NORGES BANK
INVESTMENT MANAGEMENT

Directorate-General for Financial Stability
Financial Services and Capital Markets Union
European Commission
1049 Bruxelles/Brussel
Belgium

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RE: Public consultation on the review of the MiFID II/MiFIR regulatory framework

Norges Bank Investment Management ("NBIM") appreciates the initiative by the European Commission ("Commission") to open a consultation on the review of the MiFID II/MiFIR regulatory framework. As an active participant in European and global markets, we welcome this opportunity to share our experience with the Commission.

NBIM is the investment management division of the Norwegian Central Bank ("Norges Bank") and is responsible for investing the Norwegian Government Pension Fund Global. NBIM is a globally diversified investment manager with assets valued at NOK 9 998 billion as of 31 March 2020, of which NOK 2 130 billion was invested in European equities and NOK 1 097 billion in bonds from European issuers. We have a vested interest in a regulatory environment that yields well-functioning markets in financial instruments, facilitates the efficient allocation of capital and risk and promotes long-term economic growth. Such an environment requires balancing the interests and incentives of various types of market participants, ensuring a level playing field in financial markets.

Availability and price of market data

Financial market data are a vital ingredient of the modern financial markets' ecosystem. Investors rely on accurate, readily available and timely data to make investment decisions, execute trades, and monitor implementation, among others. Other use cases include risk-management, compliance and research. Market participants such as brokers and market makers need these data in order to be effective in their role as financial intermediaries and liquidity providers.

MiFID II has laid the framework for the functioning of the European market of financial market data with an objective to make it widely available in an easily accessible, fair and non-discriminatory manner. At the core of this framework have been the provisions for enhanced transparency in the pricing of market data, i.e., the "transparency plus" approach.

Norges Bank Investment Management is a part of Norges Bank – The Central Bank of Norway

POSTAL ADDRESS
P.O. Boks 0179 Sentrum,
NO-0107 Oslo

OFFICE ADDRESS
Bankplassen 2,
Oslo, Norway

Tel. +47 24 07 30 00
Fax +47 24 07 30 01
Web www.nbim.no

Registration of Business Enterprises
NO 937 884 117 MVA

In our response letter[1] to the European Securities and Market Authority ("ESMA")'s consultation "on the development in prices for pre- and post-trade data and on the consolidated tape for equity instruments" we shared our experience as an active user of global market data: market data costs have increased globally in recent years; at the same time, limited transparency of data policies and data auditing practices have led to uncertainty on the pricing of market data and a substantial administrative burden for data users. *(Question 9)*

We also outlined principles for strengthening the well-functioning of the market of financial data, such as the standardisation of the "reasonable commercial basis" ("RCB") disclosure framework, the simplification and standardisation of data policies and auditing practices including use cases and terminology, and the harmonisation of data connectivity processes. Implementing these principles would therefore require the development of a framework for assessing whether data pricing policies are in line with RCB. *(Question 9)*

We would like to reiterate our support to a cost-based pricing of market data in conjunction with a reasonable charging fee. We welcome the fact that ESMA's proposed amendments are in this direction and broadly in the spirit of the abovementioned principles. We believe that they have the potential to enhance the current transparency plus approach, ensuring that market data are easily accessed at competitive cost-driven prices by the broad (retail and institutional) investment community. *(Question 9)*

The establishment of an EU consolidated tape for equity instruments

Other provisions in MiFID II/MiFIR have introduced a framework for the establishment of a consolidated tape ("CT") for equity and non-equity instruments. Yet an EU consolidated tape has not emerged.

