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Considerations and consultation responses regarding the adaptation of transparency rules according to MiFID II/MiFIR

Summary

Finansinspektionen (FI) published on 11 April 2017 a consultation memorandum with a proposed adaptation to the new transparency rules for non-equity-related financial instruments that will be introduced in connection with the new European regulatory framework: the Directive and the Regulation on markets in financial instruments (MiFID II/MiFIR).

FI considers transparency to be a tool for achieving more efficient and well-functioning markets. In turn, well-functioning markets contribute to financial stability and a high level of consumer protection. The responding stakeholders also agree that transparency is important for achieving efficient and well-functioning markets.

All responding stakeholders either support or have no objection to FI's position to waive the obligation to make public pre-trade order information and authorise deferred publication of post-trade information. FI will therefore waive the obligation to make public pre-trade order information if the conditions set out in MiFIR are met. FI will also authorise deferred publication of post-trade information about transactions until 7:00 PM on the second day after the day the transaction occurred, assuming the conditions are met.

A number of responding stakeholders reject FI's position to supplement the authorisation of deferred publication with earlier publication of aggregate information. Other responding stakeholders, however, emphasise the importance of not impairing the current level of transparency, which FI also considers to be of importance. In order to maintain the current level of transparency, FI will therefore require that authorised deferred publication of post-trade information be combined with publication of transactions in aggregate form for a minimum of five transactions executed on the same day in a single instrument. This information shall be made public the following working day before 9:00 AM.

FI's preliminary position not to authorise the further extension of the period of

deferred publication is rejected by several responding stakeholders. However, FI believes that the current level of transparency would be impaired if an extended period of deferral of four weeks or more would be allowed on a regular basis. FI will therefore not automatically authorise an extended period of deferral but is open to authorising such extensions under certain conditions. One condition for this is that transparency as a whole is not impaired compared to today's transparency levels. FI will evaluate the application of the adapted regulation on a regular basis and may reassess its position if conditions change.

Background

The introduction of a new European regulatory framework, the Directive and the Regulation on markets in financial instruments (MiFID II/MiFIR), means that the previous transparency regulations in the EU will be supplemented with a unified regulatory framework containing expanded requirements covering basically all financial instruments traded on a trading venue. Given this change, FI published on 11 April 2017 a consultation memorandum with preliminary assessments of the possibilities to either waive the obligation to make public or authorise deferred publication of information for non-equity-related instruments. Several participants on the securities market have utilised the possibility to submit feedback on the consultation memorandum.

General feedback

Preliminary general considerations according to the consultation memorandum

FI's assignments are to promote a stable financial system, which is defined by a high level of confidence and well-functioning markets that meet the needs of households and corporations for financial services, and provide comprehensive protection for consumers. A well-functioning market has strong market liquidity. Market participants are able to rapidly trade significant volumes at a low transaction cost and without a transaction having a negative impact on the market price. Transparency is a tool that smooths out informational asymmetries and also ensures that assets are valued and traded at fair prices. FI has previously taken steps to achieve a higher level of transparency on the Swedish market than what was required at the European level through MiFID I. This is therefore an important factor to take into consideration when the new transparency rules in MiFIR are introduced and adapted to the Swedish market. FI also makes the assessment that a Swedish adaptation of the rules should take into consideration the fundamental purpose of a unified EU regulatory framework and that competition between Swedish market participants and participants in other Member States should not be distorted.

General feedback from the responding stakeholders

The responding stakeholders agree that transparency is important for achieving efficient and well-functioning financial markets. However, most of them believe that it is important to design publication requirements in such a way as

to prevent the impairment of liquidity. Several responding stakeholders believe that FI should avoid introducing rules that lead to a lower degree of transparency than what we have today. One consultation body believes that it should never be possible to waive the obligation set out in the primary rule.

Some responding stakeholders assert that FI should take into consideration the special features of different asset classes, since markets vary and fill different needs. Several responding stakeholders also believe that it is important to harmonise the rules within the EU to avoid the risk of distorting competition.

Two responding stakeholders comment that they have yet to see a detailed analysis of the consequences for the markets as a result of the new rules and various application alternatives.

In addition to that which is related to the consultation memorandum, one consultation body also requests a regulation that ensures regular and harmonised publication of issued amounts in bonds.

