

BME Trading Focus

Improving execution for retail investors



BME Exchange – Market Structure

Introduction

In the recent years, especially after the covid-19 pandemic, retail activity in stock markets has increased. BME historically has had a significant retail presence and offers a liquidity provision service aimed exclusively at improving execution quality for these retail investors, **without any additional cost**.

In this scheme, Retail Liquidity Providers (RLPs) send their orders to the central order book to be filled only against orders flagged as retail. The orders of the retail investors are always traded at the **best price available**, whether it comes from an RLP or from another participant in the same consolidated multilateral order book. If at any time the RLP is not present or an order with better price enters the book, the retail investor also interacts with it, as RLPs compete with the rest of the participants. Therefore, by trading against an RLP, **execution of a retail order can only improve** relative to the institutional order book.

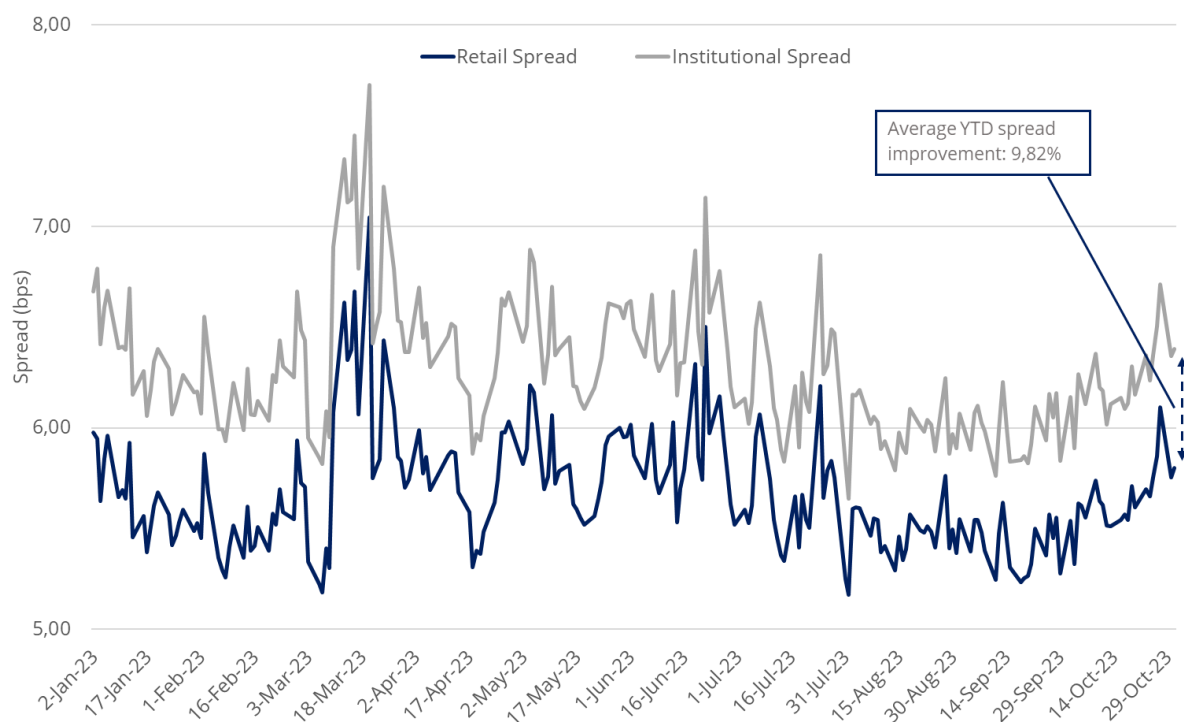
This paper is going to measure how this service contributes to a better execution for retail investors in terms of spread and prices. The analysis covers data from January to October 2023.

1 Spread improvement

With the contribution of RLPs, the spread achieved in the consolidated book is substantially lower than the institutional spread¹. On average, since January 2023, retail clients could benefit from a spread of 5.67 basis points (bps), which was **0.62 bps lower** than the spread for the rest of the market, that is a **9.82% improvement**.

The following graph shows this evolution:

Graph 01: IBEX35® retail vs. institutional spread



Data source: BME. Securities: IBEX 35® Equities. | Sample period: 02 Jan 2023 – 31 October 2023.

¹ Institutional spread understood as the spread for the overall market participants, excluding orders introduced by Retail Liquidity Providers.

2 Price improvement

Considering the mentioned results on spread improvement, the next step is to analyze the price improvement of trading against the RLPs relative to the best price of the institutional order book. This is a very relevant metric within the factors for **best execution**.

Taking into account all the trades carried out by RLPs in the period, **61% of the turnover obtained a price improvement** relative to the best price of the institutional book.

