# REPORT OF THE ADVISORY COMMITTEE OF THE NATIONAL SECURITIES MARKET COMMISSION ON THE DOCUMENT OF ESMA CALL FOR EVIDENCE ON PERIODIC AUCTIONS FOR EQUITY INSTRUMENTS

**The Advisory Committee of the CNMV has been set by the Spanish Securities Market Law as the consultative body of the CNMV. This Committee is composed by market participants (members of secondary markets, issuers, retail investors, intermediaries, the collective investment industry, etc) and its opinions are independent from those of the CNMV.**

The Advisory Committee of the National Securities Market Commission appreciates the opportunity to be able to report the document of ESMA Call for evidence on periodic auctions for equity instruments which we consider relevant for the microstructure of the European stock market.

General comments will be made in relation to the consultation and the specific questions of the document will be answered later.

## I. Introduction

A number of unexpected effects have been taking place since the implementation of the Mifid II-Mifir Directive. For stock markets as a general rule, trading is expected to pass through the order books that have pre-trade and post-trade transparency conditions. This trading is usually called lit trading for its transparency.

As opposed to lit trading we can find dark trading. Dark trading limit is set, through two waivers (Reference Price and Pre-agreed transactions), at 4% of an instrument that can be carried out in a single venue. The limit of dark trading at different venues in Europe is set at 8%. This double limit is called DVC (double Volume Cap).

When a security exceeds this limit, it receives a prohibition from ESMA and these waivers cannot be used in that security for 6 months.

Auctions (we will call them conventional auctions) that are taking place in electronic contracting systems are considered lit trading due to their level of transparency and are the opening (30 minutes), closing (5 minutes) and volatility (5 minutes) auctions. The rules of case are those of the open market, that is, price and moment of introduction.

Since the start of the DVC, a new form of auction, frequent batch auctions, has proliferated, with a duration around 0.1 seconds, different criteria of diffusion, types of orders and execution priority, that seems to have the objective of considering as lit trading what MIFID believes is dark trading and collected in a waiver with limits.

The data collected by ESMA seem clear and aimed at reducing this operation.

## II. Questions of Call for Evidence

**Q.-1 Do you agree with the two main differences identified to distinguish conventional periodic auctions from frequent batch auctions? If not, please explain why.**

We consider that the length of the auctions and the form of activation are two important differences between conventional auctions (opening, closing and volatility) and frequent batch auctions. We also include three major differences: the first would be that conventional auctions take place in the order book where purchase and sale orders are matched depending on the best prices on a continuous basis while frequent batch auctions are performed in an independent book where orders are matched to each other with a different priority than in conventional auctions. The second is that conventional auctions price is formed freely on the basis that it takes into account all the orders of the single book, in frequent batch auctions the price has to be inside the bid/ask spread (including these two prices), limiting the process of price formation. Finally, in third place, in frequent batch auctions there is broker/member preferencing to favor the applications (same broker/member).

**Q.-2 Do you agree with the observation of a rising market share for equity trading on frequent batch auctions?**

According to the data provided by ESMA, it is clear that market share of frequent batch auctions is growing, especially in values subject to the prohibition of taking advantage of the reference price waiver and the negotiated transactions waiver (Double Volume Cap DVC). It is clear that these auctions are being used as a substitute for these waivers when they reach the limits of 4% and 8%.

**Q.-3 What are in your view the main factors driving this development?**

We believe that market share traded in frequent batch auctions is growing because it is a way to avoid the double limit (Double Volume Cap DVC) established in MIFID II to limit the use of dark trading. Broker preferencing allows the case of pre-arranged trades, avoiding the negotiated transactions waiver, and the limitations on the resulting price and the conditions of the orders pegged to the mid-point of the price range allow trading in absence of the reference price waiver.
These frequent batch auctions reduce the importance of speed and latency and protect participants from High Frequency traders (HFT) but expel individual investors who are unable to participate in an auction with a tenth of a second duration.

**Q.-4 Do you agree with the four characteristics identified by ESMA? Please explain.**

Yes. We consider that these four differences (opening of the auctions, degree of dissemination of information, different order types and different modalities of cancellations and amendments) are well identified among the seven trading systems.

**Q.-5 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.**

Conventional auctions have to spread volumes associated with the best bid and offer price (or the break-even price if it exists) throughout their lifetime. Frequent batch auctions only diffuse the break-even price and the indicative volume of the auction. These frequent batch auctions disseminate this information for such a short period of time (a tenth of a second in CBOE) that it is impossible to participate in the price of these auctions. In addition, the requirement that price is within the range of best bid and offer price and the possibility of pegging orders to the mid-point price of bid and offer result in a price that is formed in another market. There is no real price formation in these frequent batch auctions and the tick size regime does not apply to orders attached to the average price of the price range.

**Q.-6 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, irrespectively of whether there is a potential match or not? Please explain.**

The level of pre-trade transparency (orders) applied by the systems that initiate auctions with the mere receipt of a first order is definitely insufficient because the deadline for the auction has started with the arrival of the first order but no information is diffused until an order enters on the opposite side forming price for a possible trading. The objective of pre-trade transparency is that orders interact in the book and that among all the diversity of orders they contribute in the process of price formation, but with such as short duration this is not possible. It's only useful for pre-agreed transactions.

We believe that it is necessary to show the information from the beginning of the auction with the same information as conventional auctions.

**Q.-7 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.**

Systems limiting their prices to the situation of another market (pegged orders) are not contributing to the price formation (they are price-accepters).

