

MiFID II's Initial Impact on European ETPs



- Three months after MiFID II's debut, European ETPs are more transparent but still highly fragmented.
- On 3 Jan. 2018, the European Union rolled out its ambitious overhaul of the regulation overseeing its financial markets, the Markets in Financial Instruments Directive II (MiFID II).
- The many reforms included, for the first time, regulations related to the transparency of secondary market trading of exchange-traded products (ETPs).

Whilst it is difficult to draw too many conclusion one quarter into 2018, trade reporting data collected by Cboe Europe highlights the high value of ETP trades reported and a significant increase in average trade size of OTC trades (a 67% increase over 2017). First quarter 2018's data also highlighted a 39% increase in the value traded on-book, albeit with almost identical average trade size. This is an encouraging sign that regulations including RDR, best execution and added transparency may be improving price formation on exchanges, even if the data continues to highlight the continued fragmentation of the market.

Market Both Big & Small

MiFID II is a much-needed change for the European ETP market, which struggles with being at once both big and small.

The European ETP market is far more dispersed than other geographical ETP markets. Unlike the U.S. where all trades, no matter what the exchange, settle through the same securities depository, Europe is a confederation of regional markets with settlement occurring domestically, other than those ETPs issued into Euroclear Bank.

Due in part to this dispersion, the European market has more ETPs on offer than anywhere else, even the U.S. There were 2,260 European-listed ETPs with 7,278 listings on 27 exchanges as of year-end 2017, compared with 2,116 ETPs listed on just four exchanges in the U.S. according to independent ETP consultancy ETFGI.

Furthermore, ETPs are not only cross-listed on many exchanges, they are also traded on MTFs, RFQ and SI platforms, in auctions, and in lit and in dark books.

Such duplication of listings and associated fragmentation of trading affects liquidity and may in part explain why, even though European investors have access to roughly the same number of products as American investors, they have still invested fewer assets in ETPs overall. At the end of 2017, investors held \$802 billion in European listed ETPs, compared with \$3.4 trillion invested in U.S. listed ETPs.

