

SWEDISH SECURITIES DEALERS ASSOCIATION

EUROPEAN COMMISSION
Directorate General Internal Market and Services
FINANCIAL SERVICES POLICY AND FINANCIAL MARKETS
Securities markets

Stockholm 2011-02-02

The SSDA Response to the Public Consultation REVIEW OF THE MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MIFID)

The Swedish Securities Dealers Association (SSDA, register id 7777147632-40) represents the common interest of banks and investment firms active on the Swedish securities market. The mission of SSDA is the maintaining of a sound, strong and efficient securities market in Sweden. SSDA promotes members' views with regard to regulatory, market and infrastructure related issues. It also provides a neutral forum for discussing and exchanging views on matters which are of common interest to its members. SSDA has a close cooperation with other trade associations in Sweden, the Nordic area and Europe.

This response deals with Fixed Income market related issues.

For issues related to Equities markets, a separate response is provided in relation to the Nordic markets, including the Swedish market, by the Nordic Securities Association, NSA.

For all other issues and markets SSDA refers to the response provided by European Banking Federation, EBF and International Capital Market Association, ICMA.

SSDA key-point

- The SSDA is very concerned about the well-functioning local Swedish market for Fixed Income. The market has during the last decades developed a well calibrated

balance between transparency and liquidity which to our understanding the issuers and authorities regard as reliable and efficient. Any changes would disturb the balance and could cause a less efficient and less transparent market.

3.4. Non equity markets

General comments regarding smaller Fixed Income markets

We cannot find any acceptable reasons at this point of time to changes the rules for well-functioning government and mortgage bond markets in the EU. The reasons for some of the proposals set out in the consultation document are not very well explained and therefore we have had difficulties to answer those proposals. Furthermore, the proposals would have been much easier to understand, analyze, evaluate and comment on if there had been an analysis of market failures and how the proposals were designed to avoid such failures. Any regulatory proposal and intervention with the markets should only be undertaken where there is clear evidence of the benefits of the changes.

For a small Fixed Income market such as that in Sweden, there is a sensitive balance between efficiency and transparency. As the Fixed Income market is a wholesale, market-maker-based market, too much transparency would hamper the willingness of intermediaries to quote prices and thus the market's efficiency. We are concerned and confused that, even at this late stage, the consultation still raises theoretical questions about liquidity, instead of basing the proposal on empirical facts on the correlations between market size, transparency and liquidity.

One way to describe a smaller market (such as the Swedish) in figures is that just 20-25 clients are continuously present in the market and finance approximately 80 % of the market. These clients are as well informed about the market (regarding prices etc) as the market makers.

(37) What is your opinion on the suggested modification to the MiFID framework directive in terms of scope of instruments and content of overarching transparency requirements? Please explain the reasons for your views.

The consultations from CESR regarding pre- and post trade transparency in non equity markets have been focused on corporate bonds, structured finance products, CDS and different kinds of derivatives. Therefore, there is a lack of discussion and also of in-depth analysis of the effects of the suggested modification on some non-equity markets, especially the markets for bonds issued by governments, banks and mortgage institutions. In our view and as far as we know in the view of the Swedish Ministry of Finance, the National Debt Office, the Central Bank and the Swedish FSA, Finansinspektionen, the present level of market transparency in the market for bonds of governments, banks, and mortgage institutions in Sweden is satisfactory for professional investors.

Furthermore, the effect of increased pre- and post trade transparency in less traded securities admitted to trading on a regulated market as well as OTC traded securities is not satisfactory analysed. The proposal fails to take account of the considerable trade-off between liquidity and price indications.

The consultation rightly advocates that different rules regarding transparency should apply to different asset classes. However, it is also necessary to take account of significant differences within every asset class depending of the size of the market, the liquidity and need for transparency. There could be different explanations or reasons for those differences but one very important factor is of course the size of the currency area. Another explanation is the size of the issue. A third explanation is the

open volume. That is the volume of the issue that in practice could be traded compared with volumes that for different reasons are not available for trading.

A future framework for pre and post trade transparency must also differentiate between the wholesale and retail market.

