RTS 15: Draft regulatory technical standards on market making, market making agreements and marking making schemes

COMMISSION DELEGATED REGULATION (EU) No …/..

of [date]

supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards further specifying the requirements on market making strategies, market making agreements and market making schemes *for investment firms engaged in algorithmic trading technique pursuing a market making strategy*

(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 in particular Articles 17 (7)(a), (b) and (c) and 48 (12)(a) and (f) thereof, and amending Regulation (EU) No. 648/2012.

Whereas:

(1) Directive 2014/65/EU pursues two main goals by determining market making obligations with respect to algorithmic traders. Firstly, the introduction of an element of predictability to the apparent liquidity in the order book by establishing contractual obligations for firms performing certain types of strategies. Secondly, as advanced technologies may bring new risks to the market, the presence of market makers ***who are investment firms engaged in algorithmic trading technique pursuing a market making strategy*** provides market participants with the ability to transfer risks efficiently ~~during stressed market conditions~~.

(2) To that end, Directive 2014/65/EU established two sets of obligations. For those investment firms engaged in algorithmic trading and pursuing “market making strategies”, Article 17 establishes the obligation to sign an agreement with the trading venues where those strategies take place, whereby the firms should provide liquidity to the market on a regular and predictable basis and have certain systems and controls in place. For the trading venues where the investment firms pursue those strategies, Article 48 of Directive 2014/65/EU not only imposes the obligation to sign the aforementioned agreements but also requires having in place a scheme to ensure that a sufficient number of investment firms sign those agreements.

(3) Given the intrinsic relationship between the obligations in both articles, it seems appropriate to include them in the same Regulation.

(4) A number of terms should be defined to clearly identify a limited number of concepts stemming from Directive 2014/65/EU. In particular, it is necessary to clarify in which circumstances a market making strategy ***for those investment firms engaged in algorithmic trading technique pursuing a market making strategy*** is taking place, as this is the element that triggers the rest of the obligations under Articles 17 and 48 of Directive 2014/65/EU in this respect.

(4A) It is also important to be clear that the use of market making regimes is an established and effective practice of many trading venues, used to facilitate the provision of liquidity to the market in one or more financial instruments for the benefit of issuers and investors. The introduction by MiFID Article 17(3) and (4) of similar market making scheme arrangements for investment firms engaged in algorithmic trading technique pursuing a market making strategy is intended to complement these existing practices and not to replace or interfere with them. This is evident from the fact that the definition of market maker in Article 4(1)(7) and its use in the exemption from MiFID in Article 2(1)(d)(i) is independent from the use of market making strategies as per Article 17(4).

(4B) Accordingly, nothing in this Regulation shall limit or interfere with the ability of a trading venue to have in place market making schemes in which those investment firms not covered by these rules for investment firms engaged in algorithmic trading technique pursuing a market making strategy under MiFID Article 17(3) and (4), may continue to participate in order to provide liquidity to the market. The provisions of this Regulation shall only apply to the

MiFID Article 17(3) and (4) schemes and the trading venue shall continue to be able to use its discretion, in consultation with its competent authority, to set such other market making schemes on such terms as it considers appropriate, as to performance required, incentives offered (if any) and other measures, in a similar way to that envisaged under Recital 10 below.

(5) Trading venues should establish a scheme of incentives to facilitate investment firms ***engaged in algorithmic trading technique pursuing a market making strategy that are*** engaged in a market making agreement performing their obligations ~~during stressed market conditions, by providing additional benefits compared to those investment firms that only provide liquidity in normal trading hours~~.

(6) Current market practice waives market making obligations after the determination of "fast" market conditions by a trading venue. This Regulation is based on the concept that ~~precisely under those types of conditions,~~ there should be a scheme of incentives to limit as much as possible the effect of sudden collapses of liquidity ***by investment firms engaged in algorithmic trading technique pursuing a market making strategy***. ***Nothing in this Regulation prevents trading venues from varying applicable market maker obligations during fast and/or stressed market conditions, for example by reducing sizes or increasing spreads, to ensure the appropriate provision of liquidity commensurate to the market conditions. Some fast market situations may continue to be considered as an exceptional market conditions.***

