

ESMA to address regulatory concerns over Frequent Batch Auctions

FBA systems have been rapidly gaining market share since the application of MiFID II. ESMA launched a call for evidence in November 2018 to better understand FBA systems and to assess whether and to which extent these systems are used to circumvent the double volume cap (DVC).

The Final Report presents ESMA's assessment of four main characteristics of FBA trading systems: limited pre-trade transparency, short auction duration, price determination within the best bid and offer price, and self-matching features. ESMA, based on the evidence gathered, will focus on pre-trade transparency and the price determination process of FBAs.

- **Pre-trade transparency**

The call for evidence identified two types of FBA systems, detailed in the Final Report, resulting in a different application of the pre-trade transparency requirements. While ESMA agrees with the views expressed by stakeholders responses that market operators should be free to decide which type of system they intend to operate, ESMA considers it important that any auction system operated provides market participants with information that an auction has started to allow for genuine pre-trade transparency. ESMA intends to clarify this via supervisory guidance.

- **Price determination**

ESMA highlighted in its call for evidence three practices which may undermine price formation and/or require a reference price waiver: the use of pegged orders, the use of price band limitations to ensure that the uncross price is always within the EBB0/PBB0, and the practice of locking in prices at the beginning of the auction.

After assessing the feedback received, ESMA remains concerned that the three practices identified in the call may weaken the price determination process of FBAs and serve as a vehicle to circumvent the DVC. Therefore, to provide certainty to the market and contribute to regulatory convergence, ESMA intends to issue in the course of the following months supervisory guidance clarifying that FBAs should be genuinely price-forming in order to operate without a waiver from pre-trade transparency.

- **Auction duration and self-matching**

The call for evidence also highlighted ESMA's concerns on two further characteristics of FBAs: short auction duration and self-matching. Following the assessment of the feedback received, ESMA does not consider it necessary to take further action on those characteristics of FBAs at this point. Concerning self-matching features of trading systems, ESMA will clarify through upcoming guidance that the use of self-matching should, for any

trading system, be in no circumstances used to formalise pre-arranged trades.

Next Steps

ESMA will work on further guidance along the lines recommended in the report, covering the areas of price determination and pre-trade transparency. Furthermore, ESMA will look at the broader effects of the MiFID II transparency regime, including the general development of the market structure in the upcoming MiFID II review reports.