



FINANSINSPEKTIONEN

Supervision of the Swedish Securities Market

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Summary

The objective of Finansinspektionen's (FI's) supervision of the securities market is a stable and well-functioning market that provides consumers with a high level of protection. In this report, FI describes the focus areas of the past year, as well as regulatory and supervisory activities that will be important ahead. Major changes on the securities market include the new regulations introduced with the purpose of improving the conditions for well-functioning markets. These include new rules on market abuse and benchmarks, as well as the new MiFID regulations that set new transparency requirements for trading in financial instruments. Developments on the different parts of the securities market are also discussed in the report, as well as supervision of financial infrastructure firms and the regulations governing them.

DEVELOPMENTS ON THE SECURITIES MARKET

In 2016, FI's analysis of trends and risks on the securities market focused on the subareas fixed income market, derivatives market and equity market.

The sound functioning of the fixed income market is crucial to the ability of the financial system to execute its core tasks. For example, it is crucial to banks' possibilities to obtain funding. If liquidity on the fixed-income market is poor, this could cause problems that threaten financial stability. According to FI's analysis, market liquidity is currently sound, although there are signs of the risks having increased.

Derivative instruments are cleared at a central counterparty, so the counterparty risk is gathered in one place. In order to avoid the concentration of counterparty risk jeopardising financial stability, stringent demands are imposed on the financial strength, governance and risk management of central counterparties. Each year, the European Securities and Markets Authority (ESMA), in cooperation with FI, evaluates the resilience of central counterparties using stress tests. The general conclusion is that the resilience of European central counterparties – including Nasdaq Clearing in Sweden – is sufficient.

The equity market serves an important purpose in terms of corporate finance. In the past two years, there has been a sharp rise in the number of IPOs. Sound liquidity and great investor interest also make Sweden an attractive country for foreign corporations' IPOs. This places demands on FI as the supervisory authority – for instance, in terms of monitoring to ensure that investor information is comprehensible and transparent.

NEW RULES FOR THE SECURITIES MARKET

In order for the securities market to function well, market participants must feel confident in the integrity of the market. To help achieve this, and to keep up with technological developments, the EU has adopted a new Market Abuse Regulation (MAR) and a new Market Abuse Directive (MAD). The new legislation provides FI with new powers to investigate, and new possibilities of issuing sanctions in the event of breaches of the market abuse provisions.

Benchmarks are indexes used to determine the value of financial instruments and contracts. Important examples are interest rate benchmarks such as STIBOR and LIBOR. Manipulation, or attempts at manipulation, of benchmarks can have serious negative consequences for the securities market. As of 1 January 2018, benchmarks will therefore be regulated through the EU benchmark regulation. The regulation enables FI to intervene in the event of infringements in setting a benchmark.

The new MiFID regulations for the European securities market will create the conditions for more efficient markets and strengthened investor protection. The regulations cover more markets and more financial instruments than those currently in place. An important means of realising the objective of the regulations is to increase transparency in trading in financial products. It will therefore be important for FI to decide on the transparency level to be applied, and the waivers that entities will be able to apply.

FINANCIAL INFRASTRUCTURE

FI is responsible for supervising financial infrastructure firms. While FI finds that financial infrastructure in Sweden functions well, there is room for further improvement, not least in areas where core parts of the business are run by other firms. Infrastructure firms are also responsible for e.g. the governance and control of the parts of the business that are outsourced. FI also finds that cyber risk is a growing area with which infrastructure firms must continue to work actively.

Operational disruption at a central counterparty could quickly spread to other firms, and thus have serious implications for financial stability. Another focus area for FI will therefore be the European Commission's proposed regulations for the recovery and resolution of central counterparties. The purpose of the regulations is to create conditions to enable a central counterparty to continue to offer critical services, i.e. those necessary for the market to function well, even if it falls into serious financial difficulty.

FI and the securities market

The securities market consists of various submarkets, some of which are considered important to financial stability. In FI's opinion, it is primarily the fixed income and foreign exchange markets – on which firms continually manage their funding and risk – that are important to financial stability. The equity market is significant because it serves as an important funding source for firms, although equity trading itself is not crucial to financial stability. The firms that form part of the financial infrastructure – central counterparties and central securities depositories – play a crucial role in enabling the execution of payments and securities transactions between different people and corporations, and are therefore systemically important.

FI'S WORK ON THE SECURITIES MARKET

FI supervises and takes part in preparing rules for the securities market and its infrastructure. FI's overall task is to promote a stable financial system that features a high level of confidence with well-functioning markets that meet the needs of households and corporations for financial services, and provides a high level of consumer protection. A "stable securities market" means that it can sustain its core functions even in financial stress. The stress can originate both from severe problems on certain markets and at individual firms.

Some of the firms supervised by FI are important to financial stability, and are therefore said to be systemically important. Financial difficulties or extensive disruption at such a systemically important firm – e.g. a central counterparty – can spread to other firms and hence have serious implications for the economy. While preventing serious difficulties at a firm is in its own interest, it is not always the case that the firm's choice of measures will be the most beneficial for the economy if, for instance, it only takes account of the consequences for the individual firm. It is because of this that the infrastructure firms that are important to financial stability are subject to specific supervision and regulation. An example of such specific regulation is the capital requirements in place for central counterparties, aimed at strengthening their resilience. In its supervision, FI also prioritises the firms that are considered to be systemically important.

Entire markets can also be important to financial stability. A disruption on a systemically important market can prompt serious ripple effects on the rest of the financial system and – ultimately – on the economy. For example, the fixed income market is crucial to the possibilities of banks to obtain funding. The fixed income market is also important to the ability of banks and other financial firms to manage their liquidity and their risks. A disruption in this market could therefore have serious implications for banks and other financial firms.

The foreign exchange market, particularly trade in currency derivatives, is also very important, because the banks need to convert funding in foreign currency to Swedish kronor, and vice versa.¹

The equity market is important to the firms' ability to obtain funding, and for investors to invest their capital. However, the equity market is not as important to financial stability as the other aforementioned markets. The reason is that a temporary disruption in the equity market would probably not spread to other

¹ Because approx. 60% of the banks' outstanding securities are issued in foreign currency, this funding must be converted into Swedish kronor to be used for domestic lending.

markets, and hence have serious implications for the financial system as a whole.

