



# SWEDEN

## FINANCIAL SECTOR ASSESSMENT PROGRAM

### TECHNICAL NOTE—REGULATION AND SUPERVISION OF CROSS-BORDER SECURITIES ACTIVITIES

This Technical Note on Regulation and Supervision of Cross-Border Securities Activities for Sweden was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in November 2016.

October 2017

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September 2017

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## REGULATION AND SUPERVISION OF CROSS-BORDER SECURITIES ACTIVITIES

Prepared by  
**Monetary and Capital Markets  
Department**

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in Sweden, led by Martin Čihák. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

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## Glossary

AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
AIFMA	Alternative Investment Fund Managers Act
AIFMD	Alternative Investment Fund Managers Directive
AUM	Assets under Management
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
DMA	Direct Market Access
EEA	European Economic Area
ESMA	European Securities and Markets Authority
EU	European Union
FI	Finansinspektionen
FSA	Financial supervisory authority
IFRS	International Financial Reporting Standards
IOSCO	International Organization of Securities Commissions
KIID	Key Investor Information Document
MiFID	Markets in Financial Instruments Directive
MMF	Money Market Fund
MMoU	Multilateral Memorandum of Understanding
MoF	Ministry of Finance
MoU	Memorandum of Understanding
MTF	Multilateral Trading Facility
NAV	Net Asset Value
NMR	Nasdaq Nordic Member Rules
NPPR	National Private Placement Regime
NWG	Nordic Working Group
OTC	Over-the-Counter
RM	Regulated Market
SAS	Statistical Analysis System
SLA	Service Level Agreement
SMA	Securities Market Act
UCITS	Undertaking for Collective Investment in Transferable Securities

## EXECUTIVE SUMMARY

**Sweden has large and diverse securities markets where services can be easily provided on a cross-border basis.** The main exchange, Nasdaq Stockholm, is part of the global Nasdaq group and operates as the hub of Nasdaq's Nordic operations. Trading in Swedish issuers' shares is fragmented across European trading venues and over-the-counter (OTC), with Nasdaq Stockholm holding a less than 50 percent market share. Remote members account for more than two-thirds of the value of equity trading on Nasdaq Stockholm. While limited data on the investment fund assets managed and marketed on a cross-border basis is available, the number of foreign investment funds sold in Sweden exceeds the number of domestic funds. Both domestic and foreign firms actively seek to benefit from the passports provided under the European Union (EU) legislation. This emphasizes the importance of robust home country regulation and supervision and requires authorities to be vigilant about potential cross-border spillovers. This complex operating environment poses challenges for Finansinspektionen (FI), particularly for the two areas, Consumer Protection and Markets, that have the primary responsibility for the regulation and supervision of securities markets.

**FI should review the Consumer Protection area's activities to assess where the current consumer protection focus should be complemented with explicit consideration of financial stability risks.** While FI's objective of promoting the financial system's stability and efficiency implicitly guides the Consumer Protection area's planning, the emphasis in most of its activities continues to be on consumer protection. This applies even in areas where Consumer Protection is responsible for both prudential and conduct supervision, as well as areas where the assessment of financial stability risks has become increasingly relevant. Fund supervision has recently addressed issues with potential financial stability implications, such as valuation of investment fund assets and liquidity risk management of corporate bond funds. However, it is important to apply this thinking explicitly across the Consumer Protection area at least when supervisory priorities are set.

**Improvements in data availability and better analysis tools would improve FI's ability to analyze risks and plan its supervisory activities.** This would support the yearly risk assessment process that FI applies to prioritize its activities. Current data challenges relate to the format of some reporting and the delay in implementing the reporting requirements under the Alternative Investment Fund Managers Directive (AIFMD). Solving these reporting challenges is a precondition for building sufficient tools to conduct regular and ad hoc analyses to target supervisory activities and assess financial stability risks. To help address these challenges, FI and the Riksbank are encouraged to seek ways to enhance authorities' cooperation in data collection and analysis. Finally, it is important that FI be able to acquire a suitable automated market surveillance system to effectively supervise cross-market and cross-border trading in the current fragmented trading environment.

**The effectiveness of Consumer Protection area's diverse inspection program would benefit from wider communication of relevant findings and recommendations.** The inspection program that uses both off-site and on-site activities has covered a range of important topics over the past

few years. Emphasis has recently been on thematic off-site inspections. FI needs to continue to ensure that any important findings are followed up with targeted supervisory and, if necessary, enforcement action at individual firms. The effectiveness of Consumer Protection's supervisory activities would be further enhanced by developing additional tools to communicate promptly the general findings and recommendations of thematic inspections to all supervised entities and, where relevant, to the public.

**Enhancements to cross-border supervisory cooperation and active participation in the work of the European Securities and Markets Authority (ESMA) are necessary complements to FI's current active domestic supervisory program.**

It is important to continue to build closer cooperation with FI's key foreign counterparts, in particular in the Nordic region and Luxembourg. The well-functioning Nordic cooperation in Nasdaq Nordic supervision is an encouraging model to follow. Given the importance of striking the right balance in the application of EU legislation, FI should actively raise issues for discussion at ESMA to enhance EU level convergence to avoid regulatory arbitrage. This is important in light of the increased ability of fund managers, funds and investment service providers to choose their domicile within the European Economic Area (EEA).

<b>Table 1. Sweden: Main Recommendations on Regulation and Supervision of Cross-Border Securities Activities</b>		
<b>Recommendation</b>	<b>Priority</b>	<b>Timing<sup>1</sup></b>
<b>Consumer Protection Area</b>		
Develop additional tools to communicate promptly the general findings and recommendations of FI's thematic inspections to all supervised entities and, where relevant, to the public (FI).	Medium	NT
Review the Consumer Protection area's activities to assess where the current consumer protection focus should be complemented with explicit consideration of financial stability risks (FI).	High	NT
<b>Fund Management</b>		
Assess the risks from the use of related party depositaries and consider requiring additional safeguards accordingly (MoF, FI).	Medium	I
Ensure that important thematic review findings are followed up with targeted firm level supervisory and, if necessary, enforcement action (FI).	High	C
Strive to undertake joint supervisory activities with foreign regulators on the management companies with significant cross-border management of funds, when either the management company or fund is domiciled in Sweden (FI).	High	NT
Seek synergies between authorities in the collection of fund management related data (FI, Riksbank).	Medium	MT
Improve the availability of data on cross-border management of investment funds (FI).	High	NT
Increase regular and ad hoc analyses of the UCITS and AIFM reporting to better target supervisory activities and analyze financial stability risks (FI).	High	NT
<b>Investment Services</b>		
Incorporate banks' investment services more explicitly into Consumer Protection area's risk classification of firms (FI).	Low	I
Consider moving the responsibility for the financial and capital adequacy analysis of investment firms to the Bank area where the primary expertise lies (FI).	Low	NT
<b>Market Surveillance</b>		
Assess what the appropriate market surveillance role for Nasdaq Stockholm is in light of ongoing changes in market structure and competition (MoF, FI).	Medium	C
Finalize the proposal on the allocation of responsibility for IFRS supervision to reduce the risk of weakening the quality of supervision (MoF).	High	I
Ensure that FI's budget enables it to acquire a suitable automated market surveillance system in order for FI to effectively undertake its market surveillance responsibility in the increasingly fragmented and electronic markets (MoF, FI)	High	I
<sup>1</sup> C=continuous; I=immediate (within one year); NT=near term (1-3 years); MT=medium term (3-5 years)		

## INTRODUCTION<sup>1</sup>

**1. This note reviews the functioning and effectiveness of the regulation and supervision of cross-border securities activities in Sweden, using the relevant International Organization of Securities Commissions (IOSCO) Principles and Standards as benchmarks.**<sup>2</sup> The analysis focuses on fund management, investment services, and market operators, which are the most relevant securities activities from financial stability perspective. Most of the regulatory framework in these areas is based on EU legislation, but certain aspects are left for national discretion. The relevant EU regulatory framework and any additional requirements applied in Sweden are described and evaluated below. The note also examines how FI applies the regulatory framework and supervises compliance with it.

**2. Many Nordic and foreign financial sector firms have concentrated their Nordic operations in Sweden and the Swedish securities markets have a high degree of participation also from elsewhere in the EU.** All Nasdaq Nordic financial derivatives trading takes place in Nasdaq Stockholm, and Nasdaq Stockholm accounts for more than half of Nasdaq Nordic's equity trading. Trading on Nasdaq Stockholm is dominated by remote members, with the market share of Swedish firms reaching only one-third of the value of trading. At the same time, competition facilitated by the EU regulatory framework is intense. Less than 50 percent of trading in Swedish issuers' shares takes place on Nasdaq Nordic, with the rest occurring primarily on U.K. trading venues and OTC. While exact information on the nature of the cross-border provision of investment services is not available, anecdotal evidence suggests that the focus of such activities is on institutional investors.

**3. Fund management services are provided increasingly on a cross-border basis.** By assets under management (AUM) of SEK 2,259 billion at end-2015, the Swedish Undertaking for Collective Investment in Transferable Securities (UCITS) market is the sixth largest in the EU. Swedish management companies also manage funds domiciled abroad, in particular in other Nordic countries and Luxembourg. At the same time, Swedish management companies are increasingly reassessing their governance structures and further shifts in the management company and/or fund domiciles are likely. Also, Sweden permits a significant number of non-EEA domiciled alternative investment funds (AIFs) to be marketed to Swedish investors. This contrasts with many other EU member states that apply significant restrictions to such marketing.

<sup>1</sup> The main author of this note is Ms. Eija Holttinen, Senior Financial Sector Expert from the Monetary and Capital Markets Department of the IMF. The on-site work supporting the findings and conclusions was conducted during August 22–September 2, 2016. The information in this note is current as of September 2016.

<sup>2</sup> The IOSCO documents referred to are: Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation, August 2013; Standards for the Custody of Collective Investment Schemes' Assets, November 2015; and Technological Challenges to Effective Market Surveillance: Issues and Regulatory Tools, April 2013.



**4. FI is the authority responsible for authorizing, supervising, and monitoring all companies operating in Swedish financial markets.** Its role is to promote stability and efficiency in the financial system as well as to ensure effective consumer protection.

## CROSS-BORDER MANAGEMENT AND MARKETING OF INVESTMENT FUNDS

### A. Market Structure

**5. Investment funds encompass a wide variety of different types of funds.** In the EU regulatory framework, a distinction is made between funds regulated under the UCITS Directive and non-UCITS. The latter are referred to as AIFs, whose managers are regulated under the AIFMD. UCITS Directive requires UCITS to be authorized, whereas the regulation of AIFs is left for national discretion. Accordingly, the Swedish UCITS Act requires FI to approve the UCITS' rules if they are reasonable for the unitholders.<sup>3</sup>

**6. Different requirements are applied to Swedish AIFs depending on whether they are special funds or other AIFs.** Special funds must be contractual funds and their rules and rule amendments must be approved by FI. The special fund format is typically chosen to enable deviating from some UCITS requirements, such as those on risk diversification or use of leverage. Special funds may also be open for less frequent redemptions than UCITS. Any deviations from the UCITS Directive requirements must be highlighted in the special fund's rules. Only special funds and certain other types of AIFs can be marketed to investors other than professional investors (see Box 1).

**7. IOSCO Principles<sup>4</sup> expect the regulatory system to require investment funds, in particular those offered to retail investors, to comply with clear criteria for both initial approval and continuing operation.** The regulator should have clear responsibility and powers with respect to the authorization of an investment fund. The Swedish approach of subjecting UCITS and special fund rules and marketing to retail investors to FI's approval complies with the IOSCO requirements.

**8. UCITS management companies must be authorized and AIFMs must be either authorized or registered.** A firm that manages a UCITS must be authorized as a UCITS management company and a firm that performs risk management or portfolio management for an AIF must be authorized or registered as an AIFM. A firm can be authorized both as a UCITS

<sup>3</sup> Approval of rule changes requires that the amended rules continue to be reasonable to unitholders; the changes do not violate the common interests of the unitholders; and any required notification to the unitholders contains suitable information on the changes, their potential consequences to unitholders, and any redemption right before the changes enter into force.

