Consultation response

Förslag till anpassning av transparensregler enligt Mifid 2/Mifir

April 2017

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment the Swedish FSA ("FI") Consultation paper on transparency under MiFID II/R. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

Introduction and general remarks

As part of MiFIR/D II, new transparency requirements will be introduced for bonds and many other instruments. AFME believes that these changes will be beneficial to the market, if they take into account the specificities of each asset class and follow a balanced approach. This is why AFME has, since very early on in the Level 1, and later Level 2 process, argued for a cautious and accurate calibration of the transparency regime under MiFID II/R: the activity of market making and liquidity provision needs to be protected. To that effect, we welcome the fact that ESMA and National Competent Authorities have been mindful of our concerns.

AFME notes that, in April 2016, the European Commission requested ESMA to phase-in the application of certain parts of the future transparency regime to mitigate possible liquidity risks to bond markets. Subsequently, ESMA amended its RTS to adopt this approach. This highlights the potential disruption that transparency could cause on certain markets, should it be calibrated inaccurately. We set out below our views on pre- and post-trade transparency, and our preferred applications of those, to get to an optimal and well-calibrated transparency regime.

In relation to the consideration of an extended deferral regime it is important to draw specific attention to the following points:

- AFME is concerned that different deferral regimes could result in fragmented markets, due to regulatory arbitrage discriminating against jurisdictions that offer limited deferral periods, thereby negatively impacting end investors.
- If market makers/liquidity providers believe they might not have sufficient time to hedge/unwind their potential inventory position, they will either add in an additional cost to reflect that risk or simply not quote, in turn impacting the liquidity and competitiveness of the asset managers.
- Harmonised deferral regimes ensure a level playing field between domestic vs other EEA participants with no negative impact to liquidity.

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Question 1:

Concerned are requested to comment on FI's position as regards the possibility to grant waiver according to the conditions set forth in Article 9.1. MiFIR (*SW: Berörda ombeds lämna synpunkter på FI:s ställningstagande beträffande möjlighet att bevilja undantag enligt villkoren i Mifir artikel 9.1.)*

AFME is of the view that waivers from pre-trade transparency requirements should be granted in relation to:

- orders that are large in scale
- orders held in an order management facility pending disclosure
- actionable indications of interest in request-for-quote and voice trading systems, and
- derivatives that are not subject to the trading obligation under article 28 of MiFIR, and other financial instruments for which there is not a liquid market.

Failure to provide waivers from the pre-trade transparency requirements would be a deterrent to liquidity provision and market making, as well as cause undue risk to entities engaged in those activities.

We stress the need for waivers to be made available and applicable from day 1 of MiFIR effective application. In addition, we also highlight to the Swedish FSA that further clarity is also required on the extension of this requirement to systematic internalisers as per MiFIR Article 18(2) which states that SI pre-trade transparency disclosure requirements may be waived where the conditions specified in Article 9(1) are met.

Question 2:

Concerned are requested to comment on FI's position as regards possibility to grant deferred publications according to the conditions set forth in Article 11.1. MIFIR *(SW: Berörda ombeds lämna synpunkter på FI:s ställningstagande beträffande möjlighet att tillämpa uppskjutet offentliggörande enligt villkoren i Mifir artikel 11.1)*

AFME is of the view that the Swedish FSA should authorise operators of trading venues and investment firms to provide for deferred publication in relation to transactions that are:

- large in scale
- in financial instruments for which there is not a liquid market
- above the size specific to the instrument, and
- packages

AFME appreciates that each National Competent Authority (NCA) will have to consider their approach to deferred publication in relation to those transactions individually. However, we believe a European coordination across NCAs, to the greatest extent possible, will benefit the industry and ensure relative consistency around a T+2 deferral, which we think would be optimal. We are concerned that each Member State implementing a different deferral framework would result in a highly-fragmented regime across Europe.

AFME's suggested approach to the deferral process is as follows, and follows ESMA's approach outlined in its September 2015 Final Report (p153) in recommending that the FCA use:

1) In relation to instruments that are not sovereign debt, its powers under MiFIR 11(3)(b) [as well as RTS2 Article 11(1)(b) and Article 11(2)(a)]; and
2) In relation to instruments that are sovereign debt, its powers under MiFIR 11(3)(b) and MiFIR 11(3)(d) [as well as RTS2 Article 11(1)(b) and Article 11(2)(c)].

