Microbites #1 - An Introduction to European Equity Market Structure: Trading Under MIFID2 - Difference between an Exchange vs MTF

For those who are unfamiliar with the European market structure landscape, or want a refresher, we are introducing a series of briefings to help you get to grips with the trading terminology, and to help users of our analytics tools. We will start with the basic building blocks, before going on to add more detail in later episodes.

There are over 70 regional, national, and Pan-European trading venues across the 51 countries of the European continent, and some 20 currencies. Fragmentation is high, and there is a rich mosaic of execution platforms and mechanisms.

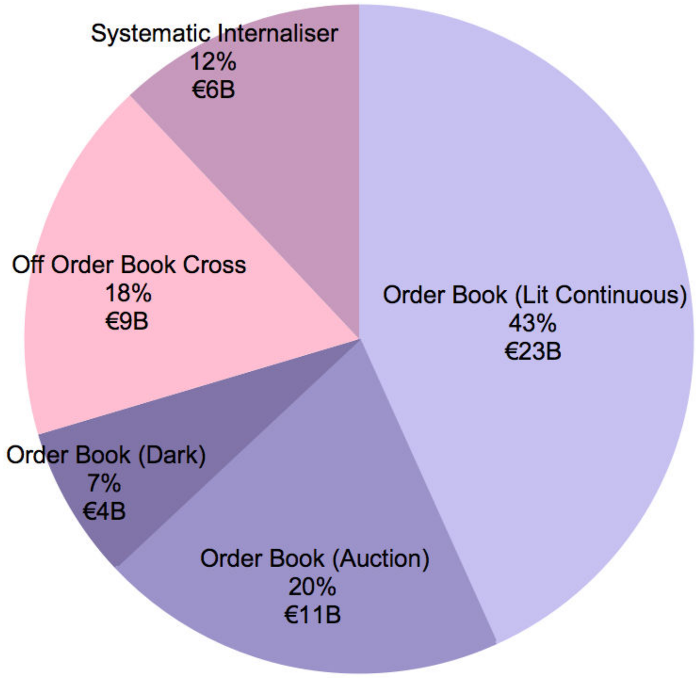
The European market structure emanates from a major update to legislation, which was implemented throughout the 27 member states of the European Union in January 2018, known as "MIFID2." It stands for the 'Markets in Financial Instruments Directive" and is accompanied by other major regulations and complex rules. European countries that are not part of the EU, such as Switzerland, Norway and the United Kingdom, tend to maintain very similar rules and standards.

Among other objectives, the law makers and regulators set out to ensure that as much trading as possible is conducted through lit electronic order books, that are available to all market participants equally, and went as far as banning OTC trading for all but the most exceptional trades.

The intent was to create better pre-trade transparency to price and liquidity which led to a structure in which there are four main ways to execute an order:

- On the electronic order book of a Stock Exchange;
- On the electronic order book of a regulated 'Multilateral Trading Facility' (MTF);
- Directly with a counterparty who is acting as a dealer and is registered as a 'Systematic Internaliser' (SI, which we will define shortly);
- Indirectly with another counterparty via a broker and subject to certain limitations, for example these trades may not be automated. In practice, these are manually executed cross trades even though the parties may remain anonymous.

In our chart here, we show the market share of On Order Book trading (Stock Exchange or MTFs) and Trading via SIs



Liquidity Types - ADV€ and Market Share 2021

When looking at the European market structure, the concept of an MTF can be confusing. Parallels are often drawn between the MTF and ATS in the US, and while this is reasonable there are some subtle differences which we will cover in later episodes. For now, the important thing is that the MTFs cover around a quarter of daily volumes and the largest, operated by Cboe which has about 54% market share of MTF volumes.

The major practical differences between an Exchange and an MTF are that:

- Exchanges are the formal trading mechanism through which companies list their shares. A company cannot use an MTF for this purpose. Exchanges are often referred to as the 'primary' for this reason.
- Thus Exchanges have a domestic orientation for the shares they cover (although some are highly international, like the LSE), and most have combined into several multi-national systems such as Euronext.
- MTFs therefore 'shadow' the shares of many primary Exchanges at once, and thus have a Pan-European orientation.
- Exchanges run only lit trading platforms. MTFs run dark platforms, lit platforms, or both.

Apart from these major differences, the concept of an Exchange and an MTF are very similar and in particular, like an Exchange or ATS, an MTF must admit any participant that is willing to abide by its rulebook and may not offer preferential treatment to any of its participants.

Finally, the other area that causes confusion for the European market structure entrant is the idea of a 'Systematic Internaliser' (SI). Very simply, an SI is a firm that trades for its own account as some form of registered market maker, liquidity provider or trade facilitator. A firm trading in this way must register as an SI with the regulator, and in return for providing market liquidity through continuous public quotes, is exempted from the rule whereby all trades must be executed on an Exchange or MTF electronic order book. In practice most SIs are also active on the public order books. This means that Investment Banks and Proprietary Trading firms are able to deal on a bi-lateral basis with other market participants, including electronically.

Each of the methods described are considered to be 'On Exchange' prints. In the case of an electronic order book, a trade report is automatically broadcast by the trading venue to the commercial market data vendors (there is no equivalent concept of an official consolidated tape). In the case of a non-electronic trade via a Systematic Internaliser or a broker, trade reports must also be published within a minute, except in very limited circumstances such as for a very large trade.

In the next episode, we will get into some detail of Lit versus Dark trading in Europe on the Exchanges and MTFs and provide a list of the venues and platforms.

At big xyt, our mission is to provide domain expertise and customised data analytics that fit your trading and investment needs. If you have any questions, we're happy to help, and we would like to hear your ideas for future episodes.

About big xyt

big xyt provides independent smart data and analytics solutions to the global trading and investment community, enabling firms to process and normalize large data sets on demand and in real time, in order to transform trading performance and analysis, and comply with regulatory requirements.

Our clients include major global investment banks (including five of the top Tier 1 firms), buy-side firms, leading exchanges, trading venues, policy makers, and regulatory bodies.

big xyt has created an ecosystem for tick data analytics covering more than 120 trading venues globally. Our unique technology normalises trade conditions of all venues allowing consistent aggregations of trading volumes, comprehensive analysis, and delivery of results in a flexible and customisable format.

big xyt's analytics solutions are relevant for a broad range of use cases including strategy development, back testing and regulatory changes. The platform offers a convenient and interactive user interface that allows users to discover relevant information quickly, and connect easily to our cloud-based platform via APIs.

As an independent company we are able focus on the needs of our clients, without bias or conflict.

About the Author

Richard Hills is Head of Client Engagement at big xyt. Richard has over 30 years' experience in capital markets, and before joining big xyt, he established and ran the electronic trading business at a major European investment bank before becoming managing director of the global equities execution team.

Richard is a market leader in market microstructure and is the author of big xyt's European Market Microstructre Survey.

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