



FINANSINSPEKTIONEN

Supervision of the securities market

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Summary

The objective of Finansinspektionen's (FI's) supervision of the securities market is to work to promote a stable, well-functioning market that offers high consumer protection. In this report, the regulatory work and the supervision conducted by FI with respect to the securities market are addressed. It focuses on the key constituents of the Swedish market currently subject to regulation and/or supervisory activities – financial infrastructure, transparency on the securities market as well as market supervision and the enforcement of financial information.

Financial infrastructure

Central counterparties, central securities depositories, stock exchanges and other types of firms that make up financial infrastructure are necessary for the financial system to work. As a consequence of new regulation following the financial crisis, central counterparties have become more important to the financial system, which in turn has given rise to new requirements for such operations. Also, entities that settle executed transactions – the central securities depositories – have become subject to new regulation.

An important priority for FI is that central counterparties and the other firms that make up financial infrastructure stand well equipped and can deal with any crisis situations that might arise. Work is currently in progress in the EU to prepare common rules for dealing with a central counterparty in serious difficulty, because there would be a risk of particularly severe implications for financial stability. In terms of financial infrastructure, FI cooperates closely with the Riksbank, which monitors to ensure the promotion of a safe and efficient payments system.

Increased transparency on the securities market

In 2014 the EU resolved on new harmonised rules for the European securities market, known as the MiFID regulations. Their overarching purpose is to create conditions for more efficient markets.¹ The new regulations will require major investment and change at both firms and the responsible authorities.

The regulations contain rules that aim to increase transparency in trading in financial products. Essentially, information regarding a high number of transactions in bonds and other interest-bearing products shall be disclosed. However, the regulations enable the supervisory authorities to grant exemptions from these rules. The rules governing exemptions are currently being prepared by the European Securities and Markets Authority (ESMA), and FI is actively involved in this work. During the year, FI decided on the early introduction of a new practice of increased transparency on the corporate bond market, because in FI's opinion this can ultimately give a more efficient market.

In addition to requirements for increased transparency, the new regulations bring more amendments to the rules applicable to trading on the securities market.

¹ The new Mifid regulations consist of the Markets in Financial Instruments Directive (MiFID 2), and Markets in Financial Instruments Regulation (MiFIR).

New rules on market supervision and the enforcement of financial information

In the past year, new EU rules regarding both market supervision and the enforcement of financial information have been presented, which are expected to lead to changes to FI's supervision. In terms of market supervision, the new rules primarily bring a new order for sanctions in market abuse. New rules have also been proposed to regulate benchmarks used by banks and other firms for pricing various financial products.

An inquiry has been presented, containing proposals for the enforcement of financial information to be reformed, and that responsibility be transferred to FI. New guidelines have also started to apply in the EU for the enforcement of financial information with a view to achieving consistent supervision in the EU.

A capital markets union

The EU Commission recently launched a project by the name of the Capital Markets Union (CMU). Its purpose is to further integrate the EU's capital market and create better conditions for financing, including outside of the banking system. The project is in its infancy, but can be expected to bring about a review of the rules governing e.g. prospectuses and securitisation. In FI's view, the concepts presented in the framework of the CMU are positive. However, it is crucial that forthcoming regulatory amendments do not weaken investor protection or financial stability.

FI and the securities market

The securities market is key to the financial system and hence the economy. On the securities market, savings are converted into financing in a process through which those in need of financing can approach potential investors. The securities market is crucial to the possibilities of both financial firms and non-financial corporations to raise funding. It also enables various market participants to manage the risk associated with certain operations. Finally, both the securities market and the payments system alike are highly reliant on financial infrastructure firms, which enable conducting payments and other transactions.

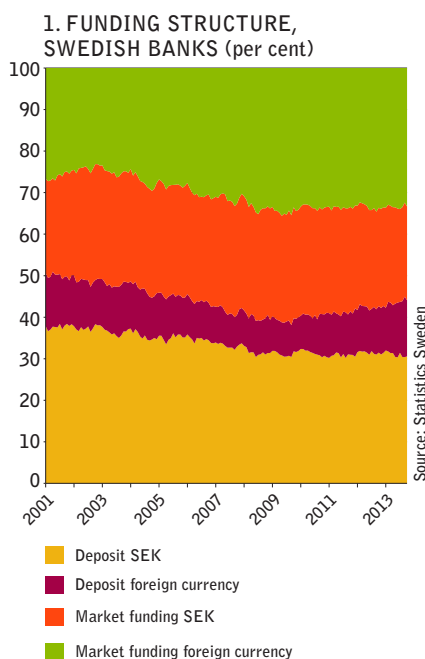
THE OBJECTIVE OF FI'S WORK ON THE SECURITIES MARKET

FI is responsible for supervising and issuing regulations for the securities market and its infrastructure. FI's overarching mission is to work to promote a stable, well-functioning securities market that meets the needs of households and corporations for financial services, and provides high consumer protection.

A stable securities market means that it can sustain its core functions in financial stress. The stress can originate both from severe problems at individual financial firms, and from a volatile market or a systemic crisis.² Some of the firms supervised by FI can be considered systemically important. Financial problems or extensive disruption, at e.g. a central counterparty or a clearing house, can spread to other firms and hence have serious implications for the economy. It is of course also in the interests of such firms to prevent being struck by serious problems. However, the firms' choice of measures are not always optimal for the economy if they only take account of the consequences for the individual firm. It is because of this that the infrastructure firms are subject to specific supervision and regulation.

Besides certain firms potentially having systemic importance, this can also be the case for certain markets. This means that a disruption affecting such markets can give rise to serious effects on the financial system at large and – ultimately – on the economy. For example, the fixed income market is crucial to the possibilities of Swedish banks to raise both long-term and short-term funding. A disruption in this market could therefore have serious implications for banks and other financial intermediaries (read more about this in the section on Developments on the securities market). The foreign exchange market is also key. This is because the banks need to convert funding in foreign currency to Swedish kronor, and vice versa (diagram 1).³

In addition to ensuring stability in the financial system, FI's task is to work to ensure high protection for consumers and investors. The defi-



Note: Refer to Swedish monetary financial

² In the memorandum "Finansinspektionen and financial stability", an account is provided of FI's work with financial stability. FI also provides its opinion on the stability in the financial system in a stability report published twice a year, in June and December. The memorandum and the report are available on <http://www.fi.se/Folder-EN/Startpage/Press/Press-releases/Listan/Stability-in-the-financial-system/>.

