

CONFIDENTIAL



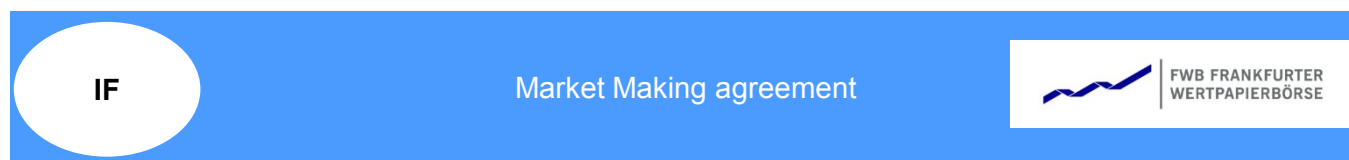
Market Making under MiFID II Regulatory Requirements and Implementation Proposal

May-June 2017



Requirement: With MiFID II investment firm that pursues a market making strategy has to enter into a binding written agreement with the trading venue (RTS 8, Art. 1)

Market Making Strategy	✓ Providing liquidity continuously in at least one financial instrument	for at least 50% of the daily trading hours during half of the trading days over a one month period
	✓ Posting firm, simultaneous two-way quotes	order and quotes are posted on both sides at the same time
	✓ of comparable size	both sizes do not diverge by more than 50% from each other
	✓ of competitive price	within the maximum bid-ask range set by the trading venue
	✓ Dealing on own account	proprietary order flow



Requirement: Deutsche Börse is obliged to offer Market Making Agreement to investment firms pursuing a market making strategy including minimum obligations and terms of market making scheme (RTS 8, Art. 2)

Market Making Agreement

Vertrag über die Beauftragung als Market Maker / Agreement on Assignment as Market Maker

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Vertrag über die Beauftragung als Market Maker
zwischen

Agreement on the Assignment as a Market Maker
between

Frankfurter Wertpapierbörse
Mergenthalerallee 61
65760 Eschborn

Frankfurter Wertpapierbörse
Mergenthalerallee 61
65760 Eschborn

und - nachfolgend genannt: „FWB“ -

and - hereinafter: „FWB“ -

- nachfolgend genannt: „Market Maker“ -

- hereinafter: „Market Maker“ -

- im Folgenden einzeln auch als „Partei“ und
gemeinsam als „Parteien“ bezeichnet -

- hereinafter individually also referred to as „Party“ and
jointly as „Parties“ -

Präambel

Die Geschäftsführung der Frankfurter Wertpapierbörse (FWB) kann bestimmen, dass in einzelnen oder mehreren Wertpapieren, die im elektronischen Handelssystem gehandelt werden, ein Market Making durchgeführt wird. Die Geschäftsführung der FWB beauftragt auf der Grundlage dieses Vertrages den Market Maker mit der Übernahme des Market Makings.

Preamble

The Management Board of the Frankfurt Stock Exchange (FWB) may decide that a Market Making shall be carried out in individual or several securities traded on the electronic trading system. On the basis of this Agreement, the Management Board of FWB assigns the Market Maker with undertaking the Market Making.

§ 1 Aufgaben des Market Maker

(1) Der Market Maker verpflichtet sich, die im Regelwerk der FWB, insbesondere der Börsenordnung für die FWB und der Handelsordnung für den Freiverkehr an der FWB in ihrer jeweils geltenden Fassung festgelegten Aufgaben für die im regulierten Markt und im Freiverkehr an der FWB gehandelten Wertpapiere zu übernehmen, die gemäß § 2 in diesen Vertrag einbezogen wurden. Dabei hat der Market Maker die jeweils gültigen von der Geschäftsführung der FWB festgelegten Mindestanforderungen an das Market Making zu beachten. Die von der Geschäftsführung der FWB festgelegten

