

## **Speech Tanya Pieters-Gorissen (AFM) at AFME's 6th Annual European Compliance and Legal Conference**

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**Speaker: Tanya Pieters-Gorissen (AFM)**

**Title:** Three high-impact issues: the energy crisis, the reliability of the trading lifecycle, and digitalisation.

### Introduction

- Thank you for inviting me. I am happy to be here as these are interesting times.
- There are many interesting topics being discussed during these days. And that is hardly surprising, as the capital markets are experiencing lots of volatility these days.
- That volatility is mainly due to the Russian invasion of Ukraine.
- Russia has throttled the gas supply, resulting in a gas crisis. Companies and consumers. Everyone is feeling the pain of the high energy bills.
- High energy costs are driving up the rate of inflation, which is eating into incomes. As a result, economic indicators are in the red.
- We can no longer take anything for granted.
- That holds true for you, but obviously for me, too.
- Normally, in the autumn months I enjoy reading a book in front of my heater in my spare time. But this autumn, that's not such a good idea.
- Not that I mind, really. I don't even have the time to read a book now. Because there is no end in sight to the current turmoil.
- There is a lot of speculation about compensation for businesses and consumers, and in some countries, governments have already introduced support measures. Political pressure is building to mitigate the consequences of inflation.
- That is why I am very interested to see what steps the European Union will take.
- The gas crisis and soaring inflation have triggered a search for solutions. I recognise the need for solutions to these problems, but at the same time I am focused on how the financial markets will hold up.
- How do we guarantee fair trading behaviour under these tense conditions? How do we ensure that the markets remain transparent and robust?
- Those are key questions for us as a supervisory authority. But obviously also for you. It is essential that market parties continue to have confidence in the fair and orderly functioning of the market.
- We all want to see an end to the turmoil. But the fact is that we are confronted with volatile markets and tension,
- and the big challenge we face is how we can deal with that wisely.
- Today I want to discuss three high-impact issues: the energy crisis, the reliability of the trading lifecycle, and digitalisation. As part of the latter issue, I will also discuss the Digital Operational Resilience Act or DORA.
- I will outline the risks associated with these issues, but I will also look ahead. What can we as a supervisory authority do to reduce the risks? And what you yourselves do?

### The energy crisis

- The first issue I will be discussing dominates the headlines these days: the energy crisis.
- When the gas supply was throttled, the demand for gas fell, but this decrease did not keep pace with the reduction of the gas supply. This has driven up gas prices dramatically.
- Do we as the AFM see this as problem?
- Yes, when it comes to the impact on people's cost of living, we obviously do.
- And when it comes to our supervisory role, do we need to intervene? That raises questions about the where, the how, and above all the 'why' of any such intervention.
- Of course I understand that some would like us to intervene. But intervening in the capital market as a supervisory authority... That is not at the top of my priorities list.
- My top priority is 'transparency and robustness'.
- Let me explain why.
- The gas price quoted on the Dutch Title Transfer Facility traded on ICE ENDEX here in Amsterdam is the leading reference price for gas in the EU.
- Given the current unpredictability of market conditions, increased price volatility and high price levels, it is all the more important that the process of price formation is transparent.
- Fair, orderly and accessible trading is pivotal to transparent pricing.
- Our priority is to ensure that the market functions properly, so that market participants can be confident that the prices formed there are fair. As a supervisory authority, we focus on protecting the integrity of the market, as well its robustness and infrastructure. We do this by actively monitoring pricing, trading activity, unusual trading behaviour and market concentrations. We also focus on safeguarding sufficient transparency to enable insight into prices, activities of market parties and concentration risks.
- The Dutch TTF futures market so far, continues to function adequately, despite the high volatility. An important indicator for the functioning of a market is the level of liquidity. Key liquidity indicators are the number of active market participants with different strategies, trading volume, and open interest. Although these indicators were affected in the TTF futures market, overall liquidity remained strong for now.
- Most trading in TTF futures contracts still primarily takes place on-venue. Open interest, which is the sum of all open positions, has halved since the start of the war. This applies to both futures contracts expiring in the coming months and contracts with a longer term. Incidentally, open interest has remained constant since then. Overall, the TTF futures market remains highly liquid in both absolute and relative terms.
- Thanks to robust risk management instruments, sufficient capital and a clear regulatory framework at both central clearing counterparties and clearing members, the post-trade chain also appears to be robust in these times of increasing volatility.
- The margin levels of parties being kept at clearing members and those of clearing members at CCPs are considerably higher than before. While the size of the margins is unprecedented, this is also sign that the measures that have been taken to prevent procyclicality are effective.
- This framework, built after the financial crisis on the basis of the principles of transparency and central clearing, has proved its value before. Both during the Brexit transition and during the pandemic. While this inspires confidence, it should not make us complacent. Because we are already seeing that the higher margin requirements are affecting clearing members and the market participants trading through those clearing members.
- And we do hear the calls for intervention, especially when prices are high or when there is a big impact on specific participants, as is the case for utilities in the current crisis. But there is also this old adage that the price is usually right. In other words, when market parties disagree

