



European Securities and  
Markets Authority

## **Reply form for the call for evidence - Periodic auctions for equity instruments**



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

Name of the company / organisation	BlackRock
Activity	Investment Services
Are you representing an association?	<input type="checkbox"/>
Country/Region	International

## Introduction

*Please make your introductory comments below, if any:*

<ESMA\_COMMENT\_CFE\_PA\_1>

BlackRock, Inc. (“BlackRock”) is one of the world’s leading asset and risk management firms. We are pleased to have the opportunity to comment on ESMA’s Call for Evidence (CFE) on periodic auctions for equity instruments.

With legislation as far reaching and complex as MiFID II and MiFIR (MiFID), a dynamic review process is necessary to best fulfil the objectives of the legislation, and ultimately to best serve Europe’s end-investors. BlackRock is supportive of ESMA’s efforts to examine and where evidence demonstrates deficiencies in the current framework, re-evaluate elements of MiFID regime, following its taking effect in January 2018.

We have engaged with global and European policymakers with regard to market structure reform over recent years, and look forward to continuing the dialogue with ESMA. By way of summary, BlackRock’s principles for modern equity market structure regulation are set out below. These guide our approach to this CFE and related issues in further reviews of MiFID.

**1. Promote innovation and encourage fair competition while moderating increasing complexity.** While competition can be beneficial for markets, there is a cost borne by investors to connect to a vast array of venues and to fully understand the complexity in the market. Further, rapid change and innovation may lead to misaligned incentives and new conflicts of interest. Today, equity markets in the US and Europe have become exceedingly fragmented and complex. Regulators should look to moderate this trend while not impeding innovation.

**2. Ensure equal and sufficient access to market data. Market data integrity serves as the foundation for investor protection and public confidence in markets.** A publicly available, aggregated view of the market is a fundamental requirement in today’s fragmented and complex equity markets. Market data must be timely, accurate, and delivered on an equitable and efficient basis. As such, it is also important for regulators to recognise the potential conflicts of interest and governance concerns which may arise from private or proprietary market data products which may compete with a public feed. Having disparate feeds and multiple protocols / channels for transmitting data may contribute to difference in data speeds and create the perception of a two-tiered ecosystem for market data.

**3. Improve investor disclosure and education.** An investor’s ability to navigate modern markets is hindered by complexity and fragmentation. It is difficult to have full oversight of the trading process when the data is incomplete or the trading practises of brokers or venues are opaque. As such, regulators should focus on improving disclosure and investor education, to empower market participants with the ability to evaluate their options and make informed investment decisions. Disclosures should be meaningful, clear and easily comparable.

**4. Establish consistent standards for price formation and market resiliency across the equity ecosystem.** Equity markets function smoothly and efficiently the vast majority of the time. However, examples of short-lived market stress events highlight the need to develop robust mechanisms across both

equity markets and related markets (such as those for equity derivatives), to ensure resilience when markets are volatile. Clear and consistent rule sets help to avoid confusion and uncertainty during times of stress. Individual controls or market mechanisms (such as single stock controls and market-wide circuit breakers) should be complementary and act in harmony. This is particularly important where stocks are traded across borders, with differing national regimes.

**5. Ensure applicability of rulesets to ETFs.** ETFs have become a valuable tool used in a variety of institutional and retail investor portfolios. Many regulations were written prior to ETF adoption, and so do not contemplate ETFs, however regulators are increasingly recognising the importance of rules tailored specifically to ETFs (such as the US ETF Rule). Rules around market structure are further behind in this regard and we encourage regulators to revisit existing rules with a view to explicitly contemplate ETFs. In addition, a global classification scheme for ETPs would help differentiate traditional ETFs from other ETPs that have different structural features and risks.

Coming to the focus of the CFE, whilst we see potential to improve the rule set or best practices for periodic auctions, periodic auctions ultimately represent an important additional source of liquidity in the equity market ecosystem, contributing to delivering best execution for end-investors. Furthermore, we generally caution against a direct intervention from regulators to shift volumes from venues, such as lit periodic auctions, onto lit continuous markets since this may lead to adverse impacts for end-investors.

<ESMA\_COMMENT\_CFE\_PA\_1>

**Q1. 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, we agree that conventional auctions are longer in duration and are typically scheduled at specific times/events. It should be noted that conventional auctions and frequent batch auctions function in similar ways with similar aims and that there are many different forms of frequent batch auctions.

<ESMA\_QUESTION\_CFE\_PA\_1>

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

<ESMA\_QUESTION\_CFE\_PA\_2>

Yes, the market share of frequent batch auctions has increased. This observation should however be viewed in the context of overall equity trading in Europe, within which periodic auctions represent only a small proportion - ESMA estimates the market share of frequent batch auctions to be between about 2% with moderately higher levels for specific stocks and time periods. Analysis of BlackRock's own execution data does not lead to materially different conclusions.