§ 1 Duties of the Market Maker

(1) The Market Maker undertakes to assume the specified duties for securities traded on the Regulated Market and on the Regulated Unofficial Market at FWB and included in this Agreement pursuant to § 2, such duties having been set forth in the rules and regulations of FWB, particularly in the Exchange Rules of FWB, as well as the Trading Regulation for the Regulated Unofficial Market on FWB, in their respective current version. The Market Maker is obliged to observe the respective current minimum requirements for Market Making as defined by the Management Board of FWB. The minimum requirements defined by the

Essential Items

- 1 Minimum requirements
- 2 Instruments covered by the agreement
- 3 Terms of market making scheme
- 4 Obligations of the investment firm to be compliant: surveillance, compliance, audit, records
- 5 Obligation to flag firm quotes submitted under market making agreement
- 6 Sanction process in case of non-compliance
- 7 Designated Sponsor obligations and privileges
- 8 Termination terms

Proposal for minimum requirements a market maker has to fulfil after having signed a market making agreement

Presence	At least 50% of the daily trading hours of continuous trading on average (excluding auctions) during one month.
Spread	<p><u>Equities</u>: max spread is determined depending on the level of liquidity in the range of: 2.5% (high liquid) – 5% (less liquid)</p> <p><u>ETFs & ETPs</u>: determined by product</p>
Size	Both sizes do not diverge by more than 50% from each other.



Liquidity class	LC 1	LC 2	LC 3
XLM in bp	≤ 100	≤ 500	> 500
Max Spread	2.5%	4.0%	5.0%

$$\text{abs } \frac{(\text{Ask Vol} - \text{Bid Vol})}{\max(\text{Ask Vol}; \text{Bid Vol})} \leq 50\%$$

Proposal for definition of exceptional circumstances where the obligation to provide liquidity does not apply

Implementation proposal for exceptional circumstances	
Extreme volatility	<ul style="list-style-type: none">▪ Automatic measurement of all Xetra products if volatility interruption has been triggered▪ If the percentage exceeds 50% of all tradable products, EMC (exceptional market conditions) is automatically triggered for 60 min and can be prolonged for another 60 min if situation repeats within EMC; the market is informed by flag on start and end of EMC.
Act of war, industrial action, civil unrest or cyber sabotage	<ul style="list-style-type: none">▪ Market Supervision triggers a Management Decision▪ Upon positive decision, EMC will be manually set for the affected products
Disorderly trading conditions	<ul style="list-style-type: none">▪ Orderly execution compromised if 50% of trading members lose connectivity▪ Market Supervision triggers a Management Decision▪ Upon positive decision, EMC will be manually set for the affected products
Technological issues, risk issues or inability to hedge position due to a short selling ban on investment firm's side	<ul style="list-style-type: none">▪ Trading member declares emergency in writing via email to market supervision: performance@deutsche-boerse.com▪ Trading member will be exempted from obligations that day

Proposal for Market Making Scheme offered by Deutsche Börse to incentivize liquidity provision in stressed markets for liquid instruments

MiFID II Intention

- to ensure orderly and efficient function of markets in instruments for which it is crucial to provide liquidity in times of increased volatility.
- to reduce the risk of overreaction to external events which can exacerbate market volatility.
- incentive investment firms during stressed market conditions to provide liquidity in these instruments.

Scope of Instruments

- Liquid equities and Exchange Traded Funds
- ESMA provides an update of the list once a year (1st of April): #282 liquid equities out of 975 are currently tradable on XETR

Proposal for minimum requirements during stressed markets

Presence	At least 50% during stressed markets
Spread	5% - 10%
Size	Ask and Bid do not diverge by more than 50%

Incentive scheme

- 100% reimbursement of trading fees for transactions executed during stressed market provided that the requirements have been fulfilled.