³ Because approx. 60 per cent of the banks' outstanding securities are issued in foreign currency, this funding must be converted into Swedish kronor to be used for Swedish lending.

ciencies and problems that might lead to an unstable market are often the same as those that could lead to deficient consumer protection. A problem often highlighted is the information gap between market participants. Information gaps are a naturally occurring market phenomenon, but if the gap is too wide it can have a negative impact on how the market functions. One way of overcoming problems associated with information gaps is to introduce rules that oblige participants to disclose their conducted transactions. FI's work on consumer protection on the securities market is largely conducted within the consumer protection operational section, which was established in 2014.⁴ Financial stability and consumer protection can also be upheld by thorough regulation or in situations of limited competition and do not actually require a functioning market.⁵ In light thereof, in its work FI must also take into consideration the fact that the securities market must function well. For the market to function well, it must be stable, and also function in a way that is as efficient as possible from an economic perspective. FI must therefore also take account of certain regulation not unnecessarily increasing costs, limiting competition or reducing the pace of innovation. So, any drawbacks brought about by a new rule must be weighed against its benefits.

The fact of the securities market functioning well is, for example, fundamental for financing to be channelled in as efficient a manner as possible for the economy, which is in turn necessary for upholding a functioning economic system. Also, in order for the securities market to function, market participants must be able to assume that market rules will be followed. Examples in this context are the enforcement of financial information and trade supervision, as well as prospectus review. Furthermore, FI attempts to create the conditions for well-functioning markets that feature healthy competition.⁶ This can occur e.g. through the introduction of transparency requirements in trade in financial products.

DEVELOPMENTS ON THE SECURITIES MARKET

Just like for goods and services on other markets, products on the securities market are under constant development. Prior to the latest financial crisis, growth in certain products on the securities market was so explosive that it can be assumed to be part of what triggered the crisis. The interconnectedness of the financial system led to the contagion of the crisis from crisis-stricken firms and markets to affecting basically the entire financial market and economy.

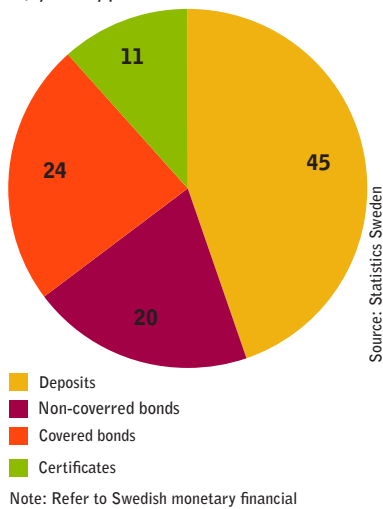
The effects of the crisis were so vast that decision-makers at global level saw fit to sharply tighten regulation of the financial system. Authorities around the globe have conducted such work on many different fronts. A clear example is the work with the capital requirements of banks. Another important area is improving fundamentals for financial markets to function in changing conditions. This, together with the market's own

4 FI's work to strengthen the position of consumers is presented in a separate consumer protection report, available on <http://www.fi.se/Folder-EN/Startpage/Press/Press-releases/Listan/Financial-advice-instant-loan-firms-and-mortgages--three-areas-in-which-consumer-protection-must-be-strengthened/>. The consumer protection report is published annually in May.

5 Prop. 2012/13:1 Expenditure area 2, p. 17.

6 However, responsibility for counteracting various types of competition-limiting collaboration and abuse of predominant positions rests with the Swedish Competition Authority.

2. DISTRIBUTION OF FUNDING
(Q4, 2014, per cent)



adaptation, is the reason for the highly extensive transformation that financial markets have undergone since the financial crisis, and which is indeed still ongoing.

In the following section, some of the development trends and risks recently observed in different areas of the securities market are discussed.

The fixed income market

Banks, the Government and large corporations raise funding on the fixed income market. The largest investors are insurance companies, pension funds and other investment funds. The fixed income market is crucial to the possibilities of Swedish banks to raise both long-term and short-term funding. In order to raise funding in the short term, access to a well-functioning money market is of core importance to the banks. This is because the banks must stand constantly prepared to pay out money at short notice. Only around 45 per cent of the total funding of Swedish banks comes from deposits. The remainder is obtained by issuing various debt instruments on the fixed income market, with covered bonds in particular standing out (diagram 2 and 3).

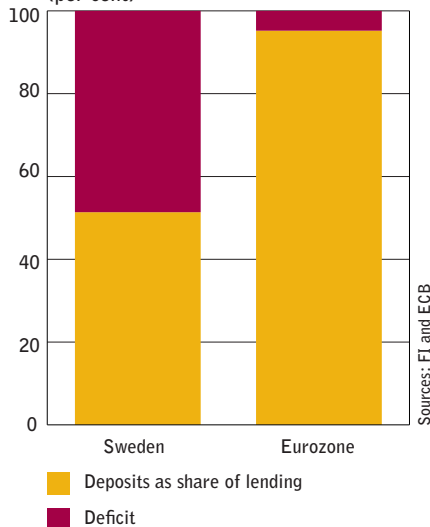
Recently, the fixed income market has become an increasingly important direct source for the financing of large Swedish corporations (diagrams 4-6). This sharp increase is partly driven by the prevailing global low interest rate environment, which has made corporate bonds a more attractive investment alternative (diagram 7). The low-rate environment has, quite simply, forced investors to take on more risk in their search for higher nominal return. Another reason for the heightened importance of the fixed income market is that it has become more expensive to borrow from banks due to e.g. stricter regulation.

Since its deregulation in the mid-1980s, the Swedish secondary market for government and covered bonds has featured major transaction volumes and hence relatively sound liquidity. At the same time, pricing transparency is limited and trading volumes have dropped. One reason is that the government bond market has contracted due to lower deficits in the state budget. Another reason could be that the market is dominated by a limited and dwindling number of participants, which play an important role as market makers. The market maker role involves an obligation to provide binding prices in normal market conditions. Hence, the market makers bear the risk until they can sell on the securities (in the case of a purchase) or the risk is otherwise covered. They are compensated for this risk mainly by maintaining a bid-ask spread. The market makers also receive a certain amount of compensation from the Government for their risk-taking.

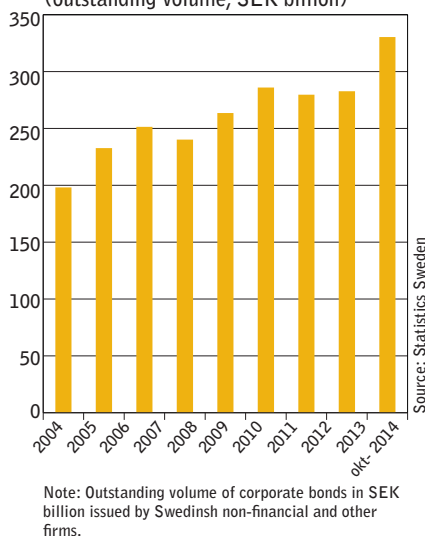
Despite reduced turnover and fewer market makers, the Swedish government and mortgage bond market currently functions relatively well. Besides trading volume, other efficiency measures, such as spreads and depth, show relatively sound efficiency. However, the matter of the number of participants has been raised on several occasions over the years, and whether the low number of participants can manage to sustain an efficient market. The question has been brought to light again by the new MiFID regulations (see below in the section “New rules for trading in financial products”).

