European Securities and Markets Authority
201-203 Rue de Bercy
75012 Paris
France

Date: 17.03.2020

RE: Consultation on the transparency regime for equity and equity-like instruments, the double volume cap mechanism and the trading obligations for shares

Norges Bank Investment Management ("NBIM") appreciates the initiative by the European Securities and Markets Authority ("ESMA") to open a consultation on the transparency regime for equity and equity-like instruments, on the double volume cap mechanism and on the trading obligations for shares. As an active participant in European and global markets, we welcome this opportunity to share our experience with ESMA.

NBIM is the investment management division of the Norwegian Central Bank ("Norges Bank") and is responsible for investing the Norwegian Government Pension Fund Global. NBIM is a globally diversified investment manager with assets valued at NOK 10,088 billion as of 31 December 2019, of which NOK 2,390 billion was invested in European equities and NOK 912 billion in bonds from European issuers. We have a vested interest in a regulatory environment that yields well-functioning markets in financial instruments, facilitates the efficient allocation of capital and risk and promotes long-term economic growth. Such an environment requires balancing the interests and incentives of various types of market participants, ensuring a level playing field in financial markets.

Trade planning and natural liquidity

Global asset managers typically invest in a large number of assets and may trade sizeable orders that can take significant time to execute. In an idealised market where all participants are present simultaneously and trading is frictionless, the execution of large institutional orders should be seamless. In practice this is rarely the case.

The main challenge for institutional investors continues to be the sourcing of natural liquidity (long-term, natural buyers and sellers) that minimises information leakages and reduces the price impact of their transactions. There are several reasons for this. First, market participants do not arrive at the marketplace at same time. Hence, liquidity and price discovery at any given point of time depends on the sometimes-limited number of active market participants. This

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

OFFICE ADDRESS
Bankplassen 2,
Oslo, Norway

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

Registration of Business Enterprises
NO 937 884 117 MVA

makes the matching between natural buyers and sellers difficult and introduces a trade-off between urgency, measured by the speed of execution, and price impact, measured in terms of implementation shortfall. Second, even when a sufficiently large number of participants is present, there is no certainty that they will be able to absorb large institutional orders.

Recently published broker research highlights differences in the liquidity landscape on a global basis, noting that outside North America sourcing natural liquidity is a challenging task. For example, the average daily volume (ADV) of stocks in Europe tends to be significantly lower than that of similar stocks in North America. This is broadly in line with our experience with trading in European equity markets – it generally takes longer to execute large orders for a given size.

Large-in-scale (LIS) and other price-impact improving trading mechanisms

NBIM supports a market structure that provides efficient price discovery as well as liquidity discovery, controls for the cost to end investors, and ensures a level-playing field in a competitive financial ecosystem. A marketplace that maximises the probability of natural liquidity matching while minimising cost for the end investor, including those due to excessive rent extraction by intermediaries, satisfies these criteria. We evaluate venues in terms of their contribution to the overall market design, noting that a well-functioning market may require multiple venues with heterogeneous transparency, size and latency characteristics.[1]

In the current European equity market landscape, LIS venues efficiently facilitate block trading between institutional investors, offering a good balance between order size and fill rates. Their mid-point execution feature is important and contributes to fair pricing. Although these venues are exempted from pre-trade transparency requirements, they do contribute to price discovery through timely post-trade reporting. We have welcomed innovation in this space as it offers tailored solutions to the needs of current market participants, especially in light of the increased institutionalisation of asset management in recent years.

The increase in the market share of LIS venues especially post-MiFID II is a positive development, which contributes to the well-functioning of European equity markets. We view them as complementary mechanisms for trading in lit markets, which also play a major role in price discovery and liquidity matching, albeit on a smaller, more frequent scale. We view that any disruption of LIS mid-point execution would harm market liquidity making European markets less attractive to large institutional investors. *(Question 1)*

When the probability of a natural liquidity match occurring within reasonable timeframe is low, institutional asset managers need to consider alternative trading strategies. For example, trading algorithms can slice a 'parent' order into sequential 'child' orders with the aim of reducing unnecessary trading costs due to information leakages. These algorithms have access to a wide range of trading venues, including price-impact improving markets that use pre-trade transparency waivers like the Reference Price (RP) waiver. The Double Volume Cap

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

(DVC) regime limits excessive use of such waivers, ensuring meaningful contribution by large order execution strategies to price formation, including via post-trade reporting.

Sourcing of liquidity outside LIS venues will inevitably lead to market impact. The use of a range of venues subject to different transparency regimes can ease adverse selection due to information leakage, leading to lower costs for end investors. We therefore regard transparency waivers as an integral component of large order execution, while their removal will inevitably have a negative impact on market liquidity. *(Question 1)*

We believe that a recalibration of the current transparency regime to ensure efficient price discovery is appropriate, given the experience of the first two years of MiFID II. We would suggest the following approach:

- Setting a minimum threshold above which transactions under the RP and Negotiated Trade (NT) waivers would be allowed. Its calculation should be data-driven ensuring that small trades as part of a larger order execution would continue to benefit from mid-point execution and price impact improving trading mechanisms. *(Question 1)*
- Keeping the possibility for trading venues to apply for combination of waivers. By removing this possibility, it is likely that different pools of liquidity that operate under different waivers would not be able to interact, thus increasing market fragmentation and potentially hurting market liquidity. *(Question 4)*
- Removing the 4% trading venue level threshold while keeping the EU level at the current 8% level simplifying the current DVC regime. *(Question 16)*
- Assessing the transparency regime using good quality post-trade data which, for example, would allow the breakdown of trading volumes according to the waivers applied. *(Question 5)*

Auctions

The distinguishing feature of auctions (sometimes called call markets) is that they allow for simultaneous, multilateral trading – they aggregate the trading demand at a discrete point in time. Any matched transactions take place at the same price. The academic literature suggests that the consolidation of order flow in call markets enhances price discovery, reduces the price impact of individual orders, and limits the risk of information leakages.[2]

Equity markets are currently undergoing a rapid transformation with trading volume shifting from the intraday, continuous session to auctions, particularly to the closing auction. This trend is well documented in European equity markets where recent data suggest that the portion of the daily volume executed in closing auctions has almost doubled in the last 5 years nearing 30% of trading volume.

