Reply form for the Consultation Paper on the Guidelines on the calibration, publication and reporting of trading halts

06 October 2016 | ESMA/2016/1440

Date: 06 October 2016

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the ESMA Discussion Paper on the Guidelines on specific notions under MiFID II related to the management body of market operators and data reporting services providers, 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_MIFID_GTH_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;
- contain a clear rationale, including on any related costs and benefits; and
- describe any alternatives that ESMA should consider.

Naming protocol

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

ESMA_MiFID_GTH_NAMEOFCOMPANY_NAMEOFDOCUMENT.

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

ESMA_MiFID_GTH_ESMA_REPLYFORM or

ESMA_MiFID_GTH_ESMA_ANNEX1

Deadline

Responses must reach us by **06 December 2016.**

All contributions should be submitted online at 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 under the heading 'Legal notice'.

Introduction

Please make your introductory comments below, if any:

< ESMA_COMMENT_MIFID_GTH_0>
FIA-EPTA members welcome the opportunity to provide comments on the ESMA Guidelines on the calibration, publication and reporting of trading halts under MIFID II. FIA-EPTA is comprised of 29 principal trading firms (**PTFs**) that deal on own account in a wide range of financial instruments traded on trading venues across the Union and engage in manual, automated and hybrid methods of trading. FIA-EPTA members are a critical source of liquidity for trading venues, allowing those who use the capital markets to invest or manage their business risks to buy or sell financial instruments quickly and at low cost. FIA-EPTA supports liquid, stable and reliable markets that foster investor confidence and efficiently allocate capital.

With regard to the use of trading halts, FIA EPTA believes that they should be used prudently and according to a transparent logic. Volatility is not by itself a bad thing; it is a factor of supply and demand. Unconstrained upward and downward price movements are essential for price discovery and for assessing parameters for risk management. Thus, trading should only be curbed by trading venues where there is a clear need to do so, i.e., to prevent disorderly trading.

With this in mind, we believe that the factors for calibrating volatility parameters should respect three overarching principles:

- Transparency - trading venues should provide market participants with sufficient information regarding which prices would trigger a volatility auction given the conditions of the orderbook, before placing an order.
- Appropriate calibration of trading halts - it is neither possible nor desirable to mandate how trading venues should estimate volatility and that the onus should be on the trading venue to appropriately reflect the specific volatility profiles of the markets it operates in the design and parameters of the volatility mechanism.
- Process - at no point should cancellation or amendments be forbidden.

We appreciate ESMA's consideration of our responses, which we would be happy to further clarify bilaterally, if desired. Please do not hesitate to contact us through pteeboom@fia.org should you have further questions or require additional input. < ESMA_COMMENT_MIFID_GTH_0>

Q1. Would you consider these factors discussed above to be useful? Could you identify any additional element to be factored in?

<ESMA_QUESTION_MIFID_GTH_1>
We believe the factors proposed by ESMA are generally useful but would caution that the use of trading halts should be fully transparent and predictable. There should be continuous re-calibration of all parameters reflecting any positive or negative impact of MiFIR pre/post-trade transparency requirements on bonds and derivatives, their liquidity profile and volatility, and the number of willing traders or liquidity providers.

We would like to reiterate that all parameters used for halting trading must meet the requirements of Recital 64[1] MiFID II and Article 48(5)[1] MiFID II. Accordingly, trading halts may be used only in cases where there is a sudden unexpected price movement and only in order to avoid significant disruptions to the orderliness of trading. Trading venues must first carry out a transparency assessment of which types of volatility are to be deemed sudden, unexpected and having led to a "significant disruption to the orderliness of trading".

In this regard, FIA EPTA would like to reiterate that the price movement must be sudden *and* unexpected (by market participants). Both conditions must be fulfilled. For example, where the price of a financial instrument falls due to a short selling strategy used or lost suffered by the issuer, this cannot constitute the unexpected price movement because evidently this fall would have been anticipated by some market participants. The fall of the price may even be very significant but still <u>not sudden</u> and <u>not unexpected</u>. Bullish or bearish sentiment (even in an extreme form) should not be considered as the trigger for using trading halts as this would undermine price formation and should be considered as market manipulation.
Regarding any additional factors, FIA EPTA believes that they should at least fulfill the three overarching principles below:

1. Transparency

FIA EPTA considers that trading venues should provide market participants with sufficient information regarding which prices would trigger a volatility auction given the conditions of the book, before placing an order. It is crucial that the model used to determine the price boundaries for volatility auctions is clearly specified, simple and accessible to all participants.