Another important submarket is the repo market. Through a repurchase agreement, a party can raise financing by selling a security, while simultaneously undertaking to repurchase it at a determined price at a set

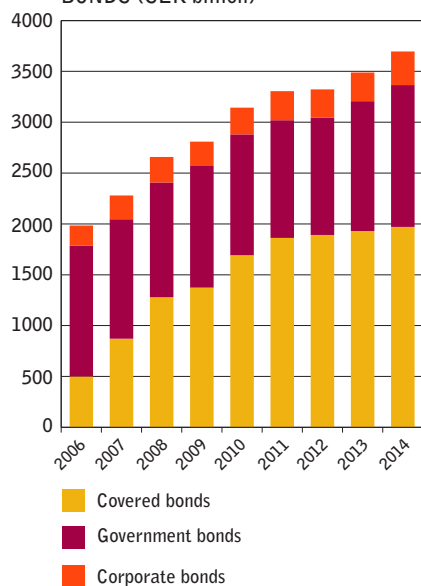
3. DEPOSIT DEFICIT 2013
(per cent)



4. CORPORATE BONDS
(outstanding volume, SEK billion)

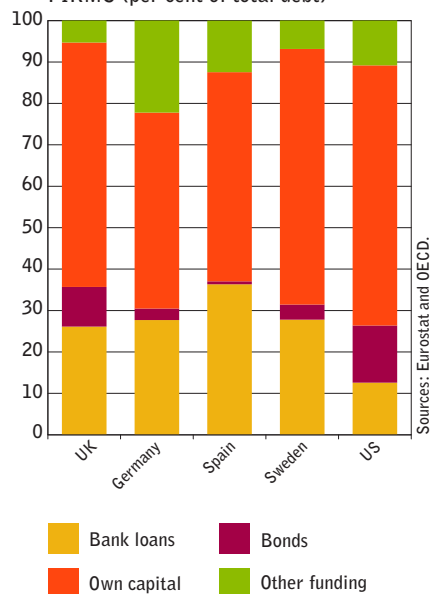


5. OUTSTANDING VOLUME OF BONDS (SEK billion)



Sources: Statistics Sweden, Swedish national debt office and Swedish Bankers' Association.

6. STRUCTURE OF FINANCING, FIRMS (per cent of total debt)



Note: Numbers for EU-countries concern Q1 2014 and US-numbers concern whole year 2013.

point in the future. The duration is usually short – in most cases up to two weeks. The average daily trading volume on the repo market exceeds SEK 100 billion. The main reason for the high trading volume in repos is that they offer investors quick, efficient access to cash. Hence, the well-functioning of the Swedish repo market is an important condition for a well-functioning securities market.

The equity market

In terms of the equity market, FI's work is largely about promoting strong consumer and investor protection. This is partially different from FI's work with the fixed income market, which is also geared to bolstering stability on a market which, to a greater extent than the equity market, may be considered important to the stability of the system.

On the equity market, in recent years FI has seen an inclination towards increasingly fragmented and automated trade. This is natural in light of stiffened competition and technological developments, and is also connected to the tightened transparency requirements for equities following the implementation of the first MiFID directive in 2007.

Swedish equities can be traded on over 100 exchanges and 200 other trading facilities around Europe today. Fragmentation of the equity market was also a condition for the sharp increase in algorithmic and high-frequency trading. These types of trading are used today for much of the trade that used to be manual. In turn, this has led to lower bid-ask spreads and higher trading volumes, while at the same time the average transaction size and transparency have declined. The altered trading pattern has affected revenues and forced into being new business models and consequently fewer brokers and brokerages. It is too early to say how these developments have affected overall market functioning.

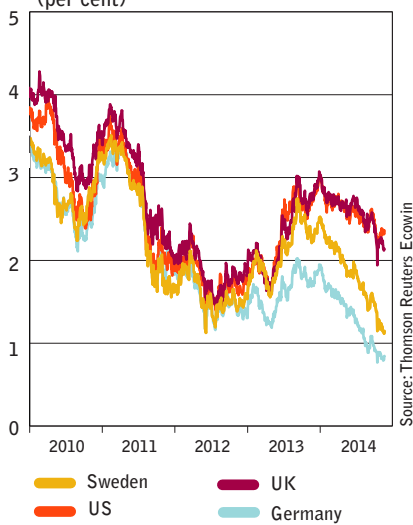
Having appropriate control functions in place among market participants in order to ensure the market works well is of great importance. The altered trading pattern presents particular challenges for both the monitoring functions of the marketplaces and FI's trade supervision. Both insider trading and market manipulation are more difficult to detect when trade is spread out across many marketplaces. When it takes place in microseconds, the challenge takes on yet another dimension. This increases the need for new methods for detecting unauthorised trading patterns, and the exchange of information between marketplaces and supervisory authorities.

As supervisory authority, FI has the task of approving the prospectuses required for e.g. stock-exchange listings. FI has therefore clearly felt the sharp increase in the number of listings in 2014 (diagram 8). An important reason for this is the strong performance of the equity market and rising valuations (diagram 9).

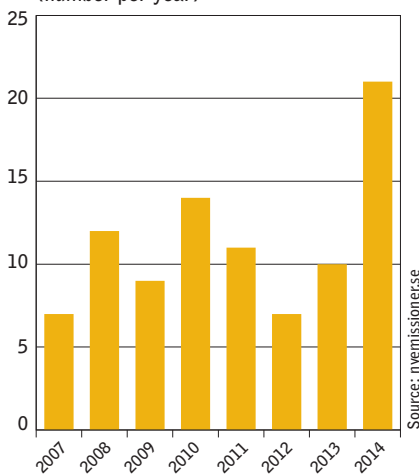
Crowdfunding

An example of a development on the securities market monitored by FI from a consumer perspective is crowdfunding. Investments in crowdfunding projects are a relatively new, but growing, phenomenon on the Swedish market. Crowdfunding is a way for small and medium-sized companies to raise money from "the crowd" – i.e. the general public. This can occur by offering the general public the opportunity to invest in a financial product, such as an equity. Project presentation and investment administration often take place online on specific platforms.

7. GOVERNMENT BOND RATES, 10Y (per cent)

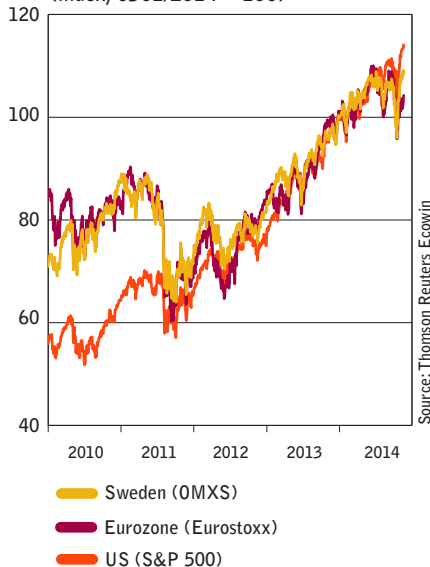


8. STOCK EXCHANGE LISTINGS (number per year)



Note: Including transfers from other market places.

