To
ESMA

NORDIC SECURITIES ASSOCIATION

Memo

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NSA response to ESMA consultation on the transparency regime for equity and equity-like instruments, the double volume cap mechanism and the trading obligations for shares.

The NSA[1] welcomes the opportunity to respond to ESMA's Consultation Paper "MiFID II/MiFIR review report on the transparency regime for equity and equity-like instruments, the double volume cap mechanism and the trading obligations for shares" Besides responding to the specific questions in the call for evidence, NSA would also like to make following general comments:

General comments

From a general perspective, the NSA is concerned with the data quality in general, as also recognized by ESMA. We fear that these challenges also affect the statistics used in the consultation reports, which should be taken into consideration in the ongoing work with the MIFIDII/MiFIR Review.

Firstly, the NSA strongly opposes the ESMA proposal to remove SIs as eligible execution places for the purposes of the share trading obligation (STO). SIs are critical suppliers of liquidity and offers more efficient execution than trading venues not at least due to the poor quality of the trading venues' order books. The removal of SIs as eligible execution venues for the STO will reintroduce a de facto concentration rule and compromise competition within trading.

Second, both the buy- and sell side in Europe (and globally) have stressed for a long period of time and substantially documented that trading venues – and in particular incumbent exchanges – already hold a monopoly position in market data, which has still not been addressed despite a broad recognition of such problems[2]. The NSA strongly supports the ESMA final report on measures to handle these market data problems and that the suggested actions are implemented.

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[1] The Nordic Securities Association (NSA) is a Nordic cooperation that works to promote a sound securities market primarily in the Nordic region. The NSA is formed by the Danish Securities Dealers Association (Børsmæglerforeningen), Finance Finland (Finanssiala), the Norwegian Securities Dealers Association (Verdipapirforetakenes Forbund) and the Swedish Securities Dealers Association (Svenska Fondhandlare-föreningen).
Nordic Securities Association's public ID number in the Transparency Register is: 622921012417-15
[2] See e.g.
https://www.esma.europa.eu/sites/default/files/library/mifid_ii_mifir_review_report_no_1_on_prices_for_market_data_and_the_equity_ct.pdf

Q1: What is your view on only allowing orders that are large in scale and orders in an order management facility to be waived from pre-trade transparency while removing the reference price and negotiated trade waivers? Instead of removing the RP and NT waivers, would you prefer to set a minimum threshold above which transactions under the RP and NT waivers would be allowed? If so, what should be the value of such threshold? What alternatives do you propose to simplify the MiFIR waivers regime while improving transparency available to market participants? Please explain.

The NSA is strongly in favor of keeping the Negotiated Trade Waiver (NTW) without any limitations such as the volume cap, since it is a very important tool not at least in smaller markets and markets with lower liquidity levels and, in addition to the benefit of retail investors, where many are directly affected via investments in pension funds. Furthermore, to our knowledge, the NTW has not been a source of misuse.

Smaller markets may not have sufficient depth of liquidity on the order book to match orders above a certain size at a particular point in time. This means that orders even slightly larger than average (but below a size which would qualify for the large in scale waiver) can negatively impact the market resulting in increased price volatility to the detriment of investors. Even shares which are classified as "liquid" under MiFIDII/MiFIR can still go through periods of lower liquidity when the use of the NTW becomes more critical in order to reduce increased price volatility and support trading activity.

Increasing the possibility of using the NTW for liquid shares during lighter trading periods will have the effect of increasing the investor appetite in such shares, at least in the smaller markets.

Negotiated trades are recognized as on-exchange transactions which are handled subject to the rules of the trading venue as supervised by the relevant regulator. In the Nordic regions, the negotiated transactions are made at or within the volume weighted spread on the lit order book of that trading venue. All negotiated transactions in equities are:

- Supervised by the same surveillance department that is also supervising the transparent order book,
- Reported immediately to the trading venue and executed subject to the trading rules of the market, and
- Published immediately in the trading venue's post-trade system and integrated into one data feed with order book deals, thereby included in all price statistics, including index calculations and the official closing price.