A legislation solely based on asset classes, disregarding other factors, could have a very negative impact on certain markets. If the size of the currency area is not taken into consideration, such legislation will be punitive for smaller currency areas. In fact, such legislation will not be neutral across the EU. In Sweden, which is a rather small currency area there is for instance one asset class (government and mortgage bonds) which contains liquid bonds as well as bonds from other issuers that are traded just a couple of times per month. Even for smaller trades, it is obvious that any requirement to more or less immediately show every trade in detail to the public will hamper the market maker's willingness to take the risk and quote prices. In the long term such a requirement will make the public market less attractive for smaller issuers because it will raise their cost of capital. Investors, including retail investors, would suffer too, because opportunities to purchase bonds, or to diversify their investments would be diminished.

Furthermore, any rules regarding transparency must of course take the average daily turnover, ADT, both in the traded volume as well as number of trades into consideration.

Regarding today's OTC trades, it is important to stress that a large proportion of the trades are OTC traded due to the fact that the aggregated amount of interest in the market is not sufficient to make it order-driven and fully transparent. The result of forcing order-driven transparency on OTC markets would be that the cost for intermediaries would become too high and hence the price discovery cost will be transferred over to the customer in an inefficient manner. OTC markets are the intermediary stage in the evolution of markets. A market in a security starts with very non-standardized transactions involving very few participants. It then evolves into a general OTC market where a certain amount of standardization is present – tight indicative bid-ask spreads on screens, standardized term sheet, etc – and finally given enough standardized interest, the market ends up as order-driven. Forcing order driven market frame works onto OTC markets from the outset will only hamper liquidity and the continuous evolution of the market.

Hence, it is very important that local regulators, in a small currency area as the Swedish market, are able to set transparency rules taking into account:

- Currency area size (e.g. SEK versus EUR)
- Local market size per asset class
- Local market structure e.g. number of active clients / market makers / issuers / benchmark systems etc.
- Market history (turnover per asset class, liquidity robustness, liquidity in relation to outstanding amounts, and liquidity in relation to GDP or other)
- Market liquidity drain risks due to too much transparency

This means in practice that the local regulator must be able to grant exceptions from e.g. the proposed transaction based publishing regime and/or prompt and precise reporting in order to preserve or allow for a liquid and efficient markets that are dependent on market makers ability to handle risk. In the Swedish government bond, mortgage bond, corporate bond as well as the cleared derivative markets, it is essential that current reporting rules are evaluated and either preserved or changed in a manner that does not hamper liquidity or market efficiency long term.

The very broad scope of the proposed regime, and the proposed very high level of transparency, needs to be reevaluated to avoid these harmful effects on smaller, less liquid markets. As an alternative to our proposal above we support ICMA's comments on this matter. In all circumstances, any

future regime has to take into consideration the above mentioned factors. In our view the general rules and obligation to calibrate the framework for government and mortgage bonds should be decided on level 1.

(38) What is your opinion about the precise pre-trade information that regulated markets, MTFs and organised trading facilities as per section 2.2.3 above would have to publish on non-equity instruments traded on their system? Please be specific in terms of asset-class and nature of the trading system (e.g. order or quote driven).

Regarding market-making-based Fixed Income:

Any pre trade regime must distinguish: between retail and wholesale markets; between order driven and market-maker markets; and according to the frequency of the trading. A wholesale market-maker market already has market-driven pre trade transparency. For illiquid securities, prices are quoted prices on request. If the securities are frequently traded pre-trade information is also shown on screens as indicative prices close to firm prices. Any mandatory requirements to quote firm prices continuously, especially in not frequently traded securities, could mean that it is not possible to quote prices at all. Both issuers and investors would suffer from the consequent absence of a secondary market.

As stated above we are extremely sceptical to a one size fits all approach. The right way forward is in our firm opinion a carefully calibrated framework which takes due care of the specific markets. Our concern is small Fixed Income markets where asset classes are a too broad measure. Extra care is needed in such markets where bonds are traded in relatively small volumes and also rather seldom. In this context, we strongly support the conclusion of CESR's advice that, except for RMs and MTFs, pre-trade transparency in non-equity markets should be left to national discretion. Without specific evidence of market failure, and analysis of how its proposals would address identified market failures, it would be inappropriate to proceed with undifferentiated requirements that would harm investors and issuers in particular markets.

Private sector pre trade transparency solutions have been tried in the past in search for the right approach to pre-trade transparency (Trade Web, Bond Vision etc) but failed. We cannot see what has changed this time which would make undifferentiated regulatory requirements succeed. The result is that end-users would get stuck with positions. Bid/ask-spreads and volume provided in the OTC markets and on Regulated Markets in financial instruments with low turnover are based on each intermediary's assessment on its own capacity to warehouse the market risk and credit risk encapsulated in each transaction. These markets are very sensitive and hard to standardize since all market makers are more or less different in all input variables into the equation: cost of funds, cost of VaR, operational cost, operational risk cost etc.

