

## EFAMA's REPLY TO ESMA's CALL FOR EVIDENCE ON PERIODIC AUCTIONS FOR EQUITY INSTRUMENTS

### Introduction

EFAMA supports all initiatives that can help achieving fair and liquid markets, as we consider that this is an important element for the protection of end-investors. We are supportive of ESMA's efforts to examine and re-evaluate elements of MiFID II regime where evidence demonstrates gaps or deficiencies.

From our perspective, MiFID II implementation has opened the market for new liquidity providers and new methods of trading beside the "historical ones" and has defined the different avenues to execute transactions.

All types of venues and market participants, including Systematic Internalisers, should be subject to rules that are

- Coordinated but not necessarily identical;
- Foster market access, market competition; and also
- Offer the largest range of product offering to facilitate market liquidity;
- Regardless of the size of the orders.

We believe that a variety of types of execution, e.g. trading venues, periodic auctions and systematic internalisers' organisation should best serve the interest of the industry to maintain flexibility in innovation and different options when trading.

We are therefore of the opinion that a well-calibrated periodic auctions regime can be further developed in a way that could

- Support liquidity in the markets, facilitating regulated funds and asset managers needs to execute orders including large orders;
- Minimize trading costs for the benefit of the (retail) investors;
- Ensure best in class execution
- In an orderly fashion with low market impact and which is not considered a circumvention of the DVP.

**Q1. Do you agree with the two main differences identified to distinguish conventional periodic auctions from frequent batch auctions? If not, please explain why.**

We agree with the description and identified differences.

**Q2. Do you agree with the observation of a rising market share for equity trading on frequent batch auctions?**

Frequent batch auctions remain a very small part of the overall Equity trading market. We have no means to assess or compare figures but according to Figures 2 provided, we would agree with the assumption.

From our members' perspective, the anticipation is that, if the regime of tick size is not sufficiently flexible in its definition, the use of periodic auction would become increasingly important.

In that perspective, we welcome the ESMA report on Tick Size and the recognition that trading at mid-point for LIS transactions has merits for investors.

**Q3. What are in your view the main factors driving this development?**

We believe that the timeframe for data gathering and analysis is insufficient. In addition, the use of periodic auction representing a less significant market share in comparison to total trading volume does not allow sufficient conclusions to be drawn as to whether and, if so, to what extent correlations exist.

We are therefore hesitant in following the assumption provided in para. 17 of this Call for Evidence.

**Q4. Do you agree with the four characteristics identified by ESMA? Please explain.**

We agree with ESMA identified characteristics to do its assessment.

However, there are significant differences across frequent batch auctions systems in how those characteristics are applied, possibly posing supervision issues.

**Q5. Do you consider that other characteristics of frequent batch auctions may explain their success and/or raise questions in terms of compatibility with the MiFID II transparency provisions? Please explain.**

Even if we understand the description provided in the report, we believe that there is not sufficient evidence that periodic auctions would in principle not be compatible with the MiFID II transparency requirements.

As mentioned in our reply to question 3, it may be too early to draw this conclusion.

An interesting perspective offered by Periodic Auctions is their ability to provide European Best Bid and Offer ("EBBO") midpoint executions which implies lower transaction costs for investors and supports best execution.

"Speed bumps" can also help equalise latency effects which investor orders might otherwise be exposed to on exchanges, but would artificially impact market functioning.

However, we want to recognise the fact that periodic auctions should not become a way to contravene to algorithmic trading and high frequency trading obligations.

**Q6. What is your view on the level of pre-trade transparency applied by systems that initiate auctions upon the receipt of a first order? In particular, should pre-trade transparency already be applied as of the start of an auction, irrespective of whether there is a potential match or not? Please explain.**

As raised in our reply to question 4, we consider that there are differences in the way batch auction systems apply pre-trade transparency.

Therefore, we are of the view that frequent batch auctions systems should disclose indicative price and quantity of matched transactions.