FI also works to ensure a high level of consumer protection. A condition for protecting consumers is that financial firms are stable and can honour their obligations. It is also important that consumers and investors obtain clear and accurate information so that they can make informed decisions.² Where the securities market is concerned, FI therefore works with supervising trading in the securities market, review and supervision according to the prospectus regulations. FI also bears the ultimate responsibility for supervising the financial information of listed corporations.³

The fact that the financial system is stable and offers a high level of consumer protection is not enough, however. A financial system can be resilient to financial stress and offer a high level of protection for consumers and other investors without meeting households' and corporations' needs for financial services. To do so, financial markets must also function well. A well-functioning market has a number of characteristics – the primary ones being sound competition, diversity in the range of financial services, and efficiency from a socio-economic point of view.⁴

In order for the securities market to function well, market participants must also feel confident in the integrity of the market, i.e. that the rules of the market are followed. If suspicions emerge about failure to follow the rules, this could lead to serious market participants leaving the market. In turn, this could bring about a market failure, ultimately through inability to access certain services. This too motivates FI's supervision of trading in the securities market.

The absolute majority of rules that apply on the Swedish securities market have their roots in decisions at EU level, which in turn often originate from global political initiatives or agreements. FI expresses views on proposals for new regulations, and participates actively in devising them, as part of the work of the European Supervisory Authorities (i.e. the European Securities and Markets Authority, ESMA; the European Banking Authority, EBA; and the European Insurance and Occupational Pension Authority, EIOPA), and other international organisations.⁵

As the supervisory authority, it is also important that FI calls attention to and analyses any negative consequences of the rules introduced. FI also has some leeway for interpreting the rules applicable to the securities market. Supported by authorisations in law and ordinances, FI may, in certain cases, supplement regulations decided by the EU or by the Swedish Parliament and Government, by issuing its own regulations or general guidelines.

2 FI's work to strengthen the position of consumers is presented annually in a separate consumer protection report.

3 The ongoing enforcement of financial information is currently done by the stock exchanges. FI supervises the enforcement of financial information of the stock exchanges, and Swedish corporations whose securities are admitted to trading on a foreign exchange. In January 2017 FI sent a consultation response to the Ministry of Finance in which FI proposes that supervision of the financial information of listed corporations be done by a self-regulation body. See the inset "FI changes its view on responsibility for the enforcement of financial information".

4 However, responsibility for counteracting various types of competition-limiting collaboration and abuse of predominant positions on the securities market rests with the Swedish Competition Authority and the European Commission.

5 Since 2014, FI has been a member of the board of the International Organisation of Securities Commissions (IOSCO), and since 2016 it has been deputy chair of its European regional committee. More information about this organisation is provided at www.iosco.org.

DEVELOPMENTS ON THE SECURITIES MARKET

The section below discusses some of the focus areas for FI's analysis of trends and risks in the securities market in 2016.

The fixed income market

FI considers the fixed income market to be systematically important. From the point of view of stability, it is particularly important that the fixed income market has sound liquidity and that it also functions well in stressed conditions.

Market liquidity describes the possibility of converting assets into liquid funds without major price changes. Good market liquidity thus makes it easier for firms to execute their payments, adapt their portfolios and reduce risks they do not wish to bear. In financial stress, market liquidity can deteriorate, which reduces financial firms' room to manoeuvre. At worst, market liquidity can disappear entirely, which could cause firms to be excluded from funding, or lose the ability to manage their risks.

On the fixed income market, trading is usually conducted through market makers. These are firms that undertake to buy or sell fixed-income securities immediately upon request at announced prices. To do so, the market maker must keep its own stock of securities, and thus assumes market risk.

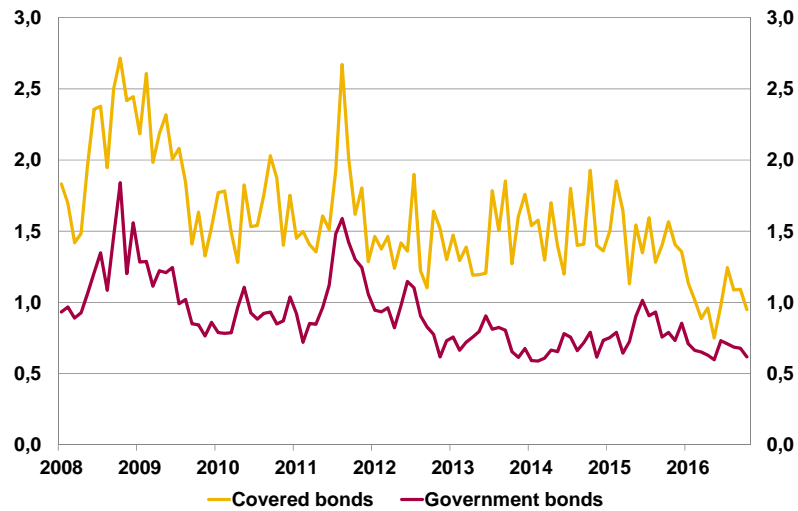
When trading occurs through market makers, their ability to serve their purpose can affect market liquidity. The ability of market makers to provide liquidity depends on their ability to manage the risks arising in their operations. As in previous years, the Riksbank's risk survey for 2016 shows that many entities in the Swedish fixed income and foreign exchange markets find that the market makers have become less active and less willing to quote prices than before. In their view, one reason for this is various financial regulations that have made trading in securities more expensive for the market makers. According to market participants, the decline in activity of the market makers has in turn caused a deterioration in market liquidity.⁶

FI uses a quantitative measure for market liquidity based on the price impact. The price impact can be described as the absolute return between two successive transactions. FI then adjusts this to obtain a maturity-neutral measure called the yield impact. Using this measure, FI sees so far no signs of a deterioration in liquidity for covered bonds or for government bonds (chart 1).⁷

⁶ See the Riksbank, The market's view of risks on the functioning of the Swedish fixed income and foreign exchange market, autumn 2016.

⁷ See FI, Stability in the financial system (2016:2).

Chart 1. Market liquidity (Yield impact, basis points)



Source: FI

Note: The chart shows the average transaction cost per month for the Swedish covered bond and government bond markets. The transaction cost is measured in yield impact, which in simplified terms is the effect a transaction has on the market rate. The yield impact measure in this chart is an enhancement of the measure used in FI analysis no. 3, 2015.

In 2016 FI also identified a number of other quantitative indicators that capture vulnerabilities of relevance to liquidity on the fixed income market.⁸ Several of the indicators show a somewhat increased vulnerability for liquidity. The aggregation of the indicators also shows that vulnerability has steadily increased in the past few years.