In the opinion of SSDA, the rules in both MiFID and the implementing measures must be flexible enough to accommodate the overriding objective to balance liquidity and transparency in the different non-equity markets in the EU, in particular taking care of smaller markets in other currencies than the euro.

In any proposal for pre trade publication of quotes it is very important that in small currency areas, such as the Swedish, the central bank and the national supervisory authority have the power to determine the detailed conditions and requirements that are suitable for the national markets and their users.

(39) What is your opinion about applying requirements to investment firms executing trades OTC to ensure that their quotes are accessible to a large number of investors, reflect a price which is not too far from market value for comparable or identical instrument traded on organised venues, and are binding below a certain transaction size? Please indicate what transaction size would be appropriate for the various asset classes.

We have mentioned above that a large proportion of Fixed Income trades are traded off-exchange due to the fact that the aggregated amount of interest in the market is not sufficient to make it order-driven and fully transparent. To force the framework of order driven markets on OTC markets is therefore wrong and could jeopardize the benefits that the OTC market brings to investors and issuers.

When assessing whether “quotes” should be accessible we need to differentiate between “live Quotes” or “indicative Quotes” on screen. “Indicative Quotes” on screen can already be accessed by anyone for any properly functioning OECD market. As regards “live Quotes”, they are most often not applicable for everybody. An OTC transaction is equally often part of a multi-leg transaction as it is a single transaction. Hence the final price provided is most often tailor-made to the request and can hence not be applicable in the same way to the “next in kind”. Neither is the proposed “too far from market value of a comparable...instrument” rule appropriate since it assumes constant correlation between different instruments which the last crisis has beyond any uncertainty proven to be exceptionally erroneous. Add to that the fact that swaps with different counterparties (that are exempt from clearing) requires different “add-ons” to cover for counterparty risk. For all these reasons, the final transaction prices will vary from the indicative quote.

Even if one were to assume that the correlations were stable, the “size” asked for would be extremely different if we were to compare different issuers within the same asset class within the same currency area (compare Spanish Government Bonds with German government bonds), not to mention the difference between different currency areas (compare Swedish Government Bonds with German Government Bonds).

SSDA do also want to stress that there is a huge difference in quoting a specific bond sporadically in lots a perhaps millions of euro and continuously quoting prices in small lots. The proposal is not well fitted to smaller markets such as those in Sweden, where transactions are typically large and infrequent.

(40) In view of calibrating the exact post-trade transparency obligations for each asset class and type, what is your opinion of the suggested parameters, namely that the regime be transaction-based, and predicated on a set of thresholds by transaction size? Please explain the reasons for your views.

First of all it is necessary to distinguish between different currency areas. There are currency areas - as well as markets within a currency area within a specific asset class - where a certain level of threshold would not affect the provided liquidity. But in other currency areas (or asset classes) (compare answers in 39) where excessive transaction-based transparency would make market making grind to a halt.

Secondly, one has to take into consideration what the value of the extra information - compared to what is given today – is, and if the customers in the particular markets are prepared to pay for it. These are markets for qualified investors who have access to massive amounts of market information already.

Thirdly, the threshold level of where transaction-based transparency would hamper liquidity varies over time, asset class, sub-asset class and currency area. More flexibility is needed in the rules to

provide for efficiency and predictability while also accommodating the changing commercial needs of market participants and regulatory priorities.

SSDA proposes that smaller markets with e.g. another currency than the euro have exceptions from the proposed rules, with the purpose of balancing liquidity and transparency for the local currency area. The national central bank has a responsibility for its own currency and an efficient and liquid money and bond market. SSDA propose that the central bank and the national supervisory authority have the necessary power to regulate the post trade transparency according to the conditions that apply for the local market. Alternative we strongly support the modifications to the post-trade regime set out in ICMA's response

Summary of current, for Swedish conditions, well balanced publishing rules, example government bonds, benchmark covered bonds and cleared derivatives:

At 9 pm, the day after the trading day the following aggregated information is published for each security that has been traded

- Average size
- Highest price
- Lowest price
- Total turnover

Regarding other bonds admitted to trading on a regulated market information is published, as above, for trades below equivalent to 2 000 000 €.

For the retail segment there is also an on exchange automated and continuous trading including immediate pre trade and post trade information.