Ideally the input parameters for these models should just be the trades carried out in that instrument during the trading day, as long as the closing price from the day before and the opening price of the exchange has an opening auction.

Particular attention should be given to newly listed instruments for which no closing price exists. In this case, the exchange should publish the reference price in their reference data, so that clients can store it in their models as a "synthetic" closing price.
If exchanges do not wish to disclose the model, they should instead publish the price bands in their market data in real time.

2. Appropriate calibration of trading halts

FIA EPTA considers that it is neither possible nor desirable to mandate how trading venues should estimate volatility or how they should reduce the occurrence of volatility auctions; there are simply too many variables at play that will affect the volatility profile of a trading venue. Different markets will attract different volatility profiles (depending on the venue's market model, the applicable tick size table, traded volumes and products, level of participant concentration, degree to which liquidity providers are present, etc.)
FIA EPTA considers that the onus is on the trading venue operator to appropriately reflect the specific volatility profiles of the markets it operates in the design and parameters of the volatility mechanism. In this regard, and looking at current practice, FIA EPTA considers that additional consideration for venue operators should be to taken into account:

- Expected (e.g. company figures, corporate actions or key macroeconomic figures) or unexpected relevant news would require wider parameters, because of a typical increase in volatility which is normal;

- Correlation with the volatility (or pricing) of a corresponding index or instrument (e.g. if the S&P index suddenly moves 5%, then European equities and indices would also be expected to have an increased volatility which is normal).
- New transparency rules imposed on bonds and derivatives, the new SI regime and the introduction of OTFs according to MiFID II will change the way that bonds and (OTC) derivatives are traded. It can be expected that statistic data currently used to calibrate trading halts will become obsolete as the liquidity or volatility profile of bonds or derivatives may change significantly. FIA EPTA therefore considers that trading venues should carry out frequent re-calibrations of all trading halt parameters to reflect the impact of the new pre/post-trade transparency rules imposed on bonds and derivatives.

3. Process

Market makers need to be able to provide tight spreads for less liquid stocks during volatility auctions. This is not possible if books are "frozen" during volatility interrupts, meaning open orders cannot be cancelled. In addition, the state of the books (continuous market, auction, closed, etc.) should all be communicated on the market data channels in real time and in sequence with the order flow.

We consider the below to be a typical pattern:

1. Incoming order tries to trade at price outside the bands
2. Incoming order is rejected
3. Clients receive the auction book state on the market data channel
4. Clients amend or cancel their existing orders and/or also place new ones
5. After a random time interval the book goes into uncrossing mode
6. Clients receive the trade prints of the orders that executed in the auction, if any
7. Clients receive the book state update moving to continuous trading

In this process, at no point should cancellation messages or amendments be forbidden. If cancellations are sent whilst the book is uncrossing, those would simply be queued in order to be executed later.
<ESMA_QUESTION_MIFID_GTH_1>

Q2. Do you consider that the Guidelines regarding calibration of volatility parameters should also apply to mechanisms to reject erroneous orders (i.e. order price / volume collars) and that ESMA should propose Guidelines on this issue at its own initiative?

<ESMA_QUESTION_MIFID_GTH_2>
No, FIA EPTA are of the view that market participants and trading venues should employ their own risk limits and parameters to reject erroneous orders. These are highly sensitive to market context and must be dynamically set in order to navigate market circumstances at any given time. Prescribing these beforehand would be impossible and the guidelines would be too complex to be implemented in a meaningful manner.