<sup>4</sup> Principle 24, Key Issues 1 and 2 and Key Question 6(a).

management company and an AIFM. AIFMD requires full authorization only for the AIFMs managing AIFs whose total AUM exceed the AIFMD Article 3 threshold, whereas the sub-threshold AIFMs are only required to be registered.<sup>5</sup> In Sweden, only authorized AIFMs are permitted to manage special funds.

**9. The UCITS Directive and AIFMD require the appointment of a depositary for each UCITS and AIF.**<sup>6</sup> A depositary must generally have its registered office or a branch in the same country where the fund is domiciled.<sup>7</sup> The competent authority of the UCITS home country must approve the depositary for each fund. Swedish legislation currently permits only credit institutions to act as UCITS depositaries, and this approach is maintained in the legislative proposal for the transposition of the UCITS V Directive. Contrary to the UCITS Directive, investment firms can also act as the depositary of any AIF and certain other entities can act as the depositary of particular types of closed-ended AIFs (see Box 1).

**10. Cross-border management of Swedish UCITS is largely limited to Nordea funds.** At end-2015, out of the 578 Swedish UCITS, only 35 were managed by non-Swedish management companies. The rest were managed by the 50 Swedish UCITS management companies. The total AUM of Swedish UCITS reached SEK 2,259 billion at end-2015. Out of this amount, SEK 227 billion were managed by foreign management companies, primarily Nordea Funds with the AUM of SEK 212 billion.<sup>8</sup>

**11. The majority of Swedish AIFs—at least by number—are special funds managed by Swedish AIFMs.** At end-2015 there were 338 Swedish AIFs, out of which 255 were special funds. The AUM data across the alternative investment management sector is not yet available, but the AUM of Swedish special funds were SEK 497 billion at end-2015, out of which SEK 16 billion were managed by other EEA AIFMs. The rest was managed by the 75 Swedish authorized AIFMs. At the same time, there were 55 registered Swedish AIFMs, but data on the AUM of the AIFs managed by them is not yet available.

**12. Swedish UCITS management companies and AIFMs also manage foreign domiciled funds.** While Swedish authorities do not collect systematic information on foreign UCITS managed

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<sup>5</sup> Registration is sufficient for an AIFM if the total AUM of the AIFs it manages do not exceed EUR 500 million in cases where the AIFs are unleveraged and have no redemption rights exercisable during a period of 5 years following the date of initial investment in each AIF; or does not exceed EUR 100 million in other cases, including any assets acquired through the use of leverage. An AIFM whose total AUM exceed these thresholds has to be authorized. A sub-threshold AIFM can also opt in for authorization, in which case it has to comply with the full AIFMD.

<sup>6</sup> However, the requirement to appoint a depositary does not apply to AIFs managed by a registered AIFM.

<sup>7</sup> However, a non-EEA AIF's depositary may be established in the AIFM's home country.

<sup>8</sup> Nordea has organized its Nordic fund management business in such a manner that the Finnish Nordea Funds Ltd is the only Nordea UCITS management company and AIFM operating in the Nordic countries. It manages Nordea funds domiciled in Finland, Sweden, Denmark, and Norway and has established branches in those countries. Portfolio management is delegated to the Swedish investment firm Nordea Investment Management AB that has branches in the other Nordic countries.

by Swedish management companies, their estimated AUM was SEK 400 billion at end-2015.<sup>9</sup> Swedish AIFMs need to report the AUM of the foreign AIFs they manage on the basis of the AIFMD reporting requirements. However, the reported data is not yet of sufficient quality to present estimates on the value of those funds.

### Box 1. Main Investment Fund Types in Sweden

**As an EU member state, Sweden has to comply with the EU UCITS Directive and AIFMD.** This means that all Swedish investment funds fall into one of two categories: UCITSs or AIFs. The UCITS Directive requires an UCITS to be authorized, whereas the AIFMD applies to the manager (rather than the fund). However, the Swedish regulatory framework requires the rules of certain AIFs, so called special funds, to be approved by FI.

Type of fund		Legal form	Manager	Depository
UCITS		Contractual fund	Swedish or EEA UCITS management company	Swedish credit institution or a Swedish branch of an EEA credit institution <sup>1</sup>
AIF	Special fund marketed to retail investors		Authorized Swedish or EEA AIFM <sup>2</sup>	A Swedish credit institution or investment firm, a Swedish branch of an EEA credit institution or investment firm, or an authorized UCITS depository <sup>3</sup>
	AIF admitted to trading on a regulated market (or equivalent) marketed to retail investors	Authorized Swedish or EEA AIFM		
	AIF marketed to semi-professional <sup>5</sup> or professional investors	No restrictions on the legal form <sup>4</sup>	Authorized or registered Swedish or EEA AIFM	

Source: UCITS Act, AIFMA.

<sup>1</sup> According to the law transposing the UCITS V Directive, the requirement for a depository to be a credit institution will be maintained in Sweden.

<sup>2</sup> An EEA AIFM also requires FI's authorization to manage a Swedish special fund. This requires, among others, that the AIFM's home member state authorization permits it to manage funds similar to special funds and that the AIFM's legal form is a limited company.

<sup>3</sup> In addition, for closed-ended AIFs that comply with the conditions in Art. 21(3)(3) of the AIFMD (e.g., private equity and real estate funds) the depository may be an entity that carries out depository functions as part of its professional or business activities. It is subject to a EUR 125,000 capital requirement.

<sup>4</sup> In practice most are contractual funds or limited companies.

<sup>5</sup> Semi-professional investors are investors that commit to investing at least EUR 100,000 and have separately stated that they are aware of the risks associated with the envisaged investment. For criteria on the funds that can be marketed to semi-professional investors, see Appendix I.

<sup>9</sup> Management companies' quarterly reports include information on the management companies' total AUM for the purpose of determining their capital adequacy requirement. However, if the company is authorized both as a UCITS management company and AIFM, this aggregate figure includes the AUM of both UCITS and AIFs.

## B. Regulation

**13. The UCITS Directive and AIFMD regulate the management and custody of UCITS and AIFs' assets and the marketing of their units and shares, including when undertaken on a cross-border basis.** The general UCITS Directive and AIFMD requirements are not discussed here, but the focus is on the elements of the regulatory framework that are most relevant for cross-border activities.

### Cross-border Management of Investment Funds

**14. IOSCO Principles<sup>10</sup> recognize that investment funds can be managed on a cross-border basis, subject to sufficient cooperation between the home and host regulators.** The Principles require that the regulatory system sets standards for the eligibility of those that wish to operate an investment fund. The regulator should also have clear responsibility and powers with respect to the authorization of an investment fund. IOSCO Principles emphasize the need for international cooperation if the entities marketing and managing the fund and having custody of its assets are located in different jurisdictions and not in the same jurisdiction where the fund is marketed.

**15. Both UCITS Directive and AIFMD permit cross-border management of investment funds within the EEA subject to a notification procedure.** EEA UCITS management companies may manage UCITS domiciled in other EEA countries by establishing a branch or on a cross-border basis.<sup>11</sup> Similarly, AIFMD provides that an authorized EEA AIFM may manage AIFs domiciled in another EEA country either by establishing a branch or on a cross-border basis. One Swedish UCITS management company has established a branch in another EEA country (Denmark). There are 16 branches of EEA UCITS management companies and two branches of EEA AIFMs in Sweden and, as noted above, relatively limited cross-border management of Swedish UCITS and AIFs from abroad. Cross-border management of foreign funds from Sweden is already relatively common and its importance is likely to increase in the future if Swedish management companies decide to convert their existing foreign subsidiaries to branches.

**16. EEA AIFMs can manage non-EEA AIFs subject to conditions set out in Article 34 of the AIFMD.** If such AIFs are not marketed in the EEA, the AIFM does not need to comply with the AIFMD requirements relating to the depositary (Article 21) and annual report (Article 22). However, there need to be appropriate cooperation arrangements between the AIFM home country competent authority and the supervisory authority of the non-EEA AIF's country of establishment. In practice

<sup>10</sup> Preamble to Principles 24 to 27, Principle 24, Key Issues 1 and 2 and Key Questions 1, 5 and 6(a).

<sup>11</sup> In case of a branch, the management company has to comply with the host country's rules of conduct stipulated in Article 14 of the UCITS Directive and the host country competent authority is responsible for supervising compliance. In contrast, a management company providing services on a cross-border basis has to comply with the home country's rules of conduct under the supervision of the home country competent authority. The rules of the UCITS home country apply to the constitution and functioning of the UCITS itself and the UCITS home country authority is responsible for supervision.

only one Swedish AIFM manages a non-EEA AIF. AIFMD does not require a member state to permit a non-EEA AIFM to manage local AIFs, and the Swedish AIFMA does not permit it.

**17. The Swedish legislation aims at enhancing investor protection by prohibiting cross-border management of Swedish AIFs.** This approach is prudent and complies with the IOSCO Principles.

### Cross-border Marketing of Investment Funds

**18. IOSCO Principles<sup>12</sup> include requirements for cases where investment funds established under one jurisdiction's laws are offered to investors in another country.** They require considering whether the entity engaged in marketing should be authorized, recognized or otherwise eligible; whether there should be requirements for the public offer of the investment fund; and whether there is adequate information sharing between the fund's jurisdiction of establishment and the jurisdiction where it is marketed.

**19. Foreign UCITS and certain foreign AIFs can be marketed to Swedish investors after an appropriate notification has been made.** Marketing of UCITS to any investor and marketing of EEA AIFs managed by authorized EEA AIFMs to professional investors is subject to a standardized notification procedure under the UCITS Directive and AIFMD. At end-2015, a notification had been made for the cross-border marketing of 920 UCITS and 555 EEA AIFs in Sweden.

**20. Marketing of certain AIFs to professional investors is subject to FI's approval.** This is required under the Swedish National Private Placement Regime (NPPR, which is based on Articles 36 and 42 of the AIFMD) in the case of marketing of non-EEA AIFs<sup>13</sup> and EEA AIFs managed by non-EEA AIFMs to professional investors. At end-2015, FI had approved EEA AIFMs to market 87 non-EEA AIFs to Swedish professional investors. Non-EEA AIFMs had gotten the permission to market a total of 483 EEA and non-EEA AIFs to Swedish professional investors.

**21. FI can approve the marketing of certain types of AIFs to investors other than professional investors.** Marketing foreign AIFs that are equivalent to Swedish special funds and foreign AIFs admitted to trading on an RM or an equivalent foreign market to non-professional investors is permitted under certain conditions. At end-2015, FI had approved the marketing of 30 such AIFs. FI can also approve marketing of certain closed-ended AIFs to semi-professional investors. Only 4 such approvals had been given at end-2015. Appendix I summarizes the regulatory framework applicable to the marketing of AIFs to Swedish investors.

**22. Marketing of Swedish funds to foreign investors is constrained by the fact that having unit classes denominated in two or more different currencies is currently difficult in practice.** This is because the Swedish legislation does not permit hedging the currency risk of the unit class

<sup>12</sup> Preamble to Principles 24 to 27. See also footnote 10.

<sup>13</sup> This also applies to EEA feeder AIFs where the master fund is managed by a non-EEA AIFM or the master fund is a non-EEA AIF.

denominated in a different currency than the base currency of the fund, which may subject the investor to foreign exchange risk. However, the final report of the government inquiry on investment fund legislation (SOU 2016:45, June 2016) proposes that legislation would be amended in this regard. The legislative changes (yet to be prepared) are proposed to enter into force on January 3, 2018.

**23. The Swedish legislation requires FI's approval for the marketing of all AIFs that are not subject to the AIFMD notification procedure.** EU member states have adopted very different practices in this regard, and FI's approach enables it to ensure that risks to the Swedish investors can be contained. The approach taken also complies with the above IOSCO requirements for cross-border marketing of investment funds.

### Delegation of Investment Management

**24. IOSCO Principles<sup>14</sup> require that the regulatory system determines the circumstances under which delegation is permitted and prohibits delegation of the fund manager's functions to the extent that it becomes a letter box entity.** The delegate should comply with all regulatory requirements applicable to the delegator's business activities. The delegator should remain responsible for the functions that it delegates and have adequate capacity, resources, and processes to monitor the activity of the delegate and ability to terminate the delegation. There should be a requirement for disclosure to investors on the delegation arrangements. The use of delegates should not diminish the effectiveness of the regulation and supervision of the investment fund. More specifically, delegation should not jeopardize the regulator's ability to effectively access data on the delegated function or to take appropriate actions in case of conflicts of interest between the delegate and investors.