(7) As established in Article 17(3) of Directive 2014/65/EU, market making strategies ***for investment firms engaged in algorithmic trading technique pursuing a market making strategy*** may relate to one or more financial instruments and one or more trading venues. However, in certain cases, it may not be practically possible for a trading venue to identify extremely sophisticated strategies. Therefore, trading venues should be able to detect market making strategies in accordance with the nature, scale and complexity of their business. The basic strategy which trading venues should be able to detect is that which affects one instrument traded on their venue. **Further, whilst clearly staying within the definitions of this Regulation, trading venues shall have discretion as to the exact mechanism used to identify and monitor algorithmic market making strategies, in order to accommodate the different technologies, monitoring granularity and capabilities of trading venues, appropriate to the nature and scale of the relevant market.**

(8) This Regulation affects ***investment firms engaged in algorithmic trading technique pursuing a market making strategy*** ~~entities engaged in algorithmic trading and pursuing a market making strategy~~, irrespective of whether trading venues have in place any type of contractual arrangement for ***established market making practices*** ~~liquidity provision~~. [These firms and trading venues should review their existing agreements on market making to ensure that their terms comply with ***Article 9 of*** this Regulation or sign those agreements where there should be one in place.]

(9) With respect to trading venues, this Regulation establishes new obligations and additional capacities that are instrumental for the effective implementation of the framework designed by Articles 17(3) and 48(2) of Directive 2014/65/EU such as the obligations of trading venues with respect to the existence of exceptional circumstances that would impede ***the ability of*** investment firms ***engaged in algorithmic trading technique pursuing a market making strategy*** ~~ability~~ to maintain prudent risk management practices or the identification of market making strategies.

(10) Regulated markets, multilateral trading facilities and organised trading facilities allowing for or enabling algorithmic trading through their systems should be considered as those where algorithmic trading may take place as opposed to trading venues which do not permit algorithmic trading. Whereas the former should have a market making scheme with respect to their members or participants engaged in algorithmic trading, the latter should not be captured by this obligation.

(11) Trading venues should determine the specific parameters to be met by investment firms ***engaged in algorithmic trading technique*** pursuing a market making strategy to access any type of incentives. In particular, trading venues should be able to determine, according to their business models, whether all the firms engaged in ***such*** market making agreements should access ~~the~~ any incentives ***that may be*** provided under the market making scheme.

(12) Trading venues may establish schemes which only reward members meeting certain parameters: either providing a certain degree of quality in the liquidity provided, measured in terms of presence, size and spread, or rewarding only those which have met the requirements above a certain threshold measured in terms of presence, size and spread.
(13) This Regulation bans capping the number of members that may take part in a market making scheme. However, nothing prevents trading venues from establishing systems whereby only those firms providing a certain degree of quality in the liquidity provided, measured in terms of presence, size and spread, can access ~~the~~ ***any*** incentives ***linked to that scheme***.
(14) This Regulation is based on the draft regulatory technical standards submitted by the European Securities and Markets Authority to the Commission.
(15) In accordance with Article 10 of Regulation (EU) No 1095/2010, ESMA has conducted open public consultations on the draft regulatory technical standards, analysed the potential related costs and benefits and requested the opinion of the Securities and Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1095/2010.
HAS ADOPTED THIS REGULATION:

CHAPTER I

General provisions

Article 1

Definitions

For the purpose of this Regulation:
(1) 'trading venue allowing or enabling algorithmic trading through its systems' means a trading venue where order submission and order matching is facilitated by electronic means.
(2) 'trading hours' means the duration of continuous auction trading, and excludes opening/closing auction sessions;
(3) '***algorithmic market making*** hours' means the duration of continuous ~~auction~~ trading excluding:
(a) opening/closing auction sessions;
(b) periods declared to be under stressed market conditions; and
(c) periods declared to be under exceptional market circumstances.
(4) 'firm quote' means an order or a quote that is executable and can be matched against an opposite order or quote under the rules of a trading venue;
(5) 'simultaneous two-way quote' is a two-way quote where both sides are entered into the order book within one second of one another ***and are present and resting at the same time. A National Competent Authority may allow a trading venue to use a period shorter than one second, if appropriate to the nature and scale of activity on that trading venue***;
(6) 'comparable size' means that the size of the opposite quotes posted in the order book does not diverge more than 50% of each other***, and above a certain minimum size as determined and made public by each trading venue***.
(7) 'competitive prices' means quotes posted within ***a reasonable percentage from the*** average bid-ask spread***, as determined and made public by each trading venue***.
(8) 'stressed market condition' refers to a condition declared by the trading venue where the price discovery process and market liquidity is materially affected by at least one of the following:

(a) Significant change in the number of messages being sent to and received from, the systems of a trading venue;
(b) Significant short-term changes in terms of market volume; or
(c) Significant short term changes in terms of price (i.e. volatility).

