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CESR Technical Advice to the European Commission in the context of the MiFID Review – Non-equity markets transparency

Reply from NASDAQ OMX

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(For descriptions of NASDAQ OMX bond markets in the Nordics, please see the Annex.)

General comment

As stated in NASDAQ OMX' response to CESR's consultation on Transparency of corporate bond, structured finance product and credit derivative markets in February 2009, NASDAQ OMX supports CESR in working towards greater transparency for non-equity markets. Indeed the markets for various instrument types differ, but the overall aim to improve transparency should be pursued. Equity markets are generally seen as liquid, but there are individual shares in which the trading activity is low. Still transparency regimes apply equally to all shares listed on regulated markets as transparency is considered to be beneficial even for less liquid shares. Thus, also markets in instruments that are not necessarily very liquid should be considered for better transparency regimes. In order to prevent a possible development where transparency regimes drives trading OTC, it is important to introduce transparency also for instruments not admitted to trading on MiFID regulated venues.

CORPORATE BONDS

General comment

It is relevant to highlight that during the financial crisis, the government bond market in Sweden proved to function very well. Even though market makers had to widen the spread during some periods the market continued to be notably liquid. The existing measures providing some degree of pre- and post-trade transparency have been seen as supporting confidence and liquidity of the markets.

In Denmark where a post-trade transparency regime for bonds is in place, the covered mortgage bonds market was also functioning during the financial crisis – and functioning much better than the covered bond markets in the rest of Europe. This situation has largely been attributed to the transparency measures which support liquidity.

Scope of corporate bonds transparency regime

Q1: On the basis of your experience, could you please describe the sources of pre- and post-trade information that you use in your regular activity

For both cash bonds (government/mortgage) and interest rate derivatives the exchange collects and distributes pre- and post-trade information about those instruments that are listed on NASDAQ OMX' market. We also use the indicative prices for these instruments to value these contracts. The prices are submitted to the exchange by market makers through our trading system and then feed out to market data vendors.

There is currently no pre- or post-trade information available for corporate bonds listed on NASDAQ OMX Stockholm.

For all bonds admitted to trading on NASDAQ OMX in Copenhagen, the exchange's data information system is used by all Danish banks to fulfill requirements for post-trade transparency similar to MiFID requirements for equities. The information is then feed out realtime via data vendors and also shown on NASDAQ OMX web with 15 minutes delay.

Pre-trade transparency in Danish instruments via the exchange system is relatively limited but some information is currently found on Reuters for the most liquid mortgage bonds.

Q2: Are there other particular instruments that should be considered as 'corporate bonds' for the purpose of future transparency requirements under MiFID?

We believe that a transparency regime should cover all bond types and not only corporate bonds. So for the purpose of future transparency requirements under MiFID, also for instance government bonds and covered bonds should be included.

Q3: In your view, would it be more appropriate, in certain circumstances, to consider certain covered bonds as structured finance products rather than corporate bonds for transparency purposes? Please explain your rationale.

Covered bonds should be within the scope of a transparency regime, irrespective of how they are classified. The covered mortgage bonds that are traded on the NASDAQ OMX market in Copenhagen are subject to a transparency regime as part of the exchange rules. This works well and is evidence that covered bonds are suitable for transparency.

Pre-trade transparency for corporate bonds

Q4: On the basis of your experience, have you perceived a lack of pre-trade transparency either in terms of having access to pre-trade information on corporate bonds or in terms of the content of pre-trade transparency information available?

Yes, there is currently a lack of publicly available pre-trade information for corporate bonds on the Nordic market. More pre-trade information would support the liquidity of the market as it would attract investors.

Q5: In your view, do all potential market participants have access to pre-trade transparency information on corporate bonds on equal grounds (for example, retail investors)? Please provide supporting evidence.

In our view it is difficult for retail investors to access information about this market since it is mainly a wholesale market, i.e. a retail investor has very limited access to investments in these types of products other than through mutual funds etc.

