SWEDISH SECURITIES DEALERS ASSOCIATION

Stockholm, 2020-03-18

SSDA response to ESMA's consultation re. MiFIR report on systematic internaliser for non-equity instruments

The Swedish Securities Dealers Association (SSDA) welcomes the opportunity to respond to ESMAs consultation regarding systematic internaliser (SI) for non-equity instruments.

Please note that SSDAs response is based on discussions with members before the effects of the COVID19 breakout are known and we reserve the right to come back with additional comments. At this stage it is important that EU regulators take a very cautious approach to any regulatory changes which may have a negative impact on the ability for companies and Member States to issue bonds and/or hedge their risks.

Before responding to the specific questions, the SSDA would like to make the following general comments.

1. General comments

- The SSDA generally supports several of ESMAs proposals which, inter alia, aim at making the provisions regarding pre-trade transparency in art 18 MiFIR less complex. However, it should be remembered that some of the paragraphs in article 18 intend to ensure that the pre-trade transparency requirements do not expose SIs to undue risk. If SIs are legally required to take on risk which they cannot handle they will no longer be willing to execute transactions to the same extent they do today. Therefore, it must be ensured that the simplification of article 18 does not have the effect of limiting the ability of SIs to provide liquidity to the market. This is particularly important for smaller bond markets, such as in the Nordics, where liquidity is totally dependent on the ability of SIs to use their balance sheets to execute client orders in illiquid instruments.

- When reviewing the pre-trade transparency regime for SIs it is important not to look at article 18 MiFIR in isolation. In fact, the impact of article 18 on SI trading is highly dependent on the rules regarding liquidity assessment of instruments and/or SSTI thresholds.

- The MiFIR transparency requirements intend to increase the efficiency of the price formation process (recital 15). However, to SSDA's understanding, clients do not currently use the pre trade MiFIR data. In the context of a review, it should therefore be a priority to ensure that the data becomes more meaningful and accessible to clients. In this connection, it is important to consider that the "non-equity" category includes very different types of instruments. For instance, liquid equity derivatives have other characteristics and are traded in a very different way compared to bonds or emission allowances.

- According to the SSDA, the application of transparency and best execution requirements for derivatives has created a lot of legal uncertainty and administrative burden for EU investment firms. At the same time, the information published is of little use (and even confusing) to clients. In our view the solution to this problem is to exclude OTC-derivatives. In addition, further analysis needs to be made of the "ToTV" concept. To our understanding, the current interpretation implies that a new ISIN will be created each day for some derivatives. This process leads to that comparisons between instruments will not be possible, and hence that the information that is the outcome has little or no value to clients.

- The current non-equity liquidity data register (FIRDS) presents some challenges with regards to automating the publication of prices on a pre-trade basis. In order to make the register more user friendly for investment firms and their clients, the liquidity assessment should be available in both human readable and machine-readable format. Moreover, additional measures should be taken to improve the quality of pre trade data. SSDA considers that a higher degree of standardisation would be helpful in this respect e.g. as regards ISINs and CFI codes.

2. Specific questions

Q 1: Do you consider that there is a need to clarify what a "firm quote" is? If so, in your view, what are the characteristics to be met by such quote?

No, the SSDA does not consider that there is a need to clarify in MiFIR what is a "firm quote". To our knowledge there has not been any problems in this area we see a risk that a legal definition could increase the complexity of the SI-rules even further.

Q2: (For SI clients) As a SI client, do you have easy access to the quotes published, i.e. can you potentially trade against those quotes when you are not the requestor? Do you

happen to trade against SIs quotes when you are not the initial requestor? How often? If it varies across asset classes, please explain.

The SSDA response is from a sell-side perspective.

Q 3: What is your overall assessment of the pre-trade transparency provided by SIs in liquid non-equity instruments? Do you have any suggestion to amend the existing pre-trade transparency obligations? If so, please explain which ones and why

Our over-all assessment is that the pre-trade transparency regime in MiFIR is of little value to the market participants active on EU non-equity markets. To our understanding, the SIs abide by the rules in MiFIR, but clients choose other sources of information for their trading.

