

Stockholm 4 June 2021

SSMAs response to ESMA Consultation Paper re. RTS 2 Annual Review

The SSMA welcomes the possibility to provide comments to ESMA's Annual Review of RTS 2.

1. General comments

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

a. Market makers are important for the well-functioning of fixed income markets in the EU

Fixed income markets are heterogeneous by nature and include different types of instruments, issuers and investors. It is therefore important that the regulatory framework in MiFID II/MiFIR allows for a range of trading models to co-exist in order to serve different functions and needs. For instance, the Swedish bond market is its own currency area, characterized by a large number of ISINs that are infrequently traded by professional clients in very large sizes. On this type of market, an order-driven trade is difficult to arrange. Therefore, market makers/SIs fulfill a very important role by bridging the gap between demand and supply of bonds whilst limiting the risk that large transactions have a market impact.

In the consultation paper, ESMA notes that there has been a reduction in the number of market making activity on the fixed income markets in EU over the last years and that this development has been driven by an increased reluctance of investment firms to be exposed to market risks as well as prudential requirements. According to ESMA, this decrease in market makers has however been compensated by an increase in electronic trading and new trading models such as all-to-all platforms (point 40, page 16).

The SSMA agrees with ESMA that regulatory developments during the past years have made it more difficult to provide market making services in the EU. The reasons are partly the ones mentioned in the consultation paper, i.e. changes to the capital requirements, but also the transparency regime in MiFID II/MiFIR has in our view made it more complex and costly for investment firms to execute clients orders against their own balance sheet.

However, even if the increased multilateral electronic trading and emergence of "all-to-all" platforms may be welcome developments for some fixed income markets, we do not agree that this

development will replace the need market making services for smaller bond markets and/or when trading in less liquid instruments or bespoke instruments with special features. To our understanding, it was made quite clear during the COVID crisis that market makers fulfil an important function also during extraordinary market conditions. For a well-functioning capital market in EU, both bilateral and multilateral trading models are needed in order to serve issuers and end-investors needs.

When analyzing the effects that ESMA's proposals to amend RTS 2 could have on the ability of investment firms to take on market risk, it is important not only to consider the proposals in isolation but also in the context of the transparency regime as a whole, including the upcoming MiFID Review. In this connection, the SSMA would like to repeat our very strong concerns regarding ESMA's proposal for real time post trade price transparency.¹ For smaller markets like the Nordics, where it is easy to identify the firm behind an individual trade, it is not enough with volume omission but also the price needs to be masked during the deferral period T+2. Otherwise there will be a significant risk of front-running. (The fact that real time price transparency work on the US bond market (TRACE), which is a very large bond market with a very large number of market makers and investors is not a good evidence that it will work on the heterogenous bond markets in EU). Moreover, if the SSTI removed, which ESMA has proposed, an adjusted LIS threshold needs to be set at a sufficiently low level in order to protect SIs from undue risk.

Finally, even if the SSMA does not strongly object to a move of the liquidity assessment and pre trade SSTI thresholds to stage 3 per se, we are surprised by the fact that ESMA proposes this change without having access to full year of data based on stage 2. We are concerned with what kind of precedent this approach may set for the future. The SSMA urges ESMA and the co-legislators to take a cautious approach in their forthcoming work to ensure that any future changes to RTS 2 (i.e. a move to stage 4) or other amendments of the transparency regime in MiFIR review do not result in even more liquidity providers retreating from the fixed income market.

b. Non price forming trades – a conflict between MiFIR and MAR

The SSMA would like to take the opportunity to raise an additional issue that concerns RTS 2 and which should be addressed by ESMA.

To our understanding, the list of so-called non price forming trades in article 12 of RTS 2² are interpreted as being exhaustive. This creates problems for the market since the types of transactions not contributing to the price discovery process changes over time and local markets may have different needs. In our view, it is important to ensure that all transactions not contributing to price discovery are exempted from transparency requirements as they may mislead the market in terms of price, supply or demand and thereby be in conflict with the market abuse regulation (MAR).

