Notice published by the AMF pursuant to Article 13(5) of Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse: Establishment of liquidity contracts as a market practice accepted by the AMF

Pursuant to Article 13(3) of European Regulation (EU) no. 296/2014 on market abuse (hereinafter the "MAR") and Articles 2(2) and 12 of Delegated Regulation 2016/908 (the "CDR 2016/908"), on 31 March 2021, the AMF notified the European Securities and Markets Authority (hereinafter the "ESMA") and other competent European authorities of its intention to establish a revised accepted market practice (hereinafter the "AMP" or "Revised AMP") for liquidity contracts, to replace the current accepted market practice applicable since 1 January 2019 (the "2019 AMP"). Liquidity contracts, entered into between an issuer and a financial intermediary (investment firm or credit institution), are intended to allow the financial intermediary to buy and sell securities independently from the issuer to improve the liquidity and the regularity of the daily traded prices of the issuer's shares.

Notification of the Revised AMP to the ESMA is part of the review, as provided for in Article 13(8) of the MAR, of the accepted market practice applicable as of 1 January 2019. As a reminder, the AMF had undertaken to implement a series of measures over a two-year transitional period, in order to evaluate and learn from the revisions to the 2019 AMP regulatory framework.

As such, in 2020 the AMF conducted on-site inspections of five investment services providers that implement such contracts. A summary of these inspections has been published on the AMF website.[1] The AMF also conducted and published on its website a retrospective analysis[2] of the impact of liquidity contracts on the French market (December 2019 - May 2020) notably in order to determine potential changes to the regulatory framework (hereinafter "the Study").

Pursuant to Article 13(4) of the MAR, on 31 May 2021 the ESMA published an opinion on its website[3] dated 28 May 2021, stating that:

- the AMF Revised AMP potential price limits during auction phases, the planned volume limits, in particular with regard to illiquid shares, and the absence of any reference to limits on positions, would not be compatible with Article 13(2)(b) of MAR as supplemented by Article 4 of CDR 2016/908;
- further, the Revised AMP price limits during auction phases would not be compatible with Article 13(2)(c) et (d) of the MAR, as supplemented by Articles 5 and 6 of CDR 2016/908; and
- the limits on resources that may be allocated to the execution of liquidity contracts under the Revised AMP would not render it compatible with Article 13(2)(e) of MAR, as supplemented by Article 7 of CDR 2016/908.

The ESMA opinion concludes that the above incompatibilities of the Revised AMP with MAR, as supplemented by CDR 2016/908, would have an impact on the operation of market forces and the interplay of supply and demand, potentially threatening the market confidence in the Union financial markets.

Following an in-depth review of the ESMA opinion and pursuant to Article 13(5) of MAR, this notice sets out the AMF's grounds for its decision to establish the Revised AMP, i.e. why the Revised AMP poses no threat to market confidence, in light of some more stringent provisions adopted by the AMF to regulate liquidity contracts with regard to ESMA's recommendations[4] (hereinafter the Points for Convergence or PfC) and the findings of the review of the 2019 AMP.

The reasons for the AMF's decision to establish the Revised AMP with regard to each of the criteria deemed non-compliant by ESMA referred to in Article 13(2) of MAR are set out below.

The Revised AMP will enter into effect on 1 July 2021.

a) ESMA considers that interventions during the auction phases, as authorized by the Revised AMP, would not be compatible with Articles 13(2)(b), 13(2)(c) and 13(2)(d) of MAR, as they can have an impact on the price during this critical phase of the negotiation

The AMF is baffled by what appears to be an unexpected shift of ESMA's doctrine.

- The AMP contains no modification of the 2019 AMP with regard to trading during auction phases, and ESMA did not consider in its 2018 opinion[5] that the market practice violated Article 13(2)(b) on this specific point, since ESMA's opinion of 11 April 2018 stated: "*Finally, despite the participation in auctions does not*

[1] See in this regard Summary of SPOT inspections on liquidity contracts.
[2] See in this regard Retrospective analysis of the impact of liquidity contracts on the French market (December 2019 - May 2020) and potential changes in accepted market practice.
[3] See in this regard ESMA opinion dated 28 May 2021.
[4] See in this regard ESMA opinion "Points for convergence in relation to MAR accepted market practices on liquidity contracts" published on 25 April 2017 and derived from Article 29(1)(a) Regulation (EC) No 1095/2010 (hereinafter "PfC").
[5] See in this regard the 2018 ESMA opinion on the AMF market practice.

fully align with the ESMA Opinion on liquidity contracts, ESMA does not find evidence whereby the capacity of financial intermediaries to participate in auctions would affect the proper operation of market forces and the interplay of supply and demand, as required by Article 13(2)(b) of MAR and Article 4(2) of the RTS on AMPs."