At the same time FIA EPTA strongly believe that it is a trading venue's responsibility to reject manifestly erroneous orders in order to preserve market integrity. Market participants may make human errors (e.g. wrong decimal position) or use incorrect or incomplete market reference data by mistake. Applying clear safeguards at the trading venue's gate would prevent bona fide executed trades being cancelled afterwards because of commercially insensible (but still valid) trading on the grounds of 'mispricing' - an argument that might even be used opportunistically as liquidity providers' trades are typically hedged immediately with corresponding offsetting trades. If the order is rejected, the hedge would never be in place and unexpected/unwanted exposure would not be prevalent (as is the case when a TRADE would be cancelled).

A bona fide market participant should not lose its gain or be confronted with unwanted risk exposure due to a naked hedge due to mistakes of other market participants. In these circumstances we would suggest a "price adjustment" rather than a trade cancellation.
<ESMA_QUESTION_MIFID_GTH_2>

Q3. Is there any other aspect which should be considered in these Guidelines so as to prevent market-wide volatility events given the current structure of European markets?

<ESMA_QUESTION_MIFID_GTH_3>
Please refer to Q1. As FIA EPTA have previously stated, volatility is not by itself a bad thing. It is a factor of supply and demand, is essential for price discovery and assessing parameters for risk management and should only lead to trading being halted in case of an immediate or existing threat to a venue's ablity to operate an orderly market. We believe ESMA's current approach (based on MiFID-II Level 1) is appropriate for the European market structure and see no reason for additional measures.

<ESMA_QUESTION_MIFID_GTH_3>

Q4. Do you consider that the proposed order and trade feed reporting standard for trading status will contribute to facilitate a correct identification of trading halts across Europe? Do you foresee any drawback on it?

<ESMA_QUESTION_MIFID_GTH_4>
Yes we do. Please note that the reasons for a trading halt may coincide. Systems and procedures should account for this.
<ESMA_QUESTION_MIFID_GTH_4>

Q5. Would you prefer a further degree of granularity in the information provided as described in the text under paragraphs 46 and 47? Please elaborate in case you consider necessary further granularity but you disagree with the proposed approach.

<ESMA_QUESTION_MIFID_GTH_5>
A useful addition could be data to identify which parameter caused a trading halt in order to identify trading strategies for prudent risk management given the circumstances at hand, while at the same time limiting or preventing trading that may prolong the trading halt.

<ESMA_QUESTION_MIFID_GTH_5>

Q6. Is the code proposed above (i.e. "VH") appropriate, or should another code be used? Please elaborate in case you consider that another code should be used.

<ESMA_QUESTION_MIFID_GTH_6>
FIA EPTA have no objection to the proposed code provided data is quick, clear, short and easy to process.
<ESMA_QUESTION_MIFID_GTH_6>

Q7. Do you agree with the reporting template proposed?

<ESMA_QUESTION_MIFID_GTH_7>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MIFID_GTH_7>

Q8. Are there any other items that should be included in the template?

<ESMA_QUESTION_MIFID_GTH_8>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MIFID_GTH_8>

Q9. Please provide any views with respect to the costs and benefits identified in the relevant annex.

<ESMA_QUESTION_MIFID_GTH_9>
We must emphasise that as long as the venue's ability to operate an orderly market is not being jeopardised or immediately threatened, trading should not be curbed; volatility is not of itself a bad thing but a function of supply and demand, often in response to events that may significantly affect an asset's value. Allowing prices to move up and down is essential to price discovery and for assessing risk management parameters on the part of market participants (particularly liquidity providers). This should be preserved to the maximum extent even if an individual share (or those in a certain geography or industry) would drop sharply or if volatility increases sharply.

Attempts to influence, cap or smoothen out price hikes or drops will be highly detrimental to the market structure as a whole. Liquidity providers are essential to price discovery. The risk that trading could be halted or limited (for other reasons than preventing a disorderly market) or that the risk parameters based on volatility are unexpectedly affected by an artificial act will significantly hamper this important role, particularly in challenging market circumstances (when price discovery and risk parameters are most essential). This, in turn, affects the opportunity for market participants to engage in risk transfer when they need it most.

Finally, trading limits or halts should never be used for ad-hoc or political reasons. Interfering with price discovery should be a last resort and only be used to safeguard systems' integrity and the orderliness of trading, even if, for example, systemic banks or other important assets or indices would be affected.
<ESMA_QUESTION_MIFID_GTH_9>