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| 9 November 2018 |

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| Reply form for the call for evidence - Periodic auctions for equity instruments |
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| Date: 9 November 2018 |

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the Call for evidence on periodic auctions on equity instruments published on the ESMA website.

*Instructions*

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, ESMA will only be able to consider responses which follow the instructions described below:

* use this form and send your responses in Word format (pdf documents will not be considered except for annexes);
* do not remove the tags of type <ESMA\_QUESTION\_CFE\_PA\_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
* if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Responses are most helpful:

* if they respond to the question stated;
* indicate the specific question to which the comment relates;
* contain a clear rationale; and
* describe any alternatives ESMA should consider.

**Naming protocol**

In order to facilitate the handling of stakeholders responses please save your document using the following format:

ESMA\_CFE\_PA\_NAMEOFCOMPANY\_NAMEOFDOCUMENT.

e.g. if the respondent were ESMA, the name of the reply form would be:

ESMA\_CFE\_PA\_ESMA\_REPLYFORM or

ESMA\_CFE\_PA\_ESMA\_ANNEX1

***Deadline***

Responses must reach us by **11 January 2019.**

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input - Consultations’.

***Publication of responses***

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

***Data protection***

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the headings ‘Legal notice’ and ‘Data protection’.

# General information about respondent

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| --- | --- |
| Name of the company / organisation | Swedish Securities Dealers Association |
| Activity | Other Financial service providers |
| Are you representing an association? |[x]
| Country/Region | Sweden |

# Introduction

Please make your introductory comments below, if any:

<ESMA\_COMMENT\_CFE\_PA\_1>

TYPE YOUR TEXT HERE

<ESMA\_COMMENT\_CFE\_PA\_1>

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

<ESMA\_QUESTION\_CFE\_PA\_1>

Yes, but, in practice, the term periodic auction is usually used to describe “frequent batch auctions” whereas closing auctions etc. are called just auctions or opening/closing/intraday auctions.

<ESMA\_QUESTION\_CFE\_PA\_1>

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

<ESMA\_QUESTION\_CFE\_PA\_2>

Since frequent batch auctions is a new phenomenon, it's natural that the proportion has risen from start up until now. The now achieved market share of about 2% is not remarkable in any way. Also, the growth in trading in these venues is likely linked to their good anti-gaming and execution quality features.

<ESMA\_QUESTION\_CFE\_PA\_2>

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

<ESMA\_QUESTION\_CFE\_PA\_3>

The relationship between frequent batch auctions and the desire to avoid the effects of Double Volume Cap is weaker than one might think at first glance. One of the biggest if not the biggest advantage of frequent batch auctions is matching at the mid, often between two ticks, inside or at the EBBO. This feature is most appreciated by the clients and gives confidence for the treatment of their orders as well.
One benefit of frequent batch auctions is the speed bump.
In total the frequent batch auctions minimize the risk that the orders have price impact and *reduces* the risk of High Frequency Trader’s interference.

<ESMA\_QUESTION\_CFE\_PA\_3>

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

<ESMA\_QUESTION\_CFE\_PA\_4>

Hard to say and dependent on the actual market situation.
The mid-price possibility in or at the EBBO with no price impact are the most important features. The “short duration” of the auctions is not short in a trading environment dominated by algorithmic trading techniques.

<ESMA\_QUESTION\_CFE\_PA\_4>

1. 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.

<ESMA\_QUESTION\_CFE\_PA\_5>

The mid-price, the minimum price impact and the speedbump. They have also proved to have good execution performance. This is something that several studies have shown, especially when comparing the price drift (“toxicity”) against traditional lit and dark venues.

<ESMA\_QUESTION\_CFE\_PA\_5>

1. 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.

<ESMA\_QUESTION\_CFE\_PA\_6>

Pre-trade transparency or an obligation to make the volumes of imbalances public would destroy the attractiveness for frequent batch auctions.

<ESMA\_QUESTION\_CFE\_PA\_6>

1. 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.

<ESMA\_QUESTION\_CFE\_PA\_7>

To show the interest to buy or sell or to just show the imbalance results in a price impact and should, in the client's interest, be avoided. Locking prices is an anti-gaming feature that can drive innovation, but it is not a key feature for the frequent batch auctions. Mid pegged orders is a key feature needed to help the clients meet their trading objectives.

<ESMA\_QUESTION\_CFE\_PA\_7>

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

<ESMA\_QUESTION\_CFE\_PA\_8>

To show the interest to buy or sell or to just show the imbalance results in a price impact and should, in the client's interest, be avoided.

<ESMA\_QUESTION\_CFE\_PA\_8>

1. 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.

<ESMA\_QUESTION\_CFE\_PA\_9>

The auction length is not short in a trading environment mainly driven by algorithmic trading techniques. The auction length could possibly be extended, but the locking of order could in that case be problematic due to higher alternative costs.

<ESMA\_QUESTION\_CFE\_PA\_9>

1. 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.