- ESMA did not deem it necessary to provide for *ad hoc* provisions with regard to trading under liquidity contracts during auction phases in its March 2021 final report on changes to the market abuse regulation on promoting the use of SME growth markets.[6]

In substance, if the Revised AMP provides that the manager of the liquidity contract will only issue passive buy or sell orders during the continuous trading phases (such a provision that goes beyond the recommendations of the PfC[7]), the obligation to solely issue passive orders during the continuous trading phase is not incidental, insofar as such a provision makes no sense during the auction phases,[8] and would *de facto* amount to ban trading during these phases.

Furthermore, the AMF hastens to remind that placing an order[9] in the central order book during the auction phase may have an impact on the auction price, even if the order in the central order book when the auction price is determined is not executed. The AMF has also established that, the earlier an order is entered during the order collection phase prior to an auction, the more likely it is that its impact will be handled by the market. In order to significantly reduce the risk of market manipulation during auction phases, in 2015 the market operator managing the trading platform implemented a randomised auction phase: under this mechanism, the auction price is set randomly during a given time frame rather than at a specific time (i.e.: from 9:00 to 9:00:30, from 17:35 to 17:35:30). This mechanism has been in place for a number of years and prevents the risk of a liquidity contract manager issuing an order in the auction phase without market participants being able to react quickly or adequately.

Finally, the AMF considers that the framework for interventions during auction phases, as provided for in the Revised AMP, is sufficient to offer a high degree of safeguards with respect to the operations of market forces and the proper interplay of the forces of supply and demand:

- the Revised AMP requires any market participant managing a liquidity contract to identify in the market operator's records each order, including those participating to an auction;
- order files are sent on a daily basis to the AMF by the market operator;
- the AMF has developed an in-house impact model in order to identify patterns resulting in significant price movements during auctions;
- pursuant to Article 13(1) of MAR,[10] compliance with the Revised AMP is necessary, however such compliance is a necessary but insufficient condition to provide exemption from the prohibition on market manipulation: any intervention under the liquidity contract during the auction phase resulting from an order or illegitimate behaviour having the effect of manipulating the auction price would be prosecuted by the AMF.

b) ESMA considers that the intervention limits in terms of volume would not be compatible with MAR and the Points for Convergence

In relation to volume limits, the Revised AMP provides for restrictions modulated according to the liquidity of the shares. For highly liquid, liquid and illiquid shares, trading under the liquidity contract should not exceed 5%, 20% and 30% respectively of the average daily turnover on the market for the previous 30 trading sessions.

In particular, ESMA notes that while the differentiation mechanism according to the level of liquidity of the shares is in line with the PfC, the daily limits for liquid and illiquid shares exceed those recommended in the PfC by 5%. Furthermore, the AMP provides that these percentage limits of the average daily turnover only apply beyond an absolute value threshold of €25,000 on cumulative trades during the same trading day. The relevant limits in percentages of the average daily trading volume will therefore only apply for daily volumes exceeding €25,000,

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[6] See in this regard ESMA report "MiFID II review report on the functioning of the regime for SME Growth Markets" published on 25 March 2021 and derived from Article 90(1)(b) of Directive 2014/65/EU.

[7] See in this regard §44 of the ESMA opinion: "*In that sense, by providing for the submission of passive orders only, the AMF AMP goes beyond the recommendation included in the ESMA Opinion on PfC, as orders in execution of liquidity contracts should not result in a direct impact on the share price, which is one of the main objectives of the price limits."*

[8] As described in Table 2 of the Annex to the Commission Delegated Regulation (EU) 2017/580 of 24 June 2016. As an example, when the price determined following the auction phase is 10 euros and results from the matching of two orders (one buy and one sell), both limited to 10 euros, it is impossible to qualify one as passive and the other as aggressive.

[9] Including the cancellation or modification of an order, or even the decision not to issue an order.

[10] Article 13(1) of the MAR: "*The prohibition in Article 15 shall not apply to the activities referred to in Article 12(1)(a), provided that the person entering into a transaction, placing an order to trade or engaging in any other behaviour establishes that such transaction, order or behaviour have been carried out for legitimate reasons, **and** conform with an accepted market practice as established in accordance with this Article.*"

compared to €20,000 recommended in the ESMA Opinion on PfC. As such, ESMA considers that the impact of the hard threshold on the volume limits allowed by the Revised AMP could result in volumes executed under the liquidity contract that are significantly higher than those recommended in the PfC, in particular in relation to illiquid shares for which the ratio between the average daily trading volume and the hard threshold is lower.