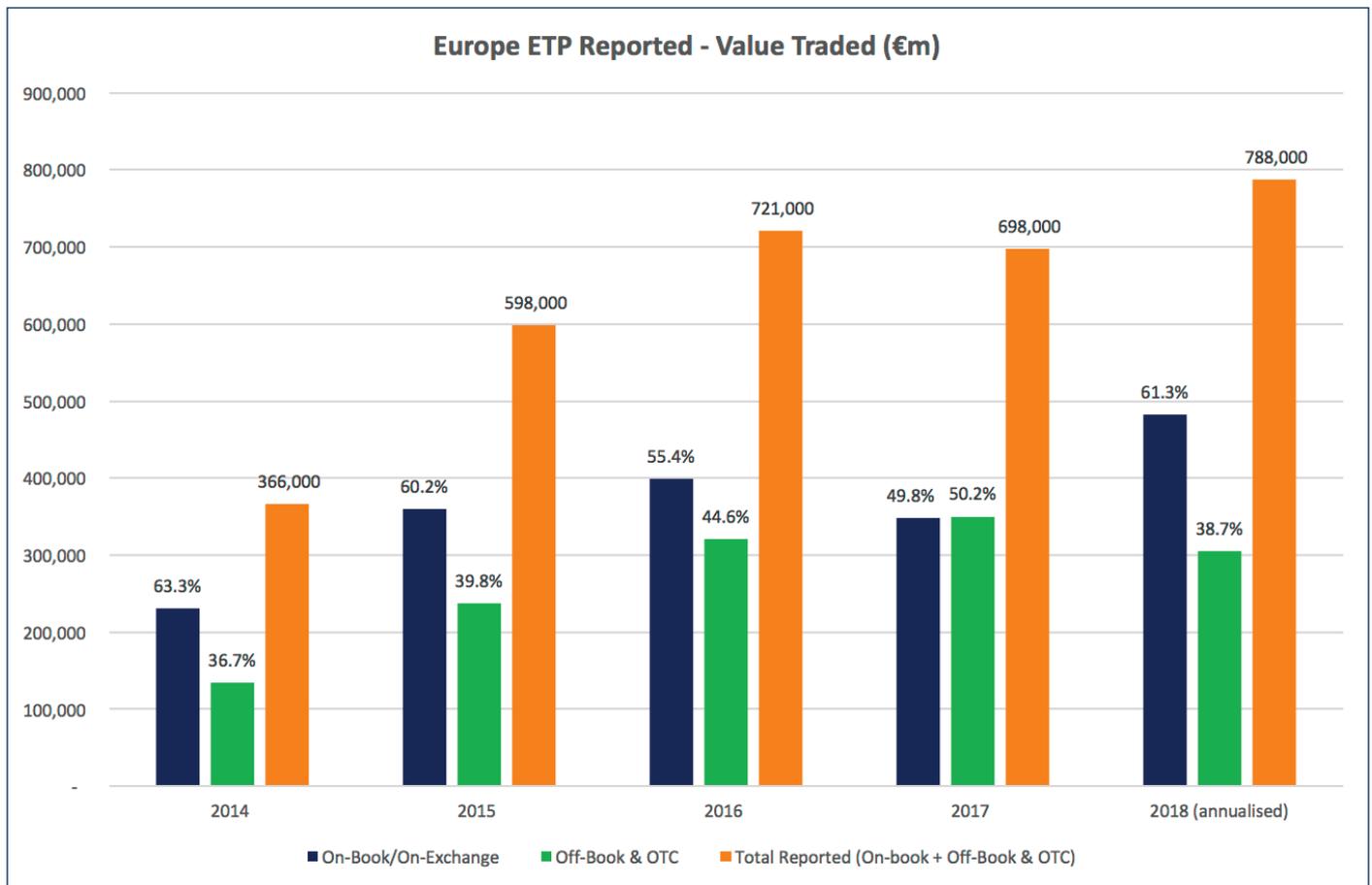
ETPs – Pan-European products designed for all but dominated by institutional participation

The added transparency under MiFID II confirms the extent to which ETP activity is OTC, suggesting that the fragmented liquidity and post trade environment in the European ETP market are arguably less of an issue for institutional investors looking to trade in size. If the industry is to grow retail participation, then it needs to evolve its on-exchange on-book activity and interestingly the early figures suggest this may be happening.

Cboe Europe, Europe's largest equities exchange and trade reporting venue, estimates that over the past four years, as much as 70% of the value of all trading activity in ETPs has occurred over-the-counter (OTC).

Whilst the proportion of OTC trades reported in 2017 appears to have increased over previous years, figures for Q1 2018 actually represent a decline year-over-year for trades done OTC (see Figure 1. It is important to note that whilst firms may report trades to Cboe Europe that they have entered into on venues like Bloomberg MTF and Tradeweb's RFQ, Cboe Europe does not, as yet, capture trades reported by such venues nor trades reported to Trade Echo.

Figure 1: Size of European ETP Market, By Total Value Traded (in € millions)



Source: Cboe Europe; data as of 31 March 2018

With so many trades, particularly by value, having gone unreported, the size and liquidity of the ETP market in Europe has been difficult to gauge and to confirm to potential investors. The increased transparency now becoming available should also improve price discovery, the formation of on-exchange markets and attract new investors.

OTC Trading: Lower Volumes, Higher Value

OTC trades that have been reported historically offer an intriguing insight into the character of the European ETP market.

More than half (50.2%) of total reported ETP trade value in 2017 took place off-book /OTC, as compared with 48.0% in lit venues. This represents a slight increase from the previous year, where 44.7% of all ETP value traded was exchanged OTC (see Figure 2).