**25. Under the UCITS Directive, member states have the discretion to determine whether and subject to which conditions delegation of investment management is permitted.** The Directive prevents delegating investment management to the depositary or to any other person with potential conflicts of interest. The delegate is required to be authorized for asset management, prudentially supervised and, in the case of a non-EEA person, subject to cooperation between the relevant authorities. Signing the IOSCO MMoU is considered to be sufficient demonstration of the ability to cooperate. Delegation must not prevent effective supervision or the fund manager from giving further instructions to the delegate or from withdrawing the mandate. The fund manager is prohibited from delegating its functions to the extent that it becomes a letter box entity. FI's Regulations include some additional requirements, including an obligation for the management company to notify FI at least one month before planned delegation. FI has the right to require necessary amendments to the delegation agreement.

**26. AIFMD includes similar, but more detailed requirements.** An AIFM must provide a detailed description of its entire delegation structure to its competent authority. Subject to the

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<sup>14</sup> Principle 24, Key Issues 8 and 9 and Key Questions 15–17.

approval of its home country competent authority, an AIFM can delegate portfolio management or risk management to a person that is not authorized for asset management or subject to supervision.<sup>15</sup> Delegation of portfolio management to such persons is not permitted under the UCITS Directive. Sub-delegation requires the consent of the AIFM and notification to the competent authority. AIFMD specifically prohibits delegation and sub-delegation of portfolio management or risk management to the depositary or a delegate of the depositary. An AIFM's liability towards the AIF and its investors is not affected by delegation or sub-delegation. Finally, an AIFM must not delegate its functions to the extent that, in essence, it can no longer be considered to be the AIFM of the AIF and to the extent that it becomes a letter box entity. FI Regulations require FI to be notified before the delegation arrangements become effective.

**27. AIFMD includes additional requirements on delegation to non-EEA persons.** A written cooperation agreement must exist between the relevant competent authorities. The agreement has to cover access to information and documents, the ability to carry out on-site inspections, and enforcement cooperation. In practice this is facilitated through FI signing the AIFMD Memorandum of Understanding (MoU) with relevant non-EEA countries. FI has signed the MoU with all the countries with which ESMA has negotiated the arrangements on behalf of EEA competent authorities.<sup>16</sup>

**28. FI's Regulations ensure its ability to supervise any delegated activities and in practice delegation takes place only to a limited extent.** The service provider has to cooperate with FI in relation to the delegated activities. FI must also have access to relevant records and to the service provider's premises and have the ability to conduct on-site inspections at the service provider. According to FI, Swedish fund managers do not typically delegate fund management related activities to foreign firms. When this happens, FI conducts the same review as in the case of delegation to a Swedish firm. FI uses the information on delegated activities in its annual risk assessment process and in planning its inspections.

**29. The UCITS Directive and AIFMD requirements together with the additional Swedish requirements facilitate sufficient supervision of delegation.** The regulatory framework complies with the IOSCO Principles and enables FI to assess the risks arising from delegation.

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<sup>15</sup> FI has not yet approved delegation of portfolio management or risk management related to financial instruments to other than supervised entities. For risk management of other assets than financial instruments, such as real estate and property, FI has approved delegation to undertakings that do not meet the criteria on authorization and supervision.

<sup>16</sup> See [https://www.esma.europa.eu/system/files/force/library/2015/11/aifmd\\_mous\\_signed\\_by\\_eu\\_authorities\\_by\\_16\\_september\\_15.xlsx?download=1](https://www.esma.europa.eu/system/files/force/library/2015/11/aifmd_mous_signed_by_eu_authorities_by_16_september_15.xlsx?download=1).

## Safekeeping and Segregation of Fund Assets

**30. IOSCO Principles<sup>17</sup> require adequate segregation of investment fund's assets from the assets of the fund manager, custodian and other custody clients.** The safekeeping of fund assets should be entrusted to independent depositaries. If the use of an independent depositary is not possible, special legal or regulatory safeguards should be applied to ensure the protection of client assets. Client assets should be identified to the depositary and to any sub-custodian it uses. Investment fund assets should be segregated from: (i) the assets of the fund manager and its related entities; (ii) the assets of the custodian/sub-custodian throughout the custody chain; and (iii) the assets of other investment funds and other clients of the custodian throughout the custody chain (unless investment fund assets are held in a permissible omnibus account). With regards to the independence of the depositary/custodian, IOSCO Standards highlight some safeguards that may be used to enhance the independence of a related party custodian.<sup>18</sup>

**31. AIFMD and UCITS V Directive include segregation and safekeeping/record keeping requirements applicable to all investment fund assets.** Financial instruments that can be held in custody but that cannot be physically delivered to the depositary must be registered in a segregated financial instruments account opened in the name of the fund or the fund manager acting on behalf of the fund. Up-to-date records have to be kept of other assets. In Sweden these enhanced requirements will apply to UCITS after the transposition of the UCITS V Directive in Sweden, which will take place on November 1, 2016.<sup>19</sup>

**32. AIFMD and UCITS V Directive include general requirements on depositary independence.** They prohibit a depositary from carrying out activities with regard to a fund or its manager, unless the depositary has functionally and hierarchically separated the performance of its depositary tasks from its other potentially conflicting tasks, and the potential conflicts of interest are properly identified, managed, monitored, and disclosed. There are also certain restrictions on having common management in UCITS management companies and their depositaries.<sup>20</sup> In addition, the delegated act (EU) 2016/438 supplementing the UCITS V Directive with regard to obligations of depositaries, which has direct effect in Sweden, regulates depositary independence. These requirements go beyond the UCITS IV Directive prohibition on the management company acting as the depositary that is still the only independence requirement applicable in Sweden, pending transposition of the UCITS V Directive. AIFMD also specifically prohibits an AIF's prime broker from

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<sup>17</sup> Principle 25, Key Issues 3 and 4 and Key Questions 7 and 8 and IOSCO Standards for the Custody of Collective Investment Schemes' Assets.

<sup>18</sup> These include additional disclosure requirements; additional capital requirements; designating specific persons who are permitted to access the investment fund's assets; and requiring an independent public accountant to verify the assets held and to conduct a certain number of examinations without giving prior notice.

<sup>19</sup> The transposition deadline was March 16, 2016. Very limited safekeeping and segregation requirements apply under the UCITS IV Directive, and contrary to some other member states, Sweden had not applied any additional national requirements.

<sup>20</sup> See Art. 21 of the Commission Delegated Regulation (EU) 2016/438 of December 17, 2015.



acting as the AIF's depository, unless the prime brokerage and depository functions are separated and conflicts of interest are properly identified, managed, monitored, and disclosed.

**33. UCITS V Directive does not prohibit related party depositories.** For example, a group bank can act as the depository for the UCITS managed by a group management company, if the group can arrange its governance in such a manner that the UCITS V Directive requirements are complied with. According to the current legislative proposal, Sweden does not plan to apply any additional requirements on the ability to use a group company as the depository. FI has supported a full prohibition of the use of related party depositories in its letters to the European Commission in January 2011 and to the Swedish Ministry of Finance (MoF) in September 2012.

**34. Delegation by the depository is subject to detailed AIFMD and UCITS V Directive requirements, which permit delegating only safekeeping tasks.** In order to provide sub-custody for financial instruments, the delegate must be subject to effective prudential regulation and an external periodic audit of financial instruments in custody. Subject to informing the investors and specific instructions from the AIF or AIFM, this principle can be deviated from in the case of non-EEA countries, if the local law requires custody tasks to be provided by a local entity and none satisfies the above conditions. The enhanced requirements for UCITS will apply in Sweden only after it has transposed the UCITS V Directive.

**35. Segregation requirements apply to delegated safekeeping.** A delegate must segregate the assets of the depository's clients from its own assets and those of the depository in such a way that they can, at any time, be clearly identified as belonging to clients of a particular depository. The delegate has to keep such records and accounts as are necessary to enable it at any time and without delay to distinguish assets of the depository's UCITS/AIF clients from its own assets, assets of its other clients, assets held by the depository for its own account, and assets held for clients of the depository which are not UCITS/AIFs.<sup>21</sup> It cannot make use of the assets unless it has received prior consent from the AIF or AIFM and notified the depository. The enhanced requirements for UCITS will apply in Sweden only after it has transposed the UCITS V Directive.

**36. The AIFMD depository liability requirements enable discharge of liability under certain circumstances.** Notwithstanding delegation, the depository generally remains liable for any loss of financial instruments held in custody. If a loss happens, the depository will have to return to the AIF or AIFM a financial instrument identical to the type lost or its corresponding value. The depository will however not be liable if it can prove that the loss has arisen as a result of an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary. Subject to the AIF's agreement, the depository can also discharge itself of liability if it can prove that a written contract between the depository and the delegate

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<sup>21</sup> ESMA published a consultation paper on December 1, 2014, on guidelines on asset segregation under the AIFMD that covers the interpretation of these requirements. On July 15, 2016 it published a call for evidence on asset segregation and custody services, extending the scope to asset segregation rules for UCITS.

expressly transfers the liability to the delegate and makes it possible to make a claim against the delegate.

**37. The UCITS V Directive largely aligns the depositary liability requirements with those of the AIFMD.** However, it does not allow any discharge of liability (including for loss of assets) when safekeeping duties have been delegated to a third party. The UCITS V Directive also requires that, in the event of insolvency of the depositary or its delegate, the assets of the UCITS held in custody are unavailable for distribution among the creditors of the depositary or delegate.

**38. FI has conducted some supervisory activities on depositaries.** Thematic inspections on depositaries of Swedish UCITS and special funds were conducted in 2009–2013. The focus of these inspections was on the organization of the depositary function and the depositaries' monitoring activities, rather than the actual safekeeping of assets.

**39. The transposition of the UCITS V Directive is important in enhancing the Swedish requirements' compliance with the IOSCO Principles and Standards.** After its transposition, the Swedish requirements will comply with the segregation and safekeeping requirements in IOSCO Principles and Standards, except those relating to depositary independence.<sup>22</sup> The law transposing the UCITS Directive will enter into force on November 1, 2016.

**40. Further enhancements to the depositary independence requirements would be beneficial.** While the requirements in the UCITS V Directive and its delegated act provide for enhanced independence of depositaries compared to the UCITS IV Directive, many member states require enhanced independence from their local depositaries. FI should initiate discussions with the relevant management companies on how they are planning to comply with the UCITS V Directive and the delegated act requirements to assess the remaining risks of the planned arrangements. Requiring additional safeguards along the lines proposed by IOSCO should be considered in such cases.

## C. Supervision

### Organization and Resources

**41. FI's Consumer Protection area is responsible for the supervision of investment funds and their managers.** In addition to the institutional responsibility for the supervision of fund managers, investment firms and a number of other firms,<sup>23</sup> Consumer Protection is in charge of supervising consumer protection by all firms under FI's supervision. The total number of staff is currently 82. The turnover in the Consumer Protection staff is similar to FI average: 16 percent. Staff has on average slightly above 4 years of experience at FI.

<sup>22</sup> As noted above, segregation requirements are intended to be further clarified by ESMA.

<sup>23</sup> 1,052 insurance intermediaries, 320 financial institutions, 99 payment services firms, 67 instant loan firms, 22 deposit taking companies, and 6 e-money institutions.

**42. Several divisions within Consumer Protection are involved in the authorization and supervision of funds and fund managers.** The Division primarily responsible for supervision is Fund Supervision (7 staff members). Investment Fund Law Department's two Divisions, UCITS Law (7 staff members) and AIFM Law (8 staff members) deal with applications for authorization of managers, approval of fund rules, and notifications on the cross-border management and marketing of funds.

### Supervisory Approach

**43. IOSCO Principles<sup>24</sup> require the regulator to apply proper supervision throughout the investment fund's life.** The regulator should have clear responsibilities and powers to conduct inspections to ensure the fund manager's compliance with the applicable standards and an effective inspection system where it carries out inspections either on a periodic or risk assessment basis. Where appropriate, the inspections should cover fund managers, custodians, and other relevant entities.