In this respect, the Study sheds light on the supply of liquidity resulting from liquidity contracts: this is significant for illiquid shares, and more nuanced for liquid or highly liquid shares. In particular, the Study shows that liquidity contracts may be genuinely effective over the long term, i.e. supply liquidity to the market regardless of market configuration, if applied with a little more flexibility in terms of volumes than the limits set out in the PfC, even if, as ESMA agrees, the number of breaches is low. According to the AMF analysis, these rare breaches occur in specific market configurations, in particular when independent market participants need additional liquidity. In any event, the Study shows that over an extended period, the market share of a liquidity contract is very slight:

- Illiquid shares: 2%
- Liquid shares: 1.3%
- Highly liquid shares: 0.5%

Furthermore, the Study shows that the effect of the hard threshold is very limited when applied to liquid and highly liquid shares. The AMF therefore considers that applying the same hard threshold to every category of shares may considerably simplify the Revised AMP, without any detrimental effects. In particular, the monitoring of volume limits is simplified for the contract manager and the compliance department of the investment firm executing multiple liquidity contracts in shares in the three liquidity segments.

Finally, the AMF maintains that the volume limits set out in the Revised AMP are set at thresholds offering a high degree of safeguards with respect to the operations of market forces and the proper interplay of the forces of supply and demand, in a context in which the revised AMP is more demanding than the PfC in that it requires market participants acting as liquidity contract managers to identify in the market operator's records each order issued on a trading platform, it being specified that;

- order books and transactions are sent to the AMF by the market operator on a daily basis;
- the AMF has developed an internal impact model in order to identify patterns resulting in significant price movements during auctions and during continuous trading periods;
- pursuant to Article 13(1) of MAR,[11] compliance with the AMP is necessary, however such compliance is a necessary but insufficient condition to provide exemption from the prohibition on market manipulation: any intervention under the liquidity agreement resulting from a transaction, an order or illegitimate behaviour having the effect of manipulating the price would be prosecuted by the AMF, regardless of the liquidity contract's market share.

The AMF considers that ESMA's PfC, drawn up before the implementation of MiFID2, without the capacity to analyse in depth the interaction between liquidity contracts and market mechanisms and without taking into account the capacity of the national competent authorities to monitor the markets, are not entirely relevant in the French case. The AMF considers that the Modified AMP system is in full compliance with MAR.

c) ESMA considers that the absence of position limits would not be compatible with MAR

ESMA notes that the Revised AMP does not make any explicit reference to limits on positions (Article 4(2) of CDR 2016/908), that would therefore only be potentially capped by the maximum amount of cash and shares that can be allocated to the execution of the liquidity contract. According to ESMA, the absence of limits on positions is not compatible with Article 13(2)(b) of MAR, as supplemented by Article 4 of CDR 2016/908.

Firstly, the AMF recalls that the Revised AMP has not changed from the AMP 2019 with regard to position limits and that ESMA did not consider in its 2018 opinion[12] that the market practice violated Article 13(2)(b) on this specific point,[13] since the ESMA opinion of 11 April 2018 stated: "*ESMA understands that the lack of limits on positions is implicitly addressed through the maximum amount of cash and securities that can be allocated to the liquidity contract and the requirement for the financial intermediary to maintain a credit balance between the shares and the cash on the liquidity contract accounts as important measures to limit the possibility to acquire a dominant position,*

[11] Article 13(1) of the MAR: "*The prohibition in Article 15 shall not apply to the activities referred to in Article 12(1)(a), provided that the person entering into a transaction, placing an order to trade or engaging in any other behaviour establishes that such transaction, order or behaviour have been carried out for legitimate reasons,* ***and*** *conform with an accepted market practice as established in accordance with this Article.*"

[12] See in this regard the 2018 ESMA opinion on the AMF market practice

[13] The opinion published in 2018 indicated: "*Finally, despite the participation in auctions does not fully align with the ESMA Opinion on liquidity contracts, ESMA does not find evidence whereby the capacity of financial intermediaries to participate in auctions would affect the proper operation of market forces and the interplay of supply and demand, as required by Article 13(2)(b) of MAR and Article 4(2) of the RTS on AMPs.*"

so Article 4(2) can be considered as met as regards position limits.". The shift in ESMA's position is therefore, again, unexpected.

