JOINT PETITION

Börse Berlin
Börse Düsseldorf
Börse München
Börse Hamburg
Börse Hannover
Börse Stuttgart
Tradegate Exchange
Bundesverband der Wertpapierfirmen

Bundesverband der Wertpapierfirmen e.V.
Schillerstraße 20, D-60313 Frankfurt/Main

European Securities and Markets Authority (ESMA)

CS 60747

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31 July 2014

MiFID II technical standards on "market maker agreements" and "market maker schemes" must not impair long established, legally sound and liquid "Hybrid" Market Models which in particular fulfil the needs of retail investors and SME-issuers

Dear Sir or Madam,

on 22 May 2014 ESMA has published a Discussion Paper on MiFID II / MiFIR (ESMA/2014/548), inviting stakeholders' views on key elements of future ESMA technical standards. In this context, ESMA also seeks responses on questions related to circumstances and conditions under which an investment firm pursuing a *"market maker strategy"* on the basis of algorithmic trading, according to Article 17(4) MiFID II, would be obliged to enter into a *"market maker agreement"* with a trading venue in accordance with Article 17(3)(b) and Article 48(2)(a) MiFID II as well as on the design and content of *"market making schemes"* which regulated markets shall be required to have in place in accordance with Article 48(2)(b) MiFID II, *"where such a requirement is appropriate to the nature and scale of the trading on that regulated market"*.[1]

Against this background, the petitioners, who are securities exchanges throughout Germany[2] together with bwf, a trade association promoting the common professional interests of market makers and independent trading houses in Germany, would like to express their concern that a misguided interpretation of the scope and content of the provisions laid down in Article 17 and Article 48 MiFID II could have severe negative consequences for investors, issuers, investment firms, securities exchanges and other venues with market maker based trading models.

In this context and with respect to the question raised in paragraph 4.1(12) DP on the relevance of *"hybrid"* systems defined by Article 17(5) MiFID I Implementing Regulation, we would like to emphasise that *"hybrid"* market models remain of significant importance for trading on all German exchanges.

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[1] ESMA Discussion Paper, Chapter 4.4., Market making strategies, market making agreements and market making schemes

[2] All of the participating exchanges run at least one *"hybrid"* market model based on auction systems with market maker support in accordance with Article 17(5) MiFID I Implementing Regulation. For the majority of the petitioners, market maker supported trading is the sole or prevailing form of trading. Depending on the market model, market making firms may be referred to by different names, e.g. "Designated Sponsors", "Skontroführer", "Spezialisten" or "Quality-Liquidity-Providers".

Typically, these trading systems are designed to fulfil in particular – but not exclusively – the needs of retail investors and SME-issuers.

According to the latest figures provided by the "Order Book Statistic German Exchanges" by Deutsche Börse, the relevant exchanges and trading segments (Berlin/Xontro, Düsseldorf, "Xetra Frankfurt Spezialist", Hamburg, Hannover, München, Stuttgart and Tradegate) account for a cumulative market share (in terms of trading volume across all instruments traded on German exchanges of 16% for June 2014. Furthermore, since the basic population (100% of all trades on German exchanges) of this accumulative statistic encloses all types of investors and all forms trading (including algo- and HFT-trading), it can be reasonably expected that the relevant market share for trading undertaken by retail investors is still significantly higher.

In general, most of these systems could be characterized as auction based systems with market maker support, whereby investment firms are assigned to be responsible for the management of order books for specific financial instruments. These order book mandates enclose high standard performance requirements in terms of the frequency and quality of published quotes, strict neutrality ensured by close monitoring by independent publicly authorised trade surveillance offices and the obligation to provide liquidity by employing an investment firms' own capital if needed.

It should be also noted that, partly as a result of the design of *"best execution"* requirements introduced with MiFID I (with the speed of execution together with the overall price being the core benchmark for *"best execution"* when executing retail orders), the importance of market making activities within these systems has grown significantly during the last years.

In the light of certain assessments und remaining ambiguity within Chapter 4.4 DP, the petitioners became alarmed that an undue extension of the limited scope of the provisions stipulated by Article 17 and Article 48 MiFID II could impair the continuance of the long established market models mentioned above which require a single market maker to have the exclusive responsibility for the price quality and liquidity provision with respect to a specific security.

However, it must be acknowledged that ESMA in Paragraph 30 of Chapter 4.4 DP correctly accentuates *"the variety of trading and business models in Europe"*. And it should be added that there is no observable political intention in the Level I text that MiFID II shall reduce the existing diversity of trading models, investors can choose from.

Therefore, it must be emphasised that any requirements for the purpose of defining *"market making agreements"* in accordance with Article 17(3) in connexion with Article 48(2)/(3) MiFID II must not impair the ability of regulated markets to define and implement divergent market maker arrangements independent from the *"market maker agreements"* under Article 17(3) MiFID II whose sole purpose lies in the mandatory extension of quoting obligations to algorithmic trading firms which act as *de facto* market makers but so far have not been subject to any binding standards regarding the stable and predictable provision of liquidity.

The fact that MiFID II at this point intends to implement a specific regime for a specific type of firms and not for market makers in general (which are still defined in Article 4(7) MiFID II without any reference to algorithmic trading), also becomes apparent from the clarification given in Article 17(4) that *"market making strategy"* in this context shall have a meaning for the purpose of this Article and Article 48 MiFID II only. Consequently, the *"market making schemes"* referred to in Article 48(2)(b) and Article 48(12)(f) MiFID II obtain their meaning only with respect to the *"written agreements"* referred to

in Article 48(2)(a) and Article 17(3)(b) MiFID II for firms pursuing a *"market making strategy"* within the limited scope of Article 17(4).

Accordingly, *"market making schemes"* should not be misunderstood as the sole and general framework, which regulated markets can implement in the future to govern the overall market making activities on their venues. While *"scheme"* remains a generic term, we therefore think that it is somehow unfortunate that ESMA, in Paragraph 45 of Chapter 4.4 DP talks about *"market making schemes"* when analysing certain aspects of market making arrangements which are currently in place.

Furthermore, with respect to the *"fair and non-discriminatory"* access requirement to *"market maker schemes"* which is laid down in Article 48(12)(f) MiFID II and now was further elaborated by ESMA in Paragraph 44 of Chapter 4.4 DP, it must be noted that this requirement is only applicable to firms pursuing a *"market making strategy"* under the limited scope of Article 17(3) in connexion with Article 17(4) MiFID II. Consequently, *"fair and non-discriminatory"* access requirement to *"market maker schemes"* must not be misunderstood as *"most favourable treatment clause"* granting unrestricted access to market making mandates a regulated market already has or might wish to establish outside the restricted scope of Article 48(2)(b) MiFID II.

In this context, one should keep in mind that the purpose of *"market making schemes"* is to ensure sufficient and stable liquidity. Therefore, it would be a paradoxical and clearly unintended result, if these *"schemes"* would impair or degenerate effective arrangements for liquidity provisions which are already in place. Accordingly, it is paramount for the survival of many well established *"hybrid"* market models that regulated markets will remain capable to restrict the number of investment firms, either for a specific financial instrument or globally, with whom they wish to enter into a market making arrangement which lies outside the scope of Article 48(2)(b) in connexion with Article 48(12)(f) MiFID II.

We kindly ask ESMA to take our consideration into account when drafting its Consultation Paper on future technical standards for MiFID II. We also would be very pleased to discuss and further elaborate the issues addressed in this letter. Please do not hesitate to contact *Michael H. Sterzenbach* of bwf[3] or any other representative of the petitioners listed below at your earliest convenience.

Yours sincerely,

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