

## PRESS RELEASE

### ESMA sees continued tense securities market conditions

The European Securities and Markets Authority (ESMA) has published its Report No. 1, 2015 on Trends, Risks and Vulnerabilities in European Union (EU) securities markets, covering market developments from July to December 2014. The report finds that market conditions in the EU have remained tense, with high asset valuations, stable asset prices over time but with rising short-term price volatility across key markets. There were strong price movements in foreign exchange and commodity markets; overall capital-market issuance for corporate funding continued to increase.

Sources of market uncertainty included the low-interest-rate environment, public debt policies in EU Member States, strong swings in exchange rates and commodity markets, and political and geopolitical risks in the EU's vicinity – all of which resulted in increased levels of liquidity and market risk, whilst contagion and credit risk remained at high levels.

ESMA also monitors market developments which may present future vulnerabilities. ESMA's report for the last half of 2014 identified the following potential issues:

- **Fund investments in loans:** the growth of funds investing in loans is one of the most consistent trends in the EU fund industry, with Assets under Management multiplying fivefold in the last two years, albeit from a low base. Whilst this offers a portfolio diversification opportunity, exposure to credit and liquidity risk is created. The report finds that loan origination funds could contribute to SME financing but also indicates that the financial-stability risk, which may be created, would need to be addressed by harmonised and adequate macro and micro-prudential supervision.
- **Smart beta strategies:** alternative index products have grown rapidly since the financial crisis. While they minimise certain weaknesses of traditional market capitalisation-based indices, they expose investors to different risks – such as increased exposure to sector

volatility. Alternative index products are often more opaque with a low level of transparency which it makes it difficult for investors to understand their risk-return profile. ESMA's report therefore sees that the main risks are related to the limited transparency of their constituents, weights, methodology and simulated past performance.

- **Monitoring systemic risk in the hedge funds industry:** the ESMA study presents new indicators for the monitoring of systemic risk in the hedge fund industry, based on sector-wide aggregated individual interdependencies of performance rates between individual hedge funds and the entire industry. This information is extracted by using a large set of fund-individual regression analyses and aggregating significant coefficients found across the industry. The results obtained show that the proposed indicators identified almost all financial crises, included in the reporting sample (January 1995 to October 2013). The methodology can be applied to both the global and the EU hedge fund industry and will be useful for further analysis of the sector.

ESMA's report looks at the performance of EU securities markets, assessing both trends and risks in order to develop a comprehensive picture of systemic and macro-prudential risks in the EU that can serve both national and EU bodies in their risk assessments.

### **Next steps**

As part of its on-going market surveillance, ESMA will update its report semi-annually, complemented by its quarterly Risk Dashboard.



## Notes for editors

1. ESMA is an independent EU Authority and works closely with the other European Supervisory Authorities responsible for banking (EBA), and insurance and occupational pensions (EIOPA), and the European Systemic Risk Board (ESRB).
2. ESMA's mission is to enhance the protection of investors and promote stable and well-functioning financial markets in the European Union (EU). As an independent institution, ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. ESMA contributes to the regulation of financial services firms with a pan-European reach, either through direct supervision or through the active co-ordination of national supervisory activity.

Further information:

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