



Brussels, 13.6.2016
C(2016) 3523 final

COMMISSION DELEGATED REGULATION (EU) .../...

of 13.6.2016

**supplementing Directive 2014/65/EU of the European Parliament and of the Council on
markets in financial instruments with regard to regulatory technical standards
specifying the requirements on market making agreements and schemes**

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

Directive 2014/65/EU in financial instruments (MiFID II), pursues two main goals in specifying the requirements for algorithmic traders engaged in market making strategies as well as the correlative obligations of trading venues. First, it introduces an element of predictability of liquidity as investment firms pursuing market making strategies are bound by contractual obligations. Secondly, it requires the presence of those firms in the market during a specified proportion of the trading venue's trading hours, particularly during stressed market conditions.

In this context, MiFID II empowers the Commission to adopt, following submission of draft regulatory technical standards by the European Securities and Markets Authority (ESMA), a Delegated Regulation further specifying the requirements applicable to investment firms engaged in algorithmic trading pursuing market making strategies and for trading venues where those market making strategies may take place.

The draft regulatory technical standards were submitted to the Commission on 28 September 2015. In accordance with Article 10(1) of Regulation No (EU) 1095/2010 establishing ESMA, the Commission shall decide within three months of receipt of the draft standards whether to endorse them. The Commission may also endorse the draft standards in part only, or with amendments, where the Union's interests so require, having regard to the specific procedure laid down in those Articles.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

In accordance with Article 10 of the Regulation (EU) 1095/2010 ESMA has carried out a public consultation on the draft regulatory technical standards. A consultation paper was published on 19 December 2014 on ESMA website and the consultation closed on 2 March 2015. In addition, ESMA sought the views of the Securities and Markets Stakeholder Group (SMSG) established in accordance with Article 37 of the ESMA Regulation. The SMSG chose not to provide advice on these issues due to the technical nature of the standards.

Together with the draft technical standards, and in accordance with the third subparagraph of Article 10(1) of Regulation (EU) No 1095/2010, the ESMA has submitted its impact assessment, including the analysis of costs and benefits related to the draft technical standards. This analysis is available at http://www.esma.europa.eu/system/files/2015-esma-1464_annex_ii_-_cba_-_draft_rts_and_its_on_mifid_ii_and_mifir.pdf

3. LEGAL ELEMENTS OF THE DELEGATED ACT

The right to adopt a Delegated Regulation is provided for under Article 17(7)(a), (b) and (c) and Article 48(12)(a) of MiFID II. Under these provisions, the Commission is empowered to adopt a Delegated Regulation further specifying the requirements on market making agreements and schemes.

ESMA submitted to the Commission one draft regulatory technical standard bundling the two empowerments in one legal act. To ensure coherence between those provisions, which should enter into force at the same time, and to facilitate a comprehensive view and compact access to them by persons subject to those

obligations, including investors that are non-Union residents, it is desirable to include these regulatory technical standards in a single Regulation.

In addition the provisions of this Regulation are closely linked in terms of substance since they all deal with a set of related obligations for investment firms engaged in algorithmic trading pursuing market making strategies and for trading venues where those market making strategies may take place.

Article 1 of this Regulation specifies the circumstances under which an investment firm performing a market making strategy should enter into a market making agreement.

Article 2 lays down the content and scope of market making agreements.

Article 3 provides a list of exceptional circumstances under which the obligation of investment firms to provide liquidity on a regular and predictable basis to the trading venue is not required.

Article 4 further specifies the obligation applicable to trading venues, to identify and make public such exceptional circumstances as well as the obligation to set out clear procedures to resume normal trading when the exceptional circumstance has ended.

Article 5 specifies the conditions under which trading venues shall not be required to have a market making scheme in place.

Article 6 lays down the minimum market making obligations that trading venues must provide when designing a market making scheme.

Article 7 sets out the requirements to ensure that market making schemes are fair and non-discriminatory.