One current example from the Swedish market relates to the situation where a retail client wants to move his/her securities in or out of an insurance (Sw: kapitalförsäkring). Although it is the insurance

¹ [SSDA response to ESMA consultation on MiFIR Transparency Regime for Non-Equity and DTO – Svensk Värdepappersmarknad \(svenskvardepappersmarknad.se\)](#)

² Same issue is applicable to equities, cf. article 13 of RTS 1

company that formally owns the financial instruments, such “move” does not lead to a real change in ownership and the transaction should therefore not be made public. The problem is that a literal reading of the transparency rules in MiFIR suggests that the information must be published post trade since there is no exemption in RTS 2 that explicitly covers this situation. Considering “the counterparty” is not an eligible or professional client, it is also uncertain if the exemption from the trading obligation in article 23.1 b MiFIR apply. At the same time, if the move is published it could mean a breach of the rules on market manipulation in MAR (wash trade). Thus, in this case there is a “conflict” between MiFID II and MAR which puts investment firms and their clients in a very difficult situation.

The SSMA therefore proposes that RTS 2 are amended and/or a new recital is included that clearly allow firms to rely on the exemption for non-price forming trades in situations where there is no real exchange of ownership and the market therefore has little value of the information and could even be misleading or in conflict with MAR if the information came out. If necessary, such rule could be made subject to the prior approval of competent authority.

2. Specific Questions

Q1: Do you agree with ESMA’s proposal to move to stage 3 for the determination of the liquidity assessment of bonds? Please explain.

Even if the SSMA does not strongly object to a move of the liquidity assessment and pre trade SSTI thresholds to stage 3 per se, we are surprised by the fact that ESMA proposes this change without having access to full year of data based on stage 2. We are concerned with what kind of precedent this approach may set for the future. The SSMA urges ESMA and the co-legislators to take a cautious approach in their forthcoming work to ensure that any future changes to RTS 2 (i.e. a move to stage 4) or other amendments of the transparency regime in MiFIR review do not result in even more liquidity providers retreating from the fixed income market. For a well-functioning capital market in EU, both bilateral and multilateral trading models are needed in order to serve issuers and end-investors needs.

Q2: Do you agree with ESMA’s proposal not to move to stage 2 for the determination of the pre-trade SSTI thresholds for all non-equity instruments except bonds? Please explain.

The SSMA supports the proposal to wait with the move to stage 2 for other non-equity instruments than bonds.

Moreover, the SSMA proposes that the decision to classify all equity derivatives as liquid and all FX derivatives as illiquid are evaluated in the forthcoming MiFID Review. Any proposal for amendments need to be based on empiric evidence and made subject to extensive consultation with stakeholders.

Q3: Do you agree with ESMA’s proposal to move to stage 3 for the determination of the pre-trade SSTI thresholds for bonds (except ETCs and ETNs)? Please explain.

Even if the SSMA does not strongly object to a move of the liquidity assessment and pre trade SSTI thresholds to stage 3 per se, we are surprised by the fact that ESMA proposes this change without having access to full year of data based on stage 2. We are concerned with what kind of precedent

this approach may set for the future. The SSMA urges ESMA and the co-legislators to take a cautious approach in their forthcoming work to ensure that any future changes to RTS 2 (i.e. a move to stage 4) or other amendments of the transparency regime in MiFIR review do not result in even more liquidity providers retreating from the fixed income market. For a well-functioning capital market in EU, both bilateral and multilateral trading models are needed in order to serve issuers and end-investors needs.

The SSMA does not support the proposal to delete the pre- and post-trade SSTI threshold and to replace it with an adjusted LIS as we consider that the threshold still fulfils an important function to protect SIs from undue risk. If the system is considered as too complex, we propose that the variable threshold is replaced by a fixed threshold instead. If the SSTI is nevertheless removed, an adjusted LIS threshold needs to be set at a level to allow SIs to take market risk.