**44. FI's supervision strategy is risk-based and prioritizes the supervision of firms, markets and products that are considered to pose the highest risk to the financial system and/or to consumers.** The extent of the risk depends on the probability of something going wrong and, in such case, on the extent of the consequences for customers and society. Risks are assessed through a yearly risk assessment process and risk classification of supervised entities. The risk assessment process identifies and ranks risks and forms the basis for FI's supervisory priorities for the following year. The risk classification system ranks the firms based on the extent of the potential negative consequences of the firms' problems for consumers or the stability of the financial system. The merger of these two dimensions—risk assessment and risk classification—provides a basis for FI's focus for ongoing supervision and inspections.

**45. FI's supervisory focus in the Consumer Protection area is on firms' compliance and internal governance and control as regards their behavior vis-à-vis their customers.** Primary focus in the risk assessment is on the products and services that are of the greatest importance to consumers. Risk classification of firms is less relevant. For fund managers the risk classification system uses their AUM as the main classification criterion.

**46. All FI's supervisory activities are required to be conducted according to its procedure for inspections.<sup>25</sup>** The choice on the use of a particular type of supervisory approach, such as an off-site or on-site inspection or the use of a thematic or firm-level activity depends on which approach is considered to be the most efficient one in each case. The inspection procedure covers the formal prerequisites (e.g., decision, planning documentation) that must be present when starting an

<sup>24</sup> Principle 12, Key Issue 1(d) and Key Question 1 and Principle 24, Key Issue 4 and Key Questions 6(b) and 8.

<sup>25</sup> FI itself uses the term investigation to refer to inspections and other supervisory activities in supervised entities as well as to investigations in unsupervised entities. This note uses the term inspection to refer to the former and the term investigation to refer to the latter.

inspection. It also explains what to pay attention to when carrying out an inspection (e.g., information gathering, analysis, communication, documentation) and the way to close the inspection when it is completed.

**47. Examples of FI’s fund management related supervisory activities in 2013-2015 include:**<sup>26</sup>

- Thematic off-site inspection on global exposures of UCITS;
- Thematic on-site inspection on valuation of assets and management of liquidity risk;
- Thematic on-site inspection on depositaries;
- Thematic on-site inspection on management of conflicts of interest;
- Thematic off-site inspection on the measurement and management of liquidity risks in corporate bond funds; and
- Thematic off-site inspection on the delegation of the risk management and compliance functions.

**48. Market participants would benefit from broader sharing of inspection findings and recommendations.** FI informs the inspected entities about the inspection findings and recommendations by sending a letter. Occasionally any general findings and recommendations are communicated more broadly, for example in special events (such as FI Forum). General conclusions are also incorporated in annual publications, such as the Customer Protection report and sectoral reports. While these are useful communication tools, they do not necessarily reach a sufficiently broad audience and may take place with a time delay that is not helpful for supervised entities that are seeking to ensure that they comply with the regulatory requirements and best practice. FI is encouraged to consider additional ways to communicate the general findings and recommendations arising from its supervisory activities. Well-functioning models are used by various authorities which regularly publish thematic review findings through various channels, such as newsletters, supervisory releases and press releases in case of important topics.

**49. In addition to risk-based supervision, FI applies the principle of “comprehensive” supervision and reacts to certain types of events (reactive supervision).** The former approach simply means that each supervised entity should be subject to at least one supervisory activity, such as an off-site inspection or review, over a three-year period. FI also conducts event-driven/reactive supervision, reacting to risks that have manifested themselves. Examples of events that FI would react to are a firm facing acute difficulties, consumers being affected by dubious advice, or the detection of some kind of market abuse.

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<sup>26</sup> In total FI’s investigation touched 90 UCITS management companies and 16 AIFMs in 2013-2015.

**50. There has been limited cross-border supervisory cooperation in relation to fund management.** Nevertheless, cross-border supervisory cooperation is facilitated under the MoUs FI has signed. In addition, the financial services authorities (FSAs) of Sweden, Denmark, Norway and Finland have established a Nordic Working Group (NWG) on the AIFMD and UCITS Directive. The objective of the NWG is to ensure efficient supervision of management companies and UCITS where the UCITS are managed by a management company authorized in another Nordic country. The principles of future cooperation, including the planning of future inspections, have been discussed in recent meetings, but no concrete decisions have been made. The NWG normally meets twice a year.

**51. Consumer Protection area's supervisory strategy explicitly emphasizes the importance of the customer protection objective.** While it is clear from the supervisory activities undertaken that financial stability also plays a role in the prioritizations made, it is recommended that FI reviews the Consumer Protection area's activities to assess where the current consumer protection focus should be complemented with explicit consideration of financial stability risks.

**52. FI has undertaken important supervisory activities in the area of fund management, conducting both on-site and off-site inspections.** Given the limited resources, the use of off-site thematic inspections has enabled touching a broader group of supervised entities on a more regular basis. However, it is essential that FI continues to allocate resources to targeted follow-up supervisory and, if necessary, enforcement activities that are likely to be needed in some cases.

**53. Given that some Swedish funds are managed from abroad and some foreign funds from Sweden, the level of cross-border supervisory cooperation should be increased.** FI should strive to undertake supervisory activities jointly with other Nordic regulators, particularly in relation to Swedish UCITS managed from other Nordic countries. Given the increasing trend of Swedish management companies managing UCITS on a cross-border basis from Sweden, it is also recommended to enhance cooperation with the authorities outside the Nordic region where the funds are or will be domiciled. This need appears to apply in particular to Luxembourg, where many Swedish fund managers have domiciled their funds.

## Reporting and Analysis

**54. IOSCO Principles<sup>27</sup> require the regulator's ongoing monitoring to include review of reports on the investment fund and entities involved in its operation (fund manager, custodian, etc.).** Such reporting should take place on a routine or risk assessment basis.

**55. Swedish UCITS management companies are subject to comprehensive periodic reporting requirements.** They include:

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<sup>27</sup> Principle 24, Key Question 7.

- Quarterly report for the management company containing a profit and loss account, balance sheet, and certain other information (e.g., AUM and number of clients) and calculation of compliance with capital requirements (national requirement);
- Quarterly report for each Swedish UCITS containing detailed information on, among others, the net asset value (NAV) of the UCITS broken down by unit holder category, value of transactions in the UCITS's units, and the UCITS's aggregated holdings in various types of financial instruments and other assets (national requirement that applies also to foreign management companies managing Swedish UCITS);
- Quarterly report on each UCITS's holdings, which includes instrument/asset level information on the portfolios of each UCITS (national requirement that applies also to foreign management companies managing Swedish UCITS);
- Annual reports by the management company containing (i) information on the types of derivative instruments used by each UCITS; as well as (ii) a description on the underlying risks, the quantitative limits, and the methods chosen to estimate the risks associated with the derivative transactions aggregated for all UCITS managed by the management company (UCITS Implementing Directive requirement that applies also to foreign management companies managing Swedish UCITS); and
- Annual and semi-annual reports for each UCITS (UCITS Directive requirement).

**56. AIFMs are also subject to comprehensive periodic reporting requirements that derive from the AIFMD.** The reporting requirements cover:

- Periodic (quarterly, half-yearly or annual) report by authorized Swedish AIFMs on each AIF they manage and by non EEA-AIFMs on each AIF they market in Sweden (AIFMD Article 24 transparency reporting, see Appendix II for a summary of the reporting requirements);<sup>28</sup>
- Annual report by registered Swedish AIFMs on the main instruments they trade in and on the most important exposures and concentrations of the AIFs they manage (AIFMD requirement); and
- At FI's request, annual report by Swedish AIFMs on each EEA AIF they manage and each EEA or non-EEA AIF they market in the EEA and a quarterly list of all AIFs they manage (AIFMD requirement).

**57. In addition, Swedish AIFMs managing special funds or marketing other AIFs to retail investors are subject to additional reporting requirements.** They cover:

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<sup>28</sup> In addition, as required by Article 24(5) of the AIFMD, FI may require additional information to be reported to it. So far it has used this possibility.

- Quarterly report for each AIFM that manages a special fund, quarterly report for each such fund, and, at FI's request, report on the holdings of each such fund (national requirement, content the same as for UCITS management company and UCITS reports);
- Quarterly report for each AIFM that manages an AIF that is not a special fund, but that is marketed to retail investors (national requirement); and
- Annual and semi-annual reports for each special fund (national requirement, content largely the same as for UCITS).

**58. The periodic reporting serves various objectives.** The main purpose of the UCITS management companies' and AIFMs' quarterly reporting is to ensure compliance with capital requirements on which regular analysis is performed. However, it is also used for ad hoc analyses, for example in the context of risk classification. The main purpose of the quarterly reports for each UCITS is to comply with FI's obligation to collect information to be included in the official financial market statistics in Sweden. Neither one of the above reports can be easily used for analysis, since the reports are submitted in PDF format. These reports are shared with the Riksbank and Statistics Sweden.<sup>29</sup> The reports on holding of assets and derivative instruments as well as annual and semiannual reports by each fund are used as an information source for FI's inspections. Ad hoc analyses are conducted both on individual funds and on an aggregate level.

**59. The underlying objective of the transparency reporting under Article 24 of the AIFMD is to monitor AIFs to identify potential sources of systemic risk.** AIFMD specifically requires the competent authorities of the AIFM's EEA home country to use the information for the purposes of identifying the extent to which the use of leverage contributes to the build-up of systemic risk in the financial system, risk of disorderly markets or risk to the long-term growth of the economy. Competent authorities are also obliged to inform the competent authorities of the other directly concerned member states, if an AIFM under their responsibility or an AIF the AIFM manages could potentially constitute an important source of counterparty risk to a credit institution or other systemically relevant institutions.

**60. FI has recently implemented a system to receive the reports required under Article 24 of the AIFMD, forward them to ESMA, and perform analyses of the reported data.** The first two parts are operational since the second quarter of 2015, and the project has defined IT controls to ensure the quality of incoming information. However, FI is still working on improving the quality of the reported data and cleaning the end-December 2015 data that covers all Swedish authorized and registered AIFMs. In the future, the plan is to perform regular analyses of the submitted information. For instance, the intention is that there will be early warnings of substantial leverage, liquidity mismatch and significant decrease in AUM. Thereafter FI plans to implement a new working process for the monitoring of systemic risk, including information sharing and cooperation with

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<sup>29</sup> In addition, the Riksbank, Statistics Sweden and the Swedish Pensions Agency collect some data from Fund managers.

different authorities. FI also intends to use the reported information in its consumer protection inspections.

**61. In addition, there are ad hoc reporting requirements.** Several such requirements apply to UCITS management companies and AIFMs. In contrast to some other countries, depositaries are not required to report breaches by fund managers to FI in a systematic manner.

**62. There are some data gaps in UCITS reporting and enhanced analysis would benefit risk identification and supervision.** FI does not systemically collect information on Swedish UCITS management companies' cross-border management of funds. FI should also continue to enhance the use of the reported data in regular and ad hoc analyses not only to support its supervisory activities, but also to enhance its understanding of the potential systemic risks arising from fund management activities.

**63. Additional efficiencies in data collection may be sought through changes in reporting formats and cooperation between authorities.** FI is encouraged to consider whether the current use of PDF reporting format is optimal. Fund reporting is also collected by many other Swedish authorities than FI. In the connection of any future changes to the content or format of such reporting, FI and the Riksbank are encouraged to seek ways to enhance authorities' cooperation in data collection.

**64. Being able to utilize the extensive AIFMD reporting data requires more work.** FI needs to complete the quality controls of the data already reported and ensure that it gets access to the data on AIFs managed by non-Swedish EEA AIFMs marketed to Swedish investors that is collected by other EEA authorities. Given the significant extent to which in particular non-EEA AIFs are marketed in Sweden, it is important to ensure that the analysis tool for the AIFMD transparency reporting will be promptly completed.

## CROSS-BORDER PROVISION OF INVESTMENT SERVICES

### A. Market Structure

**65. Both investment firms and banks provide investment services and activities in Sweden.** There are 110 Swedish investment firms<sup>30</sup> and 72 credit institutions (banks)<sup>31</sup> that are authorized to

<sup>30</sup> Out of these 110 firms, as of end-2015 a total of 88 firms conducted reception and transmission of orders; 76 execution of orders; 14 dealing on own account; 83 discretionary portfolio management; 76 investment advice; 6 underwriting and placement on a firm commitment basis; and 28 placement without a firm commitment basis. Two operated a multilateral trading facility (MTF).

