FIA EPTA response to the ESMA consultation on Periodic Auctions
11 January 2019

The FIA European Principal Traders Association ("FIA EPTA")[1] is grateful for the opportunity to comment on ESMA's Call for Evidence on Periodic Auctions. FIA EPTA is agnostic about the advent of periodic auction systems as such, and we welcome any form of meaningful market model innovation that is able to compete on its own merits with other market models. We believe it is essential that periodic auction systems offer meaningful levels of transparency, multilaterality, and contribution to price formation and believe ESMA's focus on these three elements in periodic auctions could have a positive effect.

FIA EPTA notes that exchanges are the foundation of public price discovery, and we support policy designed to facilitate that critical function. We believe markets are healthiest when policy sets the stage for fair competition across the widest possible set of diverse market participants.

As such, FIA EPTA believes that the level of trading activity on other execution protocols, including periodic auctions, should be grounded in transparency and set by fair competition, in compliance with the requirements of MiFID II. FIA EPTA encourages ESMA to continue to study the influence of various execution protocols (if any) on the critical price discovery function of exchanges.

FIA EPTA believes that transparency, open access and competition, rather than any undue regulatory advantages or burdens, should determine the appropriate balance between central limit order books and other types of market models.

As a whole, our membership does not at this point in time (only one year into MiFID-II) have a strong opinion about periodic auction systems, given the small market share they have attracted and the fact that these trading protocols are still in their infancy in Europe and have a very limited track record so far.

While periodic auctions are a small percentage of the current market volume, we nevertheless view them in the context of execution protocols that have gained in popularity post-MiFID II. We have observed that these execution protocols have emerged as alternatives to central limit order book (CLOB) activity with varying degrees of (1) transparency, (2) multilaterality, and (3) contribution to price formation.

These developments express the market's continual innovation in providing execution choices to participants. Depending on their exact configuration, periodic auctions can constitute a useful additional execution protocol as long as they allow for an appropriate level of transparency, multilaterality and contribution to price formation requirements in line with MiFID-II objectives, driven by access to quotes and competition. Periodic auctions should, importantly, not be used to facilitate crossing flow

[1] FIA EPTA represents 28 independent Principal Trading Firms (PTFs) in Europe that deal on own account, using their own money for their own risk, to provide liquidity and immediate risk-transfer in exchange-traded and centrally-cleared markets. FIA EPTA's members play a key role in the modern financial ecosystem, acting as a catalyst for innovation, choice and competition in European capital markets. Collectively, FIA EPTA members provide up to 45% of liquidity on European exchanges, improving price formation, reducing volatility and enabling end-investors to efficiently achieve their investment and risk management goals. FIA EPTA's mission is to support transparent, robust and safe markets with a level playing field for all market participants

within the same broker or a limited set of brokers. Market participants should be able to freely access and interact with quotes in a periodic auction.

Some of the limited preliminary evidence seems to suggest that periodic auctions may be used as partial replacements for the former broker-crossing networks (BCNs), or for instruments where the MiFID II dark volume caps (DVC) are in effect. However, in FIA EPTA's membership views are mixed regarding this causal relationship, as not all available evidence points in the same direction. Additionally, to the extent that the triggering of the DVC seems to be causing additional volumes to flow into periodic auctions systems, other FIA EPTA members consider, by contrast, that the root cause for such behaviour is the design and calibration of the DVC requirement itself.

Transparency
A transparent market is one in which all relevant information is fully and freely available to the public in real-time, which leads to greater efficiency. Pre-trade transparency should allow easy determination of the level of addressable liquidity.

In traditional call auctions, orders arrive into the auction order book but remain unexecuted until the end of the auction period when the orders get matched into trades. Until then, the system should at minimum display provisional price and executable size; additionally, some of FIA EPTA's members consider that, ideally, such systems should also provide information on imbalance so as to make it easier to identify buy/sell opportunities. Other FIA EPTA members consider, however, that providing such auction imbalance information for periodic auctions while other markets are open could potentially jeopardize participants' trading strategies.

Additionally, FIA EPTA members have observed that some periodic auction models show limited pre-trade transparency by disseminating no information until (or beyond) receipt of opposing orders in the same stock. While some FIA EPTA members are not concerned about this, other FIA EPTA members consider this practice to be going against the regulatory intent of MiFID-II and believe such activity should at least be paired with a requirement for a minimum order size so as to limit it to the facilitation of large institutional orders.

Multilaterality
With average durations of 50-150 milliseconds, periodic auctions have clearly been designed for algorithmic interaction. This does not in and of itself impede multilaterality as in modern electronic markets such time frames are relatively long. Rather, FIA EPTA members consider that it is important that the auction period should not be so long that it starts to resemble a minimum order resting period (which would be incompatible with MiFID II).

FIA EPTA members consider that more critical to multilaterality rather than timeframes is that an auction features a call period which enables other market participants to actively enter orders and react to the indicative price and volume information that is being disseminated so that they can interact with the flow in the periodic auction system.

In this context, some FIA EPTA members are concerned about the allowance of broker/firm priority. Broker/firm priority is a function that allows orders to match with other orders from the same broker/firm ahead of similarly priced orders from third parties, before time priority is considered. These members consider that both broker/firm priority and internal matching contradict the multilateral character of those periodic auctions allowing such functionalities.

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Contribution to price formation

The price formation process should consider all orders entered in the order book in the price determination algorithm. The best way to ensure transparent and fair price formation in the order book is to ascertain that all market participants can actually interact with the flows embedded in a periodic auction system so that there is true competition for offering the best price.

Mid-point pegged orders depend on the price formation carried out on the primary market by market makers and a variety of diverse other participants; consequently, they are not price forming. At the same time, we recognize that where large orders are actually matched at mid-point, the ensuing transactions are indeed disseminating meaningful price information in a post-trade transparency context. If mid-point peg orders are allowed, some FIA EPTA members consider venues should not count them in the volume maximizing logic for uncross price determination.

Pre-matched orders are also non-price forming and may reduce the multilateral character of execution protocols relying on them.

Periodic auction models that lock-in prices at the start of the call phase essentially fix the price on initial opposing orders for the duration of the auction, blocking new orders from affecting the price. This limits competition and price formation and does not fit in the context of lit markets.