An indicator which, for instance, means increased vulnerability to poorer liquidity is rising costs for the market makers. Another is greater use of the Swedish National Debt Office's repo facility. A shortage of government bonds could have a negative effect on liquidity. Pricing on the foreign exchange swap market, which is currently at very high levels, could have a negative impact on funding liquidity in a crisis scenario.

According to FI's analysis, market liquidity is currently sound. However, there are signs that vulnerabilities of relevance to both market and funding liquidity have increased in the past few years. If vulnerability is high, various shocks could lead to a drop in liquidity, which could cause problems that threaten financial stability. It is therefore important that FI continues to follow the developments.

The derivatives market

In Sweden, derivatives are commonly standardised but largely traded over-the-counter (OTC). The Swedish OTC derivatives market is dominated by the major banks, and interest rate swaps make up the vast majority of OTC products. However, trading in derivatives can pose risks, such as counterparty risk. To improve how counterparty risk is managed, derivatives are largely cleared through central counterparties. In the EU, rules for central counterparty clearing of OTC transactions have also been introduced through the European Market Infrastructure Regulation – EMIR⁹

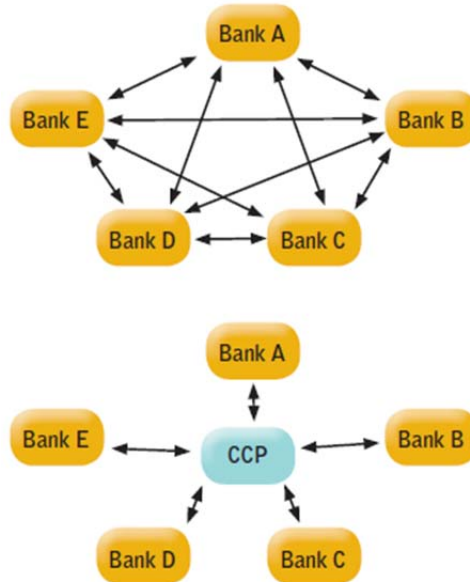
Derivative instruments are cleared by a central counterparty. This is an entity that serves as the buyer for all sellers, and the seller for all buyers. Derivatives

⁸ See FI Analysis no. 8: Vulnerability indicators for liquidity.

⁹ Regulation on OTC derivatives, central counterparties and trade repositories.

clearing in SEK can occur in both Swedish and foreign systems. In Sweden, Nasdaq Clearing is the central counterparty for derivatives trading, and is thus under FI's supervision.

Figure 1. Counterparty risks are concentrated to one firm – a central counterparty



Note. Central counterparty (CCP)

The new rules on central counterparty clearing according to EMIR have been introduced gradually in the EU. Tightened capital requirements have also been introduced for uncleared derivatives. The aim is to create further incentives for central counterparty clearing. The obligation to clear certain classes of fixed income derivative contracts in USD, EUR, JPY and GBP entered into force in 2016. As of 9 February 2017, these requirements also apply to SEK, NOK and PLN. As of 4 February 2017 requirements are gradually being introduced for derivative contracts not subject to a clearing obligation. The counterparties in non-centrally cleared derivative transactions have to exchange collateral, similar to the requirements for cleared contracts.

The clearing obligation in interest rate derivative contracts in SEK was recently introduced, and does not yet apply to all types of counterparties. It's noteworthy however that around 90% of the contracts traded OTC are already cleared. FI finds this to be a positive development since it can help reduce the total risk in the financial system.

The clearing obligation under EMIR only applies to standardised OTC derivatives. The developments towards an increasing degree of clearing has probably also reduced the use of tailored derivative instruments. These are often more complex, and difficult to clear efficiently. In FI's opinion, increased standardisation reduces the operational risks in trading in OTC derivatives and facilitates risk management and supervision. A drawback could be that firms cannot get an exact match for their risks when contracts are not tailored. FI finds that the benefits of increased transparency and increased standardisation outweigh any drawbacks.

Stress tests of central counterparties

ESMA shall, according to EMIR, annually take initiatives for evaluations, stress tests, assessing the resilience and safety of central counterparties. If the stress test indicates deficient resilience, this could prompt requirements for measures.

The findings were published in April 2016. The assessment covered 17 European central counterparties and was conducted in cooperation with FI and other European supervisory authorities as well as the European Systemic Risk Board (ESRB). According to the regulations, a central counterparty shall have access to the financial resources to cover the losses that could arise in the event of extreme price volatility on securities markets – concurrently with the default of the two largest clearing members in terms of exposure.

The general conclusion is that the resilience of European central counterparties – including Nasdaq Clearing in Sweden – is sufficient. ESMA made a number of observations that resulted in recommendations for improvements. For example, all central counterparties should assess the credit exposures of their clearing members in relation to other central counterparties of which they are members. Also, ESMA has issued individual recommendations to the central counterparties setting out that they should allow for even more extreme price volatility in various securities. ESMA has published its recommended minimum levels for extreme price volatility for various asset classes.

In 2016 ESMA's evaluation was limited to analysing credit risk. Other risk aspects, such as liquidity risks, will be captured by future stress tests.

Reporting of derivatives transactions and work on improving data quality

According to EMIR, all derivatives transactions shall be reported to a trade repository (TR). Counterparties entering, amending or terminating a derivatives contract shall ensure that the information in the contract is reported to a TR. The purpose of the reporting is to increase transparency on the derivatives market, so as to enable a better overview of the derivatives market, and assessment of systemic risks.

Data reported to trade repositories (TR data), is available to the national supervisory authorities. ESMA and the national supervisory authorities have jointly embarked on a comprehensive project to improve the quality and usability of TR data. Cooperation is needed because ESMA is responsible for supervising trade repositories while the competent authorities bear supervisory responsibility for the reporting counterparties.

The part of the work that took place in 2016 included preparations ahead of revising technical standards under EMIR.¹⁰ The new technical standards were approved by the Commission in October 2016 and published in the Official Journal of the European Union on 21 January 2017.