with prices, that does not necessarily mean that the market is not functioning. We have not seen the market yet shift away from fundamentals.

- However, 'not intervening' does not mean adopting a laissez-faire approach.
- Within ESMA we have set out clear course in terms of what the supervisory authorities in Europe should and should not do within the scope of the current regulatory framework.
- The key message here is that we must prevent any spillover of risks to the financial sector and enhance the current tool kit of supervisory authorities.
- We are sceptical of reducing margin requirements or using circuit breakers as a price ceiling. Rather, we prefer to focus on finding ways to sufficiently stabilise the market when necessary and to reduce the pressure on clearing members and CCPs.
- We are also trying to learn from this crisis and we are open to suggestions. We are seeing that the current crisis has especially hit hard among non-financial parties, and governments are intervening to support them. Many of these parties are currently exempt from the capital, licensing and transparency requirements that apply to many financial parties in this market.
- The AFM recognises the added value of putting in place similar supervision of such parties, particularly those trading in energy derivatives, and requiring them to have sufficient capital and liquidity to meet their margin obligations. We also want better insight into their positions and activities. And we expect these parties to be more proactive in their risk management, so that they are well prepared for market shocks. We cannot have a situation where insufficiently regulated parties are adding unnecessary systemic risk and where there is no level playing field with financial parties.
- The system is still functioning. But it is essential that all market parties are resilient and remain resilient. We must prevent that the energy crisis triggers a stability crisis.

### **Reliable trading chain / resilient market**

- This brings me to the second key issue I want to discuss: the reliability of the trading chain. In other words, having a resilient market.
- The scope of the debate about an orderly and robust market extends beyond the gas market and beyond the issues of fair pricing and a stable infrastructure.
- It is essential that key components of the financial markets are always adequately controlled. This ensures the continued accessibility and reliability of trading, clearing and settlement, even in times of stress.
- To monitor this, in our supervision we focus on the reliability of the trading chain and the resilience of the market.
- We also want to create room for innovation. This may be necessary due to the emergence of new financial instruments like crypto derivatives and new technologies like distributed ledger technology. We encourage such trends when they enhance the reliability and accessibility of the trading and settlement chain. But we obviously draw a line when the reliability of the chain is jeopardised.
- Due to the interconnection and interdependence of their market players, capital markets are perceptive to the loss of any single player in the infrastructure, such as a trading platform, a CCP or a critical benchmark.
- Our supervision is focused on reducing this interdependence. Also given that this is an European-wide issue, the AFM conducts this supervision in collaboration with other supervisory authorities across Europe and in the Netherlands. Our joint goal is to control the risks in the entire European trading, clearing and settlement chain.