This demonstrates that negotiated transactions are a reliable and transparent trading method, providing both benefits to the investor, but also supplementing the price formation process in the transparent order book, and providing additional liquidity to the equity markets.

Having regard to the policy goals of price formation and best trading outcomes for investors, the following specific conditions should be attached to the execution of NTW assisted transactions:

- NTW should only be used by trading venues that have lit order books, so that they can provide additional liquidity to that trading venue
- NTW should only be used for trades that are done on a bilateral basis and reported in immediately to the trading venue's system, so that these are included in index calculations, price statistics
- These must be done under the rules of the trading venue and be subject to full market surveillance
- The trading venue must be obliged to react on any misuse and if the price formation is negatively affected, and to report same to the competent authority,

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- When approving the NTW for the trading venue, and also when supervising the activity on those trading venues, the competent authority shoul retain the rights to withdraw or modify the approval for the waiver, and
- ESMA could be given a coordinating role and, if deemed necessary, have the mandate to introduce restrictions such as requirements on the trading venues that offers the NTW.

By clarifying these specific features for negotiated transactions in MiFIR it will be ensured that the NTW cannot be abused to create new separate dark pools or OTC-trading that would have negative effects on the price formation process.

Q2: Do you agree to increase the pre-trade LIS threshold for ETFs to EUR 5,000,000? Please explain.

No, the NSA does not support an increase in the LIS threshold.

Q3: Do you agree with extending the scope of application of the DVC to systems that formalise NT for illiquid instruments?

No, a broadening of the scope will most likely be detrimental to trading and liquidity in shares of smaller issuers. See also our response to Q1. In addition, there is another general with the liquidity calibration for shares, which captures too many shares as "liquid", which are not truly liquid.

Q4: Would you agree to remove the possibility for trading venues to apply for combination of waivers? Please justify your answer and provide any other feedback on the waiver regime you might have.

No. The NSA does not see the need to remove the trading venues ability to apply for a combination of waivers.

Q5: Do you agree with the proposal to report the volumes under the different waivers separately to FITRS? Please explain.

As it would be a good idea to report the volume under the different waivers, the NSA suggests that firms can report under the same regime as today in order not to increase costs when adding a new place to report.

Q6: What would be in your view an alternative way to incentivise lit trading and ensure the quality and robustness of the price determination mechanism for shares and equity-like instruments? Please explain.

The NSA agrees that steps should be taken to incentivise lit trading as the quality of the trading venues order book has decreased considerably since MiFID I. This is e.g. due to the fragmentation and the trading venues unhealthy approaches in attracting liquidity from each other. For example, the usage of maker-taker fee attracts only short-sighted liquidity which dissapears in times of distress and the "one-size-fits-all" tick size table in MiFIDII/MiFIR (RTS 11) has resulted in too low tick sizes in some markets and too high tick sizes in other markets:

Research reveal that, for instance, in the Nordic market, the present tick size tables have challenged the ability to provide good execution quality in the shares which faced a tick size decrease under RTS 11:

- In shares where the tick sizes declined, the spreads also declined
- In shares where the tick sizes declined, volumes on the best price level declined
- In shares where the tick sizes declined, BBO price update frequency increased

All of these factors make it more difficult for market players to execute larger orders with minimal market impact.

The NSA proposes to revise RTS 11 so that shares in the EU face tick sizes which support liquidity and volumes on all EU trading venues, and to increase the execution quality to the benefit of investors. The following changes should be reflected:

- Turnover velocity (turnover/free float market capitalisation) is a better proxy for liquidity than average number of trades.

- Behavioral consequences/dynamics should be taken into account more frequently, i.e. by updating the appropriate tick size quarterly, instead of yearly

- Each venue (most liquid/the incumbent exchange) should be able to determine the relevant tick size based on a tick size table with i.e. 3 options. The tick size must be respected by all (particularly relevant if the proposed new tick size table is two dimensional like the FESE tables or if creating options for the most liquid market is not doable).