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Figure 2: Reported European ETP Value Traded (in € millions)

Europe ETP Value Traded (€m)					
2014	Lit Book	Dark Book	Auction Book	Off Book + OTC	Reported Total
Total Value Traded	€222,943	€253	€8,215	€134,267	€365,678
% Value Traded	61.0%	0.07%	2.2%	36.7%	
Total # Trades	5,322,122	3,980	177,493	395,647	
Average Trade Size	€41,890	€63,546	€46,284	€339,360	
2015	Lit Book	Dark Book	Auction Book	Off Book + OTC	Reported Total
Total Value Traded	€346,813	€636	€12,384	€238,029	€567,862
% Value Traded	58.0%	0.11%	2.1%	39.8%	
Total # Trades	8,741,095	20,923	225,632	585,167	
Average Trade Size	€39,676	€30,375	€54,885	€406,771	
2016	Lit Book	Dark Book	Auction Book	Off Book + OTC	Reported Total
Total Value Traded	€362,091	€138	€7,010	€321,388	€720,627
% Value Traded	54.4%	0.02%	1.0%	44.6%	
Total # Trades	10,946,809	20,881	242,738	825,225	
Average Trade Size	€35,818	€6,594	€28,878	€389,454	
2017	Lit Book	Dark Book	Auction Book	Off Book + OTC	Reported Total
Total Value Traded	€335,240	€506	€12,182	€350,204	€698,131
% Value Traded	48.0%	0.07%	1.7%	50.2%	
Total # Trades	9,378,451	24,856	310,942	532,532	
Average Trade Size	€35,746	€20,361	€39,177	€657,620	
Q1 2018 (annualised)	Lit Book	Dark Book	Auction Book	Off Book + OTC	Reported Total
Total Value Traded	€465,157	€579	€17,345	€304,673	€787,756
% Value Traded	59.2%	0.1%	2.0%	38.7%	
Total # Trades	13,038,000	262,408	393,036	278,184	
Average Trade Size	€35,677	€2,208	€44,132	€1,095,233	

Source: Cboe Europe; data as of 31 March 2018

Furthermore, the total number of off-book/OTC reported trades fell 35% between 2016 and 2017, even though their total value rose by 9%, leading to the average reported value per OTC trade rising 69% between 2016 and 2017. These figures suggest that a large number of OTC trades, perhaps those that were being negotiated through RFQ venues, were not reported.

Meanwhile, the total volume of reported trades on-exchange, which is more than a factor of 10 greater than that for OTC markets, also fell between 2016 and 2017, by 14%. However, the total value of those trades fell too, and by the same amount: 14%.

From 2014 to 2017, total ETP trading volume for both on-exchange and OTC increased substantially, by 76% and 86%, respectively. But while the average reported value of the trades on lit venues fell by 13% over those four years, suggesting perhaps greater retail participation on exchanges, for OTC markets the average reported trade value rose 94%, highlighting institutional participation.

