

SSMA response to ESMA CfE re equity market structure

SSMA welcomes the opportunity to respond to the ESMA call for evidence regarding equity market structure.

General comments

As a general comment we want to stress that we believe that the presented data does not reflect a correct picture on where trading is taking place. Especially SI volumes are underestimated since we do not believe the UK trading data on SI is correct.

In short summary our main concern is the quick growth of volumes on Sis. This is bilateral trading that is not addressable by all market participants and will therefore create severe liquidity problems if the trend continuous. The rules for Sis should be enforced to a larger extent. It should only be bilateral at risk with no orderbook like activities taking place on Sis. There is a risk that the real price forming process will not take place on exchange but rather off exchange.

As mentioned, SI: s is supposed to operate using their own capital to facilitate client orders. It is a market maker set up where the SI is only allowed to execute at the EBBO or better. That means that per definition there can be only one bid and one offer on the SI – the quoted spread. If any depth of prices is displayed it will be close to orderbook handling and should be against the rules. It is also not allowed to match client orders on SI since it is supposed to be at risk. However, this could be circumvented by crossing both sides versus the SI quote - so called matched principal. We therefore suggest that the data analysis is complemented with analysis of time stamped data. This will show if real risk is taken by the SI, especially in cases if algos are matched vs the SI. The same or very limited differences in time stamps would indicate whether real risk is taken or not.

SSMA also suggest that the tick-size regime is revisited. It was introduced to create a level playing field between RMs and MTFs and prevent that tick-sizes became too tight. It should be evaluated whether this principal should be expanded to include all venues for fair competition and creating an overall level playing field for execution.

Q1: Do you agree with the description of the market structure summarised in Figure 1 for the purpose of the study in sections 3 and 4 based on transaction reporting data? If not, could you provide an alternative description that you consider more adapted to the reality of the European trading landscape for shares?

SSMA do not agree. SI volumes are only addressable by those who have direct access to the relevant SI. SIs is set up for pure bilateral trading and is therefore by definition not addressable by the whole market. The large volumes are also not SI quoted volumes but rather de facto crossed client trades in an orderbook like trading activity, which should not take place on a SI. Only volumes that are truly accessible by all market participants should be considered as addressable in the figure.

Q2: Do you have any insights on the XOFF transactions reported by investment firms who also act as an SI (SI-OTC trades)?

SSMA has no insight on this.

Q3: Do you agree with the general trends identified regarding on-book vs. off-book trading, and addressable vs. non-addressable liquidity? What other trends do you consider relevant, also in terms of competitive pressures?

SSMA agrees to the general trends where lit orderbook volumes on exchange decline and other liquidity pools increase. SSMA sees that off-book trading increases, non-addressable trading increases, volumes in periodic auctions increase and most critical SI volumes increase. As stated, several times the increasing SI volumes is our main concern, which is not fully reflected in the presented data.

Q4: Do you have any concerns on the impact of the identified trends on the general functioning of the EEA markets for shares? In your view, what are the implications of the relative decreasing trend in trading on CLOB for the effective price formation in the EEA markets for shares? What are the implications on price formation should this trend persist or even accelerate?

SSMA sees a risk that this negative spiral of continuing decreasing volumes and liquidity on CLOB will create a situation where the primary exchange is no longer the most relevant market. If/when that happens there will be uncertainty where the real price forming process takes place. That would be very negative for the market as a whole and raise questions of who for example is responsible for stopping trading, enforcing short selling rules etc. It is important that this trend does not continue and that enough volumes stay on the primary exchanges.

Q5: As the choice of trading facility has increased, it is important for ESMA to understand why market participants are choosing the execution facilities that they do. What are the drivers that you consider most relevant when choosing on which execution venue and with which execution method to trade?

SSMA believe the main drivers are price, liquidity and fees. Also, connectivity costs on the primary exchanges drives volumes towards other venues. One problem is also that especially large orders placed on CLOB becomes toxic and is too easy to front run, which also favours other liquidity pools. There is therefore a value in having the choice of different execution techniques on different trading mechanisms for not being too exposed to front running. There have always existed different ways of execution and is not new as such. The main problem is the rapid growth of SIs that draws volumes from the lit exchanges, especially in continuous trading. This risk concentrating volumes on a few large investment banks SIs rather than on-exchange.