This would achieve the following post-trade transparency regime:

- No details published until 7pm local time on T+2 if transaction qualifies for the standard deferral. At 7pm on T+2, utilise 11(3)b) such that all details of transactions on individual transactions are published on T+2 except volume
- Within the extended 4 week deferral period, no details published on volume, whether aggregated or not, for all eligible transactions

- Volume of individual transactions published after 4 weeks except if transaction in a sovereign debt instrument
- No publication of volume for an indefinite period for sovereigns even after 4 weeks; instead aggregated volume for sovereign instruments published on the Tuesday following the expiry of the 4 week deferral before 9:00 local time as per RTS2 Article 11(2)(c).

		Post-Trade Transparency Disclosure – Proposed AFME framework		
		Price	**Volume (Non-Sov)**	**Volume (Sov)**
LIQUID	**≤ SSTI**	Real-time	Real-time	Real-time
ILLIQUID	**≤ SSTI**	At 7pm T+2	T+4 weeks*	T+4 weeks (Aggregated)**
LIQUID & ILLIQUID	**>SSTI & > LIS**	At 7pm T+2	T+4weeks*	T+4 weeks (Aggregated)**

* All details of individual transactions.

** Aggregation must be for several transactions. To protect against situation where only one trade is executed in the week in any given ISIN, "aggregation" should be by issuer.

Question 3:

Concerned are requested to comment on FI's position to combine the grant of deferral with adjusted information beforehand, in accordance with the conditions set forth in article 11.3 a MiFIR *(SW: Berörda ombeds lämna synpunkter på FI:s ställningstagande att komplettera beviljande av uppskjutet offentliggörande med anpassad, tidigarelagd information enligt villkoren i Mifir artikel 11.3 a.)*

AFME disagrees that the Swedish FSA should combine the granting of deferral with adjusted information beforehand. The AFME view is that the Swedish FSA should use its powers under Article 11(3) of MiFIR further to allow for a "dark" T+2 standard deferral, and allow a supplementary deferral of 4 weeks for volume. This would be in accordance with the options available to the Swedish FSA under MiFIR. AFME believes it is essential that the deferral regime is accurate and proportionate in its requirements and its application. AFME believes the publication of price in real-time (under 15 minutes initially, then 5 minutes) will be particularly challenging for systematic internalisers trading in illiquid instruments or in large sizes, for only a limited benefit to the market. In addition, we do not foresee how the option to use aggregation could work in practice.

AFME strongly believes that no additional information should be made public during the standard deferral period, before T+2 has lapsed [i.e. as per MiFIR 11(3)(a) and RTS2 Article 11(1)(a)] as it would undermine the objective of the initial deferral by providing insufficient time for market makers to exit risk positions for large / illiquid transactions, and would add to the complexity and expense of the whole deferral process for no advantage.

Question 4:

Concerned are requested to comment on FI's position not to use the possibility for extension according to Article 11.3 b-d MiFIR *(SW: Berörda ombeds lämna synpunkter på FI:s ställningstagande att inte tillämpa möjlighet till förlängning enligt Mifir artikel 11.3 b-d.)*

AFME disagrees with the Swedish FSA position not to allow a 4-week supplementary deferral nor to allow indefinite aggregation for sovereigns.

Post-trade deferrals are important to ensure that market makers have sufficient time to hedge their positions and protect themselves from the risks they take by providing liquidity to the market. In many illiquid markets, it can take several months for liquidity providers to hedge/unwind their exposures and, in liquid markets, large trades are often only proxy-hedged initially, then warehoused by liquidity providers for significant periods of

time. It can take weeks or months to fully exit such positions. The inability to de-risk before the size of a LIS or illiquid trade is made public will act as a significant deterrent to the provision of liquidity. For price formation purposes, there is little value to general market participants in knowing the exact size of a trade, particularly compared to the adverse consequences to liquidity providers of excessive transparency of trade size. It should be sufficient for the market to know that a large or illiquid trade has taken place and this can be achieved by including an appropriate "flag" when the other details of the trade are published.