Tick sizes are defined as the lowest price increment in securities, and an obvious conclusion is that lower tick sizes imply lower costs. This is, from an isolated perspective, true.

However, when tick sizes are reduced below a certain level, the incentive for traders to quote is also reduced causing decreasing depth in the order book. While the change in tick size might improve the liquidity for small size orders, institutional traders are worse off. They must bear an increase in trading costs following the decline in depth throughout the entire order book (market impact).

To compensate, larger orders will increasingly be executed outside the lit order books in case tick sizes are too low or too high. This is exactly what has been observed.

Academic research supports to a large extent these considerations. Please see e.g. Kou, Huang & Chen (2010), Bourghelle & Declerck (2002), Yet, Goldstein & Kavajecz (2000), Lau & McInish (1995), Harris (1994), Darlay, Outkin, Palte og Gao (2001)

During MiFID1 – we faced an actual “tick size war” between trading platforms which reduced tick sizes to attract (low quality) liquidity from each other. This led to an industry-led creation of the so-called FESE tick size tables to harmonise the tick size regime across Europe. One of the good things about these tables was that they took various degree of liquidity in each share into account in a much better way than the present “one-size-fits-all” regime in RTS 11.

Actually, the AMF study based on Euronext[3] data apparently support this approach. Looking a pages 4 and 5 in the study, it illustrates a significant change – and mostly an increase - in tick sizes on Euronext compared to the previous FESE tables. With this in mind, the proposal from ESMA to tick size validate SI quotes up to Standard Market Size, was, as far as we know, mainly based on a study on Euronext data. Apparently, this study revealed a significant increase in SI trading at sub-tick below SMS as clients requested price improvement.

With this new information in mind, the NSA believes that the reason for the increase in SI trading at sub-tick could be due to the tick size increase at Euronext compared to

[3] http://www.amf-france.org/en_US/Publications/Lettres-et-cahiers/Risques-et-tendances/Archives?docId=workspace%3A%2F%2FSpacesStore%2F4ee6cbf6-c425-4537-ab74-ef249b9d316d

the FESE tables. NSA recommends that this study from Euronext should be replicated for other exchanges as well, since we believe the conclusions will substantiate our claim.

Q7: Which option do you prefer for the liquidity assessment of shares among Option 1 and 2? Do you have an alternative proposal? Do you think that the frequency of trading should be kept as a criterion to assess liquidity? If so, what is in your view the appropriate thresholds for the percentage of days traded measured as the ratio between number of days traded and number of days available for trading (e.g. 95%, 90%, 85% etc.)? Please explain.

In the opinion of NSA, the liquidity calibration captures too many liquid shares. This is in particular a problem in Sweden and the NSA urges ESMA to investigate this further.

Q8: Do you agree in changing the approach for ETFs, DRs as proposed by ESMA? Do you have an alternative proposal? Please explain.

The NSA has no strong opinion.

Q9: Do you agree in removing the category of certificates from the equity-like transparency scope? Please explain.

The NSA has no strong opinion.

Q10: Do you agree in deeming other equity financial instruments to be illiquid by default? Please explain.

The NSA supports this approach as the magnitude of instruments is expected to be limited. This is also expected to be the case for the liquidity of the applicable instruments

Q11: Do you agree in separating the definition of conventional periodic auctions and frequent batch auctions? Do you agree with ESMA's proposal to require the disclosure of all orders submitted to FBAs? Please explain.

No – the definitions should be identical in order to avoid misuse of the auctions and the NSA does not agree with the ESMA proposal to disclose all order submitted to FBAs.

Q12: Do you agree that all non-price forming systems should operate under a pre-trade transparency waiver? Please explain.

The NSA supports that all non-price forming systems should operate under a pre-trade transparency waiver. However, there is a need to clarify further what is "non-price forming systems" with the RTS 1, art. 2 in mind.