<ESMA\_QUESTION\_CFE\_PA\_10>

No clear benefits with longer auction duration..

<ESMA\_QUESTION\_CFE\_PA\_10>

1. 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?

<ESMA\_QUESTION\_CFE\_PA\_11>

It varies depending on instrument traded etc., but the frequent batch auctions are triggered often enough, and a lot of transactions are done.

<ESMA\_QUESTION\_CFE\_PA\_11>

1. 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.

<ESMA\_QUESTION\_CFE\_PA\_12>

All trading on trading venues is price forming in a positive way. Aggressive orders will meet passive orders, that possibly should not have been posted in a lit market (due to information leakage). This means that, without a batch auction, the aggressive order would have been consuming liquidity in the lit market. This might reduce short term volatility.

<ESMA\_QUESTION\_CFE\_PA\_12>

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

<ESMA\_QUESTION\_CFE\_PA\_13>

The frequent batch auctions differ from price reference waivers, which are indeed dark and which do not contribute to price formation. Frequent batch auctions venues provide additional features such as anti-gaming logic, pre-trading transparency and better execution performance.

<ESMA\_QUESTION\_CFE\_PA\_13>

1. 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)?

<ESMA\_QUESTION\_CFE\_PA\_14>

Our experience is that multilaterality works well.

<ESMA\_QUESTION\_CFE\_PA\_14>

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

<ESMA\_QUESTION\_CFE\_PA\_15>

The Nasdaq frequent batch auction model that we have experience with do only accept matching at or inside the EBBO which we are confident with. The same goes for CBOE periodic auctions. These two venues are the biggest frequent batch auction venues for Nordic venues.

<ESMA\_QUESTION\_CFE\_PA\_15>

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

<ESMA\_QUESTION\_CFE\_PA\_16>

All frequent batch auction markets apply a EBBO/PBBO color outside of which trades cannot occur.

<ESMA\_QUESTION\_CFE\_PA\_16>

1. 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?

<ESMA\_QUESTION\_CFE\_PA\_17>

Given the low internal matching ratio, less than 10 %, and the fact more than 90% of all liquidity in the Nasdaq auction is addressable, it means any member could have interacted with that liquidity. Looking at only the portion of internally matched trades may be misleading. In case of a participant sending in one order in the morning and the second crossing order in the afternoon, even if that is an internal match, any other participant could have interacted with the first order during a long time. This all together proves that self-matching is not frequent or deemed a problem that is risking fair and orderly trading.
Statistics with similar results have been presented by other trading venues. This is by no means a concern. The conclusion is that self-matching functionality is not the main driver behind the growth of frequent batch auction markets.

<ESMA\_QUESTION\_CFE\_PA\_17>

1. 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?

<ESMA\_QUESTION\_CFE\_PA\_18>

Preferencing may increase the likelihood of internal trade, but it does not automatically mean it always leads to an internal trade.
Nasdaq’s frequent batch auctions do provide broker internal priority in matching, but the Nasdaq algorithm first and foremost try to match as much volume as possible at a price, regardless of broker preference. When finding that price, orders from the same member participant are paired first. There is no guarantee that two equal sized orders from the same member will match, since other larger orders from the same member may have preference.
We believe that self-matching functionalities makes sense in respect of best execution. Typically, internal trades comes with a lower execution fee, and such trades do not have to be cleared and settled, minimizing costs for the end investor.
According to the description we obtained from Nasdaq, substantially less than 10% of the trades in the frequent batch auctions can be classified as self-matching. The level is not perceived as a challenge.

<ESMA\_QUESTION\_CFE\_PA\_18>

1. 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?

<ESMA\_QUESTION\_CFE\_PA\_19>

The member preferencing at Nasdaq’s frequent batch auction (and other similar markets) is appreciated, but no explanation to why the model in itself is appreciated by the clients. So, the short answer is “no”

<ESMA\_QUESTION\_CFE\_PA\_19>

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

<ESMA\_QUESTION\_CFE\_PA\_20>

This is determined by the objective of the order, best offer, the urgency, the likelihood of execution, the timing risk and the acceptable market impact.

<ESMA\_QUESTION\_CFE\_PA\_20>

1. 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.

<ESMA\_QUESTION\_CFE\_PA\_21>

The suspension of dark trading increased volumes on SIs (addressable volumes), frequent batch auctions and electronic block markets (Turquoise Plato etc). It is hard to see a development where volumes from dark venues will move to lit markets, because they represent different trading objectives.

<ESMA\_QUESTION\_CFE\_PA\_21>

1. 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?

<ESMA\_QUESTION\_CFE\_PA\_22>

Those trades that takes place, in our case at Nasdaq's frequent batch auctions (and other similar markets), is around 2% of the total turnover. It is a fairly limited part of the turnover. The model is appreciated by the clients. It would be regrettable if this appreciated and well-functioning form of matching would in any way be more stringent or, in worst case, prohibited.

<ESMA\_QUESTION\_CFE\_PA\_22>