9. STOCK EXCHANGES (index, 05/01/2014 = 100)



For some time, FI has been monitoring the trend in investment-based crowdfunding – the type in which an investor is promised the possibility of return through purchasing a share or other security. Crowdfunding can be an important financing source for newly started and innovative projects, but is often associated with substantial risks for investors. It can be a case of risks of fraud, risks relating to incomplete information from the issuer, operational risks with respect to the platforms and, not least, the risk of losing invested capital.

There is currently no specific legal regulation of crowdfunding in Sweden or the EU. At the European Securities and Markets Authority (ESMA) and the European Banking Authority (EBA), work has been in progress in the autumn of 2014 to chart out EU legislation that might be required to apply to crowdfunding platforms. In December 2014 ESMA published a report describing a number of questions that need to be addressed by the legislator.⁷ There are currently no crowdfunding platforms in Sweden that have been authorised by FI and which would hence come under supervision.

The derivatives market

Before the financial crisis, two parties could agree on which transaction would be executed, if it would be conducted over or outside of a marketplace, how it would be cleared and how any collateral would be managed. After the financial crisis, trade in derivatives, particularly credit default swaps, was identified as a strongly contributory cause of the crisis. Credit default swaps enabled investors to hedge themselves against a credit loss. The problem with such products was that they gave rise to major counterparty risks between market participants. Like other agreements, derivative contracts assume the counterparty can deliver on what was promised. In the 2008 crisis, however, confidence between counterparties became so weak that several derivatives markets ceased to function in practice, which in turn led to the inability of parties to contracts to deliver on their promises.

In 2009 the G20 countries thus agreed on new requirements for the OTC derivatives market. These requirements are based on standardised OTC derivatives being traded on exchanges or electronic platforms, and being cleared through central counterparties, when appropriate. All transactions in OTC derivatives must also be reported to a transaction register, and contracts that are not cleared through central counterparties shall be subject to higher capital requirements. The purpose of the regulation is primarily to limit systemic risks, but also to increase transparency in the area and prevent market abuse.

These requirements were implemented in the EU through the EMIR and MiFID regulations.⁸ Similar rules were previously introduced in the US through the Dodd-Frank Act. It is therefore possible even now to discern what the impact of the new rules might be on the derivatives market in the EU. In the US, for example, there has been a great shift in trading volumes towards products subject to lower collateral requirements and clearing expenses.

In time, the difference between the OTC market and trade on stock

⁷ The report is available at www.esma.europa.eu/news/Press-Release-Investment-based-crowdfunding-needs-EU-wide-common-approach?t=326&o=home.

⁸ The EMIR (European market infrastructure regulation) is the EU's regulation regarding OTC derivatives, central counterparties and transaction registers.

exchanges is expected to narrow. This is because stock exchanges will offer trade in products other than standardised ones in order to compete with OTC trade, partly because of the compulsory clearing through central counterparties. Some experts expect the share of OTC transactions cleared through central counterparties to increase sharply from 25 per cent before the financial crisis to 75 per cent through the new rules.⁹

A capital markets union

Even before the new EU Commission took office in November 2014, the establishment of a capital markets union (CMU) was stated as a priority. In February 2015 the Commission published a “green book” which discussed the matter of establishing such a union.¹⁰ The background is that the Commission wishes to promote economic growth in the EU by means of creating better conditions for financing, including outside the banking system. In an initial step, this involves a review of the prospectus regulations, and also measures to facilitate funding for SMEs and to promote the securitisation of investment-grade products. The green book also seeks input on how to tackle barriers to an efficiently functioning market, e.g. reducing the costs of marketing investment funds in the EU, developing private equity and private equity funds, measures regarding company and insolvency legislation and taxation.

FI finds it fundamentally positive that the Commission is extending the analysis on how to attain a better functioning capital market in the EU and improve corporate financing possibilities. FI sees advantages in reviewing the rules governing e.g. prospectuses and SME financing. However, in this process it is important not to undermine the rules that are justified by investor protection and financial stability. FI also finds it important to analyse what the real problems are for companies and the economy.

The Commission intends to publish an Action Plan later in 2015, in which it will describe in more detail which measures will be taken for a capital markets union to be established in 2019.

⁹ See e.g. John Hull, *The Changing Landscape for Derivatives*, *Journal of Financial Engineering*, Vol. 1, No. 3, 2014.

¹⁰ The green book is available on the website of the Capital Markets Union, <http://ec.europa.eu/finance/capital-markets-union>.

Supervision and regulation of the securities market

After the latest financial crisis, the securities market, like the rest of the financial sector, has been subject to an array of new regulation. Based on this new regulation, FI will intensify supervision of financial infrastructure firms and work towards greater transparency on securities markets. FI will also potentially gain broadened mandates in the supervision of market abuse and enforcement of financial information.

The EU Commission's agenda for the securities market has led to the introduction of many new rules, including three core regulatory frameworks: The MiFID regulations, which regulate trade in financial instruments and trading venues; EMIR – the regulation regarding OTC derivatives, central counterparties and transaction registers; and CSDR – the Central Securities Depositories Regulation. Together, these three regulations create a framework in which firms in the EU abide under the same rules. In this way, fair competitive conditions are ensured as cross-border operations on the securities market increase. The regulations shall ensure a well-functioning securities market with a high degree of confidence, efficient pricing and a high level of transparency. They shall also promote financial stability and operationally secure infrastructure.

FI's supervision of the securities market comprises certain functions and operations among basically all financial firms, but also among certain non-financial corporations and private individuals operating on the financial market. FI also bears supervisory responsibility for firms that are key to market infrastructure. These are stock exchanges, trading facilities, central securities depositories and clearing houses, some of which are central counterparties in the settlement of financial transactions.

FINANCIAL INFRASTRUCTURE

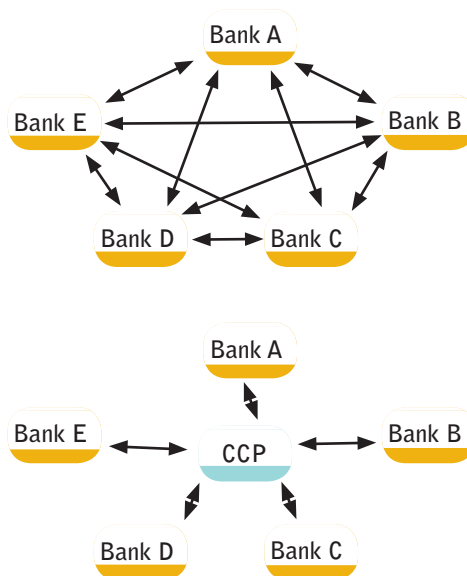
As described above, it is crucial for stability in the financial system that financial infrastructure functions securely and efficiently. It is in that light that FI conducts supervision of the firms which in turn make up the financial infrastructure.

Supervision of central counterparties

A particular problem brought to light in the latest financial crisis was, as described above, that the risks associated with OTC derivatives were not properly addressed. Deficient contracts and weak collateral management between different counterparties meant that risks could not be identified, which in turn led to substantial systemic risk. This was evidenced in the collapse of investment bank Lehman Brothers.