FI's general opinion

FI stated in the consultation memorandum's general considerations that transparency is a tool for achieving more efficient and well-functioning markets. In turn, well-functioning markets contribute to financial stability and a high level of consumer protection. The scientific studies referred to in the consultation memorandum confirm the view that transparency is overwhelmingly positive for the way markets function. FI's own assessment of the change in practice on the corporate bond market does not indicate that greater transparency had a negative effect, either.

When FI promotes well-functioning markets, there are certain financial markets that need to function to ensure that the financial system can execute its central tasks. The markets that FI considers to be systemically important are the fixed-income and currency markets; it is these markets financial firms primarily use to continuously manage liquidity, financing and risks. On the secondary market for treasury bonds and covered bonds, there are authorised market makers that have undertaken to facilitate execution and support liquidity. It is FI's assessment that these markets are currently functioning relatively well. Therefore, the goal should be, based on the options presented in MiFIR, to maintain the current degree of transparency on these markets. It is also FI's opinion in terms of corporate bonds that transparency should not be impaired compared to today.

The primary rule in MiFIR is full and immediate transparency for all non-equity-related instruments. FI's review of the effects on the fixed-income market, however, shows that a large number of the affected instruments will qualify for the pre-trade waiver and deferred publication.

The transparency requirements in effect today in Sweden cover transactions in financial instruments admitted to trading on a regulated market in Sweden or

traded on a trading venue in Sweden. One difference compared to MiFIR is that Swedish firms that trade outside a trading venue must comply with the Swedish application of the transparency regulation in all trading in a certain type of asset regardless of where the instrument is admitted and where the trading takes place. Swedish firms active on markets other than the Swedish market, therefore, may be subject to different publication requirements than other firms active on the same market.¹

Pre-trade transparency

Preliminary considerations regarding pre-trade transparency according to the consultation memorandum

Under MiFIR, a competent authority is able to waive the obligation to make public pre-trade order information. Whether and to what extent such a waiver will be granted can be adapted to Swedish conditions.

The current regulations in Sweden do not contain any requirements on pre-trade transparency in non-equity-related instruments similar to those that will be introduced via MiFIR. FI's review of the effects on the fixed-income market shows that a large number of the affected instruments will be able to apply the waiver. FI has also noted that the new requirements improve the conditions for transparency – even if the waiver is applied.

FI's preliminary assessment is that it would be too much of a readjustment to the current manner in which the market functions to eliminate the possibility to apply the waiver. FI therefore proposes that waivers according to Article 9(1) of MiFIR be granted when the conditions are met.

Feedback from the responding stakeholders

All responding stakeholders support or have no objection to FI's position. Two responding stakeholders also highlight that FI should waive the obligation in accordance with Article 18(2) of MiFIR. This would mean that systematic internalisers (SI) who have agreed to quote prices in non-equity-like illiquid instruments may be released from the obligation to inform customers about current bids.

FI's position on pre-trade transparency

No grounds have arisen on which to reassess FI's preliminary position to waive the obligation in accordance with Article 9(1) of MiFIR. FI also believes that it should be possible to waive the obligation in accordance with Article 18(2) of MiFIR. FI therefore intends to waive the obligation if the conditions are met². FI reserves the right to reassess these decisions if grounds for such were to arise.

¹ The Home State's rules apply to cross-border operations. An interpretation discussion is currently under way regarding the extent to which a branch in another EU country must apply the Host State's transparency regulations.

² The waiver is granted if the conditions according to MiFIR Article 9(1) are met.

Post-trade transparency

Preliminary considerations regarding post-trade transparency according to the consultation memorandum

Under MiFIR, a competent authority may authorise deferred publication and in addition decide on temporary suspensions in accordance with Article 11(2) of MiFIR. This means that FI can establish its position on three possible applications of the rules for publication of transactions:

1. real time transparency – if FI does not authorise deferred publication
2. deferred publication – if FI authorises deferred publication
3. adapted deferred publication – if FI authorises deferred publication combined with one of the adaptations listed in Article 11(3) of MiFIR.