On the Swedish bond market there is little experience from the application of the pre trade transparency requirements since most SEK bonds (sovereign, covered and corporate) are illiquid and trade in very large sizes, i.e. above SSTI. As noted during the negotiations of MiFID II, pre-trade transparency requirements are not well-suited for this type of market since requirements to disclose firm quotes to the public and enter into transactions with others could have a negative impact on the ability of SIs to trade large transactions against own account which in turn would harm the liquidity and, in the end, the real economy. Thus, our view is that the pre-trade transparency requirements in article 18 MiFIR, including the important phase-in regime of RTS 2, is well-calibrated since the rules mainly apply to liquid bonds trading in small sizes, i.e. typically retail bond markets in EU.

As regards derivatives, the SSDA is less convinced that the pre-trade transparency regime provides valuable information to the market – even below SSTI. As mentioned under General Comments, one solution could be to exclude OTC derivatives from the scope.

A general problem, which we know that ESMA is already aware of, relates to the poor data quality of the pre trade data. The SSDA thinks that additional level of standardization of ISINs, CFI codes etc. could be one measure that would help to address this problem. We have noticed that the same instrument (ISIN) can have different CFI codes from different venues. This also means that different venues in some cases classify the same instrument as different asset types which could lead to different LIS/SSTI values. It would be good if the CFI codes could be more aligned so that a specific ISIN would be classified as the same asset type by all venues. It would also be good if the MiFIR Identifier could be a part of the FIRDS data.

Q 4: (For SI clients) do you have access to quotes in illiquid instruments? If so, how often do you request access to those quotes? What is your assessment of the pre-trade transparency provided by SIs in illiquid instruments?

The SSDA response is from a sell-side perspective.

Q 5: (For SIs) Do you disclose quotes in illiquid instruments to clients upon request or do you operate under a pre-trade transparency waiver? In the former case, how often are you requested to disclose quotes (rarely, often, very often)? Does it vary across instruments / asset classes?

In SSDA members' experience, investment firms abide by the rules and disclose quotes to clients on request. Many members also operate under the article 9.1. waiver.

The SSDA agrees that the circular construction between article 18 and 9 MiFIR is not optimal and would support a full harmonization of the waiver regime for illiquid instruments.

No clients have asked to see quotes provided to other clients in illiquid instruments. We therefore support that this part of article 18.2 is deleted. In our view, there are good arguments why the obligation to disclose quotes to other clients in 18.2 could be removed as it has little practical meaning and this measure would simplify the rules (see response to Q 9).

Q6: Do you consider that there is an unlevel playing field between SIs and multilateral trading venues active in non-equity instruments, in particular with respect to pre-trade transparency? If so, please explain why and suggest potential remedies

Yes. The SSDA considers that the pre trade transparency rules are more stringent for SIs than for multilateral trading venues since SIs are required to make firm quotes available to clients (18.5) and enter into transactions with other clients (18.6). As ESMA rightly notes, SIs put their own capital at risk which makes them more vulnerable to transparency requirements than a trading venue, in particular as SI trades are not anonymous. In order to create a more level playing field we therefore strongly support proposals to delete the above-mentioned obligations for SIs (see response to Q8). It could also be considered to introduce a possibility for SIs to anonymise quotes.

The SSDA wishes to underline that the structure of non-equity markets differ depending on Member State and type of instrument in question. It is therefore important that the EU rules allow for both bilateral and multilateral trading and that the transparency regime take the differences in business model into account. If the rules force SIs to inter into transactions which are deemed to create risk that cannot be properly handled, SIs will no longer be able to provide liquidity to the market to the extent they do today which will have negative consequences for the real economy. In fact, if the current regime in article 18.6 is kept unchanged, future increases in the SSTI levels or changes of the liquidity assessment could become detrimental to the well-functioning of EU bond and derivatives markets.

The discussion around SI networks is in our view an equity-related issue. In our experience, SIs which are active on the Swedish non-equity market provide quotes on a bilateral basis either on the phone, though electronic systems or via trading venues facilities (see also response to Q7).

Q 7 (for SIs who are also providing liquidity on trading venues): What are the key factors that determine whether quote requesters (your clients) want to receive the quote through the facilities of a trading venue or through your own bilateral trading facilities?

