Risks and opportunities of a digital capital market
World Investor Week

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Bom Dia. Agradeço a Gabriela Figueiredo e à CMVM o convite para participar neste importante evento. É um verdadeiro prazer para mim abrir esta conferência e lamento ter de o fazer remotamente.

I am afraid I have exhausted my Portuguese and, if you allow me, I will have to continue in English.

This is an important week. We are here celebrating the World Investor Week. In Spain, we also celebrated on Monday our Day for Financial Education and these initiatives show that financial decisions are key for our lives and especially for the younger citizens. I am told that an important part of the audience today is composed by young citizens, so I will focus most of my remarks on them.

Last week, I was talking to a young man in his early twenties about the initiative of a financial education day. To my surprise, he dismissed the concept, saying that finance was something for rich people or speculators. Of course, I told him that I thought he was wrong, that finance is present at every stage of our lives and that affects the ordinary person as much, or probably more, than the wealthy. Finance is at the heart of how young entrepreneurs can fund their ideas and their projects, which in turn will determine how much employment our societies can generate. It is at the heart of how a family plans a future for their siblings, how a couple structures a common project or even of how immigrants can operate in the hardship of starting a new life in a different country. It has also all to do with our rights as citizens and informs how we influence political decisions through democratic processes, for instance when discussing how much public debt should a country have and how that affects future generations (that is a purely financial choice, between generations).

But the beauty of finance is that it follows the way that societies evolve, especially with respect to younger generations. In just 5 or 7 years, two concepts have appeared in the financial world (both banking and securities markets) that were previously absent from the discussion: digitalisation and sustainability. And both have a lot to do with the way that young Portuguese, Spanish or European citizens see the world.
Sustainability

The first obvious link is sustainability. The pace at which environmental sustainability has entered the debate in financial markets is intimately related to the importance that new generations give to it, since they are the most affected ones by climate change. But also with respect to other dimensions of sustainability, like the social one. My feeling is that, although 90% of the discussion is now around incorporating the environmental dimension, in a few years the Social and Governance components within the ESG dimension will be as important as the Environmental one. But I think the word discussion is probably misleading. We are indeed discussing about how the regulations should oblige issuers and investors to disclose data about the sustainability of financial products, but nobody is discussing anymore about whether to do that or not. In other words, the sustainability element is here to stay and it is only the pace (taking into account transition risks) and details that need to be ironed out.

Europe is leading the world on the regulatory thinking and we are also one of the jurisdictions in which the sensitivity to converge to financially sustainable products is the highest.

Digitalisation is clearly the other axis over which the financial sector is getting transformed. In biological terms, I would even say that it is mutating into a different animal. The number of new services, new features or new products that we see each week is stunning. Access to financial markets is easier than ever and it seems it is going to get better.

Whole sectors of the population that had not thought of getting close to financial markets are now flirting with the idea, thanks to technological developments. And one above all others, the Distributed Ledger Technology or DLT, has the potential to revolutionise many processes.

But this also comes with risks. I am very fond of exploring how DLT can boost efficiency and security. Cryptoassets are a very broad category and in a few years, many shares or bonds will be cryptoshares or cryptobonds. A particular category is cryptocurrencies. Those are products that do not have any intrinsic value or payment promise and that depend purely on the demand prospects and the acceptance as a mean of payment and deposit of value. As much as I am confident on the benefits of DLT for the financial sector, I am at the same time quite sceptical about the value that cryptocurrencies will bring for investors in the long run. Beyond the profits (and losses) in periods of extreme volatility, no cryptocurrency will succeed in the long run unless it becomes stable as a means of payment and a store of value. Volatile cryptocurrencies will not succeed in becoming an accepted means of payment and a store of value trusted by a majority. Nobody wants to get paid in a currency that can fall 15% within the same day. When they stabilise and become an accepted means of payment, such stabilisation, will in turn erase its attractiveness as an investment in the long term, given that by definition, they do not produce any interest. In other words, to put it bluntly, if a cryptocurrency is volatile and profitable, it will not last as a currency and if it lasts, it will stop being profitable.

Of course, there may be shorter term investment opportunities, but as we have seen these come at a huge risk. That's why financial market supervisors are warning about investing in cryptocurrencies. I know that many young people may see us as old-fashioned, conservative institutions attached to the status-quo. But trust me, as opposed to what some say, our concerns do not come because we are worried that it might turn upside down the current financial system. If it is for the better, I would not have any problem with that. It is not either because we see income and business changing from traditional finance into cryptofinance. We have seen many tidal waves in financial markets in the last 30 years (from bonds into equities; from deposits into investment funds; from funds into hedge funds; from hedge funds into private equity...and so on). Our concerns come purely because of our investor protection mandate: we see the potential damage that risky decisions in an unregulated world might have for millions of investors if they do not weight the risks very carefully.

Probably one of the most obvious changes brought by digitalisation is connected trading: the interaction between final investors in internet fora or social media and the activation of groups or communities in order to trade jointly, simultaneously. This became evident during the Gamestop case in the US.

Social media have changed many aspects of our lives. Demonstrations, parties or public criticism are organised in a totally different manner than 15 years ago. The same happens with trading by retail investors. There is nothing wrong about exchanging views in fora or social media about a company and whether it is interesting to buy or sell. But if a group on investors, cooperate to intervene simultaneously in the market so as to push the price of a stock to a certain level, that could amount to market manipulation. And it does not matter whether they are a bunch of youngsters chatting through Telegram or top hedge fund executives chatting over a drink.