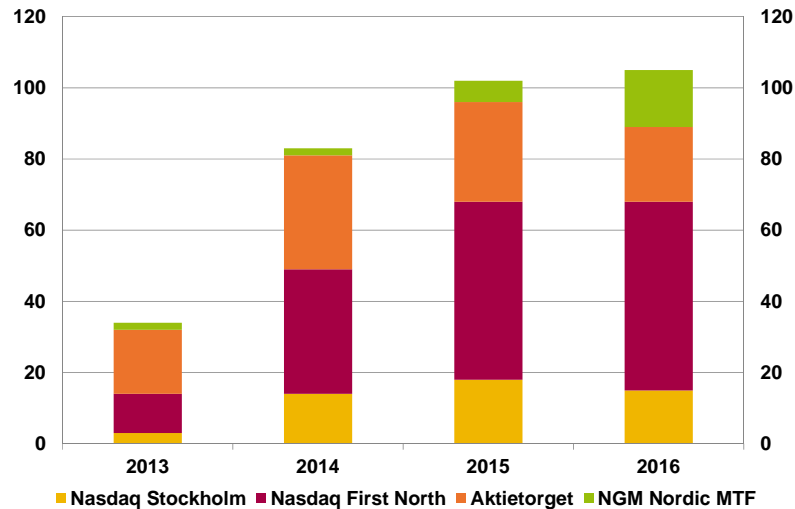
Besides the joint work together with ESMA, the national supervisory authorities also conduct recurrent investigations and evaluate data reported to TR.

The equity market

Stability and liquidity in the equity market, and a good supply of capital, are crucial for it to function efficiently. 2016 saw a continuation of the clear trend of recent years, with an increased number of new share issues and IPOs in Sweden. This places demands on FI as the supervisory authority – for instance, in terms of monitoring to ensure that investor information is comprehensible and transparent. For FI, the increased number of listed corporations also means that more prospectuses on public offerings must be reviewed. Also, there is an increase in the number of corporations under supervision for insider reporting.

Chart 2. Equity listings in Sweden (No.)

¹⁰ Implementing technical standards for minimum requirements for the data to be reported to a trade repository.



Sources: Aktietorget, Nasdaq Stockholm, Nordic MTF

Note. The chart includes secondary listings, switching lists from a foreign exchange, and spin-offs. List switches within Sweden are excluded. First North Stockholm also includes listings on First North Premier Stockholm. (No listings on NGM Equity.)

The largest increase in the number of IPOs is on multilateral trading facilities (MTFs), and not on regulated markets (chart 2). It is primarily smaller corporations that are listed on these trading facilities. One reason for why smaller corporations choose to be listed on MTFs is that listing requirements on those facilities are less stringent than for regulated markets. Since these corporations often have fewer resources and a relatively brief history, they choose to go public on MTFs to a greater extent.

Many corporations that use the equity market to obtain capital are housing development corporations. FI has also observed an increase in the number of IPOs of foreign corporations on the Swedish equity market. Sound liquidity and a great investor interest make Sweden an attractive country for foreign corporations to go public.

In the past few years, FI has been the supervisory authority that has reviewed and approved the third highest number of equity prospectuses in the European Economic Area (EEA) – only in the UK and France have FI's equivalents approved more equity prospectuses. The drivers are evident – a low interest rate environment, with inexpensive financing for corporations and a sustained high level of investor interest on the equity market.

Alternative performance measures

On 3 July 2016, ESMA's guidelines on alternative performance measures came into force. An alternative performance measure is a financial measure that is not defined or specified in the issuer's applicable rules for financial reporting, but which is used in prospectuses or in other compulsory information published by issuers. The guidelines aim to promote usability and understanding of such performance measures. This has been absent previously, and will simplify comparability between different corporations on the Swedish market, as performance measures in prospectuses have become increasingly complex. FI applies ESMA's guidelines on alternative performance measures in its supervision. This signifies control of the financial information reported by issuers in prospectuses being comparable and accurate.

Public takeover bids

FI reviews and approves offering documents and supervises the obligations of bidders. FI also follows the trends observed in the equity market. In the past few years, several Swedish corporations listed on Nasdaq Stockholm have

been the object of public takeover bids. A public takeover bid is an offer to the shareholders of a corporation (the target corporation) to acquire all shares therein. It can either be a voluntary public takeover bid, or a public takeover bid preceded by mandatory bidding. Mandatory bidding occurs when a buyer reaches 30% of the voting rights for all shares in a corporation. When mandatory bidding arises, the buyer must offer to buy the outstanding shares in that corporation. For a public takeover bid to go through, shareholders representing at least 90% of the shares in the target corporation must accept the offer. The remaining shares, equalling a maximum of 10%, in the target corporation, can subsequently be subject to compulsory redemption by the bidder.

Since 2015, a number of public takeover bids on corporations listed on Nasdaq Stockholm have not been accepted. Participants in the equity market have bought shares equalling a minimum of 10% in a corporation subject to a public takeover bid, and rejected the bid, causing it to fail. The bidder must then choose either to increase the bid to all shareholders in the target corporation immediately, or wait six months. A bidder who waits for six months can choose to only increase the bid for the smaller circle of shareholders that have not already accepted it.

In such a situation, there is a risk of a drop in the liquidity and trading in the target corporation's shares during the subsequent six-month period. When there is uncertainty about what will happen to the bid, it is difficult to judge the value of the share, which can curb trading.

FI changes its view on responsibility for the enforcement of financial information

The obligation of listed corporations to provide accurate financial information in accordance with international standards is important in enabling investors to make informed investment decisions. The accuracy of the financial information is also important to confidence in the market's integrity. The enforcement of financial information is currently divided up – the regulated trading venues are responsible for supervising periodic financial information from listed corporations, and FI is responsible for supervising the Swedish corporations whose securities are admitted to trading in a foreign exchange. FI also supervises the enforcement of financial information of the Swedish regulated markets. In 2015 a public inquiry proposed that FI take over the enforcement of financial information for all corporations from the trading venues.¹¹ At the same time, a number of industry representatives proposed that a self-regulation solution be established.

FI was initially positive on the proposal of the inquiry, because FI did not find that the proposal for self-regulation fulfilled requirements regarding independence in relation to the corporations under review.¹² Since a new proposal has emerged, FI has reviewed its position regarding responsibility for the enforcement of financial information in favour of a self-regulation solution.

The reason for the change in FI's position is that, in the autumn of 2016, FI commenced a dialogue with the self-regulation body The Association for Generally Accepted Principles in the Securities Market (the Association) regarding devising future enforcement of financial information.¹³ In brief, in the proposed self-regulation solution, the Association reviews the financial information of the listed corporations and reports any breaches to FI, which decides on any sanction. In FI's opinion, Sweden can gain more efficient and flexible enforcement of financial information if execution is delegated

¹¹ SOU 2015:19 A new order for the enforcement of financial information.