The solution to this problem was far-reaching, detailed regulation in the form of EMIR, adopted in 2012. The regulation imposes an obligation to clear most such products through central counterparties. The derivatives that are to be cleared are set out in regulations prepared by ESMA. In terms of fixed income derivatives, the clearing requirement in the proposal now published only applies to the EUR, USD, GBP and JPY. However, FI also expects fixed income derivatives in SEK to come under the clearing obligation in the near future.

How a central counterparty works



The central counterparty serves as the counterparty for both the seller and buyer in the original transaction. In this way, the counterparty risk for both parties is transferred to the central counterparty instead of each other. So, in clearing through central counterparties, counterparty risks, which were previously difficult to identify and assess, are concentrated to a single firm (figure 1). Hence, counterparty risks in the derivative market are brought to the surface, which facilitates risk management of derivative contracts.

FIGURE 1. Counterparty risks are concentrated to one firm

This concentration of risks to the central counterparty means that highly stringent requirements must be imposed on such entities in terms of their operations. In order to offer central counterparty clearing, authorisation is thus required under the EMIR regulations. Authorisation assumes that the central counterparty can meet stringent capital requirements and comprehensive requirements in terms of internal governance and control. The firm must also have solid capabilities in terms of sustaining its operations in both financial and non-financial crises, have procedures in place for managing counterparty insolvency, performing stress tests and conducting regular oversight of its risk models.

In March 2014 FI authorised the first – and to date only – Swedish central counterparty, Nasdaq OMX Clearing. The authorisation was granted following consultation with the supervisory college for the central counterparty. The college is headed by FI and also comprises representatives of ESMA, the European Central Bank (ECB) and the competent authorities in the countries in which the central counterparty operates, and in the countries in which the largest clearing members are established. As competent authority, FI is responsible for the continual assessment of the risks in the firm's operations and reporting these to the college. FI is also obliged to consult with the college in a number of key matters pertaining to the operations of the central counterparty.

Central counterparties in Sweden

In Sweden, Nasdaq OMX Clearing and Dutch company Euro CCP offer services as authorised central counterparties. Nasdaq offers counterparty clearing of equity, fixed income and index derivatives traded on Nasdaq Stockholm, and commodity derivatives traded on Nasdaq Oslo, but also clearing of OTC derivatives and repos. Nasdaq OMX Clearing was also recently authorised

for clearing foreign exchange derivatives. Euro CCP only offers counterparty clearing of exchange-traded equities. Nasdaq OMX Clearing is under FI's supervision while Euro CCP is under the supervision of the Dutch supervisory authority. FI also participates in the supervisory college of Euro CCP.

Collaboration in the EU and also globally is necessary, because it is clear that the trend is headed towards a concentration of fewer firms that offer services to different national markets. In that situation, it is important that different levels of ambition for rules or requirements do not turn into a competition issue between Member States. In terms of supervision of central counterparties and the other firms that make up the financial infrastructure, FI also cooperates closely with the Riksbank. The cooperation is explained by the Riksbank monitoring such firms as part of its task of promoting a safe and efficient payments system.

Recovery and resolution of central counterparties

Despite the significant role of central counterparties on the financial market, there are currently no specific regulations in Sweden or the EU for managing a central counterparty in severe financial difficulty.¹¹ However, several activities are under way at international level aimed at managing the risks among central counterparties. In October 2014, international body CPMI-IOSCO published the report "Recovery of financial market infrastructures".¹² It contains rules for how central counterparties, and other financial infrastructure firms, are to prepare plans for recovery from a financially strained situation. At the same time, the Financial Stability Board (FSB) published a report containing principles for devising an order of resolution for such firms.¹³

Deeper engagement in IOSCO and CPMI-IOSCO

In terms of financial infrastructure and the regulation of global derivatives markets, cooperation is in progress at the global level. In recent years, FI has deepened its engagement in the International Organization of Securities Commissions (Iosco) – an organisation that brings together authorities that conduct supervision of the securities market. At the annual meeting of the organisation in September 2014, FI was elected to join the board as representative of the European Regional Committee (ERC). FI has also joined the steering committee of CPMI-IOSCO – a body that works with matters pertaining to financial infrastructure. The body consists of representatives from IOSCO and from the Committee on Payments and Market Infrastructures (CPMI).¹⁴

The reason for the deeper engagement is the heightened importance gained by IOSCO and CPMI-IOSCO following the financial crisis. The organisations have become the global standard-setting bodies on the securities market, thus influencing legal developments both in the EU and individual countries. Several EU regulatory frameworks, such as CSDR, have their roots in principles and reports prepared by IOSCO and CPMI-IOSCO. In order for FI to fulfil its objectives, it is thus important, as early as possible, to be involved in and influence matters of importance to Sweden.

11 The Riksbank is, however, able to provide liquidity support to such a firm if it is solvent (Chapter 6, section 8 of the Sveriges Riksbank Act).

12 The report is available at www.iosco.org/library/pubdocs/pdf/IOSCOPD455.pdf.

13 FSB Key Attributes of Effective Resolution Regimes for Financial Institutions. The report is available at www.financialstabilityboard.org/2014/10/r_141015.

14 CPMI is part of the Bank for International Settlements (BIS).

The reports of CPMI-IOSCO and FSB will form the basis of the EU Commission's forthcoming proposal for new regulations for the recovery and resolution of central counterparties. The proposal will probably be presented in the spring of 2015. FI also participates in ESMA's work throughout the year in terms of preparing stress tests to study how well the risk models of central counterparties cope with various stressed situations on the market.

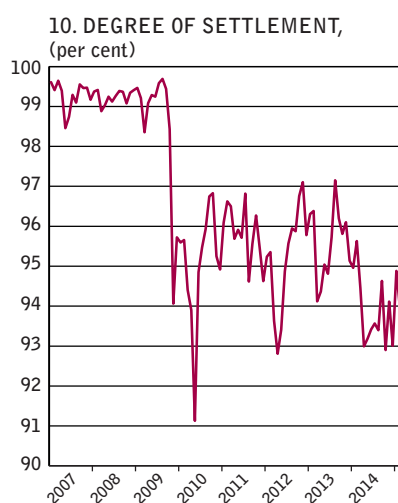
New regulations on securities depositories (CSDR)

Like central counterparties, central securities depositories are important for the financial infrastructure. The task of central securities depositories 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, Euroclear Sweden manages settlement and keeps shareholder registers for affiliated companies.

The new Central Securities Depositories Regulation (CSDR), which came into effect in September 2014, has the purpose of attaining improved security by promoting the timely settlement of securities (see the box "The Swedish market went from T+3 to T+2"). Another purpose of the regulation is to enhance efficiency by introducing harmonised rules for securities settlement in the EU.

