London Stock Exchange

Summary of responses to the consultation on market structure and trading hours

Issued 1 June 2020

London Stock Exchange Group

June 2020

Contents

Disclaimer

London Stock Exchange plc. has used all reasonable efforts to ensure that the information contained in this document is correct at the time of publication, but shall not be liable for any decisions made in reliance on it.

June 2020

Introduction

London Stock Exchange ("Exchange") would like to thank all those who took the time to reply to our recent consultation[1] on potential changes to market structure. We received over 140 responses, from respondents ranging from individual investors through to global investment banks. We also received collective feedback from industry associations and other bodies on behalf of their members.

This summary was originally prepared for publication at the end of Q1 2020, but with the unprecedented period of market activity associated with COVID-19, we postponed publication until a time when stakeholders and other interested parties could better focus on these issues.

This paper presents a summary of responses, to help progress discussions with all stakeholders, and where we feel that a strong consensus exists, to share proposed next steps.

To recap, the consultation invited feedback in respect of three proposals:
1) An adjustment to trading hours;
2) A reduction in the number of auctions for SETSqx securities in consideration of the liquidity of small cap securities; and
3) Intraday Auction activity on the Stock Exchange

Most respondents limited themselves to topic 1, but there were still a good number and range of respondents across all three topics.

[1] Consultation on market structure and trading hours

June 2020

Summary

Topic 1: Market Trading Hours on London Stock Exchange

The majority of participants did not view longer trading hours as a benefit to liquidity. This view was particularly strong from investment managers, banks and agency brokers. There was no clear consensus among the proprietary firms, market makers and retail investors/brokers who responded.

Conversely, although most respondents believed shorter hours would improve the velocity of trading and liquidity available on the order book, very few believed that this would result in an increase in trading volumes.

A significant majority of respondents were sympathetic to the arguments that a reduction of market hours could lead to improvements in diversity and wellbeing. The Association for Financial Markets in Europe (AFME) and the Investment Association (IA) summarised this in their response as follows:

"*A shorter day would improve flexibility for employees and would help to attract a more diverse range of individuals to enter trading floors. In a recent survey, nearly 50% of respondents identified shorter trading hours from nine other possible factors as a means to improve gender diversity, and second only to flexible working policies (at nearly 60%). The key benefit from shorter exchange hours will be the opportunity it affords to firms to attract, accommodate and retain individuals whose personal circumstances require more flexible working hours.*

In addition to market structure and cultural issues, trading remains one of the areas of financial services where staff face significant mental health issues. We believe the excessively long hours play a major contributory part in generating and perpetuating this problem."

However, the vast majority of those who supported this thinking also expressed the view that for this benefit to be realised most effectively, there would ideally need to be harmonisation across European exchanges and other trading venues. Without this harmonisation, the goals of improved diversity and wellbeing would be harder to achieve, given the pan-European nature of many trading roles in the financial industry.

June 2020

Some respondents also noted the potential for dislocation and additional market complexity if a trading venue were to reduce its trading hours independently, rather than as part of a harmonised pan-European change.

A small number of respondents suggested a “lunch break” as an alternative to a shorter trading day.

Some respondents did question how much impact a change in equity trading hours would have on diversity and wellbeing across the financial community. This group suggested that institutions themselves could do more in promoting these goals through initiatives such as shift working.

A few others noted London’s position as a global financial centre and questioned whether shorter market hours would be detrimental to this. Others highlighted that shorter trading hours in the US and Asia have not necessarily translated into working hours which are any shorter than those in Europe.

Most respondents did not consider the current overlap with Asian market hours to be as important as that with US market hours, at least for the present.

A few respondents noted that there are current EU proposals to abolish changing clocks during summertime, which could complicate the idea of harmonising market hours across Europe. However, at the time of writing, these proposals had not been fully ratified.

Few felt that trading hours would be a consideration for corporate issuers. However, some market makers pointed to the highly international nature of shareholders in stocks listed on London Stock Exchange. According to a recent study from Hardman & Co and Argus Vickers, 49% of all stocks listed on London Stock Exchange are held by non-UK investors, and this proportion rises to 69% for those securities in the FTSE 100. One of the key strengths of a London listing is the global reach of investors, and there are some concerns that this might be impacted by shorter hours.

In terms of derivative markets, few believed there would be any real impact of reducing trading hours. “Out of hours” trading is a small percentage of overall turnover according to those who replied on this question. Respondents expect most derivatives trading would adapt to any change to trading hours. A few respondents did highlight the need to particularly consider single stock options and futures, and the hours that these trades might need to be amended if trading hours are changed.

June 2020

In terms of the impact on retail investors, there was a wide range of views, including some who advocated longer (rather than shorter) hours. There was some consensus on a later opening time, to allow for better digestion of results and overnight news, but mixed feelings about an earlier closing time.

There was a range of opinion as to the wider implications of changing market hours. Views were mixed on earnings announcements. Some respondents argued that these should be issued later, others said issuance being an additional hour before the open would mean a better considered opening price. On Exchange Delivery Settlement Price (EDSP) timings, some viewed this as an opportunity to harmonise EDSP auction timings, while others were strongly against any change on the grounds of volatility and focus for traders on each EDSP auction.

Finally, in terms of how hours might be amended, the majority view indicated a preference for a 09:00-16:00 trading day, but with reasonable clusters advocating for both 09:00-16:30 and 09:30-16:30. A minority advocated leaving hours unchanged.

