European Securities and Markets Authority

25 April 2017
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OPINION

Points for convergence in relation to MAR accepted market practices on liquidity contracts

1 Legal basis

1. ESMA's competence to deliver an opinion to competent authorities is derived from Article 29(1)(a) of Regulation (EC) 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)[1] (ESMA Regulation).

2. Pursuant to Article 29(1)(a) of ESMA Regulation, ESMA has to provide opinions to competent authorities for the purpose of building a common Union supervisory culture and consistent supervisory practices, as well as ensuring uniform procedures and consistent approaches throughout the Union.

3. Pursuant to Article 44(1) of ESMA Regulation, this opinion has been adopted by the Board of Supervisors.

2 Background

4. Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (Market Abuse Regulation, MAR)[2] provides a harmonised framework for the prohibition of market manipulation. This encompasses a prohibition on entering into a transaction, placing an order to trade or engaging in behaviour which gives, or is likely to give, a false or misleading signal as to the supply of, demand for, or price of, an instrument within the scope of MAR, or which secures, or is likely to secure, the price of such an instrument at an abnormal or artificial level. However, MAR also provides an exception to the general prohibition of market manipulation. To benefit from that exception, the concerned person needs to establish that the transaction conducted, the order placed or the behaviour engaged in was carried out for legitimate reasons and in accordance with a market practice formally established by a national competent authority, referred to as accepted market practice (AMP).

[1] OJ L 331, 15.12.2010, p. 48.
[2] OJ L 173, 12.6.2014, p. 1

5. According to Article 13 of MAR, a competent authority intending to establish an AMP must notify ESMA and other competent authorities of its intention and ESMA has to issue an opinion on the intended AMP within 2 months from the receipt of the notification. This opinion should assess (a) the compatibility of the intended AMP with Article 13(2) of MAR and Commission Delegated Regulation (EU) 2016/908 of 26 February 2016 supplementing MAR[3] (RTS on AMPs); and (b) whether the establishment of the AMP would not threaten the market confidence in the Union's financial market.

6. During the summer of 2016, four competent authorities notified ESMA of their AMPs relating to liquidity contracts or agreements established under the regime stemming from the now repealed Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (MAD). Another competent authority notified ESMA of its intention to establish an AMP to replace the existing AMP on liquidity contracts previously established under MAD.

7. These AMPs consist in an issuer entering into an agreement with a financial intermediary that is entrusted with the task of enhancing the liquidity of the issuer's financial instruments. Although the notified AMPs are similar in nature, they nevertheless present some differences and peculiarities.

8. In the process of preparing the required ESMA opinions, ESMA considered that it would be beneficial for both competent authorities and for market participants for it to develop, to the extent possible, a relatively common approach in establishing the AMPs on liquidity contracts and the safeguards to be provided by those AMPs with respect to market integrity and confidence. A number of points were identified where the conditions of the AMPs on liquidity contracts could converge across the different Member States.

9. In this context, the four competent authorities that notified their AMPs established under MAD informed ESMA of their intention to introduce significant changes to them. Therefore, ESMA interrupted the process of issuing an opinion on the notified AMPs according to Article 11(2) of RTS on AMPs. Furthermore, on 16 December 2016, ESMA issued its first positive opinion on the AMP proposed by the Spanish NCA, the Comisión Nacional del Mercado de Valores (CNMV) to replace the MAD AMP on liquidity contracts.

10. ESMA has decided to adopt this opinion to convey common criteria that liquidity contract AMPs should have in order to ensure a more consistent and convergent approach to the establishment of AMPs on liquidity contracts across Europe and to ensure transparency on the agreed points of convergence. This opinion should be considered by national competent authorities when establishing such AMPs.

[3] Commission Delegated Regulation (EU) 2016/908 of 26 February 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council laying down regulatory technical standards on the criteria, the procedure and the requirements for establishing an accepted market practice and the requirements for maintaining it, terminating it or modifying the conditions for its acceptance - OJ L 153, 10.6.2016, p. 3–12

3 ESMA opinion

11. ESMA is of the view that the following points for convergence, setting out conditions and limits when establishing AMPs on liquidity contracts under MAR, should be taken into account by national competent authorities. This should ensure increased uniform application of the MAR regime across the Union.

3.1 Financial instruments in scope

12. The AMPs on liquidity contracts should cover shares (or other financial instruments) admitted to trading on regulated markets (RMs) and multilateral trading facilities (MTFs), provided that the issuer that will benefit from the liquidity contract has requested the admission to trading of its shares on the RM or MTF, or has approved their trading on the MTF.

13. The RM or MTF should be a trading venue in the Member State where the national competent authority has established the AMP on liquidity contracts.

3.2 Written form of the contract

14. The AMPs on liquidity contracts should provide for the liquidity contract to be entered into in a written form.

3.3 The performance of the liquidity contracts

15. The performance of the liquidity contract should only be carried out on national trading venues where the concerned instruments are traded, i.e. on RM and MTF in the Member State where the AMP is established by the national competent authority.

16. The person performing the liquidity contract should: i) be a supervised entity, i.e. firm providing investment services under MiFID and, when applicable under MiFID2/MiFIR and ii) execute the liquidity contract in its capacity as member of the trading venue(s) where the transactions relating to the liquidity contract are carried out.

3.4 The need to take into account the liquidity of instruments covered by the AMP

17. AMPs on liquidity contracts should gradate between liquid and less liquid instruments, with stricter requirements for the former, when they are included in the scope of the AMPs.