Proposal for definition of Stressed Market Condition that occurs in case of significant short-term changes in price and value after volatility interruption for “liquid” instruments

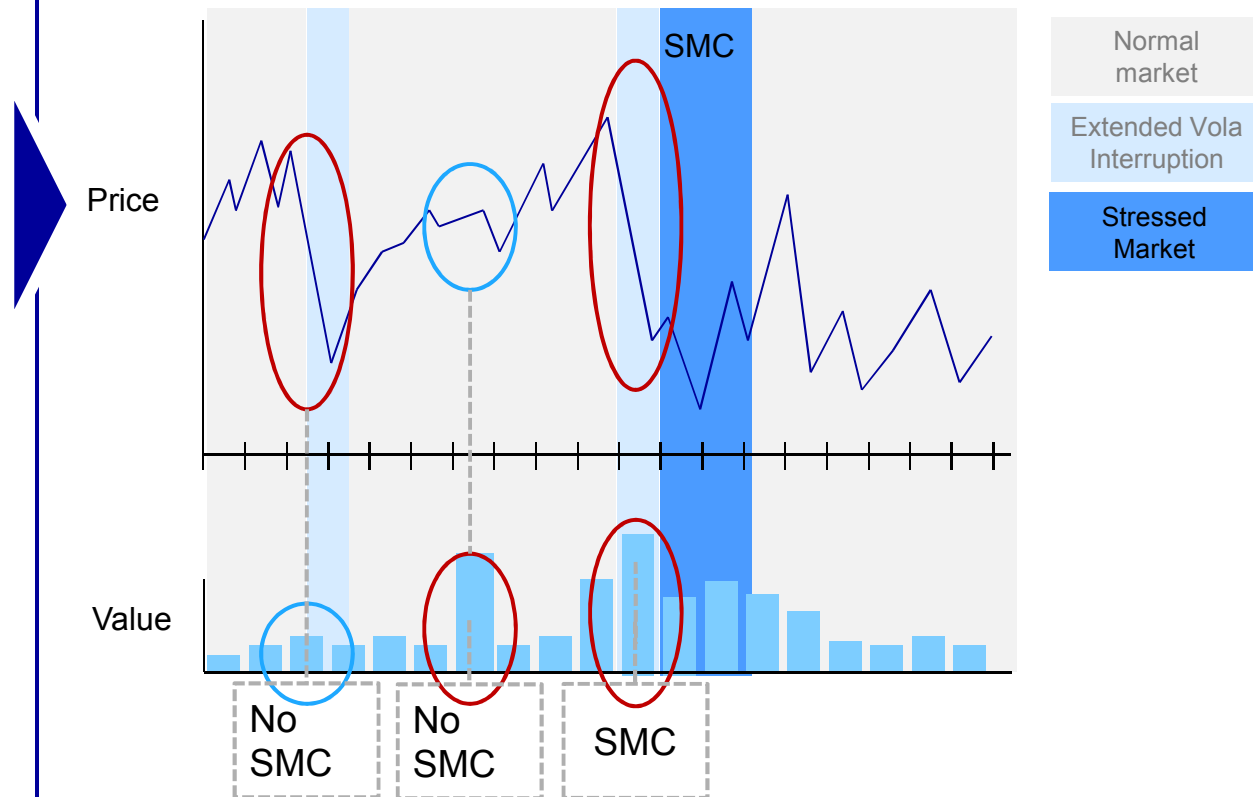
Stressed Market Conditions

- Parameters to identify stressed market are significant short-term changes of price and value.
- The resumption of trading after volatility interruptions is considered as stressed market.