The Swedish market currently has rules for the publication of information about transactions for non-equity-related instruments even if they are not as far-reaching as the primary rule in MiFIR (Articles 10 and 21). Not authorising any exemptions would be a relatively extensive change to the way in which the market functions, particularly on the fixed-income market. It is not currently clear how other EU countries will use the exemption possibilities from the primary rule. It is probable that exemptions will be granted, either in full or conditional. As a result, FI should adopt a similar approach in order not to deviate from the objective of a common regulatory framework. It is therefore FI's perception that the possibilities to apply deferred publication should be allowed if the conditions in Article 11(1) are met.

Feedback from the responding stakeholders

All responding stakeholders support or have no objection to FI's position.

One consultation body believes that FI should apply the rules in a different way than what is set out in MiFIR Article 11(1), for example with different deadlines for when the transactions must be published and that any order that is judged to be larger than normal market size should amount to at least SEK 100 million.

FI's position on post-trade transparency

FI does not believe that any cause has arisen to reassess its preliminary position to grant exemptions according to the primary rule in Article 11(1) of MiFIR. FI reserves the right to reassess this decision if grounds for such were to arise.

Supplemental requirements

Preliminary considerations regarding supplemental requirements according to the consultation memorandum

FI believes it to be important that the current level of transparency on the Swedish market for non-equity-related instruments is not impaired following

the introduction of MiFIR. If FI chooses to authorise deferred publication in full, the information about the affected transactions is to be published no later than 7:00 PM two working days after the date of the transaction. FI believes that this deviates too much from the current regulations, under which transactions shall be published as soon as possible or, for debt instruments in aggregate form, prior to 9:00 AM the day following the transaction date.

FI's preliminary assessment is that it is possible to avoid impairment of today's transparency levels by applying the adaptation options set out in Article 11(3) of MiFIR. One of these options is to request publication of limited details of transactions, excluding volume, within 15 minutes from the point of the transaction. In addition, it is possible to request publication of transactions in aggregate form if an undertaking completed five deals in one instrument. Therefore, FI intends preliminarily to supplement the authorisation of deferred publication with an adaptation according to Article 11(3)(a) of MiFIR.

Feedback from the responding stakeholders

Several responding stakeholders support FI's position and assert the importance of not impairing the current degree of transparency. Several responding stakeholders have no objections.

A number of responding stakeholders reject FI's position. They believe, for example, that the publication of prices within 15 minutes from the point of the transaction would disclose information that could harm market makers and that market makers would not have enough time to be able to close large, illiquid positions. These responding stakeholders also questioned whether it is feasible to combine the possibility of publishing individual transactions within 15 minutes (without volume) and publishing information in aggregate form since the conditions for the latter (the number of executed transactions) are not known at the point of the former option.

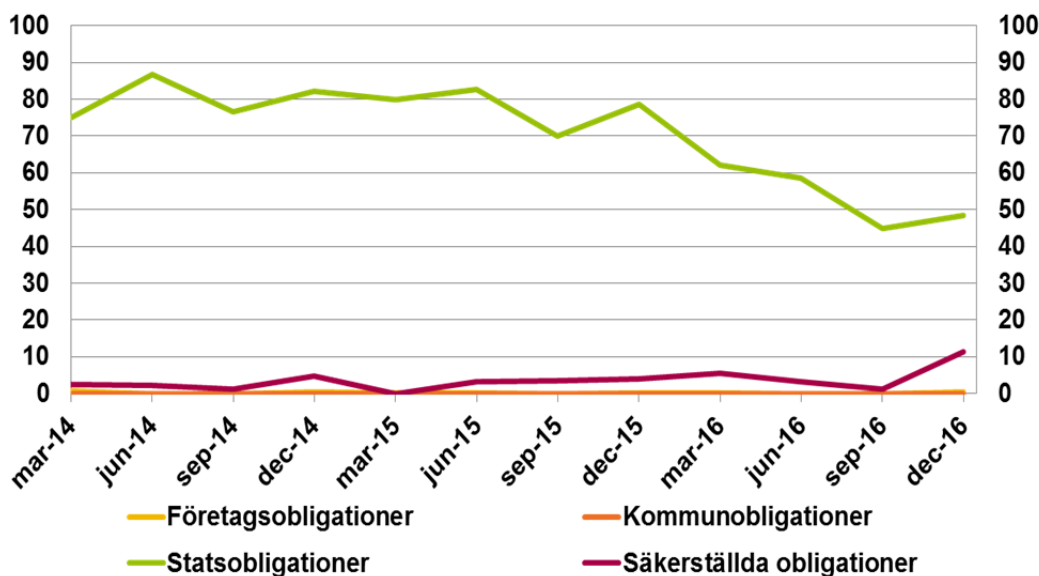
One consultation body believes it is very important to determine whether the Host State principle or the Home State principle applies when applying the rules.

