

Deutsche Börse Cash Market

MiFID II: Regulated Market Maker

Update March 2019

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Abstract

This document outlines the new requirements under MiFID II for investment firms pursuing a Market-Making strategy. This handbook shall serve as guidance for Trading Participants in order to fulfil their obligations under MiFID II.

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1 Introduction

Regarding MiFID II, which applies from 3 January 2018, Trading Members and Trading Venues are obliged to meet requirements related to market making strategies. Art 17 and Art. 48 of the Directive 2014_65 (EU) and the Commission Delegated Regulation (EU) 2017/578 (previously: RTS 8) serve as the regulatory basis. This handbook shall be used as guidance for Trading Members of Frankfurt Stock Exchange to fulfil their market making requirements. It contains information with respect to the following topics:

- 1) Obligations for investment firms to apply for admission as Regulated Market Maker
- 2) Description of market making requirements and market making scheme
- 3) Introduction of market conditions
- 4) The relationship between Regulated Market Maker and Designated Sponsor
- 5) Admission process for Regulated Market Makers and Designated Sponsors

2 Obligations for investment firms to apply for admission as Regulated Market Maker

A Trading Member on the trading venue Xetra who pursues a market making strategy in the market model “Continuous Trading with intraday Auctions” is obliged to become a registered Regulated Market Maker on the Frankfurt Stock Exchange.

A market making strategy according to the Commission Delegated Regulation (EU) 2017/578 Art.1 exists where a Trading Member

- a. posts firm, simultaneous two-way quotes of comparable size and competitive prices and
- b. deals on its own account in at least one financial instrument tradable for at least 50 percent of the daily trading hours of continuous trading, excluding opening and closing auctions
- c. during half of the trading days over a one month.

In this context:

- a quote shall be deemed to be a firm quote where it includes orders and quotes that can be matched against an opposite order or quote in the order book;
- 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;
- two quotes shall be deemed of comparable size when their sizes do not diverge by more than 50 percent from each other;
- quotes shall be deemed to have competitive prices when they are posted at or within the maximum bid-ask range that is determined by the Management Board of the Frankfurt Stock Exchange (according to minimum requirements for Designated Sponsors and Market Maker).

It is the duty of the Trading Member to identify if a market making strategy is pursued in at least one instrument and then to apply for becoming a registered Regulated Market Maker on the Frankfurt Stock Exchange. Trading Members will be not informed in advance by the Frankfurt Stock Exchange if potential market making strategies have been detected. However, the Trading Surveillance Office may investigate the trading behaviour of Trading Members in case of non-registration.

Please note that only trading activities on P-and M-accounts are relevant to identify market making strategies.

3 Description of market making requirements and market making scheme

3.1 Market making requirements

The Frankfurt Stock Exchange has amended the Exchange Rules for the Frankfurter Wertpapierbörse in order to adapt to the requirements of the Commission Delegated Regulation (EU) 2017/578. The changes include the following requirements for registered Regulated Market Makers:

- A registered Regulated Market Maker is required to provide firm quotes in at least one instrument during 50 percent of daily trading hours on a monthly average. The required quotation time will exclude opening and closing auctions, volatility interruptions and exceptional circumstances.
 - The maximum bid-ask spreads are determined by the Management Board of the Frankfurt Stock Exchange and are available in the master data sheet of all tradable instrument on xetra.com. The maximum spread is the same as for Designated Sponsors.
 - The size of two-way orders may not diverge by more than 50 percent from each other. A minimum quotation size does not apply for Regulated Market Makers.
 - A registered Regulated Market Maker is required to use the M-Account and to flag orders and quotes – that are applied in the context of their market making strategy – with the Liquidity Provision Flag.
 - Only flagged orders and quotes sent via the M-Account in registered instruments are used for performance measurement to monitor the compliance of registered Regulated Market Makers with their obligations.
 - According to the Commission Delegated Regulation (EU) 2017/578 Art. 3, registered Regulated Market Makers are not obliged to provide liquidity during exceptional circumstances. Exceptional circumstances defined by the Frankfurt Stock Exchange are communicated to the market via Newsboard message. In case of Art. 3 d), registered Regulated Market Makers have to inform Market Supervision in case of disability to maintain prudent risk management practices without undue delay.
 - A registered Regulated Market Maker is obliged to be always reachable during the trading hours of the products which they apply as part of a market making strategy.
 - A registered Regulated Market Maker is obliged to maintain records of firm quotes relating to its market making activities, which are clearly distinguished from other trading activities, to make those records available to the Management Board of the Frankfurt Stock Exchange and to keep these records for at least five years.
 - A registered Regulated Market Maker has to deploy effective systems and controls that ensure that it fulfil its obligations at all times.
 - Regulated Market Makers receive daily performance reports accessible via the Member Section on the Common Report Engine to monitor their compliance with market making obligations.
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3.2 Market making scheme

Trading venues are obliged to offer market making scheme for instruments for which there is a liquid market. Deutsche Börse AG has defined the terms of its market making scheme in the Xetra price list. The incentives are offered to registered Regulated Market Makers in these instruments if the Regulated Market Maker provides liquidity for at least 50 percent of the time when stressed market conditions are identified. Regulated Market Makers are informed about the start and the end of stressed market conditions in the respective instrument via T7 market data interfaces and via a Stressed Market Conditions (SM) flag. The requested maximum spread in time of stressed market conditions is adjusted according to the additional risk a Regulated Market Maker faces due to increased volatility.