¹² <http://www.fi.se/sv/publicerat/remissvar/2015/Remissvar-betankandet-En-ny-ordning-for-redovisningstillsyn/>

¹³ More information about the Association and its operations is provided at www.godsedpavpmarknaden.se/

to the Association. A self-regulation solution in this area is also well in line with the well-established self-regulation tradition on the Swedish securities market.

FI submitted its amended consultation response in January 2017 and the matter is currently being prepared at the Ministry of Finance.¹⁴

¹⁴ FI's consultation response on responsibility for the enforcement of financial information in Sweden is provided at <http://www.fi.se/sv/publicerat/remissvar/2017/fi-andrar-remissvar-om-redovisningstillsyn/>

Supervision and regulation of the securities market

The securities market has undergone major changes in the past few years, one reason for this being new regulations. In the EU, a number of reforms have been made aimed at preventing financial crises and improving regulation, primarily of systemically important firms. This chapter focuses on some of the future key regulations in the Swedish securities market.

In order to safeguard a stable financial system featuring a high level of confidence with well-functioning markets, rules are in place for firms and private individuals that are engaged in financial operations or provide financial infrastructure. Besides participating in devising these rules, FI follows up and analyses how they affect the securities market.

FI also supervises financial firms, and to some extent also non-financial corporations and private individuals, to monitor to ensure that they follow the rules in place. FI is responsible for supervising firms that provide financial infrastructure, such as stock exchanges, trading facilities, central securities depositories and clearing houses.

NEW RULES FOR THE SECURITIES MARKET

An important part of FI's work is to create conditions for efficient markets, and counteract various types of market manipulation. Besides the work on supervision of the securities market, focus in 2017 will be on implementing new regulations.

MiFID¹⁵, which were introduced in 2007, have the purpose of bolstering investor protection and increasing competition in trading in financial instruments in the securities market. When the directive started to apply, competition between different trading venues within the EU was opened up. In the past few years an increasing number of investors have become active on the securities market, while at the same time the complexity of products and services has increased. In 2014 the EU therefore decided on new and more comprehensive MiFID regulations.¹⁶ They will start to apply as of 3 January 2018.

In line with the developments in the securities market and in technology in the past few years, there has been a need to adapt the regulations regarding both insider trading and market manipulation. The EU has therefore also decided on a new Market Abuse Regulation (MAR) and a new Market Abuse Directive (MAD). New regulations for benchmarks will start to apply in 2018. The new regulations aim to strengthen confidence in the securities market and protect the market's integrity.

¹⁵ The Markets in Financial Instruments Directive.

¹⁶ The new MiFID regulations consist of the directive and the regulation on markets in financial instruments (MiFID 2 and MiFIR [level 1]) and technical standards and delegated acts (level 2) that supplement level 1.

Figure 2. Time line for some key regulations on the securities market.

	2016	2017	2018	2019	→
EMIR	Application				
MAR	Implemen- tation	Application			
BMR	Implementation		Application		
MiFID 2/ MiFIR	Implementation		Application		

Note. The regulations are the Regulation on OTC derivatives, central counterparties and trade repositories (EMIR), the Market Abuse Directive (MAR), the Benchmark Regulation (BMR) and the Markets in Financial Instruments Directive and Regulation (MiFID 2/MiFIR).

New prospectus regulation

In December 2016 the European Parliament, the Council and the Commission agreed on the new prospectus regulation which will replace the present prospectus directive from 2003. The new prospectus regulation is an important element in creating a European capital markets union. The purpose is to make it easier, primarily for SMEs, to gain access to the capital market in the EU.¹⁷

One of the changes is that SMEs will be able to use a new type of prospectus, known as a growth prospectus, with lesser demands on the information to be included. Also, the summary of a prospectus is limited to a maximum of seven pages.

Another change is that the exemption from the obligation to publish a prospectus for the admission of shares to a regulated market, in the event of a dilution of a maximum of 10% of the shares, will be increased to a maximum of 20% of the number of shares. It will also be possible for issuers to shorten the process and work involved in offerings of transferable securities to the general public.

Market abuse – New legislation gives FI new powers

Market abuse, which is a term covering illegal conduct on the securities market, can damage confidence in the integrity of the market and hence lead to a deterioration in the functioning of the market. In light thereof, the EU has adopted a new Market Abuse Regulation (MAR) and a new Market Abuse Directive (MAD). The Swedish legislation implementing MAR and MAD came into force on 1 February 2017. This essentially replaces existing legislation in the area, including regulations regarding insider reporting.

A difference from the former legislation is that MAR and MAD also cover trade and conduct on MTFs and on organised trading facilities (OTFs), a change that is also included in the new MiFID regulations. More stringent

¹⁷Further information on the capital markets union is available at http://ec.europa.eu/finance/capital-markets-union/index_en.htm

demands are also imposed on MTFs and OTFs to monitor trading and report suspicious transactions to FI. Previously, the market abuse rules only applied to trading in listed securities. The purpose of including more trading facilities in the legislation is to ensure that market abuse is unequivocally prohibited, irrespective of where the financial instrument is traded.

The new legislation provides FI with new powers to investigate, and the possibility of issuing sanctions in the event of breaches of the market abuse provisions. In FI's opinion, the new legislation will increase the possibility of protecting the integrity of the securities market, which can help increase the confidence of investors, corporations and banks.

FI's extended powers to investigate

FI's new powers to investigate in terms of suspected breaches of the market abuse provisions include the ability to carry out dawn raids. This means that FI can enter business premises to e.g. confiscate documents. Another new feature is that FI can temporarily ban somebody from engaging in a certain activity. It will also be possible to use two types of procedural enforcement – sequestration and attachment.

Certain cases, which have been handled to date by prosecutors, will now be investigated by FI. For example, cases pertaining to negligible and negligent breaches of bans on insider trading and market manipulation. FI already held responsibility for supervising insider reporting, but in this area FI has been given new duties due to a new division of cases between prosecutors and FI.

FI cooperates with the Swedish Economic Crime Authority (SECA) to ensure effective work in counteracting market abuse. Through the new law, the cooperation between the two authorities is altered and deepened. Going forward, FI will be responsible for investigating negligible breaches of the market abuse provisions, while SECA will continue to investigate serious breaches. The new powers to investigate place great demands on FI's operations and on the whole the new legislation entails a new, more active way of counteracting market abuse.