Q13: What is your view on increasing the minimum quoting size for SIs? Which option do you prefer?

The NSA supports increasing the minimum quoting size for SIs. With reference to Q15 and the proposed changes in SMS, NSA supports to increase the minimum quoting size to 50 %.

Q14: What is your view on extending the transparency obligations under the SI regime to illiquid instruments?

NSA does not support the proposed extension of the transparency obligations under the SI regime to cover all illiquid instruments. First of all because SIs – in contrast to trading venues – put their own capital at risk when publishing prices, which means they are more exposed to the consequences of transparency. Secondly because such an extension would dilute the definitions of and differences between liquid and illiquid instruments. And thirdly because some equities are very seldomly requested and traded by investors and therefore illiquid in nature.

Additionally, the NSA would like to stress the urgent problem of the fact that may trading venues', if not all, charge fees from Systematic Internalisers' (SIs) for distributing and publishing the SI's own quotes. This is one aspect of the problems with increasing market data costs as also reflected in the ESMA final report on market data. Extending the transparency obligation under the SI regime would only increase these market data costs even further.

Q15: With regard to the SMS determination, which option do you prefer? Would you have a different proposal? Please explain.

The NSA supports option B.

Q16: Which option do you prefer among Options A, B and C? Would you suggest a different alternative? Please explain

The NSA does **not** support any of the solutions. The NTW should be kept unrestricted for both liquid and illiquid instruments as elaborated in Q1.

In case the DVC is not removed, NSA supports option B

Q17: Would you envisage a different system than the DVC to limit dark trading? Please explain.

To improve the trading venues lit order books as elaborate in Q6 would be a significant step forward to attract liquidity and limit dark trading.

Q18: Do you agree in removing the need for NCAs to issue the suspension notice and require trading venues to suspend dark trading, if required, on the basis of ESMA's publication? Please explain.

The NSA agrees.

Q19: Do you agree in removing the requirement under Article 5(7)(b)? Please explain.

The NSA does not agree, as this change will increase the trading venues costs which ultimately will end with the clients. Furthermore, ESMA writes that this is also only possible at ESMA level, which also makes the proposal unrealistic.

Q20: Please provide your answer to the following survey (<= click here) on the impact of DVC on the cost of trading for eligible counterparties and professional clients.

N.a.

Q21: Do you agree in applying the DVC also to instruments for which there are not 12 months of available data yet? Please explain

The NSA supports this proposal.

Q22: Do you agree foresee any issue if the publication occurs after 7 working days instead of 5? Please explain.

The NSA does not foresee any issues if the publication occurs after 7 working days instead of 5.

Q23: Do you agree that the mid-month reports should not be published? Please explain.

The NSA agrees that the mid-month report should not be published.

Q24: Do you agree with ESMA's proposal to include in Article 70 of MiFID II the infringements of the DVC suspensions? Please explain.

The NSA has no comments to this question

Q25: Do you agree with ESMA's assessment that the conditions for deferred publication for shares and depositary receipts should not be subject to amendments? If not, please explain.

The NSA agrees.

Q26: Do you agree with ESMA's proposal to increase the applicable threshold for ETFs and request for real-time publication for transactions that are below 20,000,000 EUR? If not, please explain.

The NSA has not a strong opinion**.**

Q27: Do you agree with ESMA assessment of the level of post trade transparency for OTC transactions?

The NSA agrees and concurs with the need for enhancing the data quality – not only for OTC trades but in general.

Q28: Do you agree with the proposal to report and flag transactions which are not subject to the share trading obligations but subject to post-trade transparency to FITRS? Please explain.

The NSA supports a proposal which may help in demystifying the apparent concerns of the level of OTC trading and to help clarify any wrongdoings in the reporting. However, requiring the information to be sent to FIRTS directly would imply significant costs with respect to it-developments, which is considered unproportionate. The requirements should be included in the existing reporting regime.