COMMISSION DELEGATED REGULATION (EU) .../...

of 13.6.2016

supplementing Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards specifying the requirements on market making agreements and schemes

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU¹, and in particular Article 17(7)(a), (b) and (c) and Article 48(12)(a) and (f) thereof,

Whereas:

- (1) Two main goals should be attained in specifying the market making obligations of algorithmic traders pursuing market making strategies and the related obligations of trading venues. First, an element of predictability to the apparent liquidity in the order book should be introduced by establishing contractual obligations for investment firms pursuing market making strategies. Second, the presence of those firms in the market should be incentivised, particularly during stressed market conditions.
- (2) The provisions in this Regulation are closely linked, since they deal with a set of related obligations for investment firms engaged in algorithmic trading pursuing market making strategies and for trading venues where those market making strategies may take place. To ensure coherence between those provisions, which should enter into force at the same time, and to facilitate a comprehensive view of and a compact access to them by persons subject to those obligations, including investors that are non-Union residents, it is desirable to include those provisions in a single Regulation.
- (3) This regulation should apply not only to regulated markets but also to multilateral trading facilities and organised trading facilities as required by Article 18(5) of Directive 2014/65/EU.
- (4) Market making strategies may relate to one or more financial instruments and one or more trading venues. However, in certain cases, it may not be possible for a trading venue to monitor strategies involving more than one trading venue or instrument. In those cases, trading venues should be able, in accordance with the nature, scale and complexity of their business, to monitor market making strategies pursued on their own venue, and therefore should restrict corresponding market making agreements and schemes to those situations only.

¹ OJ L 173, 12.06.2014, p. 349.

- (5) All members or participants engaged in algorithmic trading pursuing a market making strategy on a trading venue which allows for or enables algorithmic trading should enter into a market making agreement with the operator of that trading venue. Incentives under a market making scheme should, however, only be required for certain instruments traded under a continuous auction order book trading system. Nothing should prevent trading venues from establishing any other type of incentives at their own initiative for other financial instruments or trading systems.
- (6) Cases where there is no mandatory requirement for trading venues to set out a market making scheme taking into account the nature and scale of the trading on those trading venues should be clearly identified. To this end, it is appropriate to identify financial instruments and trading systems that increase the risk of high volatility and for which it is crucial that the provision of liquidity is incentivised, in order to ensure orderly and efficient functioning of markets. In this respect, this Regulation should take into account that when certain liquid instruments are algorithmically traded in continuous auction order book trading systems there is a greater risk of overreaction to external events which can exacerbate market volatility.
- (7) Trading venues for which it is considered appropriate to have market making schemes in place in accordance with this Regulation should be required to review their existing agreements to ensure that the provisions of those agreements concerning algorithmic traders pursuing a market making strategy comply with this Regulation.
- (8) The market making scheme may incentivise investment firms having signed a market making agreement to perform their obligations under normal trading conditions, but should provide incentives for firms effectively contributing to liquidity provision under stressed market conditions. Therefore, there should be a scheme of incentives to limit a sudden and large-scale withdrawal of liquidity under stressed market conditions. In order to avoid divergent application of this obligation, it is important that trading venues communicate the existence of stressed market conditions to all parties to the market making scheme. Exceptional circumstances should be determined exhaustively and therefore do not include any regular or pre-planned information events that may affect the fair value of a financial instrument due to changes in the perception of market risk, whether occurring during or outside trading hours.
- (9) Members, participants or clients having signed a market making agreement have to meet a minimum set of requirements in terms of presence, size and spread in all cases. However, the members, participants or clients meeting those minimum requirements only under normal trading conditions may not necessarily access any type of incentive. Trading venues may establish market making schemes which only reward members, participants or clients meeting more stringent parameters in terms of presence, size and spread. The market making schemes put in place by trading venues should therefore clearly indicate the conditions for accessing incentives and should take into account the effective contribution to the liquidity in the trading venue measured in terms of presence, size and spread by the participants in the schemes.
- (10) In order to prevent divergent application of this Regulation and to ensure fair and non-discriminatory implementation of market making schemes, it is crucial that all members of, participants in and clients of a trading venue are informed in a coordinated manner of the occurrence of exceptional circumstances. It is therefore necessary to specify the communication obligations of the trading venues in such exceptional circumstances.