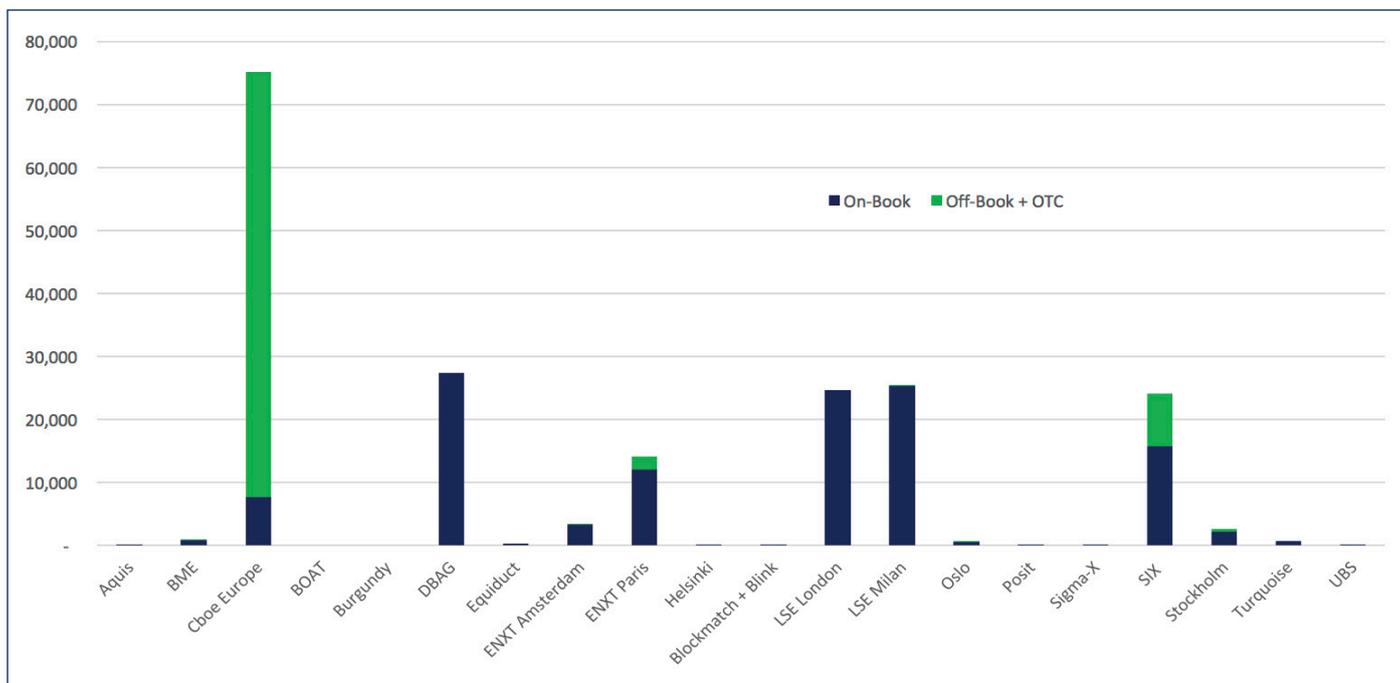
Multiple Venues for Trading and Trade Reporting

MiFID II itself will not concentrate activity on fewer and fewer venues, only competition and issuer practices will evolve this. The figures for Q1 2018 highlight the number of exchanges and trade reporting venues contributing the overall market activity.

¹ "Off-book" refers to OTC trades that were brought on-exchange where they could be price-validated, reported and available for clearing by a central counterparty clearinghouse (CCP).

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Figure 3: Total European ETP Volume By Venue



Source: Trade data licensed by or reported to Cboe Europe

N.B. OTC trades reported to certain APAs is not yet captured in the above data, notably; Trade Echo, Tradeweb and Bloomberg

MiFID II Shines A Light

MiFID II is designed to increase transparency by requiring investors, including those participating in OTC markets, to report more information about their trades.

Under the **new regulations**, ETP investors must now report no fewer than 81 data points about each transaction made, including the identity of both buyer and seller, the executed price of the trade and the number of shares traded.

Trade data will be date- and time-stamped, published through an Approved Publication Arrangement (APA), and must be stored for at least five years.

Through MiFID II, the European Union aims to foster market safety, transparency and accountability, as well as boost investor confidence and participation. Regulators hope such benefits will encourage a portion of OTC participation to move on exchange.

In beginning to reveal the true depth and size of the ETP market, the massive increase in the reported average notional value for OTC ETP trades in Q1 2018 reveals what had always been going on rather than representing a sudden spike in the amount of activity being done OTC.

What can we expect?

Though it is too early to draw conclusions from three months' worth of data, MiFID II is increasing transparency in the European ETP market. "Whilst the market has always acknowledged that the bulk of ETP value trading has been OTC, only those really involved were able to see it. Being able to quantify the market's actual liquidity and observe the price of trades, large and small, will encourage greater investment, enhance price formation and lead to further and broader activity", suggested Guy Simpkin, Head of Business Development and Cboe Europe.

❖ Please contact SalesEurope@Cboe.com for more details.