The regulation entails an array of specific 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. CSDR not only affects central securities depositories, but also other participants in the financial market because it contains comprehensive rules for making securities settlement better and more efficient. The new rules involve EU-wide incentives and administrative fines in order to promote the timely settlement of securities transactions.

The Swedish market went from T+3 to T+2



With a view to improving securities settlement, the CSDR contains requirements for how fast a transaction must be settled. This is because transactions that are not settled in time involve heightened risk and increased costs for investors. Because of this, the regulation stipulates that the number of days, between the date on which the transaction is realised on a market place (trade day) and the date on which the transaction is settled at a central securities depository (settlement day), shall be a maximum of two (T+2 meaning "trade day + 2").

The regulation sets out that the shortened settlement period (T+2) should have been introduced by no later than 1 January 2015. However, Swedish market participants, like most other European ones, decided to jointly make the transition to T+2 earlier, on 6 October 2014. Although the implementa-

tion of T+2 is going well in purely technical terms, the degree of settlement (number of transactions settled at the right time) has decreased. FI will therefore monitor developments in this area.

NEW RULES FOR TRADE IN FINANCIAL PRODUCTS

In June 2014 the EU adopted a new Markets in Financial Instruments Directive (MiFID 2) and Regulation (MiFIR) – the MiFID regulations, which will start to apply in January 2017. Like the current MiFID regulations, the new regulations aim to ensure a high degree of transparency and investor protection in trade in financial products. Unlike the current regulations, the new rules will comprise more financial products than equities alone. Both equity-linked products such as equity derivatives and other non-equity-linked products such as bonds will come under the new regulations. It is hence a matter of products traded both on and outside of regulated trading venues (OTC products).

The latest financial crisis showed that several market participants could not fully discern and evaluate the risks associated with various financial products. Greater transparency leads to a narrower information gap and hence better investor protection. Increased transparency can also bring benefits in the form of lowered entry barriers and healthier competition on the government bond and covered bond markets. In turn, this can attract more investors – probably foreign and smaller-scale ones mainly – which could in turn be positive for market functioning. Better transparency can hence also bring an increased inflow of capital.

However, these benefits must be weighed against the risk of poorer liquidity in certain market segments which could, in turn, lead to greater market fluctuations. In the short term, increased transparency can also cause some volatility in certain market segments. The short-term drawbacks must be weighed against the long-term benefits that a more transparent market can bring.

In more tangible terms, the new rules mean that information regarding a high number of transactions in bonds and other interest-bearing products shall be disclosed. For non-equity-linked products, trading venue operators shall disclose the prices, volume and timing of the transactions conducted on the trading venue. Disclosure shall be as close to real time as is technically feasible.

However, certain exemptions from these rules are possible. The exemptions are justified by consideration for the need of market makers to manage their risks when they take on large-scale positions. Exemptions are possible if the transaction is considered to be large in scale (LIS) in relation to what is normal on the market, if it refers to a product for which there is no liquid market, or if the transactions size exceeds the size specific to the instrument so that it would expose a market maker to an undue risk (SSTI). Exemptions shall be granted by the responsible supervisory authority. The rules that apply for granting such an exemption are currently being prepared by ESMA, and FI is participating in this work.

The reason for why FI has chosen to prioritise this work is closely linked to FI's task of working to promote a well-functioning fixed income market in Sweden. Although there is deficient transparency on the market today, it mainly functions well. An altered market structure could bring

benefits in the form of lowered entry barriers, although could risk leading to poorer liquidity. In light of this, it is crucial that rules and exemptions are devised and applied in the manner most beneficial to the Swedish market.

Liquidity study of government and covered bonds

In order to better judge the effects of forthcoming regulations and increased transparency on the Swedish government and covered bond market, in the past year FI has studied liquidity on this market.

As shown in Table 1, government and covered bonds that exceed a certain issue size will be classed as liquid. Transactions in a bond considered liquid must exceed a certain amount in order to enable granting an exemption from the transparency requirements. The share of the transactions that might be eligible for exemption – large in scale (LIS) and size specific to the instrument (SSTI) are shown in Table 2. An estimated half of all benchmark series transactions will thus be subject to greater transparency requirements. As a share of the trading volume, however, the change will be much lower because many relatively large transactions are traded.

The results indicate that the forthcoming regulations would increase transparency somewhat on the Swedish market. At the same time, the change is not considered to be so far-reaching as to cause a change in the present structure of the secondary market. However, this depends on how the aforementioned possibilities of exemption are devised and applied by the responsible supervisory authority.

TABLE 1. Proposed thresholds for transparency requirements

Class	Issue amount (euro) to be classed as liquid	Proposed threshold for LIS (euro)	Proposed threshold for SSTI (euro)
Government bonds in the EU	2.000.000.000	10.000.000	5.000.000
Covered bonds (fixed coupon)	750.000.000	5.500.000	2.750.000
Covered bonds (floating coupon)	750.000.000	5.500.000	2.750.000

TABLE 2. Consequences for the Swedish fixed income market

Class	Number	Number liquid	LIS (%)	SSTI+LIS (%)
Government bonds in the EU	16	16	47	55
Covered bonds (fixed coupon)	62	34	57	65
Covered bonds (floating coupon)	109	1	77	90

During the year, FI decided on the introduction of a new practice of increased transparency on the corporate bond market, because in FI's opinion this can ultimately give a more efficient market (see the box "Change in practice for corporate bonds").

Change in practice for corporate bonds

Corporate financing on the fixed income market has been growing sharply for a long time. At the same time, market transparency has not progressed and the market is dominated by a number of large-scale issuers. With a view to achieving a well-functioning market, FI saw reason to take measures to increase transparency.

In October 2014 FI announced a change in practice for disclosing transac-

tions on the corporate bond market, which started to apply on 2 February 2015. In brief, the new practice entails that all transactions shall be disclosed at aggregate level no later than 9 a.m. on the following trading day. Individual transactions can be exempted if their value exceeds SEK 50 million. Those granted such exemption may defer disclosure for ten days.

FI can determine that the introduction of the change in practice has worked well and the market participants concerned now disclose their transactions pursuant to the new rules. FI will evaluate how the increased transparency affects market functioning, which may lead to a potential adjustment in exemption practice in the future.

Tick size

On the equity market, it has recently been noted that the gap between a new offer and the existing offer for a certain object, known as tick size, has narrowed sharply. This development has benefited high-frequency trading which, with its speed, can utilise very small price movements. It is in this light that the MiFID regulations also contain new rules for the smallest permitted tick sizes for trade in various financial products such as equities, depository receipts and certificates. According to the new regulations, the lowest permitted tick size will be determined by a table that takes account of the price and liquidity of the product in question measured as the number of transactions per day.

The level of the lowest permitted tick size can have major implications for liquidity in a share, because larger tick sizes usually lead to greater order depth. The purpose of the new rules is thus to ensure orderly trade with more stable prices, without this involving unnecessarily wide spreads. Both spread width and order depth are factors that largely affect indirect transaction costs in doing business. The Swedish securities market has, because of its structure, among the highest levels of tick sizes, although the new rules may put pressure on them. In this way, the new rules will probably have a major impact on market functioning in Sweden.