(41) What is your opinion about factoring in another measure besides transaction size to account for liquidity? What is your opinion about whether a specific additional factor (e.g. issuance size, frequency of trading) could be considered for determining when the regime or a threshold applies? Please justify.

DG Markt is right to identify that many factors are relevant to getting the balance right between transparency and liquidity in establishing a post-trade transparency regime for Fixed Income markets. But, there is no way to standardise this across all different sub asset classes in all currency areas within EU. Furthermore, transaction size is not in and of itself a measure of liquidity. Currency area, issuance size, number of participants in the market, frequency of trading and the average number of days needed to turnover an issued volume should also be taken into account. Another way to measure the liquidity is the size of a buy/sell that can be traded without changing the market price.

If the legislation is to prescribe post-trade transparency, requirements have to be set at a local level, starting with the local currency area market monitoring by the local competent authority. On the spot inspections and a liability for banks to have their records available for inspection for the local FSA is a better way.

(42) Could further identification and flagging of OTC trades be useful? Please explain the reasons.

No. Specific flagging of OTC trades in post-trade reporting would simply exacerbate the problems we have identified above, and make it even more difficult for investors to find liquidity

4: Data Consolidation

The responses below (questions 43 – 59) refers to the Fixed Income Market

(43) What is your opinion of the suggestions regarding reporting to be through approved publication arrangements (APAs)? Please explain the reasons for your views

SSDA supports, given that the data reported to APAs are consistent with the local requirements/exceptions described in section 3. The need for distribution of Market Data through an APA is to SSDAs understanding not as important as for the equity trading.

(46) What is your opinion about applying these suggestions to non-equity markets? Please explain the reasons for your views.

Standardising data for such a wide universe as non-equity OTC traded products is a complex issue since the data behind two different transactions in the same product could be dependent on things such as if it's a multi-leg or single leg transaction, nature of counterparty, currency area, etc. The trade off between data transparency and accessible liquidity is omnipresent.

Comparing Equity data with Non-Equity markets data is difficult. The venue for an Equity transaction is an exchange where a price is established for a legal entity. The venue for an OTC non-Equity transaction is a bilateral agreement between two legal entities. Even for a clearing-eligible Euro swap the price quoted from one price provider will differ from another dependant on the circumstances regarding the counterparty, the chosen clearing venue and the circumstance of the transaction.

SSDA proposes that the efforts to increase the quality of post trade data is focused on the equity trading, not the Fixed Income trading.

(50) What is your opinion about applying any of these suggestions to non-equity markets? Please explain the reasons for your views.

The markets are not comparable since for instance the Fixed Income market is a market where the qualified and non-qualified investors are not mixed with each other and hence don't have the same requirements as the Equity market has. Different markets have different conditions and different types of clients and an enormous amount of sub asset classes in different currency areas. One size doesn't fit all.

As stated above the SSDA is of the opinion that the equity market should receive first and exclusive attention.

(51) What is your opinion of the suggestion for the introduction of a European Consolidated Tape for post-trade transparency? Please explain the reasons for your views, including the advantages and disadvantages you see in introducing a consolidated tape.

SSDA supports European Consolidated Tape for post-trade transparency for the equity markets. However regarding Fixed Income, the differences in characteristics regarding each currency area is so big that the question will be brought back to what kind of post transaction transparency is suitable for each sub market. The normal idea behind "consolidated tapes" is fast, short and speedy post

transaction transparency. It is not suitable for all transactions, the nature of the different markets and the transactions within each sub market are such that its information will be just fragmented execution prices which are not comparable, it would be non-neutral from a competition perspective towards smaller currency areas.

(52) If a post-trade consolidated tape was to be introduced which option (A, B or C) do you consider most appropriate regarding how a consolidated tape should be operated and who should operate it? Please explain the reasons for your view

Regarding the equity trading The SSSA supports option B (first choice) and option C.

(57) Which timeframe do you envisage as appropriate for establishing a consolidated tape under each of the three options described?

Regarding the Fixed Income market the need is low to compare with the equity market where we see the need as important.

(58) Do you have any views on a consolidated tape for pre-trade transparency data?

Regarding the Fixed Income market the information is easily accessible through vendors for standardised transactions.

(59) What is your opinion about the introduction of a consolidated tape for non-equity trades? Please explain the reasons for your views.

Fragmented and complex markets which make aggregated information not useful. For the Fixed Income market the information is already easily accessible for all qualified investors.

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