The said condition includes volatile market conditions or 'fast markets' as defined by the trading venue.
(9) 'disorderly trading conditions' means situations where the maintenance of fair, orderly and transparent execution of trades is compromised by:
(a) a trading systems' performance which is significantly affected by delays and interruptions;
(b) multiple erroneous orders or transactions~~, including cases where orders are not resting for sufficient time to be executed;~~ or

(c) a trading venue has insufficient capacity.

[(10) ' algorithmic market maker' means an investment firms engaged in algorithmic trading technique pursuing a market making strategy as per Article 3(1) of this Regulation]

CHAPTER II

Requirements for investment firms engaged in algorithmic trading technique pursuing a market making strategy

Article 2

General requirements

[Article 17(3) Directive 2014/65/EU]

1. Investment firms engaged in algorithmic trading and intending to pursue a market making strategy in a trading venue shall communicate their intention to the venue.

2. Investment firms engaged in algorithmic trading and pursuing a market making strategy shall sign a market making agreement following the notification by the trading venue in that respect, when the trading venue has detected the effective implementation of a market making strategy without prior notification. In cases where an investment firm is not willing to engage in such agreement following the notification by the trading venue, it shall disconnect the strategy identified.

Article 3

Circumstances in which an investment firm is deemed to pursue a market making strategy

(Article 17(4) Directive 2014/65/EU)

1. For the purposes of this Regulation, an investment firm ***engaged in algorithmic trading technique pursuing a market making strategy*** shall be deemed to pursue a market making strategy if it is ***dealing on own account and*** posting firm, simultaneous two-way quotes of comparable size and competitive prices in at least one financial instrument on a single trading venue for no less than ***50*** % of the daily trading hours ***consistently*** during ***a period of one calendar month.***

A trading venue may randomly sample the one month observation period, to mitigate concerns around gaming.

2. Such strategies may include quotes that are not symmetrical around the mid-point of the market bid-ask range for that financial instrument.

Article 4

Minimum obligations to be specified in the market making agreement *for investment firms engaged in algorithmic trading technique pursuing a market making strategy*

(Article 17(3) Directive 2014/65/EU)

1. The content of the binding written agreement referred to in Article 17(3)(b) of Directive 2014/65/EU shall include, at least:

(a) The organisational requirements for the investment firm in terms of systems and controls with respect to their activity under the market making agreement as described below;

(b) The financial instrument/s covered by the agreement;

(c) The specific obligations of the investment firm in terms of percentage of trading hours, size of the quotes and spread; and

(d) ***Any*** incentives ***that may be offered or*** provided by the trading venue for the performance of the obligations according to the market making scheme ~~under the normal and stressed market conditions, and in particular when trading is resumed after volatility interruptions~~.

2. The agreement shall include at least the following requirements for investment firms:

(a) posting firm, simultaneous two-way quote of comparable size and competitive prices in at least one financial instrument on the trading venue for no less than 50 % of the daily trading hours;

(b) separating the identity of orders and quotes submitted in the performance of the market making agreement from other order flows;

(c) maintaining records of orders and transactions relating to these activities so that these records can be distinguished from other trading activities and be made available to the trading venue and the competent authority; and

(d) implementing procedures to ensure the fulfilment of the requirements under (a) and (b), including having appropriate and effective surveillance, compliance and audit resources to enable relevant monitoring of its market making activity under these requirements.
3. The agreement shall specify that an investment firm engaged in a market making agreement may suspend its market making activity without incurring any penalties from the trading venue, if the trading venue determines the state of its market to be under exceptional circumstances as defined in this Regulation.