We broadly agree with the reasons for the lack of a CT as outlined in Question 7 of the Commission's report. In particular, the provision of functionally similar services by data vendors and technical challenges related to latency in fragmented European markets suggest a real-time ultra-low latency pre-trade CT too costly to be commercially viable. The lack of a standardised framework for accessing data across different trading venues, for example a harmonised data feed format, has also played a role. *(Question 7)*

Given the speed of trading in modern markets, low latency access to market data including depth of order book directly from exchanges via co-location will continue to be a key feature of the order execution landscape, which is hard for a pre-trade consolidated tape to replicate. We therefore argue that when it comes to trade execution and liquidity provision, a 'real-time' pre-trade consolidated tape is unlikely to replace current direct feed offering and is likely to come in at a high price. *(Questions 10, 11)*

In contrast, there are likely to be use cases for a post-trade EU consolidated tape for equity instruments. A cost-effective utility which provides high quality standardised data will be of use

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[1] See the letter here https://www.nbim.no/en/publications/consultations/2019/consultation-on-the-development-in-prices-for-pre--and-post-trade-data-and-on-the-consolidated-tape-for-equity-instruments/

to a number of participants in the market. Use cases will be varied including market monitoring across instruments and venues, transaction cost analysis and execution management, back-testing, risk management, compliance, and research, among others. It would also provide enhanced transparency in post-trade reporting. In line with the spirit of MiFID II, the provision of high-quality data would be beneficial for end-investors, many represented by institutional funds, improving market quality and building confidence and trust in European markets. *(Questions 10, 15)*

A real-time tape, on the other hand, with a dissemination speed at the millisecond level is not appropriate or beneficial for the average retail or institutional investor. In addition, it is likely to come at a high cost. Taking into account a comprehensive cost-benefit analysis, including the challenges of setting up an ultra-low latency aggregated pan-European tape, we would advocate a post-trade low-frequency consolidated tape. A starting point could be an end-of-day service offering non-conflated harmonised tick data for a reasonable fee. Such a service could promote market data vendor competition. In the longer run, a lower-latency tape could be explored after a careful cost-benefit analysis. *(Question 11)*

Other features of the post-trade consolidated tape, should be the availability at a reasonable cost, the high coverage, which should reflect both on- and off-venue trading activity (e.g., systematic internalisers activity), and the high level of data quality, among others. High and low liquidity instruments should be equally covered, albeit with appropriate frequency for updates. A strong governance framework and operational transparency will also be needed to ensure quality and continuity of service. *(Question 11)*

Such a consolidated tape should be of interest to market practitioners; it is likely to be commercially viable without a requirement for mandatory consumption. A concern with mandatory consumption is that, unless the fee for accessing the tape is sufficiently low, it could lead to higher direct or indirect (via broker or other trading fees) costs for investors. *(Question 11)*

The establishment of an EU consolidated tape for non-equity instruments

Unlike equities where investors can access post-trade data and have a picture of market activity (although sometimes at a high cost), there is very little or no historical information about prices for many non-equity instruments. This is particularly the case in fixed income markets, which have historically been decentralised and relatively opaque. However, there is evidence that price transparency can benefit the market liquidity and price discovery of these markets.[2]

[2] See evidence for the positive effect of price transparency in fixed income markets: Bessembinder, H., Maxwell, W. and Venkataraman, K., 2006. *Market transparency, liquidity externalities, and institutional trading costs in corporate bonds*. Journal of Financial Economics, 82(2), pp.251-288; Green, R.C., Hollifield, B. and Schürhoff, N., 2006. *Financial intermediation and the costs of trading in an opaque market*. The Review of Financial Studies, 20(2), pp.275-314; Benos, E., Payne, R. and Vasios, M. *Centralized trading, transparency, and interest rate swap market liquidity: Evidence from the implementation of the Dodd–Frank act*. Journal of Financial and Quantitative Analysis 55, no. 1 (2020): 159-192, among others.