<sup>31</sup> Out of these 72 banks, as of end-2015 a total of 58 banks conducted receipt and transmission of orders; 59 execution of orders, 54 dealing on own account; 24 discretionary portfolio management; 55 investment advice; 20 underwriting and placement on a firm commitment basis; and 22 placement without a firm commitment basis. None operated an MTF. There are in total 88 banks in Sweden, so most banks provide at least one investment service. Typical services provided by smaller banks are reception and transmission of orders, execution of orders, and investment advice.



provide investment services. Although the number of investment firms providing each service is larger for all services except underwriting and placement on a firm commitment basis—which is often capital intensive—in practice banks are the dominant players in terms of market share. For example, in Nasdaq Stockholm equity trading, 11 Swedish banks had a 31 percent market share against the less than 1 percent market share of 3 Swedish investment firms (Table 2).

#### 66. Foreign investment firms and banks seem to be very active in the Swedish market.

There are 36 branches of EEA investment firms in Sweden and 30 branches of EEA banks that have notified their home country authorities that they provide investment services and activities through a branch in Sweden. The number of firms having notified cross-border provision of services from the EEA is very high: 2,579 investment firms<sup>32</sup> and 486 banks. In Nasdaq Stockholm equity trading, the market share of foreign banks and investment firms totaled 68 percent in 2015 (Table 2). The majority of remote trading is conducted from the United Kingdom, with the 20 British remote members having a 54 percent market share. However, these large numbers do not necessarily illustrate the degree to which foreign investment firms and banks have Swedish clients. In practice, retail clients in particular tend to use domestic service providers. Non-EEA firms do not currently provide any investment services in Sweden. A non-EEA firm would require an authorization by FI to establish a branch.

**Table 2. Sweden: Number of Members and Their Market Share in Nasdaq Stockholm Trading January 1-December 31, 2015**

Type of Member	Equities	Equity Derivatives	Fixed Income Derivatives	Commodity Derivatives	Power Derivatives
	Number of Firms (as of December 31, 2015)				
	(Market Share, Value of Turnover, Percent)	(Market Share, Number of Contracts, Percent)			(Market Share, GWh, Percent)
Swedish investment firms	3 (0.79)	3 (0.21)	0 (0.00)	0 (0.00)	0 (0.00)
Swedish banks	11 (30.98)	10 (37.58)	5 (73.88)	0 (0.00)	0 (0.00)
Other Swedish members	0 (0.00)	0 (0.00)	2 (1.46)	0 (0.00)	0 (0.00)
EEA remote investment firms	31 (43.42)	31 (37.72)	6 (1.04)	3 (27.53)	3 (100)
EEA remote banks	20 (24.61)	15 (18.58)	8 (23.62)	3 (72.47)	0 (0.00)
Other EEA/Swiss remote members <sup>1</sup>	5 (0.20)	8 <sup>2</sup> (5.91)	0 (0.00)	0 (0.00)	0 (0.00)
Total	70 (100.00)	67 (100.00)	21 (100.00)	6 (100.00)	3 (100.00)

Source: Nasdaq Stockholm.

<sup>1</sup> While all other remote members are from EEA countries, there were two Swiss remote members in Nasdaq Stockholm.

<sup>2</sup> Three of these members were also equity trading members.

<sup>32</sup> In addition, 6 EEA investment firms use a tied agent in Sweden.

**67. Swedish investment firms provide services in other EEA countries to a limited extent.**

Six firms have established an EEA branch and 37 have notified that they provide cross-border services in other countries without establishing a branch. 16 of the 77 EEA branches of Swedish banks provide investment services, but according to FI any services provided tend to be targeted to professional investors. Swedish investment firms do not have non-EEA branches, and Swedish banks do not provide investment services from their 12 non-EEA branches.

**68. As a result of the firms' current business models, FI considers that cross-border supervisory cooperation on the provision of investment services is not particularly relevant.**

Most of the Swedish investment firms provide investment services only on a domestic basis. Branches are mainly for representation purposes. Foreign investment firms' Swedish branches' business operations are mostly of fairly small scale. Usually they do not provide investment services to non-professional clients. Therefore, FI has not identified any risks that would justify more intrusive supervision of branches. However, the Nordic banking groups' supervisory colleges occasionally discuss investment services. The plan of Nordea Bank to convert its Finnish subsidiary to a branch is likely to require additional cooperation between FI and the Finnish Financial Supervisory Authority.

## B. Regulation

**69. The provision of investment services in the EU, including in member states other than the home country of the service provider, is regulated primarily in the Markets in Financial Instruments Directive (MiFID).** In addition, the Capital Requirements Directive (CRD) includes the requirements on banks' provision of investment services in other EEA countries. The general MiFID and CRD requirements are not discussed in detail here, but the focus is on the elements of the regulatory framework that are most relevant for an investment services provider that conducts its activities in multiple jurisdictions.

### Notification of the Provision of Investment Services in Other EEA Countries

**70. IOSCO Principles<sup>33</sup> acknowledge the recognition of another licensing regime as a way to permit foreign intermediaries to provide services to domestic clients.** The criteria used should be transparent, clear, consistently applied, and address the same requirements as the authorization of domestic intermediaries. Information on the authorized market intermediaries, including the scope of their permitted activities, should be available to the public.

**71. MiFID and CRD provide two alternatives for an EEA investment firm or bank to provide services outside its home country.** The investment firm or bank may establish a branch in another EEA country or provide services on a cross-border basis from its home country.<sup>34</sup> Both options are

<sup>33</sup> Principle 29, Key Issue 6 and Key Question 6 and explanatory notes to Principle 29.

<sup>34</sup> In case of a branch, the host country competent authority is responsible for ensuring that the services provided by the branch within its territory comply with the obligations laid down in Articles 19, 21, 22, 25, 27, and 28 of MiFID.

subject to a notification procedure. The detailed notification requirements under MiFID apply to investment firms, whereas the notification procedure for banks is regulated in the CRD. In addition, MiFID provides that investment firms and banks can become remote members of regulated markets (RMs) and multilateral trading facilities (MTFs) in other EEA countries, provided that the RM or MTF operator informs its home country competent authority about the countries where it plans to provide remote access to its trading system.

**72. While the host country authority has a role in the supervision of branches, the home country authority is completely responsible for the supervision of services provided on a cross-border basis.** The host country authority receives the initial notification and any changes to it, but the notifications only list the investment services and activities and the ancillary services to be provided and include information on the intended use of tied agents. No program of operations/business plan needs to be attached.<sup>35</sup> In practice most competent authorities treat the provision of cross-border services as a pure notification process that does not entail any assessment of how and to whom the services are intended to be provided.

**73. It is very difficult for both the home and host country authorities to know in which countries and to what extent investment firms and banks in practice provide investment services.** This is because many firms in the EU have made a notification to all or most member states without necessarily having a concrete plan to provide services in those countries. As a result, it is currently difficult to assess the potential risks arising from the cross-border provision of services, other than on the basis of anecdotal supervisory information. In general, FI considers that the home/host system of supervision is working well in practice. It does not have any concerns about the current extent and nature of cross-border provision of services. In 2014–2015, FI received only a few complaints about foreign firms' provision of services to Swedish clients.

**74. Nevertheless, given the increasing provision of financial services over the Internet, it is important to remain vigilant about developments.** ESMA recently started a mapping on the provision of cross-border services that, at a minimum, may lead to additional convergence of practices among competent authorities. FI is encouraged to actively participate in this work and reconsider its own approaches, if needed.

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The host country competent authority has the right to examine branch arrangements and to request such changes as are strictly needed to enable it to enforce the obligations under the above Articles with respect to the services and/or activities provided by the branch within its territory. The home country competent authority may also carry out on-site inspections in the branch after having informed the competent authority of the host country.

<sup>35</sup> While MiFID refers to a program of operations also in the case of cross-border provision of services, EU competent authorities have agreed to limit the content of cross-border notifications to the information included in the standard notification form included in the Committee of European Securities Regulators' Protocol on MiFID Passport Notifications (CESR/07-317c). Similar arrangement applies in the case of banks' cross-border provision of services on the basis of the Commission Implementing Regulation (EU) No 926/2014 on the implementing technical standards relating to the notifications under the CRD.

## Outsourcing

**75. IOSCO Principles<sup>36</sup> include requirements on outsourcing and segregation of client assets.** A market intermediary is required to have an appropriate organizational structure and controls that also cover activities that have been outsourced. With regards to client assets, a market intermediary is required to make adequate arrangements to safeguard clients' ownership rights, for example through identification and segregation of those assets. The measures taken should, among others, facilitate the transfer of positions and assist in the orderly winding up of an insolvent intermediary and the prompt return of client assets.

**76. Outsourcing in connection with the provision of investment services, whether within the same country or on a cross-border basis, is subject to MiFID requirements.** Outsourcing to a third party of critical operational functions requires taking reasonable steps to avoid undue additional operational risk. Outsourcing of important operational functions may not be undertaken in such a way as to impair materially the quality of the firm's internal controls and the supervisor's ability to monitor the firm's compliance with all its obligations.<sup>37</sup> The outsourcing firm remains responsible for discharging its legal obligations and for ensuring that outsourcing does not lead to the senior management delegating its responsibilities; to altering the investment firm's relationship and legal obligations towards its clients; or to undermining or modifying any of the conditions forming the basis for the firm's authorization.

**77. FI's Regulations implement the detailed requirements on outsourcing included in the MiFID Implementing Directive.** If an outsourcing arrangement entails a significant change to the conditions under which the firm's license was granted, the firm must report the arrangement and its scope to FI. The investment firm must ensure that FI's ability to supervise and monitor the outsourced activity is not prevented in any way. The service provider is also required to cooperate with FI and provide FI with access to all records on the outsourced activity and to the service provider's premises. These standard requirements also apply to cross-border outsourcing.

**78. In addition, MiFID includes specific requirements for outsourcing discretionary management of retail clients' portfolios to a non-EEA service provider.** The service provider must be authorized in its home country to conduct such business and be subject to prudential supervision. In addition, there must be an appropriate cooperation agreement between FI and the supervisory authority of the service provider. If these conditions are not met, the investment firm or bank may outsource investment services to a non-EEA service provider only if it notifies FI of its intention in advance and FI does not oppose the outsourcing within a reasonable time.

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<sup>36</sup> Principle 31, Key Issue 1 and Key Question 1(a) on outsourcing and Key Issue 6 and Key Question 8 on segregation of client assets.

<sup>37</sup> An investment firm's operational function is regarded as critical or important, if a defect or failure in its performance would materially impair the ability of the firm to fulfill its legal obligations, its financial performance, and the soundness or continuity of its investment services and activities.

**79. Swedish investment firms outsource critical functions to other countries to a limited extent.** Cross-border outsourcing in relation to investment services takes mostly place within the Nordic banking groups. Specific information is not available on the extent to which foreign supervised entities have outsourced activities to Swedish supervised entities.

**80. MiFID includes requirements on the holding and segregation of clients' assets, including when outsourcing is used.** An investment services provider is required to keep necessary records and accounts to be able to immediately distinguish the assets it holds for one client from the assets it holds for another client and from its own assets. Only a bank providing investment services can use client funds for its own account.<sup>38</sup> An investment services provider may deposit clients' financial instruments with a third party, provided that it appoints and regularly evaluates the third party and its holding and safekeeping procedures. In particular, it must assess the third party's expertise and market reputation and the legal requirements and market practices for holding financial instruments that could adversely affect clients' holdings.

**81. Cross-border outsourcing of safekeeping is subject to specific requirements under MiFID.** Where safekeeping of financial instruments is subject to special regulation and supervision in a country where the investment firm intends to use a third party to hold clients' financial instruments, the firm must ensure that the third party is subject to regulation and supervision. An investment firm may outsource safekeeping of clients' financial instruments to a service provider in a non-EEA country that does not regulate safekeeping of financial instruments only in limited circumstances. For retail clients this is possible only if the type of financial instrument or the associated investment service requires that the financial instrument is held in the non-EEA country. A professional client can also request in writing that the firm outsources the safekeeping of its financial instruments to a non-EEA service provider.

**82. FI's Consumer Protection area's risk evaluation process for 2016 identified segregation and custody of client assets as posing a potential risk to investors.** Therefore, FI conducted an inspection on how investment firms work to ensure that they comply with the relevant Swedish legislation and regulations. The thematic off-site inspection consisted of questions on clients' deposits, clients' financial instruments, and firms' internal controls. The inspection was finalized in June 2016 and concluded that investment firms generally comply with applicable rules and regulations. A few areas of improvement were noted and conveyed to the relevant firms. In its communication with the firms, FI also emphasized the importance of this topic and urged firms to dedicate more time and resources to it.