Actions from Topic 1

London Stock Exchange notes that other European exchanges and other trading venues are currently consulting and considering their position on market hours. We await their public findings as these will be an important factor in considering any potential changes to our trading hours, given the indicated preference for harmonisation.

We also noted with interest views on the potential impact on liquidity of shorter hours and how this might impact the daily volume curve and trading conditions. We welcome any further quantitative modelling, academic or case study material on this issue.

London Stock Exchange will continue to engage actively with stakeholders and industry bodies on this topic, including discussions in relation to medium-term changes in working arrangements (such as increased working from home) that might result from the COVID-19 experience.

June 2020

Topic 2: Liquidity of small cap securities

There was mixed awareness of SETSqx auctions among investors, with some retail investors in particular being unaware of the functionality. Member firms of London Stock Exchange had a much greater awareness of SETSqx auctions.

Some retail respondents suggested it would be beneficial to individual investors if retail brokers offered greater access to auctions and other Direct Market Access (DMA) products.

Of the respondents who offered a view, many believed that a reduction in the number of SETSqx auctions would improve liquidity and even eventually participation, as each individual auction becomes a larger event.

There was a strong consensus for maintaining the current closing SETSqx auction. There was also support among a majority of respondents for removing 1 or 2 of the existing auctions.

In terms of smaller cap securities traded on SETS, there was limited awareness of Minimum Quantity At Touch (MQAT) among investors, but as was the case with SETSqx auctions, member firms had a much greater awareness of the service. In general, those that offered views thought this had worked well in terms of promoting more stable markets for the less liquid securities where this is applied. Some suggested extending, perhaps even into Exchange Traded Products (ETPs), where order book liquidity is reported as sometimes “patchy”.

With regard to Central Securities Depositories Regulation (CSDR), the majority of responses expressed concern about the potential impact on market liquidity, particularly for smaller cap stocks which are typically less liquid and more reliant on price formation by Market Makers. According to London Stock Exchange’s rules, Market Makers are under an obligation to provide two-way pricing, which often results in them selling short and covering at a later point. CSDR introduces a more prescriptive regime for buying in and cashing out of positions, putting new pressures on, and giving rise to additional costs for Market Makers who have to sell short in order to provide investors, very often retail investors, with the liquidity that they are seeking. There is a concern that the CSDR settlement rules could result in wider spreads (and thus increased execution costs for investors) or Market Makers withdrawing from some securities altogether.

June 2020

In terms of engagement with regulators on CSDR, most had undertaken this through industry bodies. The general feedback was that regulators are listening and sympathetic, but there was a broad range of issues that needed to be considered.

In terms of actions from London Stock Exchange, most of those that responded felt that measures to improve securities lending/borrowing would be helpful, but that the greater focus should be on discussions with relevant authorities to clarify how the legislation will be interpreted and applied.

In terms of MiFID II and its impact on the quantity and quality of research on smaller cap securities, most respondents who provided a view indicated they believed that there had been a steady decline. Respondents highlighted that this is supported by the QCA / Peel Hunt Mid & Small Cap Investor Survey which has highlighted an increasing investor concern on this topic. The latest survey shows 79% of investors believe the available research on small cap firms has declined, up from 54% in 2017[2].

Retail investors noted that the lack of research products available to individual investors is a longer term issue, but noted that the situation has deteriorated since the introduction of MiFID II. One respondent suggested that this might be compounded with a reduction in professional advice to individual investors, as retail brokers undergo “suitability reviews” and shy away from offering advice on investments in smaller companies.

Actions from Topic 2

London Stock Exchange notes the feedback on SETSqx and will follow up further with relevant stakeholders on the best format for SETSqx auctions.

Positive comments on MQAT are noted, and London Stock Exchange will engage in dialogue with key stakeholders on ideas for further implementation of this where appropriate.

On CSDR, concern over a potential liquidity impact is noted, and we will continue to progress a range of activities, including engagement with regulators and stakeholders, to help the market maximise the benefits of the legislation, while minimising the potential negative side effects.

[2] QCA/Peel Hunt Mid & Small-Cap Investor Surveys 2018-2020

London Stock Exchange notes some of the specific concerns raised by retail brokers and investors in terms of market access and will engage further to raise awareness of what the Exchange already provides.

June 2020

Topic 3: Auctions

Most respondents felt that the intraday auction has not attracted the broad range of liquidity that was envisaged, although some noted that it was a useful liquidity event for less liquid securities. Some suggested experimenting with a different time, but most proposed its removal. In particular, it was suggested that if market hours are shortened, intra-day liquidity would naturally increase, which was the original goal of the intraday auction.

In terms of transparency during the call phase of auctions, the majority of respondents were in favour of retaining both Level 1 and Level 2 data. Some advocated that withdrawing level 2 data would encourage larger order sizes.

Actions from Topic 3

As a result of the feedback, London Stock Exchange will discontinue intra-day auctions on SETS. London Stock Exchange will consult with key stakeholders, including regulators, to schedule this in a way that minimises any potential market disruption.

London Stock Exchange will continue to publish both level 1 and level 2 data during our auction call periods.

London Stock Exchange

10 Paternoster Square
London EC4M 7LS
T: +44 (0)20 7797 1000
www.lseg.com