Q6: What are your experiences with regard to gaining access to liquidity? To what extent are you, either directly or via a broker, able to access liquidity on relevant trading venues or relevant systematic internalisers? If not, please explain what stands in the way of gaining such access.

SSMA members believe it is difficult to connect to many different venues to get enough volume coverage. It becomes very expensive and technically demanding with both compliance and related market data charges added on top. It is not good for the market if a few large investment banks attract larger volumes through their execution offerings.

Q7: If you are an issuer, how do you see these market developments? Do you consider this an attractive environment for listing? If not, why?

SSMA members are not issuers, but they help companies in the listing process. We therefore believe that there is a risk that issuers to a larger extent will chose non-EU exchanges if CLOB liquidity becomes too low.

Q8: What conclusions would you draw from the distribution of liquidity across EEA ISINs? Do you identify any policy recommendations in this context, with a view to enhancing price formation while ensuring a level playing field across different types of venues? Do you have explanations for the high share of OTC trading observed in the ISIN's of some jurisdictions?

SSMA has no strong view but think this also correlates to lit volumes. Low lit volumes increase OTC trading.

Q9: What is your view on the evolution of dark trading on EU trading venues? Are there any structural shifts that you noticed, which you believe should be further monitored?

For SSMA members this is not the challenge for the market since it is quite a small share of the overall volume.

Q10: What concerns/issues do you highlight at this stage? Do you see a need for specific regulatory interventions also in consideration of evidence available regarding practices related to dark trading functionalities (please provide details)?

Since SSMA do not consider this a problem there is no need for regulatory intervention.

Q11: What is your view on the evolution and effects of trading in closing auctions on the EU markets? Do you agree with the presented rationale for trading in closing auctions or do you consider other drivers more important for explaining the growth and increasing significance of closing auctions trading?

SSMA believe the main effect is that increased volumes in closing auctions reduce the intraday liquidity in the continuous trading. Most important for the development is the increase in passive investments and leverage products. These types of instruments are only interested in trading on the official closing price since that creates zero slippage and no risk for the issuer. These volumes and rebalancing orders are therefore only traded in the closing auction. When the CA gains market share also normal orders need to be executed to a larger extent in the auction to achieve a good average with lower risk. There is a risk that the trend with more volumes in the CA continues and makes intraday trading very difficult with poor liquidity.

Q12: What is your view on the effects of alternative closing mechanisms offered by MTFs and SIs?

Since SSMA believe the main drivers for trading in the CA are by participants that are only interested in executing on the official closing price there is no alternative to primary exchange CA. We are aware that volumes are executed on other platforms but if the price in these would differ from the official closing there will be no interest in crossing on those mechanisms. Alternative closing mechanisms therefore are of no interest for setting the official closing but could if the price is the same attract crossing volumes for cost and transparency reasons.

Q13: What will be in your view the effects of 24h/ extended trading hours on closing auctions?

For SSMA that depends on when closing auctions will be held and if it still will have the status as official closing price. The relevant question when discussing extended hours is therefore when and how will the official closing price be set. SSMA believe that there is

little interest from the market participants to either change the status of the CA or have it later in the day. If that assumption is correct extended trading will have little impact on the closing auction. There have always been interests for pre- and post-trade markets, so the relevant question is rather how we create liquid longer trading hours outside normal official hours. An aftermarket will most likely be very dependent on market makers.

Q14: Are there any structural shifts that you noticed, which you believe the competent authorities should monitor? Would you like to highlight any concerns/issues at this stage? Do you see a need for specific regulatory interventions (please provide details relating them possibly to the data and observations available)?

SSMA thinks this structural shift creates an unlevel playing field since liquidity attracts more liquidity. Alternative trading mechanisms especially SIs therefore gain larger market shares over time which only benefits the large international investment firms and hurt the functioning of the market. It is important that the SI rules are enforced to limit this risk. SIs should be purely bilateral at risk.

Q15: What is your view on the evolution of trading in FBAs on EU markets? Why are those mechanisms gaining traction in your view? Which are the benefits and shortcomings they offer? (please elaborate)

SSMA is of the opinion that the volume in FBAs has increased^{ds} and that they are a good way to find liquidity in the short-term perspective. FBAs also have better execution performance than trading in dark pools.