18. Generally, AMPs on liquidity contracts should use the concept of liquid/illiquid shares under Article 22 of Commission Regulation (EC) No 1287/2006 (implementing MiFID).

19. In order to further differentiate among the liquid shares, AMPs on liquidity contracts may introduce a sub-category of highly liquid shares that are included in the main national equity

index ("Main Index") referred to in Article 6(4) of Commission Implementing Regulation (EU) No 827/2012[4] supplementing the Short Selling Regulation.

20. However, in those Member States where the Main Index encompasses all the liquid shares as determined under MiFID, the differentiation between liquid and less liquid instruments can follow a different approach: the AMP can determine the liquid share category on the basis of their inclusion in the Main Index whereas the sub-category of highly liquid shares would include those shares that are classified as liquid under MiFID.

21. During the execution of a liquidity contract, a share may change category, e.g. as a result of the update of the MiFID list of liquid and illiquid shares or due to a change in the composition of the Main Index. AMPs on liquidity contracts should ensure that such changes are properly taken into account and that the public is informed.

3.5 Trading conditions

22. The trading conditions relating to price limits, volume limits and submission of orders further described below should be considered with regard to the market conditions on the trading venue where the liquidity contract is performed including when the financial instruments are traded on different trading venues.

1) Transmitting both bid and ask orders

23. In normal conditions, the performer of liquidity contracts should be present with orders on both sides of the book, though with no requirement to submit the best bid and best ask or to submit symmetrical bid and ask orders.

2) Price limits

24. AMPs on liquidity contracts should specify price conditions to limit the price impact of the orders transmitted in the execution of the liquidity contract.

25. Orders relating to shares should be at a price that:

    a. **for buy orders**, is not higher than the higher between the last independent trade and the highest independent bid order in the book;

    b. **for sell orders**, is not lower than the lower between the last independent trade and the lowest ask order in the book.

3) Volume limits

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[4] Article 6(4) of Commission Implementing Regulation (EU) No 827/2012 determines the arrangements and measures to be taken in relation to short sales of a share admitted to trading on a trading venue regarding shares which are easy to borrow or to purchase, i.e. shares that meet the liquidity requirements established in Article 22 of Commission Regulation (EC) No 1287/2006, or other shares that are included in the main national equity index as identified by the relevant competent authority of each Member State and are the underlying financial instrument for a derivative contract admitted to trading on a trading venue.

26. In relation to **illiquid shares**, trades should not exceed 25% of the average daily volume on the market in the previous [20 to 30] trading sessions.

27. In relation to **liquid shares**, trades should not exceed 15% of the average daily volume on the market in the previous [20 to 30] trading sessions.

28. Where a sub-category of **highly liquid shares** is introduced, trades should not exceed 5% of the average daily volume on the market in the previous [20 to 30] trading sessions.

29. A single hard threshold (i.e. an amount of 20.000 Euro) may be allowed, especially for very illiquid shares, where even a percentage of 25% of the average daily volume on the market in a number of previous trading sessions may not allow the performer of the liquidity contract to effectively provide liquidity.

30. Each of the above limits and thresholds should take into account all the transactions carried out under the liquidity contract, cumulating buys and sales, without netting them.

4) Performance of the liquidity contract during auction phases

31. Orders submitted during any auction phase should be placed at a price that would not impact the final price of the auction, taking into account the rules and trading mechanisms of the trading venue (e.g. not impacting the theoretical price where calculated by the trading venue).

5) Block trades

32. The liquidity contracts should not generally cover block trades. However, under exceptional circumstances and subject to strict conditions identified in the AMP on liquidity contracts, block trades carried out "on exchange" under the rules of the trading venue may be covered.

3.6 Limits to the resources to be allocated to the performance of the liquidity contract

33. AMPs on liquidity contracts should ensure that the resources allocated to the performance of the liquidity contracts are proportionate and commensurate to its objectives, **taking into account the liquidity of the instruments covered**.

34. AMPs on liquidity contracts should specify the maximum amount of cash and the maximum number of shares (or other financial instruments) to be allocated to the performance of the liquidity contracts, ensuring that they overall do not exceed:

    a. for **illiquid shares**:

        500% of the average daily trading volume or 1% of the outstanding issued shares of the issuer at the time of entering into the liquidity contract associated to a resources cap of maximum 1 Million Euro.

b. for **liquid shares**:

200% of the average daily trading volume associated to a resources cap of maximum 20 Million Euro.

c. where AMPs on liquidity contracts identify a sub-category of **highly liquid shares**, either (i) 75% of the average daily trading volume, or (ii) 100% of the average daily trading volume associated to a resources cap of maximum 50 Million Euro.

35. The average daily trading volumes (turnover) referred to above should be determined in relation to a defined period before the liquidity contract is entered into.

36. Limits to the resources to be allocated to the performance of the liquidity contract should:

- be determined with regard to the average daily trading volume on the trading venue where the liquidity contract is to be performed, including when the shares are traded on different trading venues (where the liquidity contract is to be performed on more than one trading venue, the highest average daily trading volume should be used), and

- apply to all transactions (buys and sales) carried out under the liquidity contract, and should not be considered in relation to each trading venue when the liquidity contract is to be performed on more than one trading venue.

37. AMPs on liquidity contracts should explicitly mention that the resources allocated to the performance of liquidity contracts should exclusively be used for that purpose.