Q29: What is your experience related to the publication of post-trade transparency information within 1 minute from the execution of the transaction? Do you think that the definition of "real-time" as maximum 1 minute from the time of the execution of the transaction is appropriate/too stringent/ too lenient? Please explain.

The NSA has not observed any problems with the requirement to publish trades within 1 minute from the execution of the transaction and the definition is appropriate in the view of NSA.

Q30: Do you agree with ESMA's approach to third-country trading venues for the purpose of transparency requirements under MiFID II? If no, please explain.

The NSA agrees that the use of its supervisory tools (i.e. an Opinion) is adequate and there is no need to change level 1.

Q31: Do you agree that the scope of the share trading obligation in Article 23 of MiFIR should be reduced to exclude third-country shares? If yes, what is the best way to identify such shares, keeping in mind that ESMA does not have data on the relative liquidity of shares in the EU versus in third countries? More generally, would you in-

clude any additional criteria to define the scope of the share trading obligation and, if yes, which ones?

The NSA agrees that is a sensible approach to limit the scope of the STO by excluding third-country shares.

However, the NSA strongly encourages a removal of the STO in case SIs are no longer deemed eligible as execution venues for the STO in order to avoid a de facto concentration rule.

Q32: Would you support removing SIs as eligible execution places for the purposes of the share trading obligation? If yes, do you think SIs should only be removed as eligible execution places with respect to liquid shares? Please provide arguments (including numerical evidence) supporting your views.

The NSA strongly disagree with the proposal to remove SIs as eligible execution places of the STO. Such step will hurt client execution and reintroduce a de facto concentration rule by removing competition within trading. This is neither in line with MiFIDII/MiFIR nor the Capital Markets Union.

The NSA does not see a problem with an increasing role of SIs as long as the SIs business model complies with the requirements in MiFIDII/MiFIR. One of the fundamental reasons for introducing quantitative requirements and opt-in possibilities for becoming an SI in MiFIDII/MiFIR was to move trading away from pure OTC/BCNs and to increase the number of SIs to strengthen the competition between execution venues to the benefit of the clients and the efficiency in the capital market.

Furthermore, the proposal to limit the STO in liquid shares to venues only, whereas SI could remain an eligible execution place for illiquid shares is equally unacceptable. It will neither be an acceptable "middle ground" to recognize SIs as eligible execution venues for the share trading obligation above LIS.

The NSA struggles to understand what has made ESMA propose such a radical step. As for the SIs market share of trading, ESMA should bear in mind that the success of SIs, to a great extent, is due to the poor quality of the trading venues order books which is not supporting on-venue trading, and in particular with respect to larger size orders, as also described in Q 1 and Q 6.

SIs provide clients with more efficient execution, more choice and at lower costs than trading venues. For retail clients, SIs can provide immediate execution at a known price. For wholesale clients – such a pension funds - SIs can minimize the market impact when executing larger orders, which trading venues in general are unable to support. This is not at least due to the generally poor quality of the trading venues order books with low volume and undue interference from non-genuine "liquidity-providers", which is a consequence of e.g. inappropriate incentive schemes and insufficient tick sizes.

For all clients there is a wish to minimize costs and maximise return. There is no reason to punish investors by forcing them to accept higher costs due to lower execution quality. This is not appropriate investor protection. Additionally, eliminating SIs as eligible execution venues will diminish investor choice which is also not in line with MiFIDII/MiFIR.

If the concerns are that some SIs do not act according to the rules as they apply to SIs (i.e. using risk capital when executing client orders and not operating a multilateral system according to MiFIDII, art. 4 (2) (20)) but instead operating in SI networks, the NSA urges ESMA to investigate and document this allegation in depth before suggesting any alternative steps taken. In this context, the NSA is missing documentation of the apparent, multilateral business model of some SIs. From a Nordic perspective we cannot recognize this behavior. NSA is, however, open towards strengthening the description of compliant SI activity, and include this in level 2 regulation rather than in Q&As, if so needed.