The **price improvement for members is 3 basis points**, taking into account the turnover-weighted average:

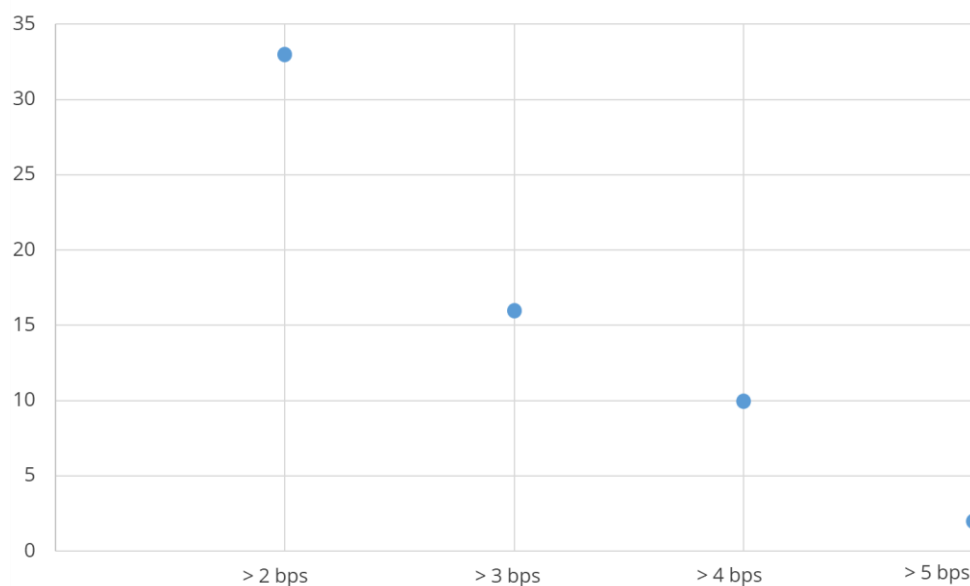
Table 01: Retail Liquidity Provision General Price Improvement.

Price improvement	
% Turnover with price improvement	61%
Price improvement (turnover-weighted average)	3 bps

Data source: BME. Securities: IBEX 35® Equities. | Sample period: 02 Jan 2023 – 31 October 2023.

On a security level, 2 securities have a turnover-weighted average price improvement over 5 bps and 8 other have a price improvement over 4 bps, following the distribution below:

Graph 02: IBEX35® Securities by Price Improvement



Data source: BME. Securities: IBEX 35® Equities. | Sample period: 02 Jan 2023 – 31 October 2023.

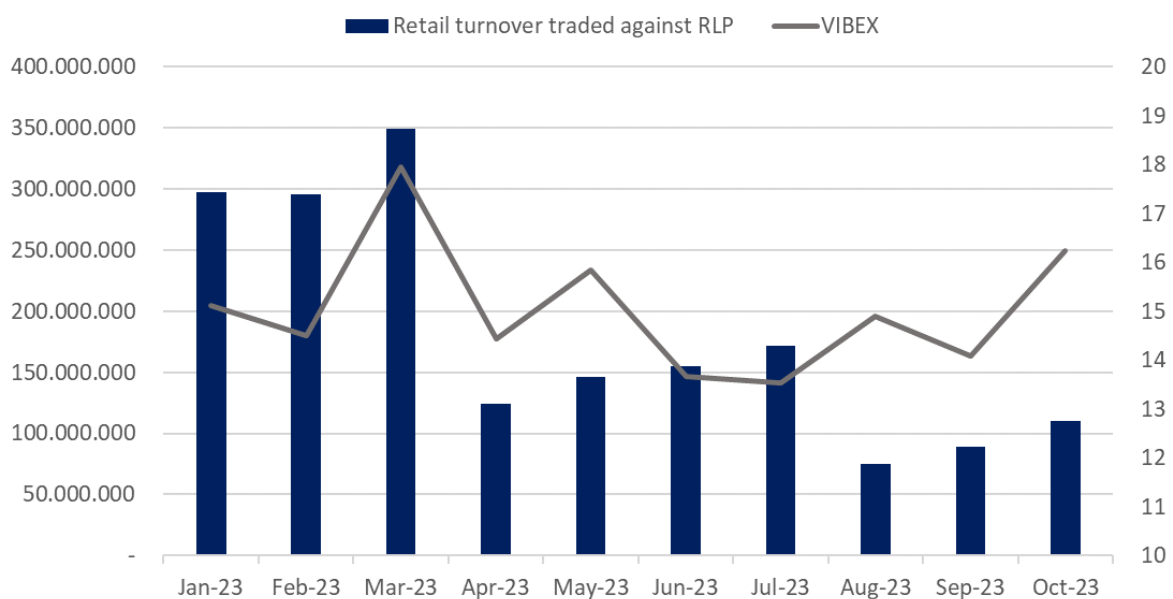
3 In-depth analysis

The RLPs enter passive² orders that stay in the book creating a new first level of prices or at the existing best bid/offer. Thus, they mainly interact with aggressive orders; in fact, **97% of the retail orders traded against RLPs are aggressive**.

Aggressive orders benefit the most from trading against Retail Liquidity Providers: the correlation between the number of aggressive retail orders and the average price improvement is of 79%. During the period analyzed, the monthly **price improvement increases 0.3 bps per each million euros traded against RLPs³**.

In cases of **high volatility** and price uncertainty the benefits of a Retail Liquidity Provision scheme increase as can be seen in the Graph 03, which shows the monthly evolution of retail turnover traded against RLPs and VIBEX⁴:

Graph 03: Turnover traded against RLPs and VIBEX.



Data source: BME. Securities: IBEX 35® Equities. | Sample period: 02 Jan 2023 – 31 October 2023.

² Art. 2 of Commission Delegated Regulation (EU) 2017/576 defines a “passive order” as an order entered into the order book that provided liquidity and an “aggressive order” as an order entered into the order book that took liquidity.

³ Number of observations: 86. Low and top 10 observations were removed to exclude outlier values: $R^2:0.33$.

⁴ [VIBEX](#): index measuring the volatility of the IBEX35®.

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