The key factor that determine where clients want to trade is where the liquidity is. In many Member States, the characteristics of bond and derivatives markets (illiquid instruments, large sizes and few market participants) make multilateral trading on a venue significantly more difficult than for shares. Therefore, liquidity is provided by SIs who execute client's

orders against their own balance sheet. Such bilateral SI trading is tailored for the specific clients' needs and allows the client to buy/sell large volumes quickly and with little market impact.

As a result of MiFID II there has been a development of new technology which has facilitated for market makers to also provide quotes though the trading venues systems and under their rules (a type of "on venue trade"). Certain clients prefer this type of trading since it means that the venue will take care of their regulatory reporting requirements.

As mentioned above, the SSDA takes the general view that is to the benefit of clients that EU regulation allow for different types of execution venues, i.e. both bilateral and multilateral.

Q 8: What is your view on the proposal to simplify the requirements in relation to SI quotes in liquid non-equity instruments under Article 16(6) and 18(7)?

The SSDA supports ESMA's proposal to delete both article 18(6) and article 18 (7) since it will create a level playing field with trading venues, limit undue risks for SIs and make the pre trade transparency regime less complex.

In particular, we agree that the obligation to enter into transactions with other clients in article 18(6) shall be abolished. An SI will agree to trade with other clients at the same price on a case-to-case basis when this is sensible from a commercial perspective taking into account factors such as the counterparty risk. An SI should not be forced by EU regulation to provide liquidity in situations where it considers that it cannot properly handle the counterparty risk. Such rules can have the effect of SIs withdrawing from the market.

In this connection, we also propose that ESMA analyses whether any amendments are needed of article 18 (5), in order to ensure coherence following the proposed deletions.

Q 9: Do you consider that the requirements in relation to SI quotes in illiquid non-equity instruments (Article 18(2)) are appropriate? What is your preference between the options presented in paragraph 52 (please justify)?

The SSDA agrees that article 18.2 MiFIR is complex and that the circular construction with article 9.1 is not optimal.

The best solution would in our view be to remove the obligation to "disclose information to other clients" (Option 3) but we are concerned of the implication of the proposed "supervisory convergence" tool described in point 51. (Which concerns are such special monitoring aimed at addressing? What is meant by" the way SIs classify instruments as liquid" – the liquidity assessment is done by ESMA?). Due to these unclarities and the risk of creating an even more complex and arbitrary rule we cannot give Option 3 our support. The SSDA therefore prefers Option 1 (status quo) at this time.

We agree with ESMA that Option 2 would lead to the same circular and complex reasoning as the present regulation and is therefore not a good alternative.

Please note that whatever solution is chosen, it is important that the policy objective in article 18.2 is maintained, i.e. that SIs are not obliged to take on undue risk or be mandated to trade with clients in instruments that are not liquid.

Q 10: What is your view on the recommendation to specify the arrangements for publishing quotes?

The SSDA notes that there is no specific question in the consultation paper with respect to section 3.4.3 on "exceptional market circumstances". In this respect, we would like to underline that while we have no objection per se towards the development of a common understanding what is exceptional circumstances for non-equity, it is important not to copy paste the rules for equities but to ensure that those circumstances are in fact relevant for the different parts of the non-equity market. On many bond and derivatives markets, liquidity is provided by SIs that trade against own account and the exceptional circumstances should relate to distressed situations where that is no longer possible. For other instruments, where venue trade is more common such as equity derivatives, the comparison to equity is more justified.

As regards the type of publication arrangements referred to in section 3.4.5 the SSDA has no firm view as long as the flexibility is kept so that firms may publish on their website as well as though APAs. The detailed requirements on publication arrangements must be relevant for trading in bonds and other non-equity instruments.