The NSA suggests that ESMA, in order to ensure that SIs are acting compliantly, strengthen the content of the supervision on the basis of the following proposal:

- According to regulation 2014/65, article 4(1)(29), a systematic internaliser is an investment firm which, on an organised, frequent systematic and substantial basis deals on own account when executing orders outside a trading venue without operating a multilateral system.

- This is further explained in recital 19 of delegated regulation 565/2017 which states that a systematic internaliser should not be allowed to bring together third party buying and selling interests in functionally the same way as a trading venue. A systematic internaliser should not consist of an internal matching system which executes client orders on a multilateral basis. An internal matching system in this context is a system for matching client orders which results in the investment firm undertaking matched principal transactions on a regular and not occasional basis.

- Under the present regime systematic internalisers in shares are obliged to provide firm quotes in sizes of minimum 10% of SMS. However, beyond that, they are vital to ensuring liquidity to the market because they normally stand ready to execute orders OTC above 10% of SMS.

Like all investment firms systematic internalisers are required to act in the best interests of their customers (best execution) and one of the ways they can do that is by being an alternative to the trading venues, in particular in trading sizes below Large In Scale.

Part of being a systematic internaliser and acting in the best interest of the customers is to bring together trading interests when this can be done without establishing a system which resembles the functioning of a trading venue. Key to defining this role is to define what constitutes “an internal matching system”. Trading venues have automated systems which assure that multiple trading interests can interact and be combined without human intervention. Thus, this should not be allowed when acting as a systematic internaliser. This would include automated systems which defer the trading so that the buying and selling interests are not combined directly and simoultaneously, but where a very short latency is added.

What should continue to be allowed is the manual handling where systematic internaliser finds an opposite trading interest, and combines a buy and a sell order. Such processes should not be seen as “a system” since the processes are not automated and since they will by nature always be ad hoc.

This situation will occur if for instance an investment firm is approached by a customer that wants to sell shares. To act in the best interests of the customer the systematic internaliser shall decide whether to route the order to a trading venue, whether to buy the shares to its inventory or whether to try to find a suitable buyer. Trying to find a buyer in such a situation via a manual process does not resemble the way a trading venue functions in the trading of shares and it cannot be defined as meeting the definition of multilateral trading, nor will there be any rules that govern such matching of opposite trading interests. The clients do not face each and have no access to a system where they can see each other’s orders.

As for risk taking, it should be clarified what this refers to. We understand that some SIs may take risk for micro or even nano seconds. This should obviously be investigated further by ESMA as this should not count as risk taking or enable these firms to act as SIs.

Q33: Would you support deleting the first exemption provided for under Article 23 of MiFIR (i.e. for shares that are traded on a "non-systematic, ad-hoc, irregular and infrequent" basis)? If not, would you support the introduction in MiFIR of a mandate requiring ESMA to specify the scope of the exemption? Please provide arguments supporting your views.

The NSA does not support the deletion of the first exemption as this will limit the flexibility for trading and potentially harm the execution quality. However, we agree that it would be beneficial to have further guidance from ESMA in specifying the scope of the exemption.

Q34: Would you support simplifying the second exemption of Article 23 of MiFIR and not limiting it to transactions "carried out between eligible and/or professional counterparties"? Please provide arguments supporting your views.

The NSA agrees with the proposal, as non-price forming trades are not only done by eligible and/or professional counterparties.

Q35: What is your view on the increase of volumes executed through closing auctions? Do you think ESMA should take actions to influence this market trend and if yes which one?

The NSA is concerned by the increasing volume in the closing auctions.

Firstly, this development undermines the continuous transparency and price discovery during the day. Thereby, the SIs are compelled to take over the role as execution venues which provides the requested execution during the day as liquidity providers.

Secondly, the concentration of volume during closing gives the trading venues – and in particular the incumbent exchanges – even more significant market power, as the need to participate in these auctions are self-fulfilling as the volume increases.

Thirdly, it should be considered to introduce a limit on the share of the trading allowed in the closing auction. In case the share is exceeded, the usage of closing auctions is should be limited even further.

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