At the NASDAQ OMX market in Stockholm, we have created a specific retail segment for corporate bonds, where there is both pre- and post-trade information available (there is however currently only one listed bond in this segment, so it is too early to evaluate).

Our conclusion is that pre-trade information is clearly absent for retail investors but also to a great extent for professional investors. Professional investors have access to information via vendors such as Bloomberg and Reuters but only for the most traded securities.

Q6: Is pre-trade transparency efficiently disseminated to market participants? Should pre-trade information be available on a consolidated basis?

There is currently only limited pre-trade transparency for corporate bonds, only available to select market participants. As already stated, we believe more pre-trade transparency should be introduced. The most important thing is that data quality is high and that standards apply so that all data is comparable. As long as this is achieved, there is no need to centrally consolidate pre-trade information.

Q7: What are potential benefits and drawbacks of a pre-trade transparency regime for:

a) the wholesale market; and b) the retail market? If you consider that there are drawbacks, please provide suggestions on how these might be mitigated.

The benefits are those described by CESR in the consultation document, para 17. That is, a better ability for investors to compare prices and to evaluate investment opportunities. It would also improve best execution. Specifically, we believe that it would be a benefit for the issuers to see where the market is, which makes it easier for them to estimate the prices of the primary market. This would incentivize the issuers to use corporate bonds as a way of financing, which will lead to better liquidity in these markets. It would also be easier for asset managers to estimate the value of their holdings of corporate bonds. Otherwise, asset managers may instead have to sell and buy back an instrument in order to estimate the market value.

These benefits are especially central for the retail market, but we believe they are also valid for the wholesale market.

In order to avoid potential negative impact from large orders the use of transparency waivers, similar to those that exist for equities today in MiFID, could be envisaged. Similarly, certain delays in the publication of transactions could be considered.

Q8: What key components should a pre-trade transparency framework for corporate bonds have? What pre-trade information should be disclosed?

Pre trade information should be made available and preferably as firm prices. In those cases where the market for a specific instrument is organized as telephone trading, indicative prices may however be more appropriate. Volume should also be included.

Post-trade transparency for corporate bonds

Q. 9 Do you think that notional value would be a meaningful piece of information to be made accessible to market participants? Is there any other information that would be relevant to the market?

Yes, we publish this today.

Q.10 Do you agree with the initial proposal for the calibration of post-trade transparency for corporate bonds? If not, please provide a rationale and an alternative proposal

It is important to maintain deferred disclosure for large in size orders. This is necessary to minimize the potential negative impact on liquidity. The proposed thresholds may appear a bit low. For the NASDAQ OMX market in Copenhagen, the thresholds are higher, but the timings are also tighter. For corporate bonds, trades smaller than € 3 Million are reported real time. For mortgage products and covered bonds, the threshold is € 14 Million. We believe the thresholds should not be lower.

As regards timing, 'real time' is within 3 minutes and the deferred disclosure time frame is 'end of day'. These timeframes work well. In para 35 CESR refers to the 16 minute deadline in the TRACE system. Observations from the NASDAQ OMX markets show that what is reportable within 15 minutes is also reportable within 3 minutes.

It should be considered to apply thresholds according to total issued amount instead of nominal terms.

It would be preferable to ensure that the data becomes of as high quality as possible, enabling comparisons. The TRACE system in the US has many benefits when it comes to data comparisons, which should also be sought for in Europe. However, the European markets are more fragmented and diverse than the US system, so we hesitate to suggest that an exact similar system should be introduced in Europe.

As we believe the relatively tight timelines applicable in the Danish markets provide important support for a well functioning and liquid market, we are also keen to be able to keep such timelines, should a future EU regime in fact be lighter. So in this case, minimum harmonization is preferred.

Q.11 Should other criteria be considered for establishing appropriate post-trade transparency thresholds?

Only size of the trade should be considered.

Q.12 Given the current structure of the corporate bond market and existing systems, what would be a sensible benchmark for interpreting "as close to real time as possible"?

