Nasdaq

Fair and Effective Markets Review (FEMR) – Comments by NLX

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Nasdaq operates an interest rates derivatives MTF – Nasdaq NLX[1] in the UK. NLX offers a range of both short-term interest rate (STIRs) and long-term interest rate (LTIRs) euro- and sterling-based listed derivative products. Further, Nasdaq operates both fixed income and commodities markets across the Nordics.

Nasdaq would like to further address following 5 key areas and the subsequent questions:

1. Transparency
2. Global regulatory convergence
3. Competition
4. Further regulatory reforms
5. Commodities markets

1. Transparency

Q1: The Review would welcome respondents' views on the definition of 'fair and effective' FICC markets proposed in Section 3. Does it strike the right balance between safeguarding the interests of end-users without unnecessarily impeding the effectiveness of FICC markets? Are the concepts of transparency, openness and equality of opportunity appropriately specified? And how does the definition compare with those used in other markets, jurisdictions, organisations or legislation?

Self-regulation: Nasdaq agrees that the ability of the market to self-regulate should not be undermined. However, in light of the past events, the possibility for self-regulation should be looked into and properly calibrated in order to avoid causing detriment to end-users/consumers.

Merit-based Access: While the banks which engage in internalisation can offer their clients best execution, the markets would overall benefit from introducing more transparency in these processes, so investors can assess whether they have received best execution or not. Internalisation is generally less transparent than on-exchange traded.

Q4: Does the market microstructure of specific FICC markets - including trading structures, transparency, asset heterogeneity or market access - enhance or diminish fairness and effectiveness? Where there are deficiencies, will recent or in-train regulatory or technological changes improve the situation, or are further steps needed? How do these answers vary across jurisdictions, or specific markets within FICC?

Microstructure improvement such as electronic execution and transparency generally enhance fairness, but beyond the MiFID 2 developments, nothing further should be necessary. The FICC market will be enhanced as a result of the measures and we should see how things develop before pushing for further change.

Q5: Is greater use of electronic trading venues for a wider range of market participants possible or desirable? Are there barriers preventing a shift to a more transparent market structure?

[1] NASDAQ OMX NLX Limited ("NLX") is authorised and regulated by the Financial Conduct Authority. NLX is a company registered in England and Wales with number 7774388 whose registered office is at Woolgate Exchange, 25 Basinghall Street, London, EC2V 5HA.

Fixed income: Such shift is certainly possible and it appears to be moving in that direction. It always would with technology innovation, but also FCA's PFOF finalised guidance may push the call around market to a screen-based model (but over time). While Nasdaq sees post trade transparency a benefit, it recognizes the need to have it properly calibrated, e.g. size specific to the instrument, for large in scale trades and for Illiquid instruments. The level of transparency in these complex markets cannot be one size fits all.

Q6: Should standardisation be contemplated across a broader range of fixed income products? How could that be brought about?

Yes, where appropriate. Some risks are not suitable for standardised mitigation techniques and risk is increased if 100% standardisation is pushed.

2. Global regulatory convergence

Q11. Are there any areas of FICC markets where regulatory measures or internationally co-ordinated regulatory action are necessary to address fundamental structural problems that exist?

Global coordination and regulatory convergence are crucial, especially in the post-trade space. Due to differences in implementation timelines, the actors who choose to become compliant in a timely manner may suffer unfair competition from actors that are delaying implementation; this includes e.g. competitors offering lower margins due to lower risk management requirements, compliance costs and others. Such discrepancies can have negative impact on markets and most importantly create systemic risk.

The clearing obligation in EMIR is being currently implemented only for certain currencies, which makes some markets safer than others, exposing more investors in certain currencies than others.

3. Competition

Q14: Is there a relationship between the level of competition in FICC markets globally and the fairness and effectiveness of those markets? What risks are posed by the increase in concentration seen in some FICC markets? In answering this, please have regard to the geographical scope of any relevant markets.

Sound competition in the market is likely to result in higher levels of fairness and effectiveness for those markets by introducing choice for clients/investors and putting downward pressure on fees charged for services.

Q15: To the extent that competition is currently ineffective in any of the FICC markets, are there market-led initiatives, technological or structural changes that may remedy this situation?

Although markets are currently very effective, Nasdaq believes that markets will continue to develop and become increasingly more effective.

Q16: Are there any lessons that can be drawn from experiences in other financial markets (or indeed other markets) about the ways that alternative or evolving market structures could impact on competition in FICC markets?

Incumbent markets use incentives to attract liquidity in new products/contracts. Regulators should understand that it isn't just MTFs competing against the incumbents with incentives.

Q18: In what ways might competition in any of the key FICC markets usefully be addressed by competition authorities (e.g. by assessing the state of competition in relevant markets)?

The use by dominant infrastructure providers of cross-subsidies and incentives between products/markets causes a significant squeeze on new entrants, which should be addressed.

4. Further regulatory reforms

Q19: Are there any additional regulatory reforms that could be helpful in promoting competition and market discipline in FICC markets?

Nasdaq is of the opinion that before designing any further regulatory reforms, the regulatory reforms that are currently ongoing – either being designed or implemented – should take full effect first. With the complexity and various interdependencies created among regulations (e.g. the MiFID /EMIR inconsistency in the indirect clearing question, trading obligation – clearing obligation dependency etc.), it is difficult to estimate the total impact.

Most importantly, the regulators should focus on synchronizing implementation timelines and greater regulatory convergence in general – both European and global – in order to avoid regulatory arbitrage and potential unfair competition, as mentioned above in reply to Q11.

5. Commodities markets

Q35: Are there any financial instruments that should be brought more fully into the scope of regulation in order to improve the fairness and effectiveness of specific FICC markets? For any instruments proposed: (a) what protections does the current framework provide; (b) what gaps remain of relevance to fairness and effectiveness; and (c) what is the cost/benefit case, bearing in mind the Review's Terms of Reference as set out in Section 1?

The Nasdaq Commodities represent large variety of derivatives globally; Nasdaq Oslo ASA is the commodity derivatives exchange. In light of the current reforms ongoing, especially MiFID 2/MiFIR, which seek to amend the scope of “financial instruments” excluding the ones that “must be” physically settled, Nasdaq is concerned that the result of these reforms will leave the majority of physically settled gas and power contracts out of the scope of financial regulation. This will have effect on position limits, clearing obligation, future benchmark regulation, etc.

European gas and power trading in derivatives with physical delivery is far larger than actual consumption.
• Volumes, Power: - physically delivered derivatives: 5,779,940 GWh - consumption: 2,064,000 GWh
• Volumes, Gas: - physically delivered derivatives: 25,693,877 GWh - consumption: 2,685,000 GWh
Value of derivatives trading that (can/must) be physical delivered: ca 936 billion Euros.
If all these derivatives – which can or must be physically settled – would be classified as non-financial instruments in MIFID II, almost a trillion Euros worth of derivatives trading would fall outside the regulatory framework of MiFID, MiFIR, and EMIR.