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Public Notice 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[1]

In accordance with Article 13(3) of the Market Abuse Regulation (MAR), on 12 February 2018 the AMF notified the European Securities and Markets Authority (hereinafter ESMA) and other competent authorities of its intention to establish an accepted market practice for liquidity contracts to replace the current accepted market practice. 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.

Pursuant to Article 13(4) of the Market Abuse Regulation, on 11 April 2018 ESMA issued a positive opinion on the compatibility of the accepted market practice notified by the AMF with the Market Abuse Regulation and regulatory technical standards on accepted market practices (hereinafter Delegated Regulation)[2], except for the provisions relating to a two-year transitional period during which issuers and financial intermediaries using liquidity contracts could have made use of specific waivers.

After a thorough review of ESMA's opinion and after extensive consultation with market participants, **the AMF, taking into account the remarks made in the opinion, provided answers to the concerns expressed by ESMA. This accepted market practice will enter into application on 1 January 2019.**

According to Article 13(5)[3] of the European Regulation on market abuse, the AMF must publish on its website, within 24 hours of the establishment of the accepted market practice, a notice setting out in full the reasons for its decision, including why the accepted market practice does not threaten market confidence.

For each of the criteria referred to in Article 13(2) of the Market Abuse Regulation which ESMA has deemed to be non-compliant in its opinion, this notice details the adjustments made by the AMF to ensure that the established market practice does not threaten market confidence.

a) Article 13(2)(a) of the MAR Regulation: Substantial level of transparency with regard to the market (§28 to 49 of the ESMA opinion)

The notified market practice provided for a two-year transitional period during which issuers and financial intermediaries bound by a liquidity contract may be allowed to not comply with the three limits as laid down by ESMA in its opinion on the convergence points for liquidity contracts[4]:

- The issuer of liquid or illiquid shares may be allowed to not comply with the limits on cash resources or the number of shares allocated to the performance of the liquidity contract;
- The financial intermediary may be allowed to trade on the market without respecting the limits of intervention in terms of volume and price.

ESMA considers that the possibility of using these waivers does not meet the requirement of a substantial level of transparency towards the public as the notified market practice does not stipulate any particular disclosure if a waiver is used (§37 to §40). ESMA suggests that a minimum level of market transparency should be required in the form of immediate ex-post information following the use

[1] NB: The authoritative version of this notice is the French version.
[2] Commission Delegated Regulation (EU) 2016/908 of 26 February 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council laying down regulatory technical standards on the criteria, the procedure and the requirements for establishing an accepted market practice and the requirements for maintaining it, terminating it or modifying the conditions for its acceptance.
[3] Article 13(5): “Where a competent authority establishes an accepted market practice contrary to the opinion of ESMA issued in accordance with paragraph 4, it shall publish on its website within 24 hours of establishing the market practice, a notice setting out in full its reasons for doing so, including why the accepted market practice does not threaten market confidence.”
[4] ESMA opinion of 25 April 2017 on points for convergence points in relation to MAR accepted market practices on liquidity contracts.

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of waivers, allowing market participants to interpret the prices and the volumes exchanged in light of the fact that the liquidity contract was operated outside the intervention limits (§41).

As for transparency with regard to the regulator, ESMA considers that the notified market practice may not comply with Article 3(2)(a) of the delegated regulation on accepted market practices because, in the event of use of waivers, the regulator's information would be incomplete in the absence of alternative volume or price limits (§49). ESMA considers that the AMF's commitments to closely monitor the use of waivers and conduct on-site investigations are not sufficient to qualify its negative assessment of compliance with this criterion (§45).

Consequently, the AMF has decided to abandon in its established market practice the waiver mechanism initially provided for, which could have enabled a financial intermediary to not comply with the intervention limits in terms of volume and price. Similarly, the AMF has discarded the possibility for an issuer to allocate resources to the performance of the liquidity contract with no limit on the amount. The established market practice now sets a limit on the resources that can be allocated by the issuer to the liquidity contract, as well as the intervention limits in terms of volume and price that financial intermediaries must comply with to remain within the framework of the accepted market practice.

Therefore, the established accepted market practice meets the transparency requirements vis-à-vis:

- **the regulator since the AMF will be notified of all agreements and contracts concluded between the issuer and the intermediary that will govern compliance with the intervention and resource limits. In addition, the established market practice will ensure that the AMF receives information on compliance with the intervention limits and resource limits;**
- **the public since the maximum level of resources that can be allocated by the issuer to the liquidity contract and the limits of intervention in terms of volume and price will be publicly disclosed.**

The AMF considers that these adjustments are likely to ensure the compatibility of the accepted market practice with the Market Abuse Regulation and that it does not threaten market confidence in light of the increased transparency obligations.

b) **Article 13(2)(b) of the MAR Regulation: High degree of safeguards with respect to the operation of market forces and the proper interplay of the forces of supply and demand** (§50 to 73 of the opinion of ESMA)

<u>b. (i) On the remuneration of financial intermediaries</u>

ESMA points out that where liquidity contracts are part of a package of services for an issuer, the independence of the financial intermediary could be compromised if those other services involve compensation paid to the intermediary (§53 to 55). Therefore, ESMA recommends analysing this parameter to ensure compliance with the provisions mentioned in Article 4(3).a of the Delegated Regulation whereby the market practice and the agreement or contract governing its use allows the person performing the accepted market practice to act independently of the beneficiary, without being subject to the instructions, information or influence of the latter as to the terms of the trading.

Consequently, the AMF has added a new provision in its established market practice providing for annual disclosure to the regulator on the services provided to the issuer in connection with the liquidity contract, as well as on the various fees received within this framework.

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(ii) The use of waivers

In its opinion, ESMA considers that the lack of identification of the market conditions under which issuers and financial intermediaries can benefit from the waivers, as well as the absence of alternative limits in terms of resources, prices or volume do not meet the requirements of Article 13(2)(b) of the Market Abuse Regulation, whereby the market practice offers a high degree of safeguards with respect to the functioning of market forces and the proper interplay between supply and demand (§63 and §72).

Against this backdrop, and as mentioned above, the AMF has decided to abandon the waiver mechanism initially provided for in the notified market practice.

To facilitate a smooth transition to the new framework for liquidity contracts, the AMF now provides for a two-year transitional period of observation from its entry into force, during which a set of relaxed criteria may be applied to liquidity contracts in the illiquid share segment and liquid share segment[5], with no such relaxation being available for the highly liquid share segment (shares included in the underlying basket of the CAC40 index).

During this period, issuers and financial intermediaries may exceed the limits (b. (iii)) in terms of volume, (b. (iv)) in terms of price and (b. (v)) in terms of allocated resources) set in the ESMA points of convergence provided that (i) these overruns are justified and (ii) they do not exceed certain maximum limits.

(