It should be as soon as possible and 3 minutes is reasonable. As already stated above, if it is possible to report a trade within, say, 15 minutes, it is also possible to report it within 3 minutes. However, depending on the market structure, end of day may be more suitable.

DERIVATIVES

General comment

Introducing transparency for derivatives is one of the important actions responding to the financial crisis. Introducing central counterparty clearing is one part of this, and pre- and post-trade transparency is another, they go hand in hand. Better transparency will support price discovery and liquidity, which in turn will facilitate for a central clearing house to accept a certain instrument for clearing. For derivatives traded on regulated markets, there are transparency regimes as part of the rules for the local market. Trading of derivatives on regulated trading venues supports the improvement and maintaining of a stable financial system. In order to avoid the potential risk of transparency driving the derivatives markets OTC to an extent that may have negative impacts for the stability of the financial system, one needs to ensure that also OTC derivatives are covered by transparency. Otherwise the regime will open up for gaming and the market may remain opaque.

Extending transparency to derivatives beyond regulated markets and however requires considerations on the scope and appropriate calibration. Instruments eligible for CCP clearing and instruments traded on all MiFID regulated venues should be within the scope.

Pre-trade transparency for derivatives

Q. 34 On the basis of your experience have you perceived a lack of pre-trade transparency in terms of access to pre-trade information?

For all fixed income derivatives that are cleared by NASDAQ OMX' CCP, i.e. both for those traded OTC and for those listed at NASDAQ OMX Nordic, there are indicative prices sent out to the market (market makers quote these in the exchange's system).. This regime could be useful as a model for an extended MiFID pre-trade transparency regime for other derivative instruments as well, both those instruments traded on regulated venues and those traded OTC.

Q. 35 Is pre-trade transparency readily available to all potential market participants?

Yes (see the answer to Q34).

Q. 36 Is the pre-trade information currently available in these markets consolidated and effectively disseminated to those market participants who make use of it?

Yes.

Q. 37 Which potential benefits and drawbacks of a pre-trade transparency regime

Only benefits as we see it. It supports price discovery and liquidity.

Post-trade transparency for derivatives

Q. 39 On the basis of your experience have you perceived a lack of post-trade transparency, both in terms of access to relevant information and the content of this information

There is some level of post trade transparency for fixed income derivatives at the NASDAQ OMX market in Sweden. Market participants (members) are obligated to report the average/hi/lo and volume in aggregate for fixed income futures to the market by end of day. This data is published (currently by the exchange) at 9.00AM the following day, both on the exchange's website and through the market data feed. As for pre-trade transparency, we believe this regime works well and that it could serve as a model for an extended MiFID post-trade transparency regime for other derivative instruments as well, both listed and OTC.

At the NASDAQ OMX market in Copenhagen, there is by agreement with the market participants the same post-trade transparency regime as for bonds.

Q. 40 Do you believe that additional post-trade transparency would be desirable?

We believe the existing post-trade transparency regimes on our derivatives markets are of benefit to the well functioning of these markets. (see Q 39 above)

Q.41 Is post-trade transparency readily available to all potential market participants?

For the derivatives admitted to trading on the regulated markets, yes.

Q.42 Which potential benefits and drawbacks of a post-trade transparency regime for interest rate derivatives?

Only benefits as we see it.

Q.43 Which are the key components (e.g. qualitative or quantitative criteria) which should be taken into consideration when designing such a post-trade transparency framework?

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Q.44 Do you think that a post-transparency regime could have some additional valuable externalities in terms of valuation, risk measurement and management, comparability and other uses in price discovering process on related underlying reference instruments?

Yes.

Bond market in Denmark

Large turnover – high transparency

The bond market in Copenhagen is among the top five in Europe measured by turnover. In 2007 the total turnover was EUR 968 billion (market value, excl. repo), which corresponds to approximately EUR 81 billion in monthly turnover. This turnover was distributed over roughly 2,300 listed bonds that by the end of 2007 had a circulating amount on EUR 393 billion.

