

Consultation on the market structure for the trading of smaller equity securities outside of the FTSE 350 index

Closing date for responses 31 January 2014

Issued 10 December 2013

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1. Executive Summary

London Stock Exchange is conducting a market consultation to further enhance the trading of equity securities outside of the FTSE 350 index (“smaller securities”). This paper covers the following areas:

- Proposals to improve the functionality of SETSqx Auctions
- Improving the depth at touch of smaller SETS securities by preventing small quantity orders setting the best bid or offer
- Criteria for a security moving from quote driven to SETS

This paper will be used to guide development of the secondary market for smaller securities and invites responses from involved and interested parties. The previous December 2012 Market Consultation on smaller securities can be found as a download at:

www.lseg.com/tradingservices

2. Introduction

In order to ensure that our trading services for the trading of smaller securities continue to meet the needs of a wide range of customers and investors, London Stock Exchange is undertaking a further market consultation that is focused on the trading of smaller securities.

London Stock Exchange currently provides three trading services for smaller securities:

- SETS, a full electronic order book with integrated market maker executable quotes and Central Counterparty Clearing, permitting anonymous pre and post trading;
- SETSqx, a hybrid trading service that provides the functionality of four daily electronic order book auctions with standalone non-electronic market maker quotes; and;
- SEAQ, a trading service used for AIM and some fixed income securities whereby at least two competing registered market makers provide non-electronic market maker quotes

As of November 2013, there are 898 securities on SETS, 1046 securities on SETSqx, and 604 securities on SEAQ.

Approach

London Stock Exchange seeks to gather feedback from all stakeholders with interest in the secondary market trading of equity securities outside the FTSE 100 and FTSE 250 indices. This feedback will be used to inform London Stock Exchange on the development of its trading services for smaller securities from a liquidity and functionality standpoint.

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3. Timetable and Contact Details

The consultation period is 7.5 weeks, and responses are requested by 31 January 2014.

Responses can be sent by email to: clients@lseg.com

Alternatively, they can be posted to:

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Consultation Questions

Information on Respondent

<p>Type of Firm</p> <p>(indicate as many functions as appropriate)</p>	<p>Issuer <input type="checkbox"/></p> <p>Corporate Adviser <input type="checkbox"/></p> <p>Market Maker <input type="checkbox"/></p> <p>Institutional Investor <input type="checkbox"/></p> <p>Retail Broker <input type="checkbox"/></p> <p>Banks or Institutional Broker <input type="checkbox"/></p> <p>Clearing Firm <input type="checkbox"/></p> <p>Index publisher <input type="checkbox"/></p> <p>Other <input type="checkbox"/></p> <p>Regulator <input type="checkbox"/></p> <p>Trade Association <input type="checkbox"/></p> <p>Individual investor <input type="checkbox"/></p>
<p>Name of Organisation/Individual</p>	
<p>Business Functions Represented (we request one response per-entity representing that entity's corporate view):</p>	
<p>Roles of Individuals contributing:</p>	
<p>Name of Individuals contributing (optional);</p>	
<p>Contact details:</p>	

4. SETSqx Auctions

SETSqx combines continuous market maker non-electronically executable quotes with four electronic auctions (8am, 11am, 3pm and 4:35pm) which are open to all market participants with order book access.

Following participant feedback, London Stock Exchange is proposing the following developments to the SETSqx auction service to improve the trading experience for investors, market participants and issuers.

- I. Moving the existing 8am auction to 9am, or the 11am auction to 10.15 to create a mid morning auction. The mandatory quoting period for market makers would remain from 08:00 until the completion of the closing auction; and
- II. Changing the current SETSqx auctions. Once the price has been formed as per current practice to maximise execution value at a given price point, orders will then be filled on time priority rather than strict price priority. This proposed change would ensure that an order would only take priority over an older order where it actually delivered price improvement.

Another potential change to the SETSqx auction process would be where orders can continue to be entered throughout the trading day but would not be displayed. Instead, where there are matched orders in the auction, an indicative uncrossing volume and price would only be disseminated for the 10 minute period immediately before each of the scheduled 4 uncrossing times.

Questions

1. Would the creation of a mid morning auction be more attractive to potential client flow?

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2. Would you support only allowing a new SETSqx order to take execution priority over an older order if it led to genuine price improvement?

3. Do you support converting SETSqx auctions to only the display of indicative uncrossing price and size which would be disseminated in the 10 minutes ahead of a scheduled uncrossing?

4. Do you have any other suggestions for improving the SETSqx auction service?

5. Small orders setting the best bid or offer in smaller SETS securities

SETS is a full electronic order book with integrated market maker executable quotes and Central Counterparty Clearing, permitting pre and post trade anonymity.

Following discussions with market participants over the past 12 months, London Stock Exchange understands that there are a number of views on orders of small size setting the best bid and offer (BBO).

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A number of market participants have noted that they may see the BBO in a smaller SETS security set by an order that is a small percentage of the Exchange Market Size.

London Stock Exchange proposes a development to the SETS trading service for smaller securities in order to improve the depth available for execution at the BBO. It is proposed to introduce a minimum order size for new resting orders to enter the order book and create a new BBO.

Under this proposal orders of any size could still be submitted to SETS. All aggressive orders that execute without resting on the book would be completely unaffected. Only passive orders that are sized at least x% of the Exchange Market Size or greater would be able to set a new BBO. Smaller passive orders priced at or outside current BBO would be processed as per current practice today, however submitters of smaller passive orders within the current BBO would receive an acknowledgement message confirming that their order had been re-priced to join the ruling BBO.

Questions

1. Do you think liquidity provision in smaller SETS securities would be improved if small orders had to be of significant size to improve the best bid / offer?
2. Would you support this development?
3. Do you have any other suggestions for improving liquidity provision in smaller SETS securities?

6. Criteria for a security moving from quote driven to SETS

In December 2012 London Stock Exchange conducted a market consultation in smaller securities which proposed new criteria for the allocation of stocks to trading services. A new quarterly review process that identifies smaller SETS securities that may be more suited to a quote driven trading service, was implemented in February 2013.

Further information on equity trading service selection criteria can be found in the Millennium Exchange Business Parameters document (third tab) at:

www.lseg.com/tradingservices

London Stock Exchange's current process is that an issuer residing on the SETSqx or SEAQ trading service can request to be moved to SETS, providing it:

- Has support of at least one market maker prepared to quote the EMS of at least £2,500; and
- Is eligible for clearing

London Stock Exchange gives the issuer and its adviser the ability to choose the trading service it resides on, dependant on market maker support, to ensure that the issuer resides on the trading service it feels is most suitable for its security. London Stock Exchange is proposing that where a market maker agrees to support a security on SETS, it must guarantee support for a minimum of three months.

Questions

1. Do you believe that support of at least one market maker is sufficient for a security to reside on SETS?
2. Do you have any further comments on this?

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