Tighter transaction reporting requirements

With the purpose of facilitating supervising trade on the securities market, harmonised transaction reporting rules are also being introduced through the new MiFID regulations. The scope of the reporting obligation will, in the new regulations, be extended to cover, besides products admitted to trading on a regulated market, also the products traded on MTF platforms, OTF platforms and through systematic internalisers (SI). Also, financial products whose underlying asset is traded on a trading venue will be subject to the reporting obligation.

According to estimates made as part of devising the regulations at EU level, the information subject to a reporting obligation will more than double from today. Furthermore, the reporting of customer data will be broadened and become more harmonised under the new regulations. The objective is to achieve traceability for each customer by means of unique client identification.

In addition to the requirements and expenses for market participants brought about by the extended reporting obligation, new requirements are imposed on FI as the supervisory authority for implementing system alterations for managing the increased data volume. A further challenge for FI, and for other supervisory authorities, will be to create procedures for managing the gathered data in a consistent and harmonised manner.

In time, FI would like to see these projects centralised to ESMA, since this would improve the quality of reported data while at the same time the costs would decrease both for the supervisory authorities and reporting parties.

TRADE SUPERVISION AND THE ENFORCEMENT OF FINANCIAL INFORMATION

The purpose of FI's trade supervision is to detect and counteract different types of market abuse, such as insider trading, unauthorised disclosure of insider information and market manipulation. FI also has the task of working to ensure that the financial information provided to the market follows established standards for reporting such information. Recently, many new regulations have emerged which, in different ways, will affect the way in which FI conducts trade supervision and the enforcement of financial information.

How does FI supervise trading?

FI's trade supervision is both ongoing and event-driven. The ongoing supervision consists of continual contacts with stock exchanges, trading facilities, listed companies, banks and investment firms, and is based on financial information reported to FI, such as on insider trading and significant changes in ownership. Event-driven supervision is triggered if, for instance, FI notices suspected market abuse, or if FI receives a relevant tip-off from market participants or the general public.

Still far too many sanctions

In 2014 FI decided on a large number of insider and major shareholding notification cases. During the year FI decided on a total of 196 sanctions due to people breaching insider or major shareholding notification rules. The purpose of these rules is to counteract market abuse and increase transparency on the securities market by means of the disclosure of the holdings and ownership structures of insiders and listed companies.

In terms of the insider rules, most of the cases pertain to insiders not having reported changes in their holdings on time. In 38 cases FI decided on sanctions against companies that did not report changes to insider positions on time. The highest individual fee in 2014 was just over SEK 1 million and pertains to several late notifications from the same insider.

The majority of the major shareholding notification sanctions pertain to late major shareholding notifications. Most of these cases were sanctions against companies. In 2014, sanctions were also imposed on shareholders of listed companies. Two cases pertain to passive major shareholding notification obligation, which entails a notification obligation for shareholders who pass a threshold passively, either up or down, due to a company event that resulted in a change in the number of shares and votes in the company. This can occur, for example, in the event of a new share issue in which the shareholder himself does not participate. The highest individual fee decided for a breach of the major shareholding notification rules in 2014 was SEK 1 million.

TABLE 3 Decisions and sanctions concerning market abuse

	Number of decisions		Sanction fees (SEK)	
	2014	2013	2014	2013
Company notifications, insider position	38	37	842.500	580.000
Insiders' notifications	109	68	5.797.100	2.498.200
Major shareholding notification	45	21	9.590.000	5.730.000
Disclosure of changed number of shares and votes	4	0	1.150.000	0
Total	196	126	17.379.600	8.808.200

FI also conducts trade supervision through investigations. In 2014 FI concluded an extensive investigation of how well investment firms follow ESMA's guidelines for systems and controls in an automated trading environment.¹⁵ The purpose of the investigation was to ensure that investment firms have implemented and comply with these guidelines, which in time ought to lead to better reporting of market abuse cases, and a reduction in the number of cases. 15 firms responded to a survey and onsite visits were paid to four of them. FI noted it was only in connection with the survey that a number of the firms ensured that they implemented the guidelines in their operations. Three firms had chosen an outsourced solution for their market monitoring, which is new for the Swedish market, and one had opted to build its own market monitoring system. There may be reason to specifically follow up on the companies that have chosen an outsourced or inhouse solution.

Benchmark regulation

One type of market abuse that has been in focus in recent years is suspected benchmark manipulation. The background is that, in the summer of 2012, it was discovered that the daily reference rate London Interbank Offered Rate (Libor) had been manipulated for quite some time.¹⁶ Several banks had manipulated it in order to influence the value of derivative contracts for their own gain. The manipulation was particularly serious because it was a matter of substantial values. This is thus a case of a type of market abuse that differs considerably from e.g. insider trading.

The revelation led to tighter regulation and monitoring. At international level, IOSCO and ESMA together with EBA have each released their set of guiding principles for how benchmarks should be computed and controlled, and how related conflicts of interest should be handled. In Sweden self-regulation of the Stibor reference rate has been done based on these principles.

FI has investigated Stibor

In the wake of the Libor scandal, in 2013 and 2014 FI conducted an investigation of the Libor equivalent – Stibor. FI's conclusion is that the banks that contribute to Stibor have implemented the new principles. This has meant that market stakeholders have gained greater insight into how Stibor is determined. It also involves greater control of how Stibor is set, both internally at each bank, and through an external administrator in the form of the Swedish Bankers' Association. Now, there is also clearer traceability in the data

¹⁵ ESMA 2012/122, "the ATG investigation".

¹⁶ The Libor reference rate is based on the interest rate which banks in London offer to other banks in London.

that forms the basis of Stibor submissions, making it easier for these control functions. On the whole, FI finds that these measures bolster confidence in Stibor and that the risk of manipulation is lower than prior to the principles being put in place.

The EU Commission has presented a proposal for a regulation on benchmarks that is expected to start to apply in 2016. The new regulation covers all benchmarks used in the pricing of financial contracts or which affect the value of derivative products. The rules pertain primarily to administrators, i.e. those who define how a benchmark is calculated and who gather submissions or perform calculations based on observable data to that end. Besides the administrators, the new rules also cover contributors and users.¹⁷ The proposal for the regulation contains rules regarding the administrators' internal governance and control, avoidance of conflicts of interest and their data control and documentation. Being an administrator will require authorisation from FI.

The regulation in its current state could have far-reaching consequences for Swedish entities. Several financial firms and non-financial corporations and authorities might potentially need to undergo authorisation from FI. In terms of the regulation in its final form, FI finds that proportionality needs strengthening. Benchmarks that are systemically important or sensitive to manipulation should be more tightly regulated than those that are not.

New sanctions order in market abuse

In April 2014 the EU adopted new rules against market abuse, which replace the Market Abuse Directive (MAD) from 2003. The new rules will be in the form of a regulation (MAR) and a directive (MAD 2). The primary purpose of the new regulations is to attain consistent regulation throughout the European Economic Area (EEA) for upholding confidence in the market. In addition, regulatory arbitrage shall be avoided at the same as predictability shall increase and complexity decrease.