- (11) For reasons of consistency and in order to ensure the smooth functioning of the financial markets, it is necessary that the provisions laid down in this Regulation and the related national provisions transposing Directive 2014/65/EU apply from the same date.
- (12) This Regulation is based on the draft regulatory technical standards submitted by the European Securities and Markets Authority to the Commission.
- (13) The European Securities and Markets Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Securities and Markets Stakeholder Group established by Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council²,

HAS ADOPTED THIS REGULATION:

Article 1

Obligation for investment firms to enter into a market making agreement

1. Investment firms shall enter into a market making agreement regarding the financial instrument or instruments in which they pursue a market making strategy with the trading venue or venues at which this strategy takes place where, during half of the trading days over a one month period, in execution of the market making strategy, they:
 - (a) post firm, simultaneous two-way quotes of comparable size and competitive prices
 - (b) deal on their own account in at least one financial instrument on one trading venue for at least 50% of the daily trading hours of continuous trading at the respective trading venue, excluding opening and closing auctions.
2. For the purposes of paragraph 1:
 - (a) a quote shall be deemed to be a firm quote where it includes orders and quotes that under the rules of a trading venue can be matched against an opposite order or quote;
 - (b) quotes shall be deemed simultaneous two-way quotes if they are posted in such a way that both the bid and the ask-price are present in the order book at the same time;
 - (c) two quotes shall be deemed of comparable size when their sizes do not diverge by more than 50% from each other;
 - (d) quotes shall be deemed to have competitive prices where they are posted at or within the maximum bid-ask range set by the trading venue and imposed upon every investment firm that has signed a market making agreement with that trading venue.

² Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

Article 2

Content of market making agreements

1. The content of a binding written agreement referred to in Article 17(3)(b) and Article 48(2) of Directive 2014/65/EU shall include at least:
 - (a) the financial instrument or instruments covered by the agreement;
 - (b) the minimum obligations to be met by the investment firm in terms of presence, size and spread that shall require at least posting firm, simultaneous two-way quotes of comparable size and competitive prices in at least one financial instrument on the trading venue for at least 50% of daily trading hours of during which continuous trading takes place excluding opening and closing auctions and calculated for each trading day;
 - (c) where appropriate, the terms of the applicable market making scheme;
 - (d) the obligations of the investment firm in relation to the resumption of trading after volatility interruptions;
 - (e) the surveillance, compliance and audit obligations of the investment firm enabling it to monitor its market making activity;
 - (f) the obligation to flag firm quotes submitted to the trading venue under the market making agreement in order to distinguish those quotes from other order flows;
 - (g) the obligation to maintain records of firm quotes and transactions relating to the market making activities of the investment firm, which are clearly distinguished from other trading activities and to make those records available to the trading venue and the competent authority upon request.
2. Trading venues shall continuously monitor the effective compliance of the relevant investment firms with the market making agreements.

Article 3

Exceptional circumstances

The obligation for investment firms to provide liquidity on a regular and predictable basis laid down in Article 17(3)(a) of Directive 2014/65/EU shall not apply in any of the following exceptional circumstances:

- (a) a situation of extreme volatility triggering volatility mechanisms for the majority of financial instruments or underlyings of financial instruments traded on a trading segment within the trading venue in relation to which the obligation to sign a market making agreement applies;
- (b) war, industrial action, civil unrest or cyber sabotage;
- (c) disorderly trading conditions where the maintenance of fair, orderly and transparent execution of trades is compromised, and evidence of any of the following is provided:
 - (i) the performance of the trading venue's system being significantly affected by delays and interruptions;
 - (ii) multiple erroneous orders or transactions;
 - (iii) the capacity of a trading venue to provide services becoming insufficient;

- (d) where the investment firm's ability to maintain prudent risk management practices is prevented by any of the following:
 - (i) technological issues, including problems with a data feed or other system that is essential to carry out a market making strategy;
 - (ii) risk management issues in relation to regulatory capital, margining and access to clearing,
 - (iii) the inability to hedge a position due to a short selling ban;
- (e) for non-equity instruments, during the suspension period referred to in Article 9(4) of Regulation (EU) No 600/2014 of the European Parliament and of the Council³.