Q16: Do you have any particular observations as regards the impact of SVC on FBAs?

SSMA has not observed anything particular in this regard. If FBAs were to be capped that volume would only move to a different trading mechanism and is therefore no problem for the market.

Q17: Are there any emerging structural shifts which you believe would warrant closer monitoring? (please elaborate)

SSMA has no view.

Q18: What is your view regarding the contribution of FBAs to price formation and transparency? Should those mechanisms be generally considered as price forming/ non price forming or this assessment should be done on a case-by-case basis depending on the specific design of the auction? (please elaborate, supplementing your views with data evidence when available)

SSMA has no strong view but recognises that the volumes are addressable, transparent and algos can interact with the FBA so from that perspective they contribute to the price forming.

Q19: Please highlight any concerns/issues you may have at this stage. Do you see a need for specific regulatory interventions, particularly regarding the tick size regime and its application to transactions and periodic auctions (please provide details)?

SSMA is of the strong opinion that level playing field is very important in this respect. The same rules for off-tick matching must apply to all different trading venues. If SIs are allowed to match off-tick all others should also be able to do that.

Q20: What is your view on the evolution of trading of SIs on the EEA markets? What are the main drivers of their growth?

SSMA see clear benefits with SIs if they operate as intended and follow the rules. For smaller clients SI trading can lower the costs, increase liquidity and deliver better client service.

The main problem is that some SIs have become too big and concentrates and draws volumes from the primary exchanges. Liquidity attracts liquidity. Per definition a SI should not have an order depth since they should be bilateral at risk and are not allowed to trade outside the EBBO. There should therefore be no other pre-trade price on the SI than a one level quoted spread, anything else should be prohibited. SI should not be allowed to interact with another SI either. If networks or back-to-back arrangements of SIs is created it should not be allowed since that risk creating a marketplace outside the ordinary exchanges. It is extremely important that SI is only pure bilateral trading at risk.

Q21: Does this picture reflect the trends you observe in SI trading? Do SI offer trading for both large and small sizes? Do these different trade size reflect different types of clients / SI businesses?

Yes, SSMA has observed these trends – also see Q20. To Q20 we want to add that to our understanding the quoted volumes on spread on SIs are quite low, which we believe should be analysed further. There should be no other activities taking place on SI other than pure bilateral trading between SI at risk and a client order.

Q22: What is your perception of the application of price improvement by SIs? Does the data analysis reflect the reality, or do you believe that there are some data quality issues in the flagging of transactions subject to price improvement?

SSMA believe that there probably are data quality issues and recognise that price improvement exists. In principal price improvement is good for clients as long as it is

done according to the rules and there is a level playing field for price improvement for all venues.

Q23: Which flags do you consider important to identify certain trade related to SI trading?

SSMA has no strong view but believe that the incorrect data on flag usage probably is linked to activities that should not take place on a SI. If for instance different algos are matched on a SI that would most likely result in many small trades and not trigger either the SIZE or RPRI flag which they probably should have.

Q24: What is your view on the evolution of SI trading on the EU markets? Are there any structural shifts that you noticed, or envisage, which you believe should be further monitored?

SSMA believe that the increasing SI volumes on the large SIs is a major problem – see Q20/21. This development lower lit on exchange liquidity and risk hurting the fundamental functioning of the market if the trend continuous.

Q25: Please highlight any concerns/issues you may have at this stage? Do you see a need for specific for regulatory interventions (please provide details possibly relating to the information and data available or observed)?

See Q20/21, SSMA is very concerned about the rapid growing SI volumes and regulatory intervention might be needed. Most important is to enforce the current rules if other practices than intended exist. If the trend continuous and enforcement does not work formal thresholds on market shares/volumes should be considered to limit SI trading.

Q26: Have you witnessed an increase in the use of benchmark trades? If so, what are the drivers of such increase on venue and on SI?

SSMA has no view

Q27: Should the use of transactions from multiple trading venues be allowed when calculating the benchmark?

SSMA has no view

Q28: When performing benchmark trades, on how many transactions is the calculation of the benchmark trade based (on average, min, max, liquid vs. illiquid instruments)?