Proposal for implementation

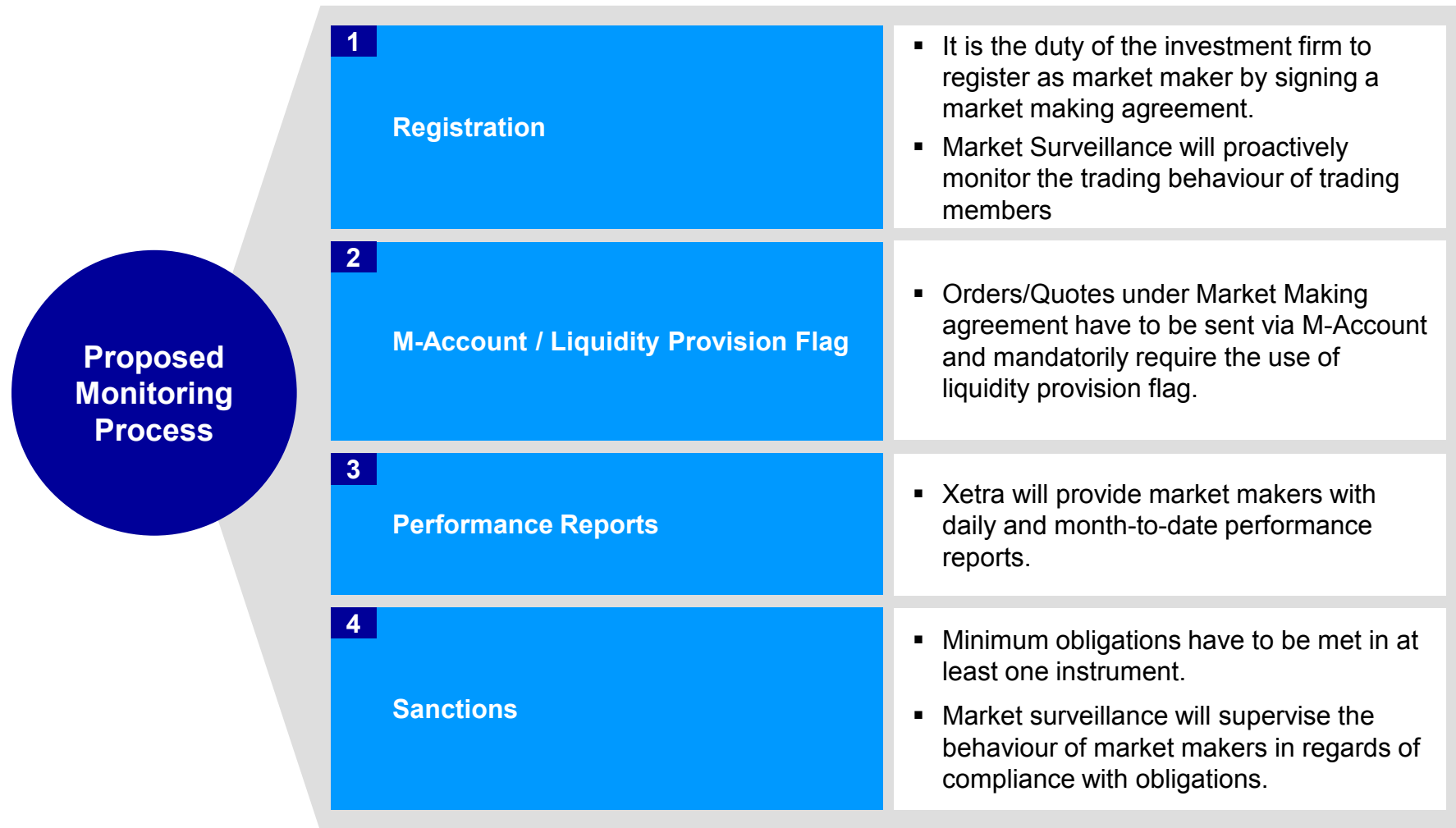
- With the resumption of trading after extended volatility interruption value is checked if it exceeds average value of previous year multiplied by parameter of x (x is defined by liquidity class of instrument)
- Stressed market lasts 60 minutes starting with the resumption of trading after extended volatility and will be prolonged for another 60 minutes from point of time when significant short-term changes in price and value have been identified again.
- Identification of stressed market is instrument based.