FI's sanctions and interventions

FI shall intervene against breaches of the market abuse provisions. Non-serious breaches, which have been handled by prosecutors to date, will be handled by FI in future, which will intervene in that case through sanction injunctions. If there is reason to assume criminal activity, the case will still be referred to the prosecutor in future.

The new legislation features a considerable increase in sanction amounts. In terms of breaches of the insider reporting provisions, the highest permitted sanction amounts have been increased more than tenfold in some cases.

New rules on benchmarks

Benchmarks are indexes used to determine the value of a great number of financial instruments and contracts. Examples include equity benchmarks, interest rate benchmarks and commodity benchmarks. Benchmarks are crucial in pricing cross-border transactions in the EU too, and shall thus be treated such that they contribute to an efficiently functioning internal market for a vast array of financial instruments and services. In connection with the latest financial crisis, suspicions about benchmark manipulation led to authorities conducting various international investigations. In some cases, there were indications of manipulation having occurred. Some of the most serious cases pertain to the manipulation of interest rate benchmarks, such as LIBOR and EURIBOR.¹⁸

¹⁸ London Interbank Offered Rate and Euro Interbank Offered Rate.

When the benchmark manipulation came to light, it became clear that several entities did not consider this to be a criminal offence, but rather an accepted grey zone. It was also difficult for authorities to lodge proceedings against institutions and private individuals due to limited powers under the prevailing regulations. Because manipulation or attempted manipulation of benchmarks can have serious implications for the market and lead to losses for investors and consumers, and have a negative impact on the real economy, it has been considered necessary in the EU to supplement the general ban on market manipulation with a ban on manipulation of the benchmark itself. MAR therefore regulates conduct relating to benchmarks specifically.

Some EU countries also already had certain rules and approaches for managing benchmarks, but these have differed between Member States. To address this, benchmarks have also been regulated within the EU through the Benchmark Regulation, which came into force on 30 June 2016, applicable as of 1 January 2018.¹⁹ The entities that will mainly be affected are administrators, i.e. entities that control the provision of benchmarks. The new rules for administrators will place demands on control and oversight, and on documentation and transparency. The regulation also entails greater responsibility for contributors of input data and benchmark users.

Swedish indexes exist today that are used as benchmarks for financial instruments. Many of them are administered by entities that are already under FI's supervision. These entities will need to apply to become registered administrators. The entities not under FI's supervision will undergo a more extensive authorisation process.

FI has, together with other supervisory authorities, worked to make benchmarks, which are systemically important or particularly sensitive to manipulation, more stringently regulated than other benchmarks. The basis has been that the regulation of benchmarks should be proportionate so as to avoid unduly heavy administrative burdens. The result of this is that the benchmarks that could potentially affect financial stability or the real economy the most will be classed as critical. For such benchmarks, the competent authority shall set up a college of supervisors. There are as yet no benchmarks in Sweden that have been elected critical, but if this occurs, FI might have the task of appointing a college of supervisors.

With the new regulations, it is hoped that the benchmarks will be more difficult to manipulate, and more transparent. Improved governance and control, and a clearer distribution of responsibilities shall help to prevent conflicts of interest. It will also be easier for FI and other authorities to intervene if breaches are detected in setting a benchmark.

The new MiFID regulations

The new MiFID regulations, which will start to apply as of 3 January 2018, have the overall purpose of creating conditions for more efficient markets and strengthened investor protection. The new rules contain requirements in a multitude of areas that could have implications for how trading in securities and the provision of securities services are organised.

FI's current regulatory work arising from the new MiFID regulations

By reason of the implementation of the new MiFID regulations, FI will propose certain amendments to its regulations. The regulations shall be imple-

¹⁹ The entry into force of a legislative act in the EU on a certain date does not commonly mean that the rules shall be applied from that particular date, but rather only means that they become generally valid. To provide Member States with time to adapt, new provisions can therefore become applicable at a later date.

mented on 3 July 2017 and start to apply on 3 January 2018 in connection with the implementation of equivalent amendments to the Securities Market Act.

In the proposal for new regulations, operating a trading venue will be subject to more stringent requirements than before. One purpose is to ensure efficient supervision in line with technical developments, for instance in areas such as high-frequency trading and market abuse. In the amendments to the regulations that FI will propose, firms wishing to apply for authorisation to operate a regulated market or trading venue will therefore be required to submit more comprehensive materials for authorisation assessment than what used to be the case.

With the new MiFID regulations, three new data reporting service providers will be subject to authorisation and come under FI's supervision. These service providers are called Approved publication arrangement – APA, Consolidated tape provider – CTP, and Approved reporting mechanism – ARM. The purpose of subjecting the new service providers to authorisation is to ensure the quality of both of the information which is to be published and help attain better transparency, and of data to be reported to FI.

With the introduction of new transparency requirements in the new MiFID regulations, FI's current regulatory provisions on transparency need to be repealed, i.e. disclosing two-way quotes and executed transactions, and the rules on systematic internalisers. This is in order to avoid dual regulation, as the new requirements will be directly applicable.

Because of the increased complexity in financial products and services, the new MiFID regulations contain requirements aimed at increasing investor protection. In FI's new regulations, certain amendments to improve customer protection will also be proposed. The amendments pertain to areas such as securing customer funds and financial instruments, remuneration provided to or by third parties, and product governance.

The proposed amendments to FI's regulations will be referred to external consultation in mid-March 2017. The amendments to FI's regulations follow the same schedule as the regulatory amendments that are to implement and adapt national law to the new MiFID regulations.

Transparency requirements

The transparency requirements in the new MiFID regulations stipulate that market operators and investment firms shall make public current bid and offer prices, as well as prices and volumes of transactions executed. The current MiFID requirements only cover publication of the price and volume for equities. In the new MiFID regulations, rules are introduced for all types of financial instrument and will apply both to trade on trading venues and OTC. The main rule is full and immediate transparency, although the requirements also provide scope for situations in which different types of waivers or deferred publication may be needed for the market to function efficiently. Waivers may, for example, pertain to the obligation to publish bid and offer prices for orders exceeding a certain size, or the possibility of deferring publication of prices and volumes for executed transactions.

When the current MiFID regulations were introduced, Sweden decided on requirements for the obligation to disclose post-trade information for non-equity financial instruments too. Therefore, already today, the provisions contain transactions in debt instruments (or futures and options contracts, with debt instruments as the underlying asset), such as bonds. With the present disclosure requirements for debt instruments, information shall be published at the aggregate level on the next trading day. To gain an understanding of how the new MiFID regulations could affect present transparency, FI has analysed

the Swedish bond market. FI's conclusion is that the possibility to provide for deferred publication in the new MiFID regulations would probably mean a deterioration in transparency in the Swedish bond market.²⁰ In the spring, FI will broaden the analysis so as to take a position on how different types of waivers and deferral for non-equity instruments shall be applied.