FI's position on post-trade transparency supplemented with a requirement that additional information be published earlier

The responding stakeholders that reject FI's position assumed that publication of information about a transaction with the exception of volume-related information (according to Article 11(1)(a)(i) RTS 2) shall occur within 15 minutes of the execution of a transaction. They take the position that this time limit is not feasible when combined with the publication in aggregate form of at least five transactions by 9:00 AM the following day. FI believes that it is not clear when information, with the exception of volume, must be made public. FI believes, like the responding stakeholders, that it is not feasible to combine the earlier publication deadlines if the information must be published at different points in time.

Both FI and a number of responding stakeholders believe that it is very important not to impair the current level of transparency in Sweden. Transparency ensures that assets are valued and traded at fair prices and contributes to efficient markets. FI will therefore authorise deferred publication combined with a supplemental requirement on earlier publication of information in aggregate form for at least five transactions³ in order to stay as close to today's regulation as possible.

Diagram 1: Share of bonds with on average 5 or more transactions per day. (Per cent)



Source: FI's transaction reporting system

Note: Treasury bonds also include premium bonds. Municipal bonds are the equivalent of "Other Public bonds" in RTS 2.

FI has determined that the above application will probably impair the current level of transparency since fewer transactions will be made public in aggregate form than before given the requirement on the minimum number of transactions that must be included. This may be compensated for by the rule that all details regarding individual transactions must be made public by 7:00 PM two business days after the date of the transaction. FI intends to evaluate and follow up on the proposed application and, for example, will evaluate whether information about a transaction, with the exception of information about volume, should be published earlier even in cases where there are fewer than five transactions. Such an application, however, should assume that information about individual transactions can be published at 9:00 AM on the day after the transaction was executed.

³ The aggregation is at the ISIN level and therefore can include aggregate information from several submitting entities.

Extended period of deferral for some information

Preliminary considerations regarding an extended period of deferral according to the consultation memorandum

FI can also authorise an extended period for deferred publication according to Articles 11(23)(b-d) of MiFIR. However, FI has not been able to identify in this analysis any reasons to justify such an adaptation.

Feedback from the responding stakeholders

Several responding stakeholders support FI's position. However, one consultation body believes it is important for FI to monitor the market to ensure that, for example, liquidity is not impaired.

A number of responding stakeholders reject FI's position. They believe that the market makers need more time to manage their risks with regard to very large volumes and some types of illiquid securities. The responding stakeholders also believe that FI should authorise an extended period of deferral in order to avoid the distortion of competition and promote a harmonised application of the regulatory framework within the EU.

FI's position on authorisation for an extended period of deferred publication

The responding stakeholders that reject FI's position believe it would distort competition to the disadvantage of Swedish participants and markets if FI were to choose to apply stricter requirements than other EU countries. The FCA in the UK has recently made public its intention to always waive the obligation for pre-trade publication and authorise deferred publication and extended periods of deferral if the conditions are met.

Sweden already applies today more far-reaching requirements on transparency than many other countries. There are currently no signs indicating that Swedish firms are at a competitive disadvantage in relation to other countries due to this. In contrast, when transparency was improved on the Swedish market for corporate bonds, the market shares for the market participants subject to the change increased.⁴ However, it is possible that the entry into force of MiFIR, with its expanded harmonisation of rules and introduction of more effective requirements on best execution, will change the conditions for competition compared to what they were before. FI will therefore continue to monitor this development.