SSMA has no view

Q29: To what extent SI take advantage of the provision in Article 15(3) of MiFIR? Please share any data you may be informative in this context to understand the extent to which SIs use this provision.

SSMA has no view

Q30: Would you be supportive of ESMA issuing guidance on benchmark trades? If yes, should it encompass quantifying the minimum requirements (e.g. minimum number of transactions to be included when calculating a benchmark price, minimum time period to cover).

SSMA has no view

Q31: Does member preferencing lead to unfair outcomes for end-investors, other members or the markets? Please explain, if possible on the basis of data.

For SSMA members this has been a practice that has worked very well in the Swedish market for a long time. It keeps volumes on the CLOB rather than being internalised by the members and thereby contributing to on exchange lit liquidity. We are aware that there are views that this is unfair, but we believe that those arguments mainly come from HFTs/MMs that only want to make a profit on the spread and not really contribute to liquidity. SSMA therefore is of the strong opinion that this practice benefits the market and want to keep it. If removed the on-exchange volumes would decrease further.

Q32: To what extent do you see evidence that member preferencing extends in practice beyond jumping the queue and may also violate price priority principles?

SSMA to not see any evidence on any expansion and want to keep the member priority as it works today. See Q31

Q33: Should member preferencing be (a) prohibited, (b) should there be rules restricting the practice, or (c) should nothing be done? If you suggest there should be rules (b), which rules would you suggest? Please explain.

Our answer is c – nothing should be done. SSMA believes the current rules and practice works well in the Swedish market.

Q34: What would be the consequence of prohibiting certain forms of member preferencing? Please explain, if possible on the basis of data.

If this practice were to be prohibited SSMA believe it would have severe consequences for the market. All members especially retail brokers would keep their orders internally rather than sending them to the market. Since exchange CLOB to a very large extent are built with retail orders this would significantly hurt lit orderbook liquidity and hurt the price forming process. The exchanges have this data very easily available.

Q35: Are you aware of other similar and common practices, for example on RFQs, where on venue competition is limited to the detriment of other investors or members? Please explain, if possible with data.

SSMA is not aware of similar practices. RFQs is a very different trading practice, and we do not see similar limitations.

Q36: Do you agree with the above three approaches?

SSMA agrees.

Q37: Do you agree with this first part of the table on addressable liquidity and price forming?

SSMA agrees. We want to stress the importance that bilateral trading mechanisms are not labelled as addressable, such as SIs

Q38: Do you agree with this second part of the table on addressable liquidity and price forming?

SSMA agrees. We want to stress the importance that bilateral trading mechanisms are not labelled as addressable, such as SIs

Q39: Would you consider that some benchmark transactions should be classified as non-addressable and non-price forming? If so, provide a clear description of the case and rationale.

SSMA agrees but have no strong view on benchmark transaction as such. If they are addressable or price forming depends on how they are executed. If they are executed in for example the closing auction, they are addressable and price forming but if matched outside the market they are not.

Q40: Do you agree with this third part of the table on addressable liquidity and price forming?

SSMA agrees. We want to stress the importance that bilateral trading mechanisms are not labelled as addressable, such as SIs

Q41: Do you agree that all transactions without a flag should be considered addressable liquidity and price forming?

SSMA do not believe that it is different flags that should determine if transactions are addressable or not. It should be defined by how well all market participants can interact with the order flow. Flags could eventually provide this information for follow up by the supervisors.

Q42: Do you agree with this fourth and last part of the table on addressable liquidity and price forming?

SSMA agrees. We want to stress the importance that bilateral trading mechanisms are not labelled as addressable, such as SIs

Q43: Do you agree with the approach on the combination of flags in the case of addressable liquidity?

SSMA do not think flags should define this but could help follow up - see Q41.

Q44: Do you agree that intragroup transactions executed by SIs should not constitute addressable liquidity and therefore, could be flagged (i.e. a new flag in RTS 1 could be added to disentangle those transactions)? Do you agree that intragroup transactions executed by SIs should be classified as non-price forming?

SSMA agrees since we do not believe SI volumes should be considered as addressable. We do not want any new flags in this respect.

Q45: Do you believe that other transactions should be flagged and excluded from the calculation of addressable liquidity (i.e. a new flag in RTS 1 should be added to disentangle those transactions)?

SSMA has no strong view but do not want new flags.