One additional issue which the SSDA strongly suggests that ESMA and the Commission address in an upcoming MiFID review relates to the fact that SI data (the published prices) are considered by the trading venues to be "unlawful" derived data (from the trading venues own published prices) infringing on the trading venues industrial property rights to those prices. At present, many venues do not allow SIs to publish this information on the SIs' web-pages or through an APA unless they pay the venues for the data, i.e. SIs need to pay venues for complying with their legal requirements as SIs under MiFID/MiFIR. In practice, this has forced SIs not only to restrict the access to the information on their webpages to a limited number of logged in clients but also to pay unjust fees for the SIs' compliance with MiFIR. This system is in our opinion not fair and is not in the interest of clients nor the policy objectives of MiFIR regarding the price formations process or otherwise.[1]

The SSDA therefore suggests that in the in an upcoming MiFID review that ESMA and the Commission clarify that the SIs do not infringe on any industrial property rights of trading

[1] The trading venues disregard the fact that SIs are obligated to make public prices that reflects prevailing market conditions (art 14:3 and 18:9). According to art 10 in RTS 1 prices reflect prevailing market conditions where they are, i.a., close in price, at the time of publication, to quotes of equivalent sizes for the same financial instrument on the most relevant market in terms of liquidity for that financial instrument. The trading venues claim that the SIs is in breach of the market data agreements in place and will cut off all information feeds to the SIs unless the SIs either (i) pay the fees for an unrestricted disseminating of the "trading venues' data" to an unlimited number of potential recipients worldwide or (ii) restrict the access and pay the trading venues fees for those clients accessing the data.

venues when SIs are making public their prices according to MiFIR and that the trading venues are prohibited from contractually limiting or charging the SIs for the SIs' publication of the their quotes.

Q 11: Do you have any comment on the analysis of Bond data and the relation with the SSTI thresholds as presented above?

The SSDA appreciates that ESMA takes the opportunity to provide feedback from the data collection exercise in October 2019. The conclusion that there is no significant quoting and trading activity in bonds just above the SSTI thresholds (point 73) is in line with our expectations, i.e. that SSTI thresholds are not used to circumvent the rules.

Q 12: Do you have any comment on the analysis of derivatives data and the relation with the SSTI threshold as presented above?

The SSDA appreciates that ESMA takes the opportunity to provide feedback from the data collection exercise in October 2019. The conclusion that there is no significant quoting and trading activity in derivatives just above the SSTI thresholds (point 79) is in line with our expectations, i.e. that SSTI thresholds are not used to circumvent the rules.

13: What is your view on the influence of the SSTI thresholds on the pre-trade transparency framework for SI active in non-equity instruments? Are there any changes to the legal framework that you would consider necessary in this respect?

The purpose of the SSTI threshold is to handle the consequences of the "unlevel playing field" referred to in point 41-42 in the CP, i.e. the fact that SIs, unlike trading venues, are putting their own capital at risk and therefore are more sensitive to transparency requirements in particular when trading in large transactions, even below LIS. Keeping the SSTI threshold is therefore very important for the well-functioning of the EU non-equity markets. We also think that the phase-in of the SSTI thresholds was a very sensible measure and that it should be maintained.

However, as regards the methodology for calculating SSTI thresholds we can see some merit in changing from a variable threshold to a fixed threshold, since this would be an easier system for retail clients to understand. Wholesale clients typically have more resources to stay informed of changing variable thresholds. However, any such fixed threshold would of course need to be determined in a way so that the policy objective of protecting SIs against undue risk is fulfilled. The level of the threshold may differ depending on the type of instrument at hand.

Q 14: What is your view on the best way for ESMA to fulfil the mandate related to whether quoted and traded prices reflect prevailing market conditions and in particular: (1) the source of data for the SI quotes/trades (RTS 27, APA); (2) the source of market data prices; and (3) the methodology to compare the two and formulate an assessment?

The SSDA is sympathetic towards the difficult task that has been given to ESMA to determine whether quotes and traded prices reflect prevailing market conditions. In our view, the best would probably be to get data from APAs, provided that the data quality can be ensured. In

our opinion, the usefulness of the RTS 27 report is very questionable in general and in particular as a reliable source for data regarding SI trading.

Also, we would like to underline that a key issue is how the words “reflect prevailing market conditions” is interpreted by ESMA.

Finally, please see response to Q 10 relating to the problem that many venues consider that SIs need to pay them for complying with their legal requirements according to articles 14.3 and 18.9 MiFIR. In practice, this has forced SIs not only to restrict the access to the information on their webpages to a limited number of logged in clients but also to pay unjust fees for the SIs’ compliance with MiFIR. This system is in our opinion not fair and is not in the interest of clients nor the policy objectives of MiFIR regarding the price formations process or otherwise.

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