<ESMA\_QUESTION\_CFE\_PA\_2>

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

<ESMA\_QUESTION\_CFE\_PA\_3>

Periodic auctions generally run multiple sessions throughout the day, seeking to attract buyers and sellers, in particular for trading in larger size. They then match orders efficiently following a clearly defined ruleset.

Periodic auctions enable brokers and traders to enhance execution performance for their clients by executing very cost efficiently. We believe that periodic auctions have gained market share in recent years because they are additive to the equity market eco-system's liquidity and help achieve better execution; smart order routers access periodic auctions when seeking liquidity and this can enhance execution performance beyond only executing on a central limit order book alone ("CLOB").

Overall, we see periodic auctions as a positive innovation, complimenting other sources of liquidity and ultimately enabling end-investors to receive best execution by allowing trading at the mid-point, which in turn lowers overall costs and enhances returns for Europe's savers.

<ESMA\_QUESTION\_CFE\_PA\_3>

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

<ESMA\_QUESTION\_CFE\_PA\_4>

Yes. There are, however, significant differences across frequent batch auction systems in how those characteristics are applied. We will note these differences in our subsequent responses and recommendations.

<ESMA\_QUESTION\_CFE\_PA\_4>

**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.**

<ESMA\_QUESTION\_CFE\_PA\_5>



A further factor that contributes to the success of Periodic Auctions is their ability to provide EBBO mid-point executions which implies lower transaction costs for investors and supports best execution.

Additionally, while durations are short, they are long enough to introduce 'speed bumps' that can help equalise latency effects which investor orders might otherwise be exposed to on exchanges.

<ESMA\_QUESTION\_CFE\_PA\_5>

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

<ESMA\_QUESTION\_CFE\_PA\_6>

All frequent batch auctions systems should disclose indicative price and quantity once a match has occurred. Pre-trade transparency should not be applied before a match has occurred as this could cause information leakage and increase transaction costs and volatility.

Additional pre-trade transparency could be considered with a focus on applying a minimum auction duration time to enable the potential for improvements in auction bids to occur. Further, pre-trade transparency can be enhanced by considering how to optimally integrate periodic auctions – and other execution venues – into an official European Best Bid and Offer (EBBO).

<ESMA\_QUESTION\_CFE\_PA\_6>

**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.**

<ESMA\_QUESTION\_CFE\_PA\_7>

See our responses to questions 5 and 6.

Orders submitted into a periodic auction, including mid-EBBO pegged orders, determine indicative un-crossing size and price. These data points are shown to the market as part of an auction's pre-trade transparency requirements, implemented by auction operators and dependent on the exact auction mechanics. For this reason, we consider pre-trade transparency requirements to be met by midpoint pegging orders. We should acknowledge that midpoint pegging and execution allows investors to reduce transaction costs. Additionally, we recommend considering how to integrate transparency data from periodic auctions – and from any other execution venues – into an official EBBO and consolidated tape.

<ESMA\_QUESTION\_CFE\_PA\_7>

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

<ESMA\_QUESTION\_CFE\_PA\_8>

In general, order imbalance data can attract offsetting liquidity which is positive for investors.



We would like to raise awareness though that order imbalance from periodic auctions might enable high-frequency participants with latency advantages to exploit the auction imbalance by positioning themselves on an exchange faster than investors who then need to unwind their imbalance.

Additionally, in this US equity market such imbalance data is sold in separate feeds rather than providing it on the official tape (or SIP in the US). We think that is detrimental as it is an obstacle to attracting more liquidity.

If imbalance data were made available in Europe, we recommend mandating it as part of a consolidated tape with mechanisms to mitigate latency effects; we do not consider it urgent to make the data available.  
<ESMA\_QUESTION\_CFE\_PA\_8>

**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.**

<ESMA\_QUESTION\_CFE\_PA\_9>

All orders on frequent batch auction systems are placed on the auction order book, with most orders resting for long periods until matching opportunities are identified so. In that sense, the auction durations can be misleading and there is no benefit to extending the duration further. We 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.

Executions take place on a priority rule of price, volume and time which is fully multilateral and allows periodic auctions to contribute to fair and orderly trading as part of the broker's smart order routing.  
<ESMA\_QUESTION\_CFE\_PA\_9>

**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.**

<ESMA\_QUESTION\_CFE\_PA\_10>

See the response to question 9.

A minimum auction duration time could be considered for all frequent batch auctions to enable adequate pre-trade transparency and the potential for improvement in executions. We believe it should be left to auction operators whether they wish to introduce defined periods beyond the minimum period (e.g. longer durations for less liquid instruments), however we see no urgency for instrument-specific duration.  
<ESMA\_QUESTION\_CFE\_PA\_10>

**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?**

<ESMA\_QUESTION\_CFE\_PA\_11>

Auction operators or brokers who route orders to auctions are in a better position to provide evidence.

<ESMA\_QUESTION\_CFE\_PA\_11>



**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.**

<ESMA\_QUESTION\_CFE\_PA\_12>

In our view, frequent batch auction systems are price-forming and contribute to the price discovery process.