Article 5

Exceptional circumstances impeding for investment firms engaged in algorithmic trading technique pursuing a market making strategy providing liquidity on a regular and predictable basis

[Article 17(3)(a) and 48(12)(a) Directive 2014/65/EU]

1. A trading venue shall ensure that its market making agreement ***for investment firms engaged in algorithmic trading technique pursuing a market making strategy*** specifies that in case of exceptional market circumstances as defined below, an investment firm engaged in a market making agreement will not have to adhere to all the obligations stipulated in such an agreement as long as those exceptional circumstances remain.
2. Exceptional circumstances ~~shall only~~ include***, but are not limited to***:
(a) Circumstances of extreme volatility, leading to an interruption of trading with respect to ***some or*** all instruments traded on that venue;
(b) Political and macroeconomic events such as acts of war, industrial actions and civil unrest or acts of cyber sabotage;
(c) System and operational matters that imply disorderly trading conditions;
(d) Circumstances which impede the investment firm's ability to maintain prudent risk management practices which are either:
    (i) Technological issues including problems with a data feed or other system that is essential in order to be able to carry out a market making strategy;
    (ii) Risk management issues, which would encompass problems in relation to capital or clearing; and,
(e) For non-equity instruments, when a national competent authority temporarily suspends the pre-trade transparency requirements following a significant decline in liquidity of a particular class of financial instrument in accordance with Article 9(4) of Regulation (EU) No 600/2014.
3. In particular, the exceptional circumstances described in paragraph 2 shall not include any regular or pre-planned information events that may affect the fair value of a financial instrument owing to changes in the perception of market risk. Such a circumstance may occur during or outside the trading hours.
4. In assessing the performance of investment firms engaged in a market making agreement, periods affected by an exceptional circumstance shall be taken into account to ensure that non-performance by the investment firms during such times is not penalised.
5. The exceptional circumstances shall be made public by the trading venue as soon as technically possible except in the case of circumstances that impede the investment firm's ability to maintain prudent risk management practice as described above.
6. Trading venues shall validate exceptional circumstances that contradict the investment firm's ability to maintain prudent risk management practice.
7. Trading venues must set out procedures to resume algorithmic market makingwhen the period constituting an exceptional circumstance has concluded. These procedures shall include a guide on the timing of such resumption and shall be made publically available.
8. With the exception of situations mentioned in paragraph (2)(b) above, exceptional circumstances cannot automatically be extended beyond the market close.

CHAPTER III

Requirements for trading venues with respect to market making agreements and market making schemes for investment firms engaged in algorithmic trading technique pursuing a market making strategy

Article 6

General

[Article 48(2)(b) Directive 2014/65/EU]

A trading venue allowing or enabling algorithmic trading through its systems shall have a market making scheme in place with respect to the investment firms engaged in algorithmic trading that pursue market making strategies in it.

Article 7

Cases where it is not appropriate for a trading venue to have a market making scheme in place for investment firms engaged in algorithmic trading technique pursuing a market making strategy

[Article 48(2)(a) Directive 2014/65/EU]

Trading venues not allowing for or enabling algorithmic trading through their systems or a specific segment of their systems shall not be required to establish market making schemes for those systems or specific segments of their systems as defined in this Regulation.

Article 8

Market making scheme *for investment firms engaged in algorithmic trading technique pursuing a market making strategy*

1. Trading venues shall establish a market making scheme ***for investment firms engaged in algorithmic trading technique pursuing a market making strategy*** which describes:

(a) The specific content of their market making agreements as described above; and

(b) Such scheme of incentives ***as the trading venues shall, in its discretion deem appropriate*** for the investment firms subject to the market making agreements that will define:

(i) The minimum parameters to be met in terms of presence, size and spread that shall imply at least posting firm, simultaneous two-way quotes of comparable size and competitive prices in no less than one financial instrument on the trading venue for no less than 50 % of the daily trading hours;

(ii) The parameters that should be met in terms of presence, size and spread to access incentives; and

(iii) ***Any*** incentives in cases where those parameters have been met. ~~In particular, the market making scheme shall establish:~~

~~- Incentives offered for performing a market making strategy during normal trading hours.~~ Trading venues may establish that only the best performers under the market making agreement will access those incentives~~; and~~

~~- Incentives offered in stressed market conditions to compensate for the additional risks taken by investment firms engaged in a market making agreement~~

2. Market making schemes shall specify that an investment firm engaged in a market making agreement may suspend its market making activity without incurring any penalties from the trading venue, if the trading venue determines the state of its market to be under exceptional circumstances as defined in this Regulation.