In the derivatives market, the transparency requirements will also be affected by the new trading obligation rules, and by which derivatives are considered to be traded on a trading venue. ESMA has published a proposal setting out that the most liquid fixed-income derivatives shall be traded on a trading venue,²¹ which also means that they are subject to the new transparency requirements.

Position limits

The new MiFID regulations place limitations on the size of positions that may be taken in commodity derivatives. The purpose of the limitations is to address the high level of volatility in commodity prices on the global commodities market. FI will therefore be responsible for setting position limits in commodity derivatives contracts traded on trading venues and OTC contracts that are financially equivalent thereto. The position limits will be prepared through methods of calculation established by ESMA. ESMA must also approve the limits proposed by FI. The rules on position limits do not only cover financial institutions; Swedish farmers, electricity suppliers and industrial companies could also be affected. FI is currently working on preparing procedures for communicating position limits to the market.

The ESMA regulation in relation to the EEA agreement

In connection with the EU's issuance of regulations, a separate process is occurring to transpose Union legislation into the EEA agreement that regulates Union law in relation to the EFTA countries Norway, Iceland and Liechtenstein. In the autumn of 2016 the ESMA regulation was transposed into the EEA agreement and the three EFTA countries are now included in the European supervisory system, but without voting rights. In the EEA, supervisory work has a different structure and the ESMA regulation has been fundamentally modified in terms of the EEA agreement, particularly regarding who makes decisions on intervention (which are made by the EFTA Surveillance Authority) and mediation between the supervisory authorities of the EU (such as Finansinspektionen) and the supervisory authorities of EFTA (such as Finanstilsynet in Norway). In light of how the Swedish and Norwegian securities market are interlinked, this will involve increasing cooperation as part of the European system. For the EFTA countries, this means closer cooperation with the institutions of the EU.

FINANCIAL INFRASTRUCTURE

Active, risk-based supervision

FI is responsible for supervising firms that are at the core of the infrastructure of the securities market. It is a case of regulated markets, organised trading facilities, central securities depositories (CSDs) and clearing houses. Out of the operations supervised by FI, the following are considered systemically important.

- Euroclear Sweden AB – settlement system for securities.
- Nasdaq Clearing AB – central counterparty for financial derivatives, commodity derivatives and repos.
- Bankgirocentralen BGC (Bankgirot) – clearing of mass payments.

²⁰ Supervision of the Swedish securities market, 10 March 2016.

²¹ Discussion Paper, The trading obligation for derivatives under MiFIR, 20 September 2016.

- The foreign infrastructure systems EuroCCP (clearing of equities) and LCH.Clearnet (clearing of e.g. equity and fixed-income derivatives) through international colleges of supervisors.

Supervisory work, and development of new regulations for the infrastructure area, are conducted in close cooperation with other international supervisory authorities and forums for cooperation in order to ensure harmonised implementation and application of international legislation.

The financial infrastructure is stable and well-functioning, but challenges exist
In FI's opinion, the financial infrastructure in Sweden functions well and has a high degree of operational reliability. However, there is scope for further improvement at infrastructure firms and, at the regulatory level, there are important matters to decide on. In the coming year, a number of areas will be of particular interest.

Work with the Commission's proposal for regulations regarding the recovery and resolution of central counterparties will continue. Central counterparties are of great and growing importance in the financial infrastructure. The absence of such regulations (which are in place for banks) could mean consequences that are difficult to gauge and negative for financial stability, if a central counterparty falls into difficulty.

The authorisation of Euroclear Sweden AB according to the central securities depositories regulation (CSDR) will be an important matter for FI. The new regulations contain much more detailed provisions than the existing Swedish regulations. The adaptation work therefore places great demands on the firms subject to the regulation, for example upgrading the existing VPC system – work that not only involves Euroclear Sweden, but also all participants that settle securities transactions in the VPC system. FI finds it particularly important to limit the running operational risks in the system during the course of this work, which places great demands on internal governance and control.

On top of the work on devising and implementing new regulations in the area, FI finds it crucial for infrastructure firms to continue improving their internal governance and control. This applies not least in areas where core parts of the business are run by other firms, irrespective of whether this is done within or outside of the same group. Responsibility for the business cannot be outsourced, and assuming that responsibility requires expertise, processes and clear governance at the firm subject to authorisation.

FI also finds that the work of the infrastructure firms on assessing and counteracting cyber threats must continue, which requires active efforts at both the operational level and at the strategic management level.

Recovery and resolution of central counterparties

Requirements for compulsory counterparty clearing, and an increased share of voluntary clearing, have led to an increase in the importance of central counterparties. After the clearing requirement was introduced, the share of cleared fixed-income contracts on the OTC market in Europe increased from around 36% in 2009 to around 60% at the end of 2015.²²

As mentioned above, stringent demands are imposed on central counterparties' resilience, governance and risk management, which has resulted in a relatively low risk of default. However, because of the increased importance of the central counterparties, a default could have very serious implications for financial markets. There is therefore a need to introduce, as has already taken place for banks, rules for the recovery and resolution of central counterparties.

²² http://europa.eu/rapid/press-release_MEMO-16-3990_en.htm

The purpose of recovery and resolution is so that a firm can continue to offer critical services, i.e. functions and services necessary for financial markets to function, even if the firm falls into serious financial difficulties. In this way, financial stability is not jeopardised and at the same time there is a reduced risk of having to use taxpayers' money to bail out the firm.

The lack of regulations for dealing with a central counterparty in financial difficulty has led to several initiatives in the past few years, mainly at the global level. Both CPMI-Iosco and the Financial Stability Board (FSB) have published reports on the topic.²³

In November 2016 the Commission presented a bill regarding a framework for recovery and resolution pertaining to central counterparties, their participants and any parent companies of central counterparties. The proposal is based on the legislation applying to the resolution of banks, but is adapted for central counterparties in terms of dealing with insolvency and operational procedures, especially as regards the allocation of losses. There is also an intention to coordinate the work with that being done at global level within FSB. The Commission's bill for a regulation will be addressed by the European Parliament and the Council before it can be adopted.