We regard the availability of good quality post-trade data at a reasonable price as a positive development for market participants in fixed income. We would therefore encourage the establishment of a post-trade consolidated tape for European bonds. Such a consolidated tape needs to be carefully designed to strike a balance between the need for better post-trade information on prices and concerns about information leakages. *(Question 15)*

Given the large number of issuances and the buy-and-hold nature of this market, trading in bonds can generally be rather infrequent. It is for this reason that we believe that investors would benefit the most from a delayed post-trade tape. This may mean that information would be disseminated after a set period (e.g., a number of days) where the delay window is pre-calibrated such that it takes into account the liquidity of the instruments and traded size. A simple common framework for the tiered classification of bonds into liquidity profiles should be reviewed periodically based on high quality data. The published information should include the ISIN, execution timestamps and prices, among others. To protect against information leakage, features such the deferral of publication of large trades or a cap at the reported trade size should also be considered, particularly when trading takes place in illiquid bonds. *(Questions 11, 15)*

We believe that the technical specification of such an initiative should be developed through active participation by various stakeholders – exchanges, dealers, asset managers and other investors – with the guidance and oversight by ESMA to ensure effective completion. The implementation should take place in phases to allow for market participants to adjust their trading behaviour to the new landscape.

The status of systematic internalisers (*Questions 24-26*)

Regulatory innovation under MiFID II has contributed to the shift of trading in equity instruments from crossing networks and dark venues to systematic internalisers ("SIs"). In our response letter[3] to ESMA's consultation on "the transparency regime for equity and equity-like instruments, on the double volume cap mechanism and on the trading obligations for shares", we shared our views on the role of banks/brokers' SIs, which we summarise here.

We recognise the role of banks/brokers' intermediation in modern financial markets. Banks/brokers' commit capital at risk when necessary in order to facilitate institutional client trading decisions across asset classes. Some mechanism to allow such a service at a fair price should be available for the well-functioning of financial markets. In the current ecosystem, SIs allow banks/brokers to contribute to liquidity provision and meet certain trading needs, for example the facilitation of urgent liquidity, high-touch trading, and the handling of complex trades (e.g., basket trading or derivative hedging), among others.

We advocate a level-playing field for SI activity, and we believe that further analysis on their contribution to price and liquidity discovery is needed. Such an analysis requires better access

[3] See the letter here https://www.nbim.no/en/publications/consultations/2020/consultation-on-the-transparency-regime-for-equity-and-equity-like-instruments-etc/

to high quality data in conjunction with appropriate time horizon to allow a rigorous assessment of SIs' contribution to well-functioning markets.

An aspect of the regulatory environment that needs to be taken into consideration while assessing SIs' future role is their transparency regime. Increasing transparency, for example by raising minimum quote size from the current 10% SMS to a multiple of SMS would be appropriate, particularly for liquid securities. For the less liquid segment of the market, ensuring banks/brokers' intermediation activity is not hindered remains important, as they are the main source of liquidity in these markets.

The Double Volume Cap (*Question 82*)

NBIM supports a market structure that provides efficient price discovery as well as liquidity discovery, controls for the cost to end-investors, and ensures a level-playing field in a competitive financial ecosystem. Such a market structure may require the operation of complementary trading mechanisms with heterogeneous transparency, size, and latency characteristics.[4]

The main challenge for institutional investors continues to be the sourcing of natural liquidity (long-term, natural buyers and sellers) that minimises information leakages and reduces the price impact of their transactions.

In the current European equity market landscape, large-in-scale ("LIS") venues provide a good source of natural liquidity, which complements trading in lit markets by offering a good balance between order size and fill rates. When the probability of a natural liquidity match occurring is low, asset managers need to use alternative trading strategies outside LIS venues. For example, they use trading algorithms to access a wide range of trading venues, including price-impact improving markets that use pre-trade transparency waivers like the Reference Price (RP) waiver. The use of such waivers aims to reduce unnecessary trading costs due to information leakages.

We therefore regard LIS mid-point execution and the other transparency waivers as integral components of institutional order execution, while their removal will inevitably have a detrimental effect on market liquidity. We also note that the Double Volume Cap (DVC) regime limits the excessive use of such waivers, ensuring meaningful contribution by large order execution strategies to price formation, including via post-trade reporting.