Illustration of SMC Mechanism for Liquid Equities and ETFs*



* https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_mifid_sha

Proposal for monitoring process by Deutsche Börse with regard to the compliance of investment firms





Designated Sponsor Program



Current status: Designated Sponsor is a Market Maker with stricter obligations incentivised by 100% transaction fee reimbursement during normal trading conditions



Additional obligations

Presence: Continuous Trading Opening & All Auctions Volatility Interruptions	Equities / ETFs & ETPs 90% / 80% 90% / 80% 80% / 70%
Spread*	2.5% – 5%
Size*	€10k - €20k

- FDAX-rule to suspend performance measurement in times of high volatility in place provided that minimum obligation of 50% participation rate during continuous trading is met.
- In case of non-compliance six months in a row Deutsche Börse has the right to cancel the Designated Sponsor contract in the respective instrument.

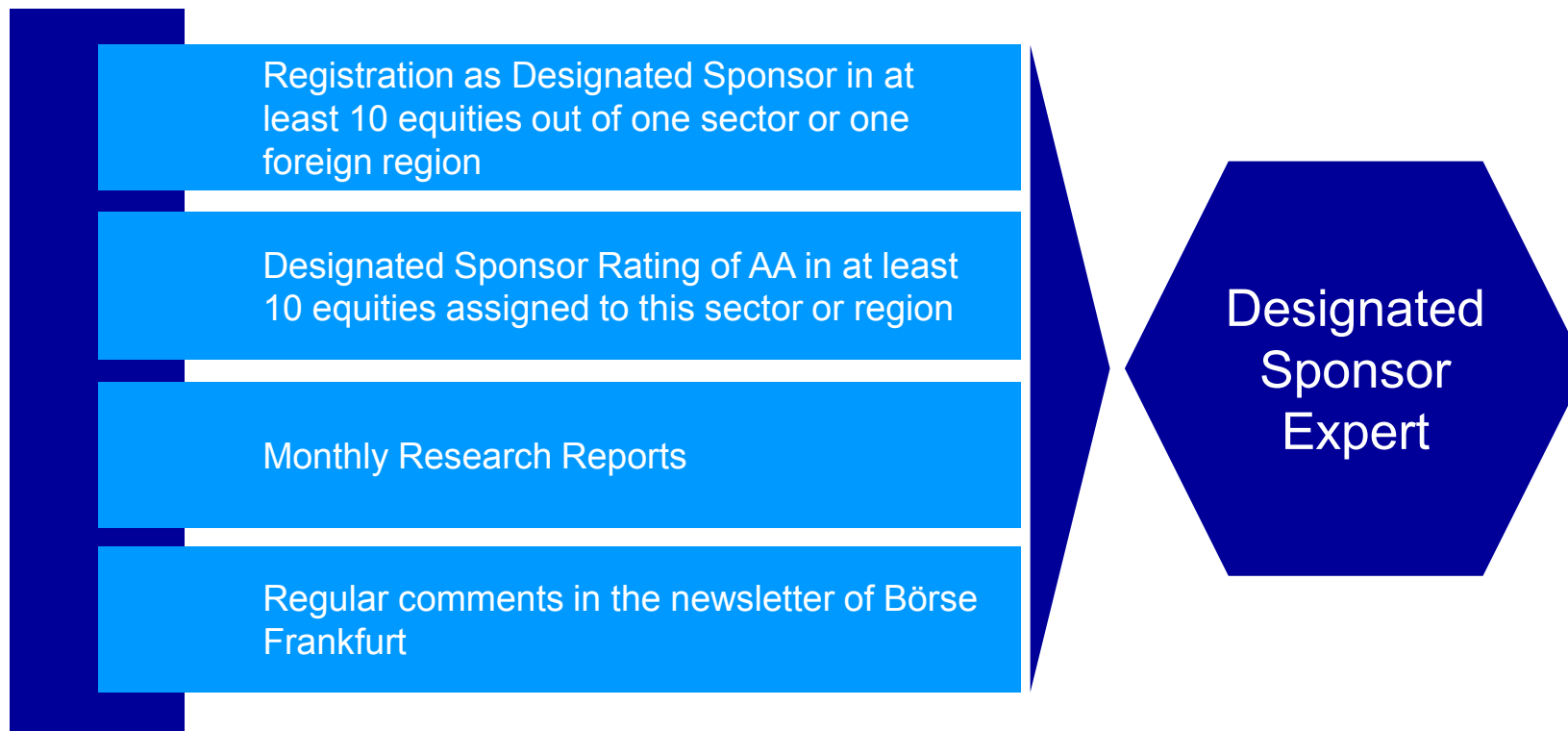
Minimum obligations

- Provision of firm quotes for at least 50% of the trading hours during continuous trading on average over a one month.