**Q.-8 Would you see benefit in frequent batch auction systems providing information on market/order imbalance? Please explain.**

Yes. This information is very interesting to be able to participate in the auction, if time permits.

**Q.-9 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.**

No, the duration is very limited to meet the objectives of multilateral pricing. In fact it seems to be established in this way to avoid this possibility. The length is very short, prices are restricted to the price range of other markets. These characteristics do not contribute to a fair, multilateral and orderly price. And they do not allow others to participate in these auctions.

**Q.-10 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.**

Yes. A longer length could allow interaction with other investors to shape a multilateral, non-bilateral process.
The relationship between length and liquidity of the instruments does not seem very relevant in these cases, the most important aspect is that the information is published and there is enough time to react.

**Q.-11 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?**

**Q.-12 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.**

Absolutely. We believe that these are not price-forming systems. As we have mentioned in previous answers price of these auctions is fixed in another or other markets, the orders pegged to the mid-point of the price range, the possibility of choosing the counterpart member and the short length of the auctions make that price cannot be formed freely. In addition, in some of these frequent batch auction systems if PBBO (Principal (market in terms of liquidity) Best Bid Offer) does not exist, trading does not take place and valid orders for the auction (GFA Good for auction) are cancelled.

Although price derives from another market it does not use the corresponding waiver. We believe this is against the transparency objectives of MIFID II. The price range of frequent batch auctions result in executions, which are very similar to the Reference Price transactions subject to the Double Volume Cap (DVC).

Other features such as trading at last price traded use a reference price waiver, as shown in Example 4 page 12 and Example 6 page 15 of the ESMA document 2011/241h, of 20 June 2016.

**Q.-13 Do you consider that these functionalities resemble reference price systems (in particular when matching transaction at mid-point)? Please explain.**

Yes. Mid-point orders enter the book without price, in any case with a limit and they are matched at mid-point of the price range of other markets.

**Q.-14 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)?**

In fact we believe that they do not form price because multilateral interaction is not possible due to the short length and the shortage of interveners who can participate.

**Q.-15 Do you consider that the possibility of pegged orders might weaken the price determination logic? If yes, which measures would you recommend?**

Yes, with pegged orders (orders whose price varies according to the existing price in real time in another market) price derives from the existing one in other markets, therefore they do not provide price formation. We believe these orders should not be allowed for these auctions. Orders pegged to a price that does not respect the tick size regime should not be allowed.

**Q.-16 How frequently are mechanisms used to prevent an auction uncross at a price outside the EBBO or PBBO (e.g. patterns and occurrences)?**

These mechanisms are being used by venues that offer frequent batch auctions. The resulting price from frequent batch auction has to be always within the EBBO (European price range) or the PBBO (price range of the main market).

**Q.-17 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?**

In MIFID II the pre-agreed transactions are conducted under the negotiated transaction weaver, subject to the DVC (Double Volume Cap). We consider that self-matching and broker preferencing allow negotiation of pre-agreed transactions without using the corresponding waiver, especially if this is combined with the short duration of the auctions.

**Q.-18 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?**

Yes

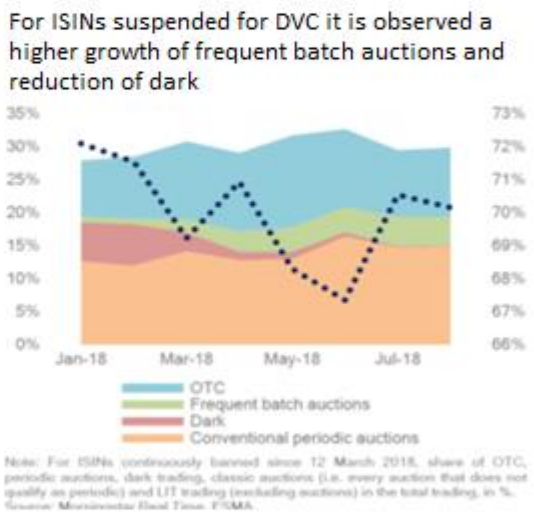
**Q.-19 In your opinion, is the feature of member preferencing indispensable for the success observed in frequent batch auction systems since the application of MiFID II?**

It is not the only aspect to take into consideration. It is the combination of short duration, price limitations and broker preferencing which allows avoiding the DVC and the tick size regime.

**Q.-20 How do you determine on which execution venues to conclude transactions. Please explain.**

**Q.-21 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.**

In line with the data of the ESMA Call for evidence and with the data of Fidessa Fragulator it is clear that frequent batch auctions have attracted the volume that has been banned to perform through the use of dark trading (Price Reference waiver and negotiated transaction waiver) for having reached the limits of DVC. Trading limit throughout these two waivers is set at 4% of an instrument that can be carried out in a single venue. The limit of dark trading at different venues in Europe is set at 8%. When these levels are reached and the prohibition is activated, that volume is replaced by negotiated volume as it is shown in the ESMA chart.




**Q.-22 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 expect these volumes to adjust to the Mifid II objectives and we hope they are carried out with the necessary guarantees of transparency migrating to transparent markets.

## III.-Conclusion

This Consultative Committee advocates for studying and limiting these frequent batch auctions due to the clear indications suggesting that they want to avoid the limits that MIFID II has incorporated into the trading of these characteristics. In particular, the aspects to be reviewed would be: duration of these auctions, pre-trade transparency, types of orders accepted, tick size regime, range of executable prices and preference in the matching.