A light recalibration of the current transparency regime might be appropriate, given the experience of the first two years of MiFID II. One example could be the simplification of the DVC regime by removing the 4% trading venue level threshold while keeping the EU level at the current 8% level. There could also be a minimum threshold above which transactions under the RP and Negotiated Trade (NT) waivers would be allowed. This could ease concerns about the role of 'dark trading'. Any threshold should ensure that small trades that are part of a large

[4] See Norges Bank Investment Management, "Sourcing liquidity in fragmented markets." Asset Manager Perspective, no. 1 (2015).

order execution would continue to benefit from mid-point execution and price-impact improving trading mechanisms.

Foreign Exchange (FX) functioning (*Questions 92-93*)

The market structure of the spot FX market has historically been decentralised and opaque with dealers playing a central role in liquidity provision. Dealers intermediate by bringing together buyers and sellers typically using a bilateral principal model. Intermediation eases 'search frictions' by speeding up the process of finding a counterparty. However, it also introduces practices that can give rise to systematic information asymmetries between dealers and their clients.

In a recent paper, we identified three such practices: the last look practice, the lack of adequate risk controls and liabilities for the algorithms that execute trades, and the lack of pre- and post-trade transparency.[5] In particular, the last look allows the dealer to step back from an earlier offer to trade if certain conditions are not met, even after a client has agreed to the price.[6] This introduces uncertainty in execution and may lead to unnecessary information leakages. In contrast in other markets, for example equity markets, such practice is not observed since prices are generally firm.

The spot FX market has largely been outside the scope of post-crisis regulation, including the MiFID II/MiFIR. Instead, the FX community has developed a set of global principles of good practice, the FX Global Code ("Code"), aiming at promoting effective and transparent trading and resilient infrastructure in FX markets. While market participants do not have to adhere to the Code, they are encouraged to adjust their practices to its spirit.

We believe that that there has been some progress in certain areas in the functioning of the FX market aligned with the Code. For example, there is now more transparency around the last look practice in the dealer-to-client segment of the market; more work is needed especially in the case of anonymous electronic trading platforms. With reference to trading algorithms, market-wide standards on the governance of dealers' algorithms are still not in place, thereby increasing demands on clients' broker review process. Finally, despite commercial initiatives to set up consolidated tapes and mid-matching pools, the spot FX market remains relatively opaque to date.

NBIM is committed to the Code and has aligned its internal practices with the Code's applicable principles. We believe that there is a need for a greater adherence to the Code by the investment community. We would welcome a quantitative assessment of the impact of the Code on the well-functioning of FX markets to date. Such an assessment will help to identify areas of slow progress and develop proposals for the betterment of the efficacy of the Code.

[5] See "Managing information asymmetries in foreign exchange markets", Asset Manager Perspective, 02/2017, Norges Bank Investment Management, for an overview of FX markets market structure.
[6] See "The Role of Last Look in Foreign Exchange Markets", Asset Manager Perspectives, Norges Bank Investment Management, 03/2015.

Widespread adoption of the Code and adherence to it can promote fair and effective global FX markets. However, alternative approaches such as binding regulation on market practices should be considered if the current approach is not widely adopted and fails to deliver its objective to promote well-functioning FX markets. Given multinational nature of FX markets, a harmonised approach across jurisdictions would be necessary.

Conclusion

We have an interest in encouraging market structure that contributes to the attractiveness of European markets for the broad investment community. We therefore welcome this important consultation of the European Commission on the review of the MiFID II/MiFIR regulatory framework.

We appreciate this opportunity to share our perspective, and we remain at your disposal should you wish to discuss these matters further.

Yours sincerely

Emil R. Framnes
Global Head of Trading, NBIM

Yazid M. Sharaiha
Head of Market Structure and Trading Research, NBIM