An important new feature brought about by the new regulations pertains to sanctions in market abuse. Today, Sweden's system for investigating and sanctioning market abuse is based purely on criminal law, and Sweden is alone in the EU to have such a system. Under the new market abuse regulations, besides criminal sanctions (incarceration and fines), there will be administrative sanctions in the form of sanction fees for at least serious market abuse cases. The implementation of these provisions in Sweden has been addressed by the Government's commission of inquiry into market abuse, which in its report proposes that FI assumes responsibility for the administrative sanctions. The inquiry proposes that the criminal sanctions be addressed by the Swedish Economic Crime Authority (SECA), as is currently the case.¹⁸

In brief, the new order involves SECA, in each individual case of suspected market abuse, having to choose a particular route. If SECA is of the opinion that the breach was intentional, it shall commence an investigation that could result in criminal sanctions. If SECA is of the opinion that there was no intention, the case shall be transferred to FI for investigation and any decision on administrative sanctions. FI supports the pro-

¹⁷ A contributor is the party providing input to an administrator, and a user is a party who refers to a benchmark when devising a contract or derivative.

¹⁸ See SOU 2014:46 Market abuse II.

posals of the inquiry and also highlights the importance of very close cooperation primarily with SECA but also other supervisory authorities in the EU. FI also points out that extended supervisory responsibility requires increased resources.

New organisation and new guidelines for the enforcement of financial information

The enforcement of financial information involves verifying that annual reports, six-month reports and quarterly reports submitted by listed companies to the market are prepared in accordance with applicable accounting rules.¹⁹ The enforcement thus largely covers non-financial corporations (e.g. Volvo, Ericsson and H&M). Part of the responsibility for the enforcement of financial information has long been delegated to the regulated markets (currently Nasdaq Stockholm and Nordic Growth Market), which shall be responsible for the enforcement of financial information among the companies on their respective regulated markets. Although the stock exchanges perform a great deal of the work, FI is, as the responsible authority, ultimately responsible for the enforcement of financial information.

There has been a discussion recently on whether responsibility for the enforcement of financial information should be organised differently to how it is today. On 4 March 2015 an inquiry was presented proposing that the ongoing review should be coordinated and conducted by a single independent entity.²⁰ Furthermore, it is proposed that FI continues to be the responsible authority and that the possibility of delegating the enforcement of financial information should not be exercised. The proposal would entail FI having full responsibility for the enforcement of financial information as of 1 January 2016. According to FI, the implications of the proposal are reasonable and FI thus supports implementing the reorganisation, although an increase in duties would require increased resources for FI.

In December 2014 ESMA's guidelines for monitoring periodic financial information came into effect. The guidelines apply to how national enforcement of financial information should be organised, and how enforcement should be coordinated in the EU. These guidelines are an update of former standards. In several areas, clarifications have been made to attain consistent enforcement in Europe and uniform application of IFRS by listed companies. The biggest difference to the previous standards is that these guidelines have a higher status. Each country must now inform ESMA of its intention to comply with the guidelines or explain its intended non-compliance. There is thus less scope than before for refraining from complying with these rules.

FI has notified ESMA that Sweden will apply the guidelines upon entry into force, except on the two points where the guidelines conflict with Swedish law. FI and the two regulated markets (Nasdaq Stockholm and Nordic Growth Market), have applied the guidelines in their respective enforcement as of 29 December 2014.²¹

19 Following amendments to the EU's Transparency Directive, quarterly reports will no longer form part of the enforcement of financial information. This amendment will be implemented in Swedish law by 26 November 2015 at the latest.

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

21 Read more in point 8 of Guidelines for the enforcement of financial information.

Glossary

Benchmark series (bond) A large series of a bond that follows a certain standard and is traded through a market maker.

Central counterparty Firms that serve as the counterparty, i.e. the seller for all buyers and the buyer for all sellers of the financial products being traded.

Central securities depository Firms which keep registers of securities and settle transactions executed on a stock exchange. An example of such a firm is Euroclear Sweden.

Certificate Financial product for trading on the money market issued by a bank or other firm.

Clearing house Firm authorised to conduct clearing operations. An example of such a firm is Nasdaq OMX Clearing.

Clearing operations Operations consisting of performing settlements with respect to the obligations of clearing participants, serving as counterparty for both buyers and sellers of financial instruments, or otherwise assuming responsibility for securities settlement.

Covered bond A bond whose holder has a special right of priority in the event of bankruptcy. The purpose of covered bonds is that the credit risk is normally lower than for non-covered bonds, which means a reduction in borrowing costs.

Credit default swap A financial product in which the credit risk is transferred from one entity (such as a bank) to another entity.

Crowdfunding A method for financing products or ideas by means of approaching a high number of, often small-scale, investors.

Depository receipts When shares in foreign companies are traded on a Swedish stock exchange, this occurs in the form of a depository receipt. A depository receipt is issued by a financial firm. The holder of a depository receipt does not own the shares and thus has no right to vote at the AGM.

Derivative Umbrella term for a type of security. Features of financial derivatives is that they are linked to 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) The authority responsible for regulating banks in the EU.

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

IFRS (International Financial Reporting Standards) International standard for the accounting of listed companies.

Libor (London Interbank Offered Rate) Daily reference rate that banks offer other banks on the London money market.

Market maker A financial entity that provides a bid and ask price for a certain financial product. In this manner, the market maker ensures that liquidity in the product is always guaranteed.

Mifid (Markets in Financial Instruments Directive) A directive on trade in financial products that started to apply in 2007. In 2017 that directive will be replaced by a new one (Mifid 2) and a new regulation (Mifir).

Multilateral trading facility (MTF) A trading facility on which several buying and selling interests are brought together.

Order depth List of buy and sell orders currently at each price level, i.e. how many wish to buy or sell a certain financial product at a certain price.

Organised trading facility (OTF) Trading facility that is neither an MTF nor a regulated market. On an OTF, unlike other trading venues, equities are not traded.

OTC (Over the counter) Term used for financial products (such as derivatives) that are traded directly between buyers and sellers outside of a stock market or trading facility.

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

Repo (repurchase agreement) A financial contract in which a party sells a security, while simultaneously undertaking to repurchase it at a determined price at a set future point in time.

Settlement (of securities) A process in which securities are transferred from the seller's to the buyer's account and payment is transferred from the buyer's to the seller's account.

Spread The difference between the best bid price and best ask price in the order depth on a financial market. The spread can be used as a rough measure of an asset's liquidity; a wide spread means that few participants wish to buy and sell and liquidity is hence low, and vice versa.

Stibor (Stockholm Interbank Offered Rate) Daily reference rate that banks offer other banks on the Stockholm money market.

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

Systematic internaliser A firm which, in an organised, frequent and systematic manner, trades on its own account by executing customer orders outside of a regulated market or trading facility.

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



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