In addition to ensuring that market-makers and other liquidity providers have sufficient time to hedge their exposures, there are other reasons why an extended deferral period is needed in respect of volume. There are circumstances in which the publication of trade size may contribute to market instability. A planned cross jurisdictional, cross currency acquisition is a practical example of this. Such transactions have significant exchange rate risk and it is common for the take-over to be preceded by large foreign exchange forward transactions (sometimes conditional on completion of the transaction) some days or weeks in advance of expected finalisation of the take-over. In the absence of extended volume omission, a very large foreign exchange forward transaction would be published, which could give rise to speculation, could result in distortion of other market prices, and could even imply a leakage of material non-public information. The period of volume omission needs to extend at least beyond the typical tenors of these transactions. Similarly, pre-hedging of new bond issues can give rise to activity in interest rate swaps, and large trades being published post-trade without volume.

Example – a Sweden based asset manager is selling an illiquid corporate bond to a dealer (who is not an systematic internaliser, therefore the post trade reporting obligation sits with the seller). The dealer sits in a jurisdiction that has granted a supplementary deferral of T+4 weeks, but the Swedish asset manager is required to report T+2 therefore the volume traded is in the public domain.

The dealer (based in a T+4 weeks jurisdiction) may not have been able to hedge/ unwind the trade before it's known publicly and will therefore factor that into any price/spread quoted for clients sitting in T+2 reporting jurisdictions.

Example - Swedish Asset manager wants to <u>sell</u> a block size, SEK 75MM, of corporate bond: XS1590778889 TELIAS 3 ¼ 10/04/77

	Scenario 1 Asks a quote from a local market maker who is an SI	Scenario 2 Asks a quote from a non-Swedish non-SI, from country EEA1	Scenario 3 Asks a quote from a non-Swedish SI, from country EEA2
Deferral regime applied	Sweden	Sweden	EEA2
***Assume* Deferral rules**	End of T+2 for price & volume	End of T+2 for price & volume	End of day T+2 for price, 4 weeks for volume
Price impact	If market maker considers that there is a chance that all/most risk cannot be warehoused/unwound, may charge more or not quote	If market maker considers that there is a chance that all/most risk cannot be warehoused/unwound, may charge more or not quote	Market maker will be generally confident that all/most risk can be warehoused or unwound within 4 weeks so price will be competitive
Liquidity impact	Swedish participants may be put at a competitive disadvantage versus their EEA counterparts – both asset managers and liquidity providers		

With this in mind, AFME believes the 4-week deferral extension [i.e. as per MiFIR 11(3)(b), and RTS2 Article 11(1)(b)], with the option to aggregate trades in sovereign debt instruments once that 4 week has lapsed, in conjunction with the initial standard deferral is extremely critical, and we would urge the Swedish FSA to reconsider their position to that effect.

We are also concerned that other NCAs have, or may, adopted the approach suggested under question 2. AFME believes that maximum harmonisation across jurisdictions is key to avoid a fragmentation of the market,

particularly for those instruments traded cross-border. There is a real concern that non-harmonisation could lead to liquidity fragmentation, with trades qualifying for a deferral more likely to be traded in jurisdictions that offer the extended period, particularly those offering the 4-week supplementary deferral for volume. This could lead to regulatory arbitrage and an unlevel playing field between various jurisdictions, and penalise end-investors who should be able to access the same level of liquidity in different countries.

Conclusion

The ability to benefit from available waivers from pre-trade transparency and deferrals from post trade transparency is critical for AFME's Members. On post-trade specifically, we would like to encourage the Swedish FSA to reconsider its view, and allow market participants to benefit from the supplementary deferral of 4-weeks, as set out in our response to question 4. We would also stress the importance of allowing a "dark" T+2 deferral, as noted under question 3. This is to allow market makers and other liquidity providers to have sufficient time to hedge their positions and protect themselves from the risks they take by providing liquidity to the market, as well as to ensure maximum harmonisation across all EU jurisdictions and ensure investors have access to the same levels of liquidity as clients in other jurisdictions.

AFME would welcome the opportunity to discuss the points covered in this response in more detail with the Swedish FSA at the earliest opportunity.

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