Secondly, if the AMF agrees, in line with ESMA's opinion of 11 April 2018 that liquidity contract positions are necessarily capped by the resources allocated by the issuer, it nevertheless considers that the liquidity contract cannot be implemented over a long period without maintaining a balanced approach on cash and equity resources.

In any event, the AMF considers that its specific monitoring of liquidity contracts and its enhanced supervision tools offer a high degree of safeguards with respect to the operations of market forces and the proper interplay of the forces of supply and demand.

d) ESMA considers that the resource cap provided for by the Revised AMP would not allow compliance with Article 13(2)(e) of MAR (absence of risk for the integrity of, directly or indirectly, related markets, whether regulated or not, in the relevant financial instrument within the Union)

With regard to the resources allocated to the execution of the liquidity contracts, ESMA notes that, in line with the PfC, the Revised AMP provides for limits modulated according to the liquidity of the shares subject to the liquidity contract:

Segment	"Relative" cap	"Absolute" cap
Illiquid shares	- 1% of market capitalisation	- €2m
Liquid shares	- 300% of daily turnover	- €20m
Highly liquid shares	- 100% of daily turnover	- €50m

However, ESMA states that, while the differentiation for the level of liquidity of the shares is in line with the PfC, the calculation method under the Revised AMP is not in line with the PfC:

- in relation to liquid shares, ESMA observes that the resources allocated as a percentage of the average turnover may be 50% higher than the limits recommended by the PfC.
- in relation to illiquid shares, ESMA notes that the Revised AMP departs from the limits recommended in the PfC both in relation to the percentage of resources allocated (calculated in relation to market capitalisation rather than the outstanding issued shares at the time of entering into the liquidity contract) and in relation to the hard threshold, which is double that of the PfC recommendation (€2 million rather than €1 million).

ESMA therefore considers that an unjustified allocation of resources, combined with the lack of limits on positions, may have an impact on the interplay of supply and demand by favouring the possibility of acquiring a dominant position in the market, with potentially detrimental effects on market confidence. Furthermore, ESMA notes the broad compliance of liquidity contracts with the resource limits of the PfC, as highlighted by the Study. Therefore, ESMA is of the view that the additional resources allowed by the AMP are not commensurate with its objectives (Article 7(b) of CDR 2016/908).

In this regard, the AMF has informed ESMA that one of the Study's objectives was to determine to what extent some thresholds or limits should be modified. In other words, the AMF conducted an analysis of the data in the context where, pursuant to Article 2(1)(b) of CDR 2016/908, the AMF must consult the stakeholders before establishing a market practice as an Accepted Market Practice. During these consultations, the AMF found that the caps on resources set by the Revised AMP needed to take some, however limited, specific situations into account.

Regarding liquid shares, the Study showed that this segment is heterogeneous,[14] and discussions with stakeholders led to the conclusion that the proper implementation of liquidity contracts on the least liquid shares in this segment may require a greater amount of assets than that provided for in the PfC.

Regarding illiquid shares, it was observed that liquidity contracts with resources exceeding €1 million concern the most liquid shares in this segment, in a context in which this segment is still much more heterogeneous than the liquid share segment. Discussions with stakeholders also led to the conclusion that the proper execution of a liquidity contract in illiquid shares may require a greater amount of assets than that provided for by the PfC.

According to the AMF's analysis, the easing of resource limits with regard to the caps recommended by the PfC does not pose a risk to the integrity of directly or indirectly related markets on which the financial instrument concerned is traded, considering that:

- the AMF has developed liquidity contract monitoring systems capable of identifying market manipulation patterns and assessing the impact of the liquidity contract on the security's market;

[14] As such, the average turnover in 2020 for liquid shares was around €8m, while the fifth percentile amounted to around €370,000.

- in some respects, the Revised AMP is more demanding than the PfC with regard to price trading limits. Given that the Revised AMP only allows passive orders, as opposed to the PfC, which allow aggressive and liquidity consuming orders issued at a price limited to that of the last independent trade, it is less likely to undermine market integrity;
- pursuant to Article 13(1) of MAR, compliance with the Revised AMP is necessary, however such compliance is a necessary but insufficient condition to provide exemption from the prohibition on market manipulation: any intervention under the liquidity contract resulting from a transaction, an order or illegitimate behaviour having the effect of manipulating the market would be prosecuted by the AMF, regardless of the resources allocated to the liquidity contract.

Here again, the AMF considers that ESMA's PfC, drawn up before the implementation of MiFID2 and in the absence of the capacity to analyse in depth the interaction between liquidity contracts and market mechanisms, are not fully relevant in the case of France.