[2] See discussion in Madhavan, A., "Trading mechanisms in securities markets." Journal of Finance 47, no. 2 (1992).

Closing auctions play a major role in the well-functioning of markets. Our experience of trading in closing auctions is overall positive – well-designed closing auctions attract natural liquidity and contribute to efficient price discovery. *(Question 35)*

Well-functioning closing auctions have certain defining characteristics, enabling the benchmarking of exchanges' offerings globally. Exchanges should continue their efforts to evaluate the mechanisms used. In addition, closing auction liquidity needs to remain accessible to all market participants, with an appropriate level of transparency. Innovations linked to closing auctions, such as market-on-close crossing mechanisms offered outside of the primary exchange, should be assessed for potential unintended consequences, including the risk of further market fragmentation. *(Question 35)*

Frequent batch auctions (FBAs) are a recent market innovation in Europe with a relatively modest market share. Their discrete time design feature can enhance liquidity matching and market stability by reducing the speed advantage of certain market participants. As a result, competition on speed is replaced by competition on price.[3] This feature makes them attractive to institutional investors who want to minimise interaction with high frequency traders.

From our own experience from trading on these venues, they are promising venues for sourcing natural liquidity and have the potential to improve execution quality for long-term investors. *(Questions 11, 12)*

Although FBAs share many common features with European closing auctions, their distinct characteristic is that they take place in parallel with continuous trading. For this reason, their degree of pre-trade transparency should be carefully calibrated to maximise participation and facilitate price discovery while reducing the potential for information leakage. Academic literature suggests that orders should not be displayed during the auction call phase to prevent gaming.[4] In line with these findings, we support limited pre-trade transparency for periodic auctions during the order submission phase. The mandatory disclosure of orders could lead to unfair information leakage and may deter investors from using this trading mechanism, and as such should be avoided. *(Question 11)*

In terms of price discovery, our view is that to the extent that the displayed price information during the call phase is the result of real buy and sell interest, then FBAs should be considered as price forming. Functionalities that match transactions at mid-point (or better) could be suitable for market participants who demand execution price certainty. *(Question 12)*

Systematic internalisers

Regulatory innovation under MiFID II has contributed to the shift from crossing networks and dark venues to systematic internalisers (SIs). Our comments here refer to banks/brokers' SIs;

[3] See Budish E., Crampton P., and Shim J., "The high-frequency trading arms race: Frequent batch auctions as a market design response." The Quarterly Journal of Economics 130, no. 4 (2015): 1547-1621.
[4] See Budish E., Crampton P., and Shim J., "Implementation details for frequent batch auctions: Slowing down markets to the blink of an eye." American Economic Review 104, no. 5 (2014): 418-24.

other intermediaries such as electronic liquidity providers also offer alternative SIs but we will not address these in our discussion.

Banks/brokers as intermediaries play an important role since they can commit capital at risk when necessary in order to facilitate institutional client trading decisions across asset classes. Their role needs to be assessed using a cost-benefit framework. In particular, the regulatory framework for SIs needs to cover a number of factors. These include their contribution to price and liquidity discovery, the reduction in market impact costs for large institutional orders, and the facilitation of urgent liquidity needs of some market participants, among others. In the current ecosystem, they may also need to be assessed regarding their competitive impact on other on- and off-exchange trading mechanisms, including potential complementarities. This may include the handling of more complex trades (e.g., basket trading or derivative hedging). Some mechanisms for banks/brokers to facilitate such trades at a fair price should be available for the well-functioning of financial markets. Any analysis of the diverse SI regime should take into account the evident asset manager demand for high-touch trading and capital commitments by banks/brokers *(Question 32)*

We advocate a level-playing field for SI activity to evolve; we believe that further analysis on their contribution to price and liquidity discovery is needed. Such an analysis requires better access to high quality data covering both quotes and trades. Providing academics and industry researchers with this necessary information allows a better assessment of SIs' contribution to well-functioning markets.

The level of both pre-trade and post-trade transparency needs to be taken into consideration while making market design choices related to SIs' future role. It is very likely that some improvements and recalibrations can be made. We would recommend, however, that any major adjustment to the SI regime is deliberated after allowing for a thorough analysis to be conducted with appropriate time horizon for the data to be statistically meaningful.

We believe that raising the minimum quote size from the current 10% SMS to multiple of SMS would be appropriate, particularly for liquid securities. In the case of less liquid securities, careful calibration is needed to ensure that market making remains as efficient as possible. Ensuring banks/brokers' intermediation activity is not hindered remains important for the less liquid segment of the market, since there may not be other feasible liquidity sources. Reducing available liquidity from these banks/brokers would be to the detriment of these listed firms and to the market more broadly. *(Questions 13, 14, 15)*

Conclusion

We have an interest in encouraging innovations that contribute to the attractiveness of European markets for global investors. We therefore welcome this important consultation of ESMA on the transparency regime for equity and equity-like instruments, the double volume cap mechanism and the trading obligations for shares.

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

Yours sincerely

Emil R. Framnes
Global Head of Trading, NBIM

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