The Bond market in Copenhagen is characterized by being one of the most transparent in Europe. Thus, the bond members are, with only a few exceptions, required to report and publish all trades within a few minutes. The result is a market with a high level of price transparency to the benefit of both issuers and investors. Both price and trading data is published on the Nasdaq OMX homepage.

Mortgage Bonds

The Danish Mortgage Bonds are unique due to the special way in which property/real estate investments are funded in Denmark. The strengths of these products are:

- The Danish law for issuance of Mortgage Bonds is stringent
- Issuance is very cost-efficient
- The distribution network is extensive
- A global "balance principal" applies
- The principle of low investor risk has been maintained since the 19th century
- So far no investors have lost their invested capital and no mortgage credit institution/mortgage credit bank has ever gone bankrupt.
- A clear majority of the Danish Mortgage Bonds have been rated by internationally recognized rating agencies.

With a circulating amount on EUR 290 billion and 1,877 bonds listed by the end of 2007, the mortgage bond segment accounts for the greater part of the Danish fixed income market. The total turnover of mortgage bonds in 2007, measured by market value (excl. repo), was EUR 722 billion.

Government Bonds

All Danish government bonds and notes can be traded at NASDAQ OMX - Copenhagen. These bonds are characterized as being "low risk securities" that have attracted a significant interest from foreign investors.

The circulating amount of the Danish Government Bonds was EUR 62 billion by the end of 2007. The value has been decreasing during the last couple of years due to lower need for government borrowing in Denmark. The total turnover in 2007 was EUR 177 billion (market value, excl. repo).

Structured Bonds

Throughout the last couple of years NASDAQ OMX - Copenhagen has seen an increasing interest for both issuing and investing in Structured Bonds. Thus, the number of Structured Bonds has double 4 times. We have therefore created a special market for the issuing and trading of these Bonds. The investors can now choose between more than 350 different bonds with a total market value of approximately EUR 10 billion.

By creating a special market for Structured bonds NASDAQ OMX - Copenhagen hopes to increase the transparency for these bonds. Based on the latest years development we furthermore expect this market to grow, with higher turnovers, increasing circulating amount and a higher degree of diversification among the bonds.

Corporate and Other Bonds

NASDAQ OMX - Copenhagen has a special market for corporate bonds, convertible bonds, Covered Bonds (issued by banks) and other bonds. This market is called Corporate and Other Bonds. By having a separate market for these bonds we intend to increase focus on the many different bonds that can be traded at NASDAQ OMX - Copenhagen.

The Swedish Fixed Income Market

The majority of trading in Swedish Fixed income products is done between banks (Primary dealers) and institutional investors. The total turnover in the Swedish Fixed Income Market averaged over 60.000 MSEK per day for the year of 2007 (repos excluded). Long-term interest rates are mainly traded in Government bonds, Mortgage Bonds and futures contracts for these bonds. During 2007 the average turnover was more than 26,000 MSEK per day in bond futures contracts cleared by NASDAQ OMX Stockholm. In addition to this, trading is also done in corporate bonds, Interest Rate Swaps and different types of structured products.

Short-term interest rates are mainly traded in IMM-FRA contracts and T-bills. Trading in short term interest rates is also done in commercial papers, deposits and repos.

NASDAQ OMX Swedish Fixed Income Market

The Swedish Fixed Income Markets have several submarkets in the NASDAQ OMX trading system, Saxess:

- Interbank Trading in 2, 5 and 10 year Government Bonds for Primary Dealers
- The Swedish National Debt Office Auctions
- The Bulletin Board Market for reporting and indicative pricing
- The retail market for trading in retail bonds

NASDAQ OMX also delivers other market place services to the Swedish Fixed Income market. For example:

- STIBOR fixing
- NASDAQ OMX Swap fixing
- F/X fixing
- Distribution of housing loan rates

Listing of bonds at NASDAQ OMX Stockholm

NASDAQ OMX Stockholm also offers listing of bonds for issuers. NASDAQ OMX Stockholm offers listing services for Benchmark bonds, Corporate bonds and Retail bonds. Today over 1,800 SEK denominated bonds are listed at NASDAQ OMX Stockholm.