Article 9

Fair and non-discriminatory market making schemes for investment firms engaged in algorithmic trading technique pursuing a market making strategy

1. The terms of the market making scheme shall be publicly disclosed on the website of the trading venue.

2. Any proposed changes to the terms of the market making scheme shall be communicated ***by the trading venue*** to the existing participants ~~not less than three months ahead of the proposed effective date~~ ***with sufficient notice. Trading venues may vary applicable market maker obligations during fast and/or stressed market conditions, for example by reducing sizes or increasing***

spreads, to ensure the appropriate provision of liquidity commensurate to the market conditions.

3. Trading venues shall provide the same incentives ***(if any),*** terms and conditions to all members ***engaged in algorithmic trading technique pursuing a market making strategy that are*** engaged in a market making agreement who perform equally in terms of presence, price and size, according to published, non-discriminatory and objective criteria.

4. Trading venues shall not limit the number of participants in ***such*** a market making scheme, but may limit the access to the incentives to those members which have met certain parameters either providing a certain degree of quality in the liquidity provided, measured in terms of presence, size and spread, or rewarding only those which have met the requirements above a certain threshold measured in terms of presence, size and spread.

5. The incentives offered under ***such a*** market making scheme have to be proportionate to the effective contribution to the liquidity in the trading venue measured in terms of presence, size and spread. In particular, those incentives shall promote the presence of members engaged in market making agreements in case of stressed market conditions.

[6. The provisions of this Article shall apply to all market maker schemes of a trading venue, including those that are not applicable to investment firms engaged in algorithmic trading technique pursuing a market making strategy under this Regulation]

Article 10

Responsibilities of the trading venue for investment firms engaged in algorithmic trading technique pursuing a market making strategy

1. A trading venue shall have in place arrangements in accordance with the nature, scale and complexity of their business to identify market making strategies as defined by Article 17(4) of Directive 2014/65/EU pursued by its members in cases where they have not notified in advance their intention to pursue a market making strategy.

2. Where it is not practically possible for a trading venue to identify strategies involving more than one venue or more than one financial instrument, it shall have arrangements in place to detect strategies affecting one instrument traded in its venue.

3. Trading venues shall monitor and enforce compliance by investment firms of all requirements specified in this Regulation and the market making agreements. In particular, a trading venue shall:

(a) have the ability to ~~set negative incentives~~ ~~***that***~~ ***seek*** to ensure that firms ***engaged in algorithmic trading technique*** pursuing a market making strategy shall:

(i) Inform the trading venue before the implementation of the strategy;

(ii) Sign a market making agreement following the notification by the trading venue where the firm has been detected as pursuing a market making strategy;

(iii) Prevent those firms from implementing that strategy in cases where the firm rejects signing the market making agreement; and

(iv) Ensure that firms engaged in a market making agreement meet the respective requirements laid down in the agreement on a systematic basis. In this respect, trading venues shall ensure that non-compliant firms ***that regularly fail to meet their obligations are subject to appropriate sanctions. Systematic and frequent failure by an investment firm engaged in algorithmic trading technique to meet market maker obligations without cause may lead to its deregistration as a market maker by the trading venue.*** ~~are not only excluded from potential benefits, but also risk a significant fine~~.

(b) put in place effective measures to verify the effective provision of liquidity on an on-going basis, and to detect that the obligations under the market making agreements are fulfilled; and,

(c) keep a detailed record on the measures and penalties adopted, as well as on the monitoring activity carried out on members' behaviour with market making obligations.

4. Trading venues shall publicly disclose on their website:

(a) The terms of ***such*** market making scheme;

(b) The names of all members that have signed ***such*** a market making agreement; and

(c) The financial instruments covered by those agreements.

Article 11

Requirement for trading venues with respect to market making agreements for investment firms engaged in algorithmic trading technique pursuing a market making strategy during stressed market conditions

1. Trading venues shall identify and communicate to the members engaged in a market making agreement the existence of stressed market conditions in their market through readily accessible channels.

2. Trading venues shall establish procedures to determine stressed market conditions, and the trading arrangements during such stressed market conditions. These procedures shall be publicly available.

Article 12

Entry into force

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

It shall apply from 3 January 2017.

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

Done at Brussels,