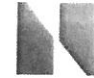

NORGES BANK
INVESTMENT MANAGEMENT

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Date: 31.07.2014

ESMA's MiFID II/MiFIR Discussion Paper and Consultation Paper

Norges Bank Investment Management ("NBIM") appreciates the opportunity to comment on the Discussion Paper and Consultation Paper prepared by ESMA concerning the implementation of the MiFID II/MiFIR regulations. ESMA has undertaken a formidable task over the past few years, and we appreciate the effort that has gone into the preparation of these papers. There can be few more polarizing issues for European financial markets than the future and direction of the regulation of these markets. The implementation of these regulations and directives will have substantial and lasting impact including possibly some unintended consequences. NBIM appreciates the opportunity to explain our views and to have them considered.

NBIM is the investment management division of the Norwegian Central Bank (Norges Bank) and is responsible for investing the Norwegian Government Pension Fund Global (the "fund"). We are a large, global, active long term investor in global financial instruments, including many of the instruments referenced in ESMA's MiFID II/MiFIR Discussion Paper and Consultation Paper. The fund is invested in assets in excess of NOK 5 500 billion (EUR 650 billion) of which approximately EUR 240 billion is invested in European listed equities and euro-denominated bonds.

We engage in the development of regulatory frameworks and industry-wide standards to safeguard the long-term interests of the fund. We have a vested interest in having a regulatory environment that provides for well-functioning markets in financial instruments, encouraging a vibrant and heterogeneous investors community. This requires balancing the interests and incentives of various types of market participants. We are under no illusion that all incentives can be aligned and moral hazards resolved; neither do we believe that regulations designed at one point in time will be able to cover all possible developments in the market environment. To be prepared for future developments, we advocate a robust, flexible and simple regulatory framework with the aim of providing a balanced, level playing field for all market participants.

Based on our experience as a market participant, we believe there are several key aspects to such a

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regulatory framework:

- **Robust Framework for Incorporating Future Technological Change**

  The last few years have seen very rapid and profound changes in the technologies used in trading venues, particularly for equities and related instruments. This has led to equally profound changes in execution strategies, both in Europe and in other global markets, with the result that algorithmic execution strategies are now completely dominant in most market places. This has led to the emergence of new market participants who have been able to profitably interact with algorithmic execution flow. The current regulatory framework is not sufficiently flexible to balance the interests of all market participants following these changes in market structure. We welcome the approach that ESMA has taken in trying to redress this.

  We support a simple and flexible approach to regulation that is robust to future changes in technology and resultant market participant strategies. Our comments on market structure and the regulation of liquidity providers reflect this approach: Rather than prescriptively defining High-Frequency Trading firms (HFTs), for example, we recommend focusing on the impact that they have on other market participants. Regulation should ensure that the conditions for a level playing field exist.

- **Ensuring a Level Playing Field in Financial Markets**

  We support regulation which provides for fair competition in the market place. In particular, we view HFTs as having at least the potential of being valuable sources of liquidity. However, we do advocate that they should compete on a fair basis. This means regulating and controlling market access. In the case of co-location of market participants' facilities in close physical proximity to a trading venue's matching engine, for example, we believe investment firms should have the right to co-locate, for a fee. This could enable them to send information to trading venues more quickly, a commercial benefit. However, we do not believe that they should receive trade and quote information quicker than other market participants – since such information is a public good. In our view, regulation should endeavour to provide fair and simultaneous access for everyone.

- **Increasing Transparency and Competition**

  As a large market participant, we are in favour of a transparent marketplace. In particular, we support efforts in bringing greater transparency to non-equity instrument trading. Based on our experience with fixed-income instrument trading in the US, we believe that transparency can lead to greater liquidity. Due to this, we encourage ESMA to take an active approach in implementing transparency objectives in non-equity instruments – for example regarding the shortening of post-trade deferral periods, and pre-trade quote transparency. We believe the overall net effect may be an improvement in liquidity. Likewise in equity instruments, we believe shortening the delay in trade reporting and simplifying the definitions for Large-in-Scale trades could provide more liquidity.

  While we favour competition in trading venues, we believe that some of the proposed regulations in MiFID II/MiFIR may be challenging to implement. In particular, we consider the restrictions on off-exchange trading volume, the dual volume cap rule, as being not incentive compatible without the very active, real-time involvement of a regulatory entity. We believe that the 4 per cent limitation per trading venue can be implemented. However we believe the 8 per cent aggregate limit could become an attractor. Breaching the 8 per cent limit could be in individual trading

venues' interest, and could incentivise them to bring forward trades. We can envisage a sequential limitation on aggregate off-exchange trading volume – for example, if 8 per cent is breached during the course of one month, the subsequent month's individual limits are lowered from 4 per cent to a lower number. This could be a workable alternative which would not require real-time monitoring by a regulatory entity.

Our more detailed response to ESMA's Discussion Paper and Consultation Paper are filed electronically via ESMA's web site www.esma.europa.eu and are also attached as Appendix 1 and 2 to this letter.

Once again, we thank ESMA for the opportunity to comment on these very important market structure issues. We also look forward to participating in future discussions regarding European market structure.

Yours sincerely

Øyvind Schanke
Global Head of Equity Trading

William Ambrose
Global Head of Business Risk

Appendix 1: Response to ESMA's Consultation Paper
Appendix 2: Response to ESMA's Discussion Paper