The Icelandic Fixed Income Market

NASDAQ OMX has operated a regulated market for bonds and bills in Iceland since 1986. Throughout this period it has endeavored to increase the efficiency of this market by steadily improving both the technical framework and trading options.

The transparency of the Icelandic market is probably among the best on any international fixed income market, since on-exchange trading comprises around half of aggregate bond and bill trading. In the first quarter of 2008, for instance, the share of on-exchange trading was 71%. The high proportion of on-exchange trading can very likely be attributed to the active market making for benchmark classes, which keeps their liquidity high.

The great majority of listed classes are indexed: 70% of the total number, or 72% of the total market value. Trading in the benchmark classes, which are primarily Housing Financing Fund bonds (HFF) and Treasury

notes (RIKB), comprised the lion's share (approx. 97%) of total bond market trading in the first five months of 2008, or the equivalent of ISK 2,851 billion (bn). Average daily turnover in the first five months of 2008 was over ISK 28 bn, compared to a daily average of ISK 7 bn for the same period the previous year.

The interest rate level in Iceland in the first five months of 2008 can only be regarded as high by international comparison, since the 3M nominal rate averaged 13 %, the 1Y rate averaged 12.7% and the 5Y rate 10.2%. The 5Y real interest rate averaged 5.1% and the 10Y rate 4.6%.

The NASDAQ OMX Fixed Income Market in Iceland

The Icelandic fixed income market consists of three sub-markets:

OMX ICE CP Fixed Income
OMX ICE DP Fixed Income
OMX ICE Premium bonds

The NASDAQ OMX Fixed Income Indexes in Iceland

In order to facilitate comparison of interest rate levels and market value, OMX Nordic Exchange in Iceland calculates five fixed income market indexes for benchmark classes. All of them are total return with a fixed duration.

Non-indexed:
3M OMXI3MNI
1Y OMXI1YNI
5Y OMXI5YNI

CPI-Indexed:
5Y OMXI5YNI
10Y OMXI10YI

Listing of bonds on NASDAQ OMX in Iceland

At the beginning of May 2008, there were 340 bonds and bills listed on NASDAQ OMX Iceland, with a total market value of over ISK 1,549 bn. In addition to Treasury notes and HFF bonds, there are listed bonds and notes of commercial banks, savings banks, corporations, credit institutions, municipalities and foreign parties.

Bonds Finland

OMX Nordic Exchange offers listing and electronic trading for fixed income instruments at OMX Nordic Exchange Helsinki. Most of the bonds listed on the OMX Nordic Exchange Helsinki are structured products and bank certificates. There are currently more than 400 bonds listed on the exchange.

Fixed Income Derivatives

Nordic Fixed Income Derivatives are traded and cleared in a unique market structure. Trading is performed off exchange ("OTC") and then reported to OMX Derivatives Markets who becomes the counterparty to both the buyer and seller, i.e. central counterparty ("CCP") clearing. This structure combines the advantages of a cleared market, with the flexibility and the secured liquidity of a market maker driven OTC market.

Designated market makers quote bid-offer prices on request from customers. The presence of multiple designated market makers ensures that a market participant always can find fair and tradable prices. Market makers also quote indicative derivative prices in OMX Nordic Exchange's SAXESS system. These prices are disseminated through information vendors. Derivative contracts are not traded in the SAXESS system but the indicative prices serve as good indicators of the prevailing market price level.

A trade between a market maker and a customer is initially a bi-lateral buy or sell agreement between the two parties. After trade execution the market maker report trade details to OMX Nordic Exchange, who match the trade and offer CCP services. By acting as a CCP, OMX Derivatives Markets takes on the contract obligations against both the buyer and the seller. There are several advantages with CCP-clearing, such as administration of payments and deliveries, counterparty risk issues and provision of multilateral netting possibilities.