Finance for Europe

Association for Financial Markets in Europe

AFME Position on possible Reference Price Waiver restrictions

Background

The transparency regime for equities introduced under MIFID II allows the use of a number of pre-trade transparency waivers which waive the obligation to provide bid and offer prices and the depth of trading interest for certain types of transactions (typically trades that are large or bespoke in nature).

The reference price waiver (RPW) is applied under Article 4(1), MiFIR and removes the obligation for market operators to provide pre-trade transparency information where that trading venue references prices from a trading venue where the relevant share was first admitted to trade or the most relevant market in terms of liquidity.

ESMA has previously consulted on the removal of the RPW and in its July 2020 report on the transparency regime for equities instruments, it recommended that the RPW be retained. However, in addition ESMA proposed to limit the potential use of the RPW to orders above a certain percentage of the large-in-scale threshold or to a certain multiple of the standard market size for the relevant share. We set out our position on the use of the RPW and ESMA's proposals below.

Reference Price Waiver – benefits to investors

Pre-trade transparency waivers allow institutional managers of retail money, such as pension funds, to protect orders, avoiding adverse signalling effects that might be exploited to the disadvantage of end investors.

For the investment fund industry which manages large retail funds, average orders are commonly of a size somewhat or significantly above regular lit market sizes, but not always above the Large-In-Scale threshold. Therefore, an unrestricted RPW is complementary, rather than alternative, to the LIS waiver and important to obtaining optimal execution outcomes and reducing implicit trading costs.

Institutional investors decisions – "parent orders" vs "child orders"

It is also important to note that, to obtain the best possible execution, large orders are often split into smaller orders (so called "child orders") to be able to make use of different pools of liquidity. The RPW offers an efficient means to execute these child orders while reducing signalling the existence of the larger "parent" order, without which would result in worse execution outcomes for investors.

This is partly because the existing offering on exchanges is more tailored to the needs of principal and high frequency traders, with smaller trade sizes and additional trading and infrastructure costs. Conversely, this is often not a suitable mechanism for professional investors representing savers and pensioners.

ESMA advice on Equity Markets Transparency – protection of the price formation process

We note that ESMA has consulted upon the removal of the RPW in its entirety and did not recommend this in its July 2020 report.

Association for Financial Markets in Europe
London Office: 39th Floor, 25 Canada Square, London E14 5LQ, United Kingdom T: +44 (0)20 3828 2700
Brussels Office: Rue de la Loi 82, 1040 Brussels, Belgium T: +32 (0)2 788 3971
Frankfurt Office: Bürohaus an der Alten Oper, Neue Mainzer Straße 75, 60311 Frankfurt am Main, Germany
T: +49 (0)69 153 258 963
www.afme.eu

Further, with regard to restrictions to trading under the waivers, ESMA only consulted in relation to the percentage levels of the double volume cap, notably removal of the 4% venue cap which it subsequently recommended.

ESMA has not consulted upon nor subsequently recommended any other restrictions to the RPW and no thorough formal assessment of size thresholds has ever been conducted.

AFME would be supportive of a proposal that ESMA continues to monitor the level of trading under the pre-trade transparency waivers in EU markets. We support the notion that price formation needs to be protected and believe that ESMA should be able to intervene in extraordinary circumstances where it has been established that the level of trading under the pre-trade transparency waivers is undermining the price formation process.

AFME Contacts

April Day	Pedro Pinto	Marta Dawydzik
April.Day@afme.eu	Pedro.Pinto@afme.eu	Marta.Dawydzik@afme.eu