**83. The EU and Swedish regulatory framework on outsourcing and segregation complies with the IOSCO requirements.** Given the fact that lack of compliance with the segregation

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<sup>38</sup> The Swedish legislation also allows investment firms to apply for authorization to receive funds on account from clients in order to facilitate securities transactions. In such cases, investment firms are exempted from the requirement to segregate funds from the firm's own assets, but they are subject to the same initial capital requirement as banks.

requirements imposes significant risks to investment services providers' clients, FI has appropriately focused on this area in its supervisory activities.

## C. Supervision

### Organization and Resources

**84. FI's Consumer Protection area is responsible for the supervision of investment firms and banks' provision of investment services.** It is also in charge of the prudential supervision of investment firms, supported on an ad hoc basis by the Bank area's Capital Requirements Directive/Regulation (CRD/CRR) experts. The division primarily involved in the supervision of investment firms and banks' provision of investment services is Investment Firms Supervision (8 staff members). Securities Business Law Division (12 staff members) deals with applications for authorization and notifications on the provision of services from/to Sweden. Applications and notifications relating to banks' provision of investment services are dealt with in cooperation with the Bank area.

### Supervisory Approach

**85. IOSCO Principles<sup>39</sup> require that a regulator has a supervision program.** The program should include internal processes, skilled and knowledgeable staff and other resources to monitor compliance with relevant regulatory requirements. A regulator is required to have an effective inspection system where inspections are carried out either on a periodic basis or based on a risk assessment.

**86. FI's general supervision strategy described in the fund management section applies also for the providers of investment services.** The risk classification system for investment firms uses the nature of the clients (professional/non-professional) as a key criterion, together with the types of investment services provided. The emphasis is on the services that have the most significant impact on customer protection in case of problems with the firm. Banks that provide investment services are not included in Consumer Protection's risk classification process, but their investment services are taken into account when risk areas are identified and supervisory activities are planned.

**87. The same types of supervisory activities are conducted on investment firms and banks providing investment services as on fund managers.** The principle of comprehensive supervision also applies. Examples of FI's supervisory activities in 2013–2015 include:

- A thematic survey on the manner in which investment firms and banks conduct market surveillance, which was also subject to a follow-up survey.

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<sup>39</sup> Principle 12, Key Issue 1(d) and Key Question 1, Principle 31, Key Issue 8(i) and Key Question 19.

- A thematic survey followed by on-site visits to several investment firms to assess how the firms complied with ESMA's Guidelines on Systems and Controls in an Automated Trading Environment for Trading Platforms, Investment Firms and Competent Authorities.
- A thematic on-site inspection at several investment firms on the distribution of complex products.
- Several for cause inspections in individual investment firms covering various topics, such as internal controls, compliance, use of tied agents, and distribution of structured products. Six of these inspections led to sanctions (remark, warning and/or fine as well as the revocation of one investment firm's authorization). The three fines imposed ranged from SEK 150,000 to SEK 10 million and totaled SEK 17.65 million.

**88. FI should consider incorporating banks' investment services more explicitly into the Consumer Protection area's risk classification of firms.** While banks are already covered in many inspections, explicitly considering the nature and degree of their activities at the planning stage may further help target supervisory activities. This is also likely to provide a better overview on the importance of banks' investment services and thereby allow FI to make better decisions on how to use its resources.

**89. A number of inspections on domestic activities have been conducted and there does not seem to be an immediate need to enhance cross-border supervisory cooperation.** Given the limited degree of investment firms' cross-border activities, the need for such cooperation would primarily relate to the Nordic banking groups' provision of investment services. The channels for enhancing such cooperation already exist through the supervisory colleges and can be used more extensively, if needed. The need for more cooperation is likely to arise in connection with Nordea Bank's planned conversion of its Finnish subsidiary into a branch.

## Reporting

**90. IOSCO Principles<sup>40</sup> require market intermediaries to provide periodic reports to their regulators and to inform their regulators on material changes.** In particular, sufficiently frequent, timely and detailed reporting on the firm's compliance with capital requirements, combined with one-off reporting when the relevant threshold levels are approached is required. The regulator is expected to regularly review the firm's capital levels, including through periodic and for cause inspections, and take appropriate action when the reviews reveal material deficiencies.

**91. Swedish investment firms are subject to standard periodic and ad hoc reporting requirements.**<sup>41</sup> Periodic reporting covers quarterly and annual financial information, including capital adequacy, that applies at both individual firm and group level. Reports are reviewed by the

<sup>40</sup> Principle 29, Key Issue 5 and Key Question 5, Principle 30, Key Issues 2 and 4 and Key Questions 6 and 8.

<sup>41</sup> Periodic and ad hoc reporting requirements also apply to banks that provide investment services, but they are not specifically related to the provision of investment services.

Consumer Protection area, and the Bank area provides ad hoc support when deep expertise in capital requirements is needed. FI's analysis focuses on capital requirements and large exposures, where compliance is reviewed mainly through the analytical tool Statistical Analysis System (SAS). SAS incorporates trigger levels, the breaching of which leads to an alert. An alert is also created if an investment firm gets close to breaching the own funds requirements. Firms that have breached the requirements or are close to breaching them are contacted to analyze the situation and take appropriate action. Ad hoc reporting is required for material events that can affect the firm's authorization and material changes in the firm's organization.

**92. No investment firm has been assessed to be systemically important.** FI applies the guideline issued by the European Banking Authority on the criteria to be used to determine if an institution is systemically important under Article 131(3) of CRD. No Swedish investment firm has been assessed to pose any systemic risk.

**93. While investment firms are unlikely to pose systemic risk, the way FI has allocated the responsibility for reviewing and analyzing investment firms' financial information and capital adequacy may not be optimal.** The EU capital adequacy framework has become progressively more complex, and maintaining deep expertise at both the Bank and Consumer Protection areas is a challenge. FI is encouraged to consider whether it would be more efficient to allocate the responsibility for the review and analysis of investment firms' reporting to the relevant experts in the Bank area, with Consumer Protection area's investment firm experts providing the needed support. This may more effectively ensure prompt verification of the correctness of reporting and identification of any risks in the investment firms than the current arrangement.

## MARKET OPERATORS' CROSS-BORDER ACTIVITIES

### A. Market Structure

**94. Nasdaq Stockholm is the dominant trading venue in Sweden.** It operates one RM and one MTF, First North Sweden.<sup>42</sup> Nasdaq Stockholm's market share in RM and MTF on-platform trading of Swedish shares during January 1, 2015–July 31, 2016 was 62 percent (see the section on market surveillance for details on OTC trading). The rest of the RM and MTF on-platform trading in Swedish shares takes place primarily on U.K. RMs and MTFs, with the three small Swedish trading venues having in total a less than 0.5 percent market share.<sup>43</sup> As a result, this section focuses on the regulation and supervision of Nasdaq Stockholm.

**95. Nasdaq Stockholm is part of the Nasdaq Group operating primarily in the United States and Nordic and Baltic countries.** Nasdaq Nordic Ltd, the holding company that owns

<sup>42</sup> In addition, there is another market operator, Nordic Growth Market NGM, that operates both an RM and MTF and one investment firm, ATS Finans, that operates an MTF (Aktietorget).

<sup>43</sup> Source: Fidessa Fragulator. On-platform trading here includes trading that Fidessa reports under the categories lit, auction, and dark.



(directly or indirectly) the Nordic and Baltic exchanges, central securities depositaries and clearing houses, is established in Finland and is a supervised entity under the Finnish legislation.

## B. Regulation

**96. MiFID includes basic requirements for the operation of RMs and MTFs, but most of the regulatory framework applicable to RM operators is based on member states' domestic legislation.** The general requirements are not discussed here, but the focus is on the elements of the regulatory framework that are most relevant for a market operator that is part of a cross-border group.

### Outsourcing

**97. IOSCO Principles<sup>44</sup> have requirements on outsourcing by market operators.** They include the continued responsibility of the market operator for all outsourced functions and the ability of the regulator, the market operator and the auditors of the market operator to have access to the service providers' books and records relating to the outsourced activities and to obtain promptly other relevant information.

**98. The EU regulatory framework does not include requirements for outsourcing by RM operators,<sup>45</sup> but outsourcing is addressed in FI's General Guidelines.** They require supervised entities to notify FI in advance if they intend to outsource a significant part of their licensed operations or certain other important activities. While outsourcing is permitted both within the same group or to an external service provider, the board of directors and managing director of the delegator remain responsible for the outsourced activities. The requirements are the same whether outsourcing takes place within Sweden or on a cross-border basis.

**99. FI reviews the outsourcing arrangements upon notification and on an ongoing basis in line with its risk-based supervisory approach.** The assessment of the arrangements includes reviewing and assessing: (i) documentation such as outsourcing agreements, service descriptions and Service Level Agreements (SLAs); (ii) the manner in which the supervised entity monitors the SLAs; (iii) business continuity plans of both the supervised entity and the service provider; (iv) training and monitoring procedures; and (v) governance arrangements for outsourcing. FI has applied this approach to reviewing the outsourcing arrangements of Nasdaq Stockholm where some regulated and unregulated firms within the Nasdaq Group run some operational functions on behalf of Nasdaq Stockholm. Where outsourcing also impacts the other Nasdaq Nordic exchanges, FI assesses the outsourcing arrangements in cooperation with the other Nordic FSAs. In recent years, the Nordic FSAs have paid significant attention to getting additional information on the Nasdaq

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<sup>44</sup> Principle 33, Key Issue 3 and Key Question 3(c).

<sup>45</sup> However, when operating an MTF, market operators are subject to the same requirements as investment firms with regards to outsourcing.

Nordic exchanges' outsourcing arrangements and assessing their impact on the exchanges' continued compliance with the regulatory requirements.

**100. The regulatory requirements on outsourcing by market operators in Sweden are comprehensive and FI supervises Nasdaq Nordic's compliance with them jointly with the other Nordic FSAs.** The requirements cover cross-border outsourcing, which is important in the case of Nasdaq Nordic exchanges. Nevertheless, the complexity of Nasdaq Group's legal structure and the specific risks in outsourcing important functions on a cross-border basis, particularly to unregulated entities, make the assessments quite challenging. As a result, FI should continue to closely monitor developments in this area and assess their impact on the efficiency and integrity of the Swedish market, as appropriate.

## C. Supervision

### Organization and Resources

**101. FI's Markets area is responsible for the supervision of Nasdaq Stockholm.** Markets' objective is to secure efficient securities markets that have a high degree of confidence, sound price formation, and high level of transparency. In addition to the institutional responsibility for Nasdaq Stockholm and other operators of trading and post-trading infrastructures, the area is responsible for market monitoring, prospectus approval, and anti-money laundering. The total number of staff is currently 60. The turnover in the Markets staff is particularly high: 28 percent. Staff has on average only slightly over 2 years of experience at FI.

**102. Most of the supervision of Nasdaq Stockholm is conducted as part of the overall supervision of Nasdaq Nordic exchanges.** This is undertaken jointly with the other Nordic FSAs by a dedicated team composed of the representatives of each Nordic FSA. A few staff members from FI's Infrastructure Supervision and Market Monitoring Divisions participate in Nasdaq Nordic supervision, supported on legal issues by the Equity Markets Law Division.

### Supervisory Approach

**103. IOSCO Principles<sup>46</sup> require that a regulator has a program that includes oversight mechanisms to verify an exchange's compliance with its statutory or administrative responsibilities.** A regulator is required to have an effective inspection system where it carries out inspections of the exchange either on a periodic basis or based on a risk assessment.

**104. The Nordic FSAs prepare a joint risk assessment and supervision plan on the Nasdaq Nordic exchanges.** The annual risk assessment identifies risks and ranks them based on the impact and probability of each risk, which forms the basis for the annual joint supervision plan. Joint inspections/supervisory reviews during the last three years have covered several important topics in a comprehensive manner: direct market access (DMA) and sponsored access, outsourcing, cyber

<sup>46</sup> Principle 12, Key Issue 1(d) and Key Question 1 and Principle 34, Key Issue 1 and Key Question 1(b).

security, and access to market data (ongoing). The Nordic FSAs' supervisory team also meets on a quarterly basis. Generally, one half of each meeting is internal to the FSAs and the other half is devoted to a meeting with Nasdaq Nordic.