Periodic auction trades take place when two opposing orders match. If the same orders were executed on an exchange and do not match, the buy order would be executed at the higher offer price and the sell at a lower bid price. As a result, both investors could be executing at worse prices – and would be worse off than if they had traded at midpoint.

The size and informational content of such orders in this example is the same though and trading on exchange or in a periodic auction does not make the order more or less price forming.

It could be argued that the matching process of buys and sell stabilises the price discovery process and reduces intraday volatility. In contrast, more trades and more market impact on an exchange does not constitute a higher quality of price formation.

<ESMA\_QUESTION\_CFE\_PA\_12>

**Q13. 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>

See the response to question 12.

One of the major benefits derived from all periodic auctions is the price mechanism. We support trading at mid-point and have previously expressed our views to EU policy makers on the importance of this feature for providing optimal outcomes for end-investors and for the competitiveness of European equity markets.

<ESMA\_QUESTION\_CFE\_PA\_13>

**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)?**

<ESMA\_QUESTION\_CFE\_PA\_14>

All frequent batch auction systems enable orders to be placed on the auction order book with most orders resting for long periods until matching opportunities are identified with executions taking place.

The execution rules are based on clear priorities (price, volume, time) which helps against undesirable latency effects and enables brokers to integrate period auctions into smart order routers. As a result, a broad set of market participants can execute in periodic auctions, delivering best execution to their clients.

To further strengthen the contributions to price formation we are supportive of minimum durations that allow for updating of auction bids. We also support efforts to integrate pre-trade transparency data and executions into a real-time official EBBO and consolidated tape.

<ESMA\_QUESTION\_CFE\_PA\_14>

**Q15. 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>

No, pegged orders are an efficient execution mechanism for investors and, like other orders in periodic auctions, part of the price discovery process.

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. Two large buy and sell orders of the same size on an exchange will create market impact into opposite directions which in turn can create intraday volatility. All else equal, the final best bid and offer in the CLOB will likely be where it was before these offsetting trades – on exchange execution has not improved price discovery yet increased intraday price movement. Further, unmatched residual quantities still get executed on execution venues without matching and are not removed from any price formation process.

<ESMA\_QUESTION\_CFE\_PA\_15>

**Q16. 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>

There are times when the lit market trades outside the EBBO, even at small size, and as a result investors execution performance is not as good as it could have been. This underlines the need for a Consolidated Tape of quotes and trading in Europe. Trades within the EBBO are desirable for investors to achieve best execution. The possibility of receiving executions outside of the EBBO should not be equated with better price discovery and better investor outcomes.

<ESMA\_QUESTION\_CFE\_PA\_16>

**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?**

<ESMA\_QUESTION\_CFE\_PA\_17>

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.

To improve transparency, it is desirable to be able to easily identify self-matched broker transactions in a periodic auction in a clean consolidated tape of trades in Europe.

We think it is unbalanced to describe self-matching on exchanges as “an efficient way of internalising order flow by lowering the cost of execution for final clients”, yet to interpret self-matching in periodic auctions as prohibited cross trades. We recommend equal treatment and a level playing field, whether self-matching occurs on an exchange or elsewhere.

<ESMA\_QUESTION\_CFE\_PA\_17>

**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?**



<ESMA\_QUESTION\_CFE\_PA\_18>

Operators of auctions are better placed to answer this. We have no anecdotal evidence of such behaviour.

<ESMA\_QUESTION\_CFE\_PA\_18>

**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?**

<ESMA\_QUESTION\_CFE\_PA\_19>

No, levels are low and not essential for the success of periodic auctions. Self-matching is neither damaging nor is it additive for investor execution performance.

Some frequent batch auctions allow brokers to opt out of self-matching features. BlackRock has not observed a performance differential in transaction costs when a broker opts in or out.

<ESMA\_QUESTION\_CFE\_PA\_19>

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

<ESMA\_QUESTION\_CFE\_PA\_20>

BlackRock provide guidelines for execution venue usage that brokers can use for transactions in pursuit of best execution for clients. At the same time, we allow broker discretion as well and quantitatively assess the overall quality of execution. It is important to recognise that overall execution quality results from how the broker accesses execution venues and manages their complicated linkages.

<ESMA\_QUESTION\_CFE\_PA\_20>

**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.**

<ESMA\_QUESTION\_CFE\_PA\_21>

The DVC highlights that it is hard to predict the outcomes of direct intervention. We think it is more effective to increase transparency via a consolidated tape and EBBO to allow market participants to execute optimally within a competitive environment of execution venues.

<ESMA\_QUESTION\_CFE\_PA\_21>

**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?**

<ESMA\_QUESTION\_CFE\_PA\_22>

It is important to recognise that volume which is matched against other clients would in the absence of a periodic auction be likely to migrate to other venues which provide block crossing. It is unlikely to migrate entirely onto exchanges as this would lead to worse transaction costs for investors.

Brokers who route client orders are incentivised to route to venues that provide the best execution quality as this is what they are assessed on, further strengthened by MIFID II's best execution requirements.

<ESMA\_QUESTION\_CFE\_PA\_22>