Article 4

Identification of exceptional circumstances

1. Trading venues shall make public the occurrence of the exceptional circumstances referred to in points (b), (c) and (e) of Article 3(1) and, as soon as technically possible, the resumption of their normal trading after the exceptional circumstances have ceased to exist.
2. Trading venues shall set out clear procedures to resume normal trading after the exceptional circumstance have ceased to exist, including the timing of such resumption, and shall make those procedures publicly available.
3. Trading venues shall not extend the declaration of exceptional circumstances beyond market close unless this is necessary in the circumstances referred to in points (b), (c) and (e) of Article 3(1).

Article 5

Obligation for trading venues to have market making schemes in place

1. Trading venues shall not be required to have market making scheme as referred to in Article 48(2)(b) of Directive 2014/65/EU in place except for any of the following classes of financial instruments traded through a continuous auction order book trading system:
 - (a) shares and exchange traded funds for which there is a liquid market as defined in accordance with Article 2(1)(17) of Regulation (EU) No 600/2014 and as specified in [reference to Commission Delegated Regulation under MIFIR articles 1 and 3 determining liquid markets for the above instruments];
 - (b) options and futures directly related to the financial instruments set out in point (a);
 - (c) equity index futures and equity index options for which there is a liquid market as specified in accordance with point (c) of Article 9(1) and point (c) of Article 11(1) of Regulation (EU) No 600/2014 and [reference to Commission Delegated Regulation on transparency requirements in respect of bonds, structured finance products, emission allowances and derivatives].

3

2. For the purposes of paragraph 1, a continuous auction order book trading system means a system that by means of an order book and a trading algorithm operated without human intervention matches sell orders with buy orders on the basis of the best available price on a continuous basis.

Article 6

Minimum obligations as regards the market making schemes

1. Trading venues shall describe in their market making scheme the incentives and the requirements that must be met in terms of presence, size and spread by investment firms in order to access those incentives under:
 - (a) normal trading conditions where the trading venue offers incentives under such conditions.
 - (b) stressed market conditions, taking into account the additional risks under such conditions.
2. Trading venues shall set out the parameters to identify stressed market conditions in terms of significant short-term changes of price and volume. Trading venues shall consider the resumption of trading after volatility interruptions as stressed market conditions.
3. For the purposes of point (a) under paragraph 1, trading venues may in their market making schemes specify that incentives shall only be granted to the best performer or performers.

Article 7

Fair and non-discriminatory market making schemes

1. Trading venues shall publish on their websites the terms of the market making schemes, the names of the firms that have signed market making agreements under each of those schemes and the financial instruments covered by those agreements.
2. Trading venues shall communicate any changes to the terms of the market making schemes to the participants in those schemes at least one month prior to their application.
3. Trading venues shall provide the same incentives to all participants who perform equally in terms of presence, size and spread, in their market making schemes.
4. Trading venues shall not limit the number of participants in a market making scheme. However, they may limit the access to the incentives included in the scheme to the firms which have met pre-determined thresholds.
5. Trading venues shall continuously monitor the effective compliance of the participants with the market making schemes.
6. Trading venues shall establish procedures to communicate the existence of stressed market conditions on its trading venue to all participants in a market making scheme through readily accessible channels.

Article 8

Entry into force and application

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall apply from the date that appears first in the second subparagraph of Article 93(1) of Directive 65/2014/EU.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 13.6.2016

For the Commission
The President
Jean-Claude JUNCKER