- Firm quotes include any orders and quotes that are posted in a way that both sides are present in the order book at the same time of comparable size and competitive prices.
- The obligation to provide liquidity does not apply in times of exceptional circumstances.

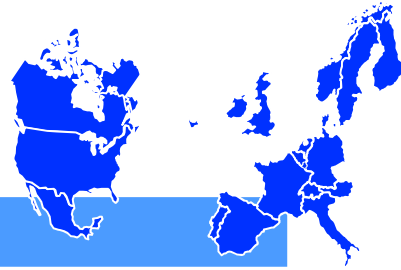
* Depending on level of liquidity determined by liquidity class / for ETFs & ETPs spread and size is determined by product

NEW: Designated Sponsor can qualify for becoming an Expert in single regions or sectors

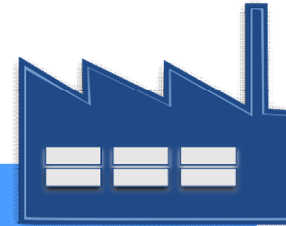
- Designated Sponsors gain expertise and deep knowledge by supporting a basket of equities of single sectors or regions enabling them to offer on top services such as research reports and liquidity provision of higher quality.
- Deutsche Börse recognizes this special expertise of these participants and offers the Expert status if following conditions are met:



Potential regions and sectors available for the status of a Designated Sponsor Expert



Regions
Asia
Benelux
France
United Kingdom
North America
Austria
Switzerland
Scandinavia
Spain



Sectors
Construction & Materials
Chemicals & Pharma
Energy / Commodities
Finance
Health Care
Industrial Goods & Services
Information Technology
Consumer & Retail
Media
Utilities