- A resilient market is a market without single points of failure. It is a market with multiple providers and competition between providers, which forces them to innovate.
- To make this possible, the market needs to be transparent, with acceptable barriers to entry for new competitors.
- This in turn requires that market participants have proper and timely access to accurate trading information. The AFM not only monitors compliance with transaction reporting and transparency requirements, but also advocates the establishment of a consolidated tape.
- Such a centralised system for the collection of trading information and the accessibility of market data and centralised reference prices is essential to the orderly functioning of capital markets. And it is also essential for investors when making investment decisions.
- At present, the European market is highly fragmented, with dozens of national regulated markets and trading platforms. This has given rise to a strong need for readily available and accessible centralised price information. The AFM recognises this need and has prioritised addressing it.

### Digitalisation

- The need for robustness applies not only to the chain as a whole, but certain also at the level of individual financial institutions.
- The structure of the markets and the behaviour of trading parties are being impacted by technological developments, extensive digitalisation, continuing internationalisation, and an increasing focus on sustainability.
- In this respect, I want to discuss the impact of digitalisation on your operations in particular.
- We are seeing that electronic trading systems and algorithmic trading are steadily gaining ground. This is a very positive development, also because we want to see more trading through multilateral systems where multiple parties can interact with each other.
- A particularly positive development I see is on the bond markets, where a clear shift is happening from voice-driven bilateral trading to electronic trading on trading platforms.
- For low-touch transactions, this creates more transparency and freedom of choice for the buy side. And we are seeing new players like electronic market makers, are entering this market, which used to be dominated by banks.
- But these developments also place different demands in terms of ensuring adequate operations and robust processes
- Fortunately, many risks are already covered by the MiFID framework, which sets organisational requirements and requirements for effective systems and controls at the level of individual firms
- But the current regulatory framework does not cover all risks.
- Unfortunately, digitalisation inherently increases the risk of cyber threats. Particularly now that electronic trading systems are gaining ground, it is essential that these risks are adequately mitigated.
- The EU aims to mitigate these risks significantly by introducing the Digital Operational Resilience Act or DORA, which addresses overall digital resilience and cybersecurity in particular.
- This large package of European legislation has the following goals:
  - harmonising the currently fragmented requirements for digital resilience across the EU;
  - creating a basic framework for financial firms currently not covered by regulation in this respect; and
  - reducing the risks associated with the outsourcing of services by the financial sector to critical ICT third-party service providers.

- The AFM welcomes this new legislation and this new mandate. There will undoubtedly be further crises and the market will therefore remain unpredictable. But we hope these new instruments will enable us to ensure the continued accessibility, availability and reliability of the market in the event of another crisis.
- At the same time, we are well aware that the introduction of DORA will require you to change gears quickly to meet the following requirements:
  - You will need to have a sound, comprehensive and well-documented risk management framework also in relation to any outsourcing risks when using third party service providers
  - You will need to put in place policy mechanisms to identify ICT risks
  - And to ensure to address ICT incidents DORA properly.
- The AFM recognises the usefulness of innovation and technological developments, but it is essential that they do not jeopardise the proper and safe functioning of the market. By putting in place the applicable measures, including those prescribed by DORA, we can jointly ensure the continued accessibility, availability and reliability of the market, also in the event of a crisis.

### Ladies and Gentlemen

- I have discussed three key issues affecting the capital markets: the gas crisis, the reliability of markets, and the impact of digitalisation.
- Addressing these issues will require a lot of work.
- Both on your part as financial firms and on our part as the AFM.
- We will assess whether you, the individual market players, manage to put in place adequate operational resilience, with a specific focus on digital resilience, ethical trading behaviour and adequate transparency.
- However, we will not be constantly pointing a finger at you like a stern headmaster.
- I am a big proponent of maintaining a healthy dialogue. But at the same time we will of course maintain our autonomy as a supervisory authority.
- This is the only way that we can together ensure an open, reliable and resilient capital market.
- Thank you for your attention.