We are of the view that applying pre-trade transparency on batch of unmatched transactions would be detrimental to institutional investors as it would cause information leakage and consequently increase transaction costs.

**Q7. What is your view on the level of pre-trade transparency applied by systems that initiate auctions upon the identification of a possible match? In particular, do you consider that systems locking in prices at the beginning and/or allowing the submission of orders pegged to the midpoint meet the pre-trade transparency requirements? Please explain.**

As mentioned on multiple occasions in relation to different legislative initiatives (MiFID II/MiFIR, IFD/IFR), we insist on the need to maintain the existence and the real capability to use waivers to execute large transactions that would not impact markets and that could be executed at best price for end-investors.

As a reminder, Large in Scale (LIS) orders need the capability to use the existing waivers under MiFIR that allow execution at mid-point and have a meaningful role for the efficient execution of large transactions and liquidity matching opportunities also for equities transactions.

Execution at the midpoint of the reference market best bid and offer must then remain accessible, independently of the trading venue or the trading access and should remain a global practice that also ensures fair and competitive transaction costs.

**Q8. Would you see benefit in frequent batch auction systems providing information on market/order imbalance? Please explain.**

We believe that forcing disclosure information on market imbalances in periodic auctions and even more in batch auctions might have aversive effects as it would among other aspects display approved deferral strategies that would otherwise remain protected.

If imbalance data were made available in Europe, we recommend mandating it as part of a consolidated tape and only if it provides with mechanisms to mitigate latency effects, prevents front-running and does not discourage asset managers from trying to trade large trades.

**Q9. Do you consider the auction length of frequent batch auctions as appropriate? In particular, how does the short auction length contribute to fair and orderly trading? Please explain.**

The increase in speed of execution in automated trading (not HFT) has substantially improved. Orders may be placed within fractions of milliseconds, so that even in a short auction length several hundreds of orders could be placed.

On the other hand, batch periodic auction does not require superfast trading technology, so it may mitigate a technological race for speed and thus prevent a competitive edge of HFT.

Therefore, and to remain useful but avoiding market manipulation, the regime defining the time of "opening" of the auction periods should be aligned to the EBBO.

This would facilitate the implementation of a regime of auction that could be reasonably linked to the volatility, i.e. typical movements in the price band of the EBBO, to reflect market conditions without creating risks of manipulation.

We also think that a minimum auction duration time should however additionally apply to enable the potential for improvements in auction bids to occur and increase participation.

**Q10. Would you see benefits in having a longer auction duration? Do you consider that the auction duration should take into account the liquidity and/or type of instruments traded (e.g. a longer auction duration for less liquid instruments)? Please explain.**

A minimum auction duration time could be considered for all frequent batch auctions to enable adequate pre-trade transparency via a consolidated tape.

**Q11. In your experience, how often do frequent batch auctions result in a match, and how many transactions are executed per frequent batch auction on average?**

We do not have sufficient information to comment.

**Q12. Do you consider frequent batch auction systems as non-price forming systems? Please explain. Should a characteristic of any trading system be that it is always price forming in order to operate without a waiver? Please explain.**

According to our information, not all members are using periodic auction in a systematic manner. The ones that are frequently using them consider that frequent batch auction systems are price-forming and contribute to the price discovery process, similar to any other transaction.

**Q13. Do you consider that these functionalities resemble reference price systems (in particular when matching transaction at mid-point)? Please explain.**

As mentioned above, we do not have sufficient data to duly assess the possible impacts.

However and as frequently mentioned, we are of the strong view that execution at mid-point and the protection of the use of waivers are critical elements for providing optimal outcomes for end-investors as well as institutional investors.

**Q14. How do frequent batch auctions ensure multilaterality and interactions of trading interests in the price formation process (e.g. diversity of participating members, average number of participants, distribution of orders involved per transaction)?**

As mentioned above, we do not have sufficient data to duly assess the possible impacts.