The primary rule of MiFIR is that post-trade information shall be made public as close to real time as is technically possible. Several responding stakeholders believe that market makers need more time to manage their risks. FI believes that authorisation to defer publication of information until 7:00 PM the second business day after the day of the transaction (with some information published earlier) should normally be enough to manage risk. FI believes that there is a

⁴ FI Memorandum: *Transparens på marknaden för företagsobligationer*, 11 November 2015. Available only in Swedish.

risk that the current level of transparency will be impaired if an extended period of deferral of four weeks or more would be allowed. Therefore, FI will not automatically authorise extended periods of deferral.

In the event that the total transparency, given FI's other positions above, is still judged to be satisfactory, FI may consider authorising extended deferral of some information. In these cases, FI will evaluate whether the current level of transparency can be maintained even with such an authorisation. FI has determined in examples in the consultation memorandum that the share of bonds and related derivatives that may be classified as liquid is low. This also is the case for primarily government bonds and to some extent covered bonds. For liquid bonds, transactions that fall below the threshold values (SSTI and LIS)⁵ that apply to deferred publication will be published within 15 minutes from the transaction and in this way contribute to transparency. It is also more probable, primarily for government bonds and to some extent covered bonds, that the number of transactions may total five or more each day and thus lead to the publication of a daily aggregate volume the day after the transaction date.

FI therefore believes it will mainly be government bonds and covered bonds that will apply an extended period of deferral for some information before the level of transparency begins to suffer.

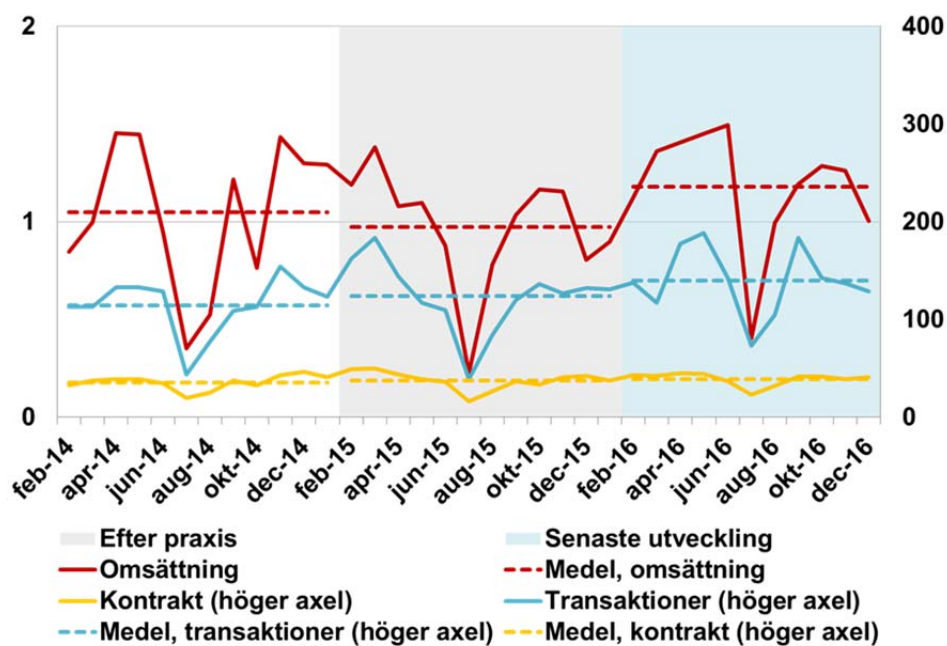
It is very important that FI follow this development on the markets in order to identify whether the new regulations under MiFIR and the application of deferred publication result in any changes in trading patterns. FI reserves the right to reassess any decisions if grounds for such were to arise.

⁵ A transaction that exceeds a specific size for the financial instrument (SSTI) or if it is larger than normal size on the market (LIS).

Appendix 1

One consultation body points to a methodology error in FI's evaluation of the change in practice on the corporate bond market. Even after correcting this error, FI's conclusions remain the same. See the updated results in Diagram 1.

Diagram 1. Daily transaction activity for all corporate bonds (SEK billion) (number)



Source: Finansinspektionen's transaction reporting system.

Note: The diagram shows an average per month of daily transaction activity during the period February 2014 to December 2016. *Turnover* is the average daily turnover per month. *Contract* shows the average daily number of active bond contracts per month. A bond is considered active if it is traded at least once during a specific day. *Transactions* are calculated as the average of the daily number of transactions per month.