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Appendix



Overview of MiFID II requirements for market making

Level 1: MiFID II Art. 17 & Art. 48	Level 2: RTS 8	FiMaNoG II
<p>Art. 17(3) IF that engages in algorithmic trading to pursue a market making strategy shall</p> <ul style="list-style-type: none"> a) carry out market making continuously except under exceptional circumstances b) enter into a binding written agreement with the trading venue which shall include the obligations c) have in place effective systems and controls to ensure that it fulfils its obligations. 	<p>Art. (1) Obligations for IF to enter into a market making agreement: definition of market making strategy.</p>	<p>Art. 3 §79(4) verpflichtet WpDU, welches algorithmischen Handel unter Verfolgung einer Market-Making-Strategie betreibt,</p> <ul style="list-style-type: none"> 1) diese Strategie kontinuierlich zu betreiben, abgesehen von außergewöhnlichen Umständen 2) einen schriftlichen Vertrag mit dem Handelsplatz zu schließen, in dem die Verpflichtungen festgelegt werden 3) über wirksame Systeme und Kontrollen zu verfügen, dass es jederzeit diesen Verpflichtungen nachkommt.
<p>Art. 17(4) IF pursues a market making strategy when dealing on own account, posting continuously firm, simultaneous two-way quotes of comparable size and at competitive prices.</p>	<p>Art. (2) Content of market making agreement: shall include obligations of IF and terms of market making scheme; trading venues are obliged to monitor the compliance of the IF with the agreement.</p>	<p>Art. 4 §79(5) Market-Making-Strategie beinhaltet Handel auf eigene Rechnung bei Stellen von festen zeitgleichen Geld-und Briefkursen vergleichbarer Höhe zu wettbewerbsfähigen Preisen.</p>
<p>Art. 48(2) A regulated market has in place</p> <ul style="list-style-type: none"> a) a written agreement with all IF pursuing a market making strategy b) schemes to ensure that a sufficient number of IF participate in such agreements. 	<p>Art. (3) Exceptional Circumstances: the obligations of investment firms to provide liquidity shall not apply in any of the determined events.</p>	<p>Art. 8 §26c Market-Making-Systeme:</p> <ul style="list-style-type: none"> (1) Die BörsO muss Bestimmungen über die Zulassung von WpDU durch die GF enthalten (2) Die Börse trifft Vorkehrungen für eine ausreichende Zahl an WpDU als Market-Maker (3) Die BörsO muss Verpflichtungen im Zusammenhang mit Zuführung von Liquidität enthalten (4) Die GebührenO muss Bestimmungen über die Verringerung von Gebühren enthalten, die für Zuführung von Liquidität gewährt werden. Das gilt nicht, wenn der Börsenträger bereits Vereinbarungen mit dem WpDU getroffen hat. (5) Verweis auf RTS 8 zu einzelne Anforderungen an die Ausgestaltung von Market-Making-Systemen
<p>Art. 48(3) The written agreement shall at least specify</p> <ul style="list-style-type: none"> a) the obligations of the IF in relation to the provision of liquidity and scheme b) Any incentives in terms of rebates offered and rights according to liquidity provision. 	<p>Art. (4) Identification of exceptional circumstances: Trading venue shall make public the occurrence of the exceptional circumstances.</p>	
<p>The regulated market shall monitor and enforce compliance by IF with the requirements of such binding agreement.</p>	<p>Art. (5) Obligation of trading venues to have market making schemes in place: only required for certain instruments under a continuous auction order book trading system.</p>	
	<p>Art. (6) Minimum obligations as regards the market making schemes during stressed market conditions.</p>	
	<p>Art. (7) Fair and non-discriminatory market making schemes: defines transparency terms, no limitation of participants and principle of equality.</p>	

Definition of trading conditions “normal”, “stressed”, “exceptional”

Normal Market Conditions	Stressed Market Conditions	Exceptional Circumstances
<ul style="list-style-type: none"> Regular trading conditions in continuous auction markets 	<ul style="list-style-type: none"> Post volatility interruptions Significant short-term changes of price and volume 	<ul style="list-style-type: none"> Extreme volatility in majority of instruments Disorderly trading conditions at TV Lack of prudent risk management by IF
<ul style="list-style-type: none"> Quotation parameters with target coverage of trading day for given size and spread parameters Minimum coverage of 50% per RTS 8 	<ul style="list-style-type: none"> Risk-adjusted quotation parameters in spread and size terms proposed Minimum coverage of 50% per RTS 8 	<ul style="list-style-type: none"> No obligation to provide liquidity on a regular and predictable basis, i.e. no market making obligation

- During normal trading conditions investment firms under MM agreement are obliged to provide firm quotes for at least 50% of the trading hours during continuous trading for each trading day
- Firm quotes include any orders and quotes that are posted in a way that both sides are present in the order book at the same time of
 - comparable size when their volume do not diverge by more than 50% from each other
 - competitive prices when their limits are within the maximum bid-ask range set by the trading venue
- Stressed market conditions are characterized by significant short-term changes in price and volume. In addition, the resumption of trading after volatility interruptions is considered as stressed market conditions (only of relevance for MM schemes).
- The obligation to provide liquidity does not apply in times of exceptional circumstances:
 - extreme volatility when majority of instruments face volatility interruption
 - Act of war, industrial action, civil unrest, cyber sabotage (to be defined by management)
 - Under disorderly trading conditions of TV
 - Investment’s disability to maintain prudent risk management practices (to be reported by investment firm)