AUTORITÉ DES MARCHÉS FINANCIERS

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The AMF publishes an analysis of the implementation of liquidity contracts and their effects

This study analyses the accepted market practice for liquidity contracts on the Paris Stock Exchange between December 2019 and May 2020 and suggests possible future fields for development. The regulator noted an improvement in quoted spreads and in the price impact of transactions, which were more pronounced for illiquid securities than for liquid and highly liquid securities.

A liquidity contract is a contract between an issuer and an investment services provider to foster market liquidity of an issuer's shares. In accordance with the European Market Abuse Regulation (MAR), the AMF has established an accepted market practice for share liquidity contracts, which came into force on 1 January 2019 and sets limits in terms of volumes, price and resources allocated. This accepted market practice gives the issuer and the service provider legal security with regard to the regulations on market abuse, provided that they comply with the terms of the practice.

Between December 2019 and May 2020, more than 440 French companies whose shares are traded on the Euronext regulated market and on Euronext Growth benefited from a liquidity contract, i.e. nearly 70% of listed companies. These liquidity contracts were implemented by around ten investment services providers.

An improvement in quoted spreads

The study shows that trading volumes involving liquidity contracts were slight, amounting to €4.9 billion over the six months analysed. This represents less than 1% of total volumes traded on these stocks and less than 0.5% of all trading in the Paris marketplace. For 3% of the trading sessions, the use of a liquidity contract effectively enabled the setting of a reference price for an issuer on that day for 79 illiquid securities.

Statistical and econometric analysis show that liquidity contracts can improve the quoted spreads and the price impact of the transactions for all security classes, although the impact on illiquid securities is more pronounced than on liquid and highly liquid securities. It can also be noted that liquidity contracts improve the quoted spreads for liquid and highly liquid securities in periods of market stress. The assessment is less clear-cut regarding effective spreads: a positive effect was observed, outside times of crises, for liquid securities alone. The observed impact on market depth is marginal.

Compliance with limits set by the market practice

The study also provides an analysis of trading in terms of volumes and price in relation to the limits in effect since January 2019. Compliance with these limits determines whether the liquidity contract transactions fall within the scope of the accepted market practice established by the AMF. Transactions that do not comply with these limits are not prohibited, but they do lose the benefit of the exemption provided for in Article 13 of the MAR.

The analysis revealed that:

- limits were breached a small number of occasions involving small amounts, and these breaches concerned only a minority of listed companies;
- price limit breaches represented a quarter of amounts traded, but most of these were orders that contributed to the liquidity of the order book;
- lastly, with regard to the conditions of resources allocated by issuers to liquidity contracts, the study hints at approaches for fine-tuning their extent.

Read more

↘ Retrospective analysis of the impact of liquidity contracts on the French market (December 2019 - May 2020) and potential changes in accepted market practice

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