This trend can also affect market dynamics. It touches upon matters like how to apply the investment recommendations regime in the Market Abuse Regulation to individuals that, although not professionally, present themselves as experts in a social network. When someone presents him or herself as an expert on financial instruments and recommends to others a trading strategy or simply to buy or sell some financial instrument, that person needs to act according to certain rules. He needs to disclose for instance whether he has an interest in those products (long or short). I have seen several times in my life a person recommending to buy something just because he had bought it previously and, when all the followers bought and the price went up, he would be secretly selling his stock before the others and making a profit at their expense. And, of course, every single time we have seen that, such person was fined and sanctioned, since this is a violation of market rules. What I am trying to say is that, when trading within a community, we need to be very vigilant and careful, since group dynamics, especially if led by people with low moral and legal standards, can lead to conducts that breach the law.

The Gamestop case points out the power of connected trading and poses pretty fundamental questions on how preferences and passion by many small investors can alter price formation. I firmly believe this requires regulators to think seriously about these dynamics. Regulators should be exquisitely neutral on this and we should avoid any politically-tainted discussion or any sense of David vs Goliath. We should apply the law evenly to small or large investors, professional or retail, European or foreign and, importantly, long or short. And we should also ensure that firms regulate the flow of client orders based on risks and well established criteria, not on their commercial interests. My impression is that regulators have the right legal tools to tackle this matter, but we need to reach parts of the population that are not necessarily aware of market and trading rules, in order to increase legal awareness.

The connection between regulators and regulated entities is strong and the latter tend to follow what the former say. But that is not the case with the general population. The easier the access through digital devices, the wider the spectrum of the population that is engaged in some manner with financial markets. And that poses conduct risks, as we have just seen. So regulators need to re-think how they communicate their messages, warnings and requests towards society as a whole. We also need to go digital on that and improve our communication strategies.

Another element closely related to digitalisation is the apparent reduction in commissions by some new entrants, typically new fully-online brokers called neobrokers. In some cases, the reduction in commissions is achieved by being more agile, responsive and direct than traditional players which makes them more competitive and efficient. That is excellent news.

But lowering costs can also have a hidden face. It can be achieved by charging commissions (not to clients but) to trading venues or investment firms that pay them to receive their order flow. Doing so is a dangerous way to go and is likely to run against the interests of the investors and clients. If your provider does not charge you an explicit commission but charges a worse price, you may be worse off. It is like those foreign exchange booths that you see in airports with a big sign saying "No Commission". Usually the commission is included in the spread and the price you pay or get for your currency. So it is important to do your analysis and decide with all the information. Since the incentive to camouflage explicit commissions worsening the prices for the client is high, and not all clients might do the numbers, regulators are vigilant about this practice.

I think we should also be aware that with the pandemic, the increased use of mobile devices to access information and the low interest rates that traditional fixed-income products yield, the environment has become a good breeding ground for financial scams, which these days come attached to the most volatile products, cryptocurrencies. But this is no news: in every historical period, scams have been conducted with the assets showing larger price movements. It could have been spices in the 16th century, tulip bulbs in the 17th century, silver in the 18th, gold in the 19th or real estate in the 20th. It is only logical that bubbles and fraud go hand in hand.

The mechanisms through which rational and sometimes educated or highly educated people fall into a scam, are quite complex. Behavioral economists have dedicated their life to understanding why people believe that they know better than others, why people underestimate the risks if presented with a big prize, why they filter information and retain only the positive one, etc. One famous effect if the so-called FOMO (the fear of missing out an opportunity within a community, when everybody else is doing something). All that can push rational people into dodgy or even fraudulent financial investments.

Here supervisors (but also prosecutors and judges) have a role to play, although it is harder to tackle. It is very hard to prevent someone to put at risk his or her wealth if they are really decided not to "miss out an opportunity". There are only two things we can do: improve the mechanisms to detect and punish fraudsters and improve the financial literacy and the investor education of the population.

This leads us obviously to financial education. I truly believe that no investor is better protected than a well-educated and well-informed investor. If you allow me the analogy, financial literacy is a kind of "lifevest", which we should wear at all times, against financial and economic storms. But financial supervisors like CMVM and my own organisation, cannot rely just on the "lifevest in a boat" to ensure the financial safety of the passengers. We also need to check that the boat is in good order and that the captain knows what he or she is doing.

In financial regulation there have been two extreme positions during the years, with an infinite array of intermediate states. One claims that investors are fully responsible for their acts and, provided they are well informed, the public sector should intervene as little as possible. The other, places the onus on the controls by public authorities, with little room for the role and the decisions of the investor. I am personally against both, since finance is way too complex to adopt a simplistic approach.

Public investor protection, even with a high level of financial literacy or even expertise, will always be required. That's why supervisors and regulations exist and it's also why the discussions around financial regulation are so important.

But I would not like to conclude putting too much emphasis on risks. it is important to engage in financial markets, with proper information and education but also with confidence. Especially the younger end of the population, will benefit from relying on financial investments more than their parents, who relied in real estate and bank deposits probably too much. Young entrepreneurs can benefit from financial markets too, by using them as leverage to expand their projects, thinking big and losing the fear of incorporating new partners and investors to their projects. Even going public, as a listed company, when the time is right.

That is the essence of the Capital Markets Union initiative led by the European Union: to incorporate more entrepreneurs and more individual investors to capital markets, for their benefit and also for the benefit of the European economy.
Let me conclude now. It is obvious that finance is changing at an incredible pace and in most instances for the better. In a few years time, financial markets will be quite different from today's but we will all continue to take financial decisions, even if through different means or on different products. Financial regulation has an important role to play in the way in which we incorporate those changes and channel them for the benefit of retail investors. But in the end, it's personal decisions and choices, based on proper information and financial education, what will determine the extent to which finance helps individuals to achieve their goals and dreams.
Thank you very much.