As long as frequent batch auction systems enable orders to be placed on the auction order book and execution allocations taking place on a Price-Volume-Time basis, we are of the view that they can therefore be considered as truly multilateral in nature and contributing to fair and orderly trading.

Lastly, we do want to insist on the need to create a framework that facilitates execution at mid-price, the use of EBBO and the fast development of a consolidated tape for equities.

**Q15. Do you consider that the possibility of pegged orders might weaken the price determination logic? If yes, which measures would you recommend?**

We disagree with the notion that prices at or within the EBBO have limited contribution to genuine price formation. More executions or more prices outside of the EBBO are not necessarily synonymous with higher quality of price discovery and formation.

**Q16. How frequently are mechanisms used to prevent an auction uncross at a price outside the EBBO or PBBO (e.g. patterns and occurrences)?**

We do not have sufficient data to duly assess the possible impacts.

**Q17. What are your views on self-matching functionalities, and in particular member preferencing, in the context of frequent batch auction systems taking into account their short auction length? Do self-matching functionalities, and in particular member preferencing, coupled with other features of frequent batch auctions (short duration, locked-in prices) contribute to fair and orderly trading?**

Due to the low levels of broker self-matching we have no particular concerns, although we equally do not think that self-matching is an essential feature for periodic auctions.

Self-matching functionality, including member preferencing, has been available on most Exchanges and Lit and Dark MTFs for many years in European and International markets. Such trades helps

reducing execution fees and drastically reduce clearing/settlement costs for the benefit of EU Investment firms and end investors.

If broker preferencing takes place in the clearing process of an auction, all other things being equal, it would be the most price sensitive and efficient way to execute. So far, such preferencing would not be predictable but coincidentally ensures the best execution downstream.

**Q18. Do you consider that self-matching functionalities, and in particular member preferencing, on frequent batch auction systems may be used to formalise privately negotiated transactions?**

We do not have sufficient data to duly assess the possible impacts.

**Q19. In your opinion, is the feature of member preferencing indispensable for the success observed in frequent batch auction systems since the application of MiFID II?**

From our perspective, the regime to be defined must mandatorily protect the use of waivers for equities as well as the possibility to effectively use the deferral regime.

**Q20. How do you determine on which execution venues to conclude transactions. Please explain.**

As mentioned in our introductory remarks, EFAMA is supporting every initiative that can achieve fair and liquid markets, as we consider that this is the best way to protect end-investors.

Due to the changes in market structures created by MiFID II implementation and the related opportunities for new market participants, asset managers have diversified their ways to source liquidity.

Therefore, we are of the view that all types of venues and market participants, including Systematic Internalisers, should be subject to regimes that:

- are coordinated but not necessarily identical;
- Foster market access, market competition; and also
- offer the largest range of product offering to facilitate market liquidity;
- regardless of the size of the orders.

And

Should serve the best interest of the industry to offer best execution and to maintain flexibility and different options when trading.

We also want to alert ESMA on the fact that some brokers and venues are envisaging "trade delays" that better serve their business model. Should this be the case, we consider that this would be another form of market manipulation that should receive the same level of scrutiny as for periodic auctions.

**Q21. Which execution venues attracted the most trading volume following the suspension of dark trading venues under the DVC and why? Please substantiate your answer by quantitative data where available.**

We do not have sufficient data to duly assess the possible impacts.

Our preliminary view is that the DVC highlights that it is hard to predict the outcomes of direct intervention.

**Q22. Should trading under frequent batch auctions become subject to stricter requirements in the future, to which type of execution venues do you expect the current trading volume under frequent batch auctions to migrate to?**

We do not consider it necessary to tighten existing regulation.

Volumes matched against other clients would likely migrate to other venues which provide block crossing in the absence of a periodic auction. Indeed, we consider it unlikely that block trade would migrate entirely onto exchanges especially as we consider that this would lead to worse transaction costs for investors due to the disappearance of another competitive way to transact.

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Brussels, 11 January 2019

[19-4001]