**105. Ongoing supervision also largely happens jointly.** The Nordic FSAs exchange information on a frequent basis and endeavor to form common opinions and make joint decisions. Among other issues, joint ongoing supervision has addressed various market microstructure initiatives (e.g., routing strategies, order types, auction arrangements, anonymity, market making/liquidity provision arrangements, and establishment of a dark pool). The Nordic FSAs have requested follow-up reporting in connection with related changes to the market functionalities to monitor how the volumes develop and which investment firms are involved in the activity. In addition, Nasdaq Nordic informs all FSAs about trading system incidents, including by providing an explanatory report after each incident has closed. A summary of all incidents during the quarter is submitted to each Nordic FSAs' quarterly meeting. The incident reports are discussed in the FSAs' meetings to identify serious problems and possible patterns underlying the incidents. Also, major IT projects have been reviewed to ensure that the exchanges and their members are prepared for the launch.

**106. Regular meetings and provision of information also take place at the local level.** FI's quarterly meetings with Nasdaq Stockholm have a fixed agenda covering, among other topics, updates on market surveillance matters (including ongoing member and issuer surveillance cases); general information on Nasdaq Stockholm's strategy, financial situation, governance and control functions; and information on market functioning, including on any incidents. Ongoing supervision has addressed, among other issues, the split of Nasdaq Stockholm into two legal entities, one operating the exchange and the other operating the CCP.

**107. The Nordic FSAs have a robust joint supervision program for Nasdaq Nordic exchanges, complemented with local activities in relevant areas.** Risk assessments are well-considered and address important topics in exchange supervision. The supervision program covers key elements of the regulatory framework for market operators both through ongoing supervision and inspections and supervisory reviews. While resource availability occasionally leads to delays in completing some supervisory activities, the joint supervision team has largely been able to promptly address acute supervisory issues.

## Review of Rules

**108. IOSCO Principles<sup>47</sup> require a regulator to have a role in reviewing exchange rules.** The Principles require a regulator to be informed of the securities to be traded and to review or approve the listing/admission to trading rules. The regulatory framework is also expected to provide for fair access to the exchange through the fairness and objectivity of admission criteria and procedures. Amendments to the rules should be provided to, or approved by, the regulator.

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<sup>47</sup> Principle 33, Key Issue 4 and Key Question 4 and Principle 34, Key Issue 2 and Key Question 2.

**109. FI reviews that Nasdaq Stockholm’s rules and procedures are compliant with the Securities Market Act (SMA).** This is not based on any direct obligation under the current legislation, but rather follows from the general requirements of the SMA on listing/admission to trading, issuer disclosure requirements, trading, and membership/access. FI also expects Nasdaq Stockholm to inform and seek the FI’s view about any changes to the exchange’s rules and procedures before they are adopted.

**110. Where relevant, the Nordic FSAs aim at coordinating their views on the market model changes that underlie Nasdaq Nordic exchanges’ rule changes.** The need for coordination depends on the type of changes and can be initiated by Nasdaq Nordic exchanges or by any of the Nordic FSAs. The strongest need for coordination relates to the trading related changes. Nasdaq Nordic Member Rules (NMR) apply to all Nasdaq Nordic exchanges, so any changes to the membership requirements and related processes are also generally subject to coordination. Since the regulatory framework and listing processes for issuers differ between the Nordic countries, the need to coordinate the views on the listing/admission to trading and issuer disclosure requirements has been limited.

**111. The Nordic FSAs’ cooperation and FI’s own role ensure that any significant issues in Nasdaq Nordic’s rules can be appropriately addressed.** This approach complies with the requirements of IOSCO Principles.

## CROSS-BORDER MARKET SURVEILLANCE

### A. Market Structure

**112. Trading in Swedish issuers’ shares is very fragmented.** During January 1, 2015 to July 31, 2016 the trading was distributed as presented in Table 3.

**113. Equity derivatives trading of Nasdaq Nordic is concentrated on Nasdaq Stockholm.** The large majority of these trades (approximately 97 percent) takes place in derivatives whose underlying instruments are shares that have been issued by a Swedish company.

**Table 3. Market Share in Trading of Swedish Issuers' Shares  
January 1, 2015-July 31, 2016**

Trading Venue	Market Share, Percent
Nasdaq Stockholm	46.04
BATS (U.K.)	31.18
Turquoise (U.K.)	5.82
UBS MTF (U.K.)	1.20
Posit (Ireland)	1.02
Acquis (U.K.)	0.51
Instinet Blockmatch (U.K.)	0.36
Liquidnet (U.K.)	0.22
Aktietorget	0.18
Equiduct (Germany)	0.04
Sigma-X (U.K.)	0.03
NGM	0.03
Smartpool (U.K.)	0.01
Burgundy	0.01
OTC <sup>1</sup>	13.33
Total	100.00

Source: Fidessa Fragulator.  
<sup>1</sup>In addition to OTC trades reported to trade data reporting systems, the market share of OTC trading here includes off-book and SI trades Fidessa reports under those RMs and MTFs that do not conduct any order book or auction trading in Swedish issuers' shares. Off-book and SI trades that Fidessa reports under the RMs and MTFs that also conduct order book trading have been included in their market share.

## B. Nasdaq Nordic Exchanges' Market Surveillance

**114. IOSCO Principles<sup>48</sup> require market operators to have reliable arrangements for the monitoring, surveillance, and supervision of the trading system and its members.** Market operators are expected to have mechanisms to identify and address disorderly trading conditions, including any contravening conduct. IOSCO Principles also require market operators to consider whether key market surveillance functions can be outsourced and limits outsourcing to situations where it does not impair the market operator's ability to exercise its statutory responsibilities for the proper supervision of the market.

**115. MiFID and the Swedish SMA require RM and MTF operators to conduct market surveillance.** MiFID imposes obligations on RMs to establish and maintain effective arrangements and procedures to monitor that members comply with the RM's rules. The RM operators have to report significant rule breaches, disorderly trading conditions or potential market abuse to the RM's competent authority. SMA includes specific requirements according to which an exchange must have an independent surveillance function to fulfill the monitoring obligations related to members,

<sup>48</sup> Principle 33, Key Issues 2 and 3 and Key Questions 3(a) and (b).

issuers, and trading. It is also required to have a disciplinary committee that is responsible for making decisions on breaches of the exchange rules. More specifically, SMA requires that an exchange monitors that:

- Financial instruments fulfill the listing and admission to trading requirements.
- Issuers fulfill their disclosure obligations.
- Trading and price formation occurs in compliance with legal requirements and good market practice.
- Trading participants comply with the membership/access requirements.

**116. In practice, the Nasdaq Nordic exchanges coordinate their market surveillance responsibilities to a significant extent.** This includes outsourcing of certain activities. This is justified on the basis of the fact that they share the same trading engine, the same market surveillance system, and the same market functionalities and trading rules.

### Issuer Surveillance

**117. Nasdaq Stockholm's issuer surveillance obligations are wide.** Nasdaq Stockholm's issuer surveillance verifies that a prospective issuer complies with the exchange's listing requirements and monitors the issuer's compliance with those requirements on an ongoing basis. It also monitors Swedish issuers' compliance with the disclosure requirements set out in the SMA and in Nasdaq Stockholm's own rules. Foreign issuers are required to comply with their home country disclosure requirements in addition to Nasdaq Stockholm's rules. If issuer surveillance detects any breaches, it must report them to FI.

**118. Nasdaq Stockholm's responsibilities for issuer surveillance are broader than in many other countries.** This is because the Swedish legislation also assigns to Nasdaq Stockholm the responsibility to monitor compliance with the takeover rules and perform surveillance of companies' compliance with the International Financial Reporting Standards (IFRS). The appropriateness of the current arrangement for IFRS supervision was addressed in the final report of the government inquiry on changed disclosure requirements on securities markets (SOU 2015:19), which proposed that the responsibility for IFRS supervision should be given to FI. The related legislative changes were initially supposed to enter into force on January 1, 2016, but submitting the legislative proposal has been delayed due to other priorities. As a result, the issue remains open.

### Member Supervision

**119. Access to RMs and MTFs is subject to criteria derived from MiFID.** RMs and MTFs must ensure that access to their facilities is subject to criteria designed to protect the orderly functioning of the market and the interests of investors. In addition to investment firms and banks, MiFID permits RMs and MTFs to admit as members or participants other persons that are fit and proper, have a sufficient level of trading ability and competence, have (where applicable) adequate

organizational arrangements, and have sufficient resources for the role they are to perform. Nasdaq Stockholm admits such unregulated members the number of which is currently 16. All except two are remote members.

**120. MiFID II significantly limits RMs' ability to admit members other than authorized investment firms and banks.** In particular, high-frequency algorithmic trading firms will require authorization as investment firms. Direct electronic access to a regulated market can be provided only by members that are investment firms or banks. These changes are aimed at controlling the risks arising from the increased use of high-speed trading technology and will require Nasdaq Nordic exchanges to change their membership criteria.

**121. The MiFID equal access requirements have been implemented in the Nasdaq Nordic exchanges' rules.** NMR contain harmonized membership requirements for all RMs operated by Nasdaq Nordic exchanges. When a firm applies to become a member, it chooses the exchanges for which it is applying for membership. While an application is reviewed in a centralized manner under the coordination of Nasdaq Nordic Member Services, each exchange makes its own formal decision to approve the application for membership.

**122. Nasdaq Nordic exchanges conduct reviews of the members' compliance with the NMR.** The reviews include periodic monitoring of compliance with the NMR membership criteria and ad hoc reviews on compliance with specific requirements. Recently the latter reviews have focused on the requirements for DMA and sponsored access. All unregulated members are subject to a review once a year, while a random set of regulated members is reviewed every year in such a manner that each member is reviewed at least every five years.

### Trading Surveillance

**123. Some activities of Nasdaq Nordic exchanges' trading surveillance are centralized.** Nasdaq Stockholm's trading surveillance is responsible for real-time market surveillance on all Nasdaq Nordic exchanges,<sup>49</sup> with the exception of surveillance of commodity derivatives trading that is undertaken in Norway. When Nasdaq Stockholm trading surveillance detects suspicious trading, it first scrutinizes it. Suspicious cases are forwarded to the surveillance unit of the relevant exchange, which is responsible for investigating the cases arising from trading on its exchange. Each exchange is also responsible for reporting any suspected misconduct to its competent authority. Nasdaq Stockholm also has to report suspected market abuse to FI. In 2015, Nasdaq Stockholm referred 40 suspected insider trading cases and 30 suspected market manipulation cases to FI.

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<sup>49</sup> In addition, each local exchange performs real-time market surveillance for all the Nordic markets on an ad hoc or rotating basis, thus maintaining the knowhow and business continuity.

## Dealing with Disorderly Trading Conditions

**124. Nasdaq Nordic exchanges are subject to the MiFID requirement for RMs and MTFs to ensure fair and orderly trading and efficient execution of orders.** To achieve this, RMs and MTFs must have soundly managed technical systems, including effective contingency arrangements to cope with systems disruptions. They must comply immediately with any instruction from the competent authority to suspend or remove a financial instrument from trading and be able to do it themselves if a financial instrument no longer complies with their rules.

**125. Nasdaq Nordic exchanges' responsibility to uphold fair trading is covered in the NMR section on extraordinary measures.** This gives the exchanges the right to use certain measures, when they consider that certain circumstances (e.g., market disturbances, communication interruptions or technical disruptions) are influencing their ability to maintain well-functioning trading operations. Such measures include suspending and limiting trading operations, limiting the number of electronic connections per member, limiting the number or volume of trades or orders through one, several or all electronic connections, or closing one or more electronic connections. The measures may be taken with respect to all trading, a particular market, market segment, instrument, DMA, sponsored access, algorithmic trading or a particular member. The primary exchange may also halt trading in an individual instrument due to the general public's insufficient or unequal access to information on the issuer or other issuer related reasons. Volatility guards may also lead to automatic halting of trading followed by an auction period before continuous trading is resumed.