4 Introduction of market conditions

With MiFID II, three market conditions are introduced:

- Normal Trading Conditions (NM)
- Stressed Market Conditions (SM)
- Exceptional Circumstances (EM)

The status “Normal Trading Conditions” is defined as a status of the market which is neither a market in a “Stressed Market Condition” nor a market under “Exceptional Circumstances”. SM are characterised by significant short-term changes in price and volume. In addition, the resumption of trading after volatility interruptions is considered as SM. “Exceptional Circumstances” are determined exhaustively by the legislator according to Commission Delegated Regulation (EU) 2017/578, Article 3. The implementation of SM and Exceptional Circumstances on the trading venue Xetra are outlined in the following.

4.1 Stressed Market Conditions (SM)

According to Commission Delegated Regulation (EU) 2017/578 Articles 5 and 6, trading venues are required to have market making schemes for instruments for which there is a liquid market under stressed market conditions. The respective instruments are identified by a T7 flag available in the downloadable master data file with all tradable instruments (“Regulatory Liquid Instrument”).

Regulated Market Makers who fulfil the obligations under stressed market conditions are rewarded by a reimbursement of transaction fees for executions during stressed markets. The obligations include a presence time of at least 50 percent during SM with firm quotes of a maximum spread twice the maximum spread as defined during normal market conditions.

The market making scheme is available in more detail in the Xetra Price List.

Stressed Market Conditions are defined according to Art. 3 on instrument level, when significant short-term changes of price and volume have been detected. The period after resumption of trading after a volatility interruption is determined as a stressed market.

On Xetra, Stressed Market Conditions are determined per instrument when an extended volatility interruption is triggered and the executed volume (in units) exceeds significantly the average volume per price tick of the previous year. The Stressed Market Conditions lasts 60 minutes and can be prolonged when conditions for a stressed market have been detected.

Start and end of SM are communicated to the market via the T7 market data interfaces.

4.2 Exceptional Circumstances (EM)

Exceptional Circumstances refer to exceptional market conditions (EM) which are caused by some unscheduled events and which have a major impact on the trading environment. Typically, exceptional circumstances affect all instruments in a market. Exceptional circumstances which relate to critical issues for a Trading Member according to the Commission Delegated Regulation (EU) 2017/578 Art. 3 (d) are not announced to the market.

Exceptional Circumstances for the cases outlined in the Commission Delegated Regulation (EU) 2017/578 Article 3 (a), (b), (c) and (e) are decided by the Management Board of the Frankfurt Stock Exchange and announced via Newsboard message. By default, Exceptional Circumstances are valid for one hour for all tradable instruments. The condition may be extended until the end of the trading day.

Exceptional Circumstances according to the Commission Delegated Regulation (EU) 2017/578 Article 3 (d), where the Xetra Participant's ability to maintain prudent risk management practices is prevented, are not announced via Newsboard message. In these cases, the registered Regulated Market Maker declares Exceptional Circumstances to Market Supervision specifying the instruments, expected duration time and the reasons for disability to maintain prudent risk management practices. Regulated Market Maker has to inform Market Supervision in due time when exceptional circumstances no longer apply. The performance measurement will be suspended for the affected time.

There will be no quotation requirement during Exceptional Circumstances. The affected time will be excluded from performance measurement.

5 The relationship between Regulated Market Maker and Designated Sponsor

A Designated Sponsor is a Regulated Market Maker with higher requirements. In addition to the obligations of a regulated Market Maker to enter firm quotes of at least 50 percent during Continuous Trading, a Designated Sponsor commits himself to fulfil higher requirements. Higher requirements are described as follows:

- Participation in opening auctions of 80 percent in ETFs & ETPs and of 90 percent in equities
- Participation in regular auctions (opening, intraday and closing) of 80 percent in ETFs & ETPs and of 90 percent in equities
- Participation in volatility interruptions of 70 percent in ETFs & ETPs and of 80 percent in equities
- Minimum quotation volume depends on the level of liquidity of an instrument (liquidity class) or determined per ETF or ETP

Designated Sponsors in equities are not obliged to provide liquidity during F-DAX conditions prerequisite that at least 50 percent participation rate during continuous trading is achieved on a monthly average.

Designated Sponsors benefit from reimbursement of transaction fees if requirements are fulfilled. In addition, the Designated Sponsor as a Regulated Market Maker receives incentives for providing liquidity during stressed market conditions.

The Designated Sponsor incentive scheme is available in more detail in the Xetra Price List.

6 Admission process for Regulated Market Maker and Designated Sponsor

A Trading Member of Xetra who pursues a market making strategy according to the Commission Delegated Regulation (EU) 2017/578 Art. 1 in the trading model “Continuous Trading with intraday Auctions” is required to apply for being admitted as a Regulated Market Maker on the Frankfurt Stock Exchange. The admission form is available on xetra.com.

The admission form is preceded by Group Client Key Account Management Trading. All Designated Sponsors have to submit the Regulated Market Maker application form to act as Designated Sponsor.

With the registration as Regulated Market Maker, the regulated Market Maker can register in single instruments in which a market making strategy is pursued by using the eListing tool. The eListing tool is accessible via the Member Section of the Deutsche Börse website.

A Regulated Market Maker who would like to receive the Designated Sponsor license has to sign an agreement with Deutsche Börse, committing himself to fulfilling higher requirements, and can benefit from transaction fee reimbursement during normal trading conditions.

Trading Participants who are registered as Designated Sponsors can register in single instruments via eListing tool, choosing between the role of Regulated Market Maker only or Designated Sponsor. Trading Participants who only submitted the application form for Regulated Market Maker can register in single instruments as regulated Market Maker only. In one given instrument, a Trading Member can either be a Regulated Market Maker or a Designated Sponsor.