According to the bill, a central counterparty shall prepare a recovery plan for managing situations when there is a risk of the resources required by EMIR for insolvency situations failing to suffice. The plan shall be reviewed by the supervisory authority. The central counterparties' supervisory authorities shall have special tools enabling them to take measures before a central counterparty collapses or its activities can harm financial stability.

A resolution authority shall be appointed, with responsibility for preparing a resolution plan per central counterparty. The resolution plan shall state how a central counterparty can be restructured and its critical functions preserved if recovery were to fail. The resolution authority shall also establish a college of resolution for cooperation with other national authorities. If a central counterparty defaults, or has a probability of default, and if no private initiatives are considered able to prevent a default, and resolution is in the public interest, the resolution authority shall put the central counterparty into resolution.

The resolution authority will have certain resolution tools, which are to be used to minimise costs for governments and taxpayers. Instead, the private sector shall bear the brunt of the costs (such as shareholders and clearing members).

New rules on securities depositories

Central securities depositories are important participants in the financial infrastructure. Their task is primarily to register securities, provide securities accounts and take care of settling transactions. "Settlement" refers to the transfer of securities from the seller's to the buyer's account, and the matching transfer of payment from the buyer's to the seller's account. In Sweden it is Euroclear Sweden that settles transactions from the fixed-income and equity markets, and certain derivative transactions. Euroclear Sweden also performs registration and account-keeping of securities, and maintains shareholder registers for affiliated companies.

Because of the key position of the central securities depositories on the securities market, it is crucial that they function well, even under stress. The Central Securities Depositories Regulation (CSDR) came into force in September 2014 and addresses some of the risks in securities settlement systems. One purpose

²³ CPMI-Iosco, April 2012, *Principles for financial market infrastructures*, CPMI-Iosco, October 2014 *Recovery of financial market infrastructures*, Financial Stability Board (FSB), October 2014 *Key Attributes of Effective Resolution Regimes for Financial Institutions* FSB Discussion note 16/08/2016 *Essential aspects of CCP Resolution Planning*,

of the regulations is, for example, to attain improved security by promoting timely securities settlement. Another purpose of the regulation is to introduce harmonised rules for securities settlement in the EU. Work is still in progress on preparing details in the regulations, and implementation is occurring gradually.

The regulation brings an array of requirements for central securities depositories, for example which type of operations they may conduct and how they shall be organised, particularly with respect to risk management and the allocation of responsibilities. Central securities depositories shall submit their application for authorisation to FI within six months after certain technical standards have come into force, which is expected to occur in the near future. The new requirements must be fulfilled in order for a central securities depository to be authorised under the CSDR.

Glossary

Alternative performance measure Financial measure which is not directly identifiable in the issuer's financial statements (e.g. in the income statement, balance sheet and cash flow statement) in which amounts are added, deducted or divided. It is beyond the measures defined in applicable financial reporting rules (such as IFRS and the Annual Accounts Act).

Attachment Measure relating to collateral for state receivables, whereby property is taken as collateral for a certain liability.

Benchmark Index used for measuring the value of a financial instrument or measuring the performance of an investment fund.

Central counterparty Financial firms that serve as the counterparty, i.e. the seller for all buyers and the buyer for all sellers, in trade in financial instruments on a market.

Clearing house Firm authorised to conduct clearing operations and which participates in clearing and settlement of transactions in financial instruments.

Covered bond A bond whose holder has a right of priority in the event of bankruptcy. The credit risk is thus normally lower compared to unsecured bonds.

CPMI-IOSCO Cooperation between representatives from IOSCO and the Bank for International Settlements (BIS) Committee on Payments and Market Infrastructures (CPMI) on matters regarding financial infrastructure.

Derivatives Financial instruments entailing agreements regarding events or conditions at a specific future point in time. The value of a derivative is linked to the value of an underlying asset, such as equities, equity indexes, currencies, interest rates or commodities.

European Banking Authority (EBA) Authority that prepares common regulatory and supervisory standards. It is also responsible for regulating banks in the EU.

European Insurance and Occupational Pensions Authority (EIOPA) Authority responsible for the regulation of the occupational pension and insurance sector in the EU.

European Securities and Markets Authority (ESMA) Authority responsible for the regulation of the securities market in the EU.

Financial Stability Board (FSB) International body that seeks to promote financial stability by monitoring the global financial system and issuing recommendations

Foreign exchange swap Agreement between two parties to exchange, during a predetermined period of time, one currency for another.

Interest rate future Agreement that grants a right and an obligation, at a future point in time, to buy or sell a financial instrument at a predetermined price.

Interest rate swap An agreement between two parties to exchange, during a predetermined period of time, a certain interest rate for another.

International Organization of Securities Commissions (IOSCO) International standard-setting organisation for the securities market.

Market maker Financial entity that sets bid and ask prices in a certain financial instrument, thus supporting liquidity in the instrument.

MiFID regulations Markets in financial instruments directive that started to apply in 2007. In 2018 that directive will be replaced by a new one (MiFID 2) and a new regulation (MiFIR).

Multilateral trading facility (MTF) Trading facility that is organised and provided by an investment firm or market operator which brings together several third parties wishing to buy and sell financial instruments.

Organised trading facility (OTF) Trading facility that is organised and provided by an investment firm or market operator and which brings together several third parties wishing to buy and sell bonds, structured financial products, emission rights or derivatives.

OTC (Over The Counter) Trade in financial instruments that does not occur on a stock exchange or trading facility.

Regulated market An authorised trading venue that enables bringing together several buying and selling interests.

Sequestration Temporary measure pending a court ruling in a case, in which the enforcement authority can secure property so that it is not destroyed or otherwise disappears.

Settlement (of securities) Final settlement of a liability through the transfer of securities from the seller's to the buyer's account, and transfer of payment from the buyer's to the seller's account.

Stress test Analysis of various scenarios to test resilience to unforeseen and negative events.

Systematic internaliser Investment firm which, to an organised, frequent and considerable extent, trades on its own account when executing customer orders outside of a trading facility.

Systemic risk The risk of key functions being seriously disrupted or completely disabled in all or parts of the financial system.

Systemically important Financial firms and markets of importance to financial stability.

Trade repository (TR) Firms that collect reporting and maintain a register of information on derivatives.

Volatility A term used to designate price movements in financial instruments. The volatility describes how much the price of a financial instrument varies.

Yield impact Measure of market liquidity that reflects the change in market rates that can be observed between two transactions conducted on the same day in a bond.



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