it's just a no-brainer that authorities in 28 member states should not have to individually build up very specialized expertise to deal with all new developments. The HOW question is intellectually more challenging. F.i HOW do we deal with the use of data? Different supervision organizations are involved. Who is the responsible authority? Look at the difficulties that occur with the introduction of PSD2.

I think the current proposals could be seen as the bare minimum of what is needed to come to a central hub and spokes model with a pivotal role for ESMA. We need to take it a step further. I think a lot can be learned from what is called in the management literature co-creation. Supervisors will all have their specializations, based on their experiences and home markets. A network based on co-creation will enable us to jointly work on the desired supervisory outcomes. We need to support each other by sharing data, market intelligence, IT systems, creativity and knowledge. And to really improve our outcomes, we also need to think beyond the current supervisory community. I think we need to tap into the data and creativity of scholars, market participants, and investor organizations. ESMA can play a huge contribution in bringing together all the bits and pieces of what is needed to effectively supervise the capital markets.

I must admit, I don't have all the answers, but I know for certain that financial markets are changing rapidly. The only way to protect consumers and investors, is to be constantly able to adapt to a rapidly changing market.

Supervisors need to be agile. We therefore need to transform ourselves into a supervisor 2.0 or even 3.0, which is fast, alert, and can deal with today's and tomorrow's challenges. If the big data owning companies are increasing the market position based on 'digital & online first', we could learn from that and prepare to follow the same track.

After all, wherever the market will bring us, we – supervisors - will still be responsible for our citizens. A responsibility that will become more challenging once the markets enter deeper into unknown territory with yet unknown players and yet unknown services and products. To be clear, we have to adapt and transform. If we do nothing we end up supervising Jurassic Park while the real world is already operating in another dimension. Far beyond our supervision.

Ladies and Gentlemen, it's time to enjoy dinner.

I would like to close my introductory remarks with a metaphor. An American metaphor for courage is the tale of Hans Brinker: A little Dutch boy that saved his village by putting his finger in a hole in the dyke. It's typically the way Americans like to see it. In Holland we use 'putting your finger in the dyke' as an expression of useless behavior. We know it will not stop the water. One boy cannot prevent us from drowning. The only solution is to strengthen the dyke together to prevent it from collapsing. This might not be needed today, but we know for certain there will be another storm and spring-tide in the future. And we need to be prepared for that big one.

This is not different in financial markets. We know storms will come, and we know we should be prepared. The moment to start preparing is not tomorrow, it is now. As I said, the proposals of European Commission offer a much welcomed first step. But I would strongly advise to go beyond that and create a market supervisor that has all the instruments, data and intelligence to deal with today's and tomorrow's market challengers and challenges. Whoever and whatever they may be.