**126. Nasdaq Stockholm's authority to suspend trading is set out in the SMA.** A trading suspension may be imposed, among other cases, when there is a clear risk that trading will no longer be carried out on equal terms or will not be based upon sufficient information. Nasdaq Stockholm must immediately inform FI when trading has been suspended and provide the reason for the action taken. Nasdaq Stockholm is also obliged to disclose the suspension.

**127. Information on trading suspensions is shared between the Nasdaq Nordic exchanges and competent authorities.** NMR requires that the primary exchange suspending trading notifies the other Nasdaq Nordic exchanges where the instrument is admitted to trading about the suspension. MiFID also requires it to inform FI, which is obliged to inform other EEA countries' relevant competent authorities. ESMA and EEA national competent authorities share information on all suspensions through a system operated by ESMA.<sup>50</sup> Except where it could cause significant damage to the investors' interests or the orderly functioning of the market, the competent authorities receiving a notification about a suspension decision made by another competent authority must also suspend trading of that financial instrument in the trading venues located in their jurisdiction.

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<sup>50</sup> Suspension and Restoration Information System, SARIS.



## Disciplinary Activities

**128. Nasdaq Nordic exchanges have their own disciplinary rules and procedures, and the disciplinary processes work independently of each other.** If Nasdaq Stockholm Surveillance suspects that a member or listed company is breaching NMR or other Nasdaq Stockholm's rules, it reports the matter to the disciplinary committee which decides on any sanctions. Potential sanctions towards members include reprimands, fines or temporary or permanent expulsion, while brokers may be warned or have their license withdrawn temporarily or permanently. Potential sanctions towards issuers and their parent companies include reprimands, fines or delisting. The disciplinary committee is required to get a statement from FI before taking disciplinary actions against an issuer or market participant under FI's direct supervision. The same requirement does not apply to non-Swedish issuers and members, but Nasdaq Stockholm may nevertheless choose to consult any foreign authority responsible for their supervision. For minor breaches, Nasdaq Stockholm may handle the matter itself and can issue a non-public reprimand.

## Conclusions and Recommendations

**129. Nasdaq Stockholm has an important market surveillance role.** This covers issuer surveillance, member supervision, trading surveillance, and related disciplinary activities. Several changes are underway that are likely to have an impact on this role. IFRS supervision may be transferred out of Nasdaq Stockholm; the inability to have unregulated members after the transposition of MiFID II reduces its responsibility for member supervision; and the increasing fragmentation of trading will force FI to adopt a larger role in trading surveillance. In light of the ongoing and future changes in market structure and competition, it is important that the MoF and FI continue to assess what the appropriate market surveillance role for Nasdaq Stockholm will be going forward. A prompt decision on the allocation of the responsibility for IFRS supervision is important to reduce the risk of weakening the quality of supervision.

## C. FI's Market Surveillance

**130. IOSCO Principles and Standards<sup>51</sup> emphasize the importance of market surveillance.** The regulator must ensure that there are arrangements for the continuous monitoring of trading that trigger inquiry whenever unusual and potentially improper trading occurs. There must be an automated system that identifies unusual transactions on authorized exchanges and regulated trading systems. There should be sufficient arrangements to monitor and/or address cross-market trading. Sufficient cooperation and information sharing arrangements with relevant foreign regulators must be in place, if there are foreign linkages, substantial foreign participation or cross-listings. Market authorities should regularly review and update their surveillance capabilities, including systems, tools and surveillance staff skills, particularly with respect to technological

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<sup>51</sup> Principle 36, Key Issues 2-4 and Key Questions 3-5 and Principle 12, Key Question 2 and Technological Challenges to Effective Market Surveillance: Issues and Regulatory Tools.

changes. They should also work collectively and take any appropriate steps to strengthen their cross-border surveillance capabilities.

**131. MiFID sets transaction reporting obligations on investment firms and banks providing investment services.** Firms that execute transactions in financial instruments admitted to trading on an RM must report the details of those transactions to their competent authority at the latest by the close of the following working day. The competent authority receiving the transaction report must submit it to ESMA so that it can be forwarded to the competent authority of the most relevant market in terms of liquidity. The most relevant market in terms of liquidity is defined in the MiFID Implementing Regulation. In case of shares and equity derivatives, this would typically lead to the competent authority of the country where the (underlying) share was first admitted to trading receiving all transaction reports. For example, FI would receive all transaction reports for trading in Swedish listed companies' shares and related equity derivatives, wherever in the EEA this trading takes place.

**132. The most significant obstacle to the effective use of transaction reporting data is the lack of a sufficient analysis system.** FI's current tools are relatively rudimentary. In its letter to the MoF in May 2016, FI informed the MoF of an additional budget need to acquire a new system. The basic functionalities required of such a system are the ability to recreate trading patterns, visualize the relationship between trading and price sensitive information, as well as compile reports as a basis for further investigations.

**133. Trading in Swedish issuers' shares is very fragmented and it is necessary to complement the market surveillance conducted by Nasdaq Nordic with FI's own surveillance.** The current EU transaction reporting requirements and exchange of transaction reports between competent authorities (together with the MiFID II enhancements to this reporting) provide a good basis for identifying cross-market and cross-border abuses. Having an automated system is required by the IOSCO Principles. It is therefore recommended that sufficient budget will be allocated to FI to enable it to acquire a suitable automated market surveillance and analysis system.

## Appendix I. AIFMD and Swedish AIFMA Requirements for Cross-Border Marketing of Alternative Investment Funds

Fund			Manager	
Investor type	Fund type	Domicile	Authorized EEA AIFM	Non-EEA AIFM
Professional	All AIFs	EEA	Notification to home state authority (AIFMD Art. 31 or 32 and AIFMA 4:6 or 5:3)	FI approval under Swedish NPPR (AIFMD Art. 42 and AIFMA 5:10) subject to compliance with: <ul style="list-style-type: none"> <li>• The AIFMD Art. 22-24 and, where relevant, Art. 26-30 disclosure, reporting, portfolio company disclosure and asset stripping requirements.</li> <li>• Cooperation arrangements in place for systemic risk oversight between the relevant supervisory authorities.</li> <li>• Anti-money laundering measures and rules to prevent financing of terrorism in place in the home country of the AIF and AIFM.</li> <li>• An agreement in place complying with the OECD Model Tax Convention on Income and on Capital and ensuring an effective exchange of information in tax matters.</li> </ul>
		Non-EEA	FI approval under Swedish NPPR (AIFMD Art. 36 and AIFMA 4:8 or 5:5) subject to compliance with: <ul style="list-style-type: none"> <li>• Full AIFMD except the depositary requirements (“depositary light”).<sup>1</sup></li> <li>• Cooperation arrangements in place for systemic risk oversight between the relevant supervisory authorities.</li> <li>• Anti-money laundering measures and rules to prevent financing of terrorism in place in the home country of the AIF and AIFM.</li> <li>• An agreement in place complying with the OECD Model Tax Convention on Income and on Capital and ensuring an effective exchange of information in tax matters.</li> </ul>	
Non-professional	Special fund or equivalent <sup>2</sup>	EEA	FI approval (AIFMD Art. 43 and AIFMA 4:1, 4:2 or 5:6) subject to: <ul style="list-style-type: none"> <li>• FI approving a Swedish special fund’s rules (no separate marketing notification is required).</li> <li>• EEA AIF complying with the same requirements as a Swedish special fund and being able to make necessary payments and redemptions in Sweden.</li> </ul>	FI approval (AIFMD Art. 43 and AIFMA 5:11) subject to: <ul style="list-style-type: none"> <li>• The AIF complying with the same requirements as a Swedish special fund.</li> <li>• The non-EEA AIFM complying with the same requirements and conducting similar business as an EEA AIFM and being under supervision in its home country.</li> </ul>

Fund			Manager	
Investor type	Fund type	Domicile	Authorized EEA AIFM	Non-EEA AIFM
		Non-EEA	FI approval (AIFMD Art. 43 and AIFMA 4:3 or 5:6) subject to: <ul style="list-style-type: none"> <li>• Compliance with the same requirements as in the case of non-EEA AIFs marketed to professional investors.</li> <li>• The non-EEA AIF complying with the same requirements as a Swedish special fund and being able to make necessary payments and redemptions in Sweden.</li> </ul>	FI approval (AIFMD Art. 43 and AIFMA 5:11) subject to: <ul style="list-style-type: none"> <li>• Compliance with the same requirements as in the case of AIFs marketed to professional investors.</li> <li>• The non-EEA AIF complying with the same requirements as a Swedish special fund.</li> <li>• The non-EEA AIFM being under supervision in its home country.</li> </ul>
Non-professional	AIF admitted to trading on an RM or an equivalent non-EEA market	EEA	FI approval and providing a KIID for the AIF (AIFMD Art. 42 and AIFMA 4:4 or 5:6).	
		Non-EEA	FI approval (AIFMD Art. 43 and AIFMA 4:4 or 5:6) subject to: <ul style="list-style-type: none"> <li>• Compliance with the same requirements as in the case of non-EEA AIFs marketed to professional investors.</li> <li>• Providing a KIID for the AIF.</li> </ul>	FI approval (AIFMD Art. 43 and AIFMA 5:11) subject to: <ul style="list-style-type: none"> <li>• Compliance with the same requirements as in the case of AIFs marketed to professional investors.</li> <li>• Providing a KIID for the AIF.</li> </ul>
Semi-professional <sup>3</sup>	Closed-ended AIF <sup>4</sup>	EEA	FI approval (AIFMD Art. 43 and AIFMA 4:5 or 5:7).	
		Non-EEA	FI approval subject to compliance with the same requirements as in the case of non-EEA AIFs marketed to professional investors (AIFMD Art. 43 and AIFMA 4:5 or 5:7).	FI approval subject to compliance with the same requirements as in the case of AIFs marketed to professional investors (AIFMD Art. 43 and AIFMA 5:12).
Sources: AIFMD, AIFMA. <sup>1</sup> The depositary only has to carry out cash flow monitoring, safekeeping and certain monitoring tasks. <sup>2</sup> An EEA or non-EEA AIF that is equivalent to a special fund must meet several requirements: (i) its sole objective is to make collective investments in transferable securities or in other liquid financial assets as defined in the UCITS Directive; (ii) it operates on the principle of risk-spreading; (iii) its units are redeemed at the request of unitholders; and (iv) a KIID is provided to investors. <sup>3</sup> Also applies to registered AIFMs. <sup>4</sup> A closed-ended AIF here means an AIF that has no redemption rights exercisable during at least five years from the initial investment and that according to its investment policy generally invests in issuers or unlisted companies to acquire control.				

- AIFMs whose AIFs' AUM exceed EUR 500 million but do not exceed EUR 1 billion report on a half-yearly basis and AIFMs whose AIFs' AUM exceed EUR 1 billion report on a quarterly basis.
- An AIFM subject to the half-yearly reporting obligation still has to submit quarterly reports for each AIF whose AUM exceed EUR 500 million.
- An AIFM has to submit only annual reports for each unleveraged AIF that invests only in unlisted companies and issuers in order to acquire control.

<b>Reporting obligations of authorized Swedish AIFMs and above threshold non-EEA AIFMs</b>			
<b>Type of AIFM</b>	<b>Content of the report for each AIF</b>		
	Main instruments, markets, exposures and concentrations (AIFMD Article 24(1))	Instruments traded, turnover, illiquid assets, risk profile, risk management, asset categories and stress tests (Article 24(2))	Overall level of leverage, leverage breakdown (borrowing and embedded leverage), reuse of assets, five largest borrowing sources on each AIF that employs leverage on a substantial basis (Article 24(4))
Authorized Swedish AIFM managing a Swedish AIF or EEA AIF, whether or not that AIF is marketed in Sweden or EEA	x	x	x
Authorized Swedish AIFM managing a non-EEA AIF that is not marketed in Sweden or EEA	x		x
Authorized Swedish AIFM managing a non-EEA AIF that is marketed in Sweden or EEA	x	x	x
Authorized Swedish AIFM managing a non-EEA AIF that is not marketed in Sweden or EEA that is the master AIF of a feeder AIF which the AIFM also manages and that feeder AIF is: (a) an EEA AIF; or (b) a non-EEA AIF that is marketed in Sweden or EEA	x		x
Above threshold non-EEA AIFM marketing in Sweden (reporting only on the AIF being marketed)	x	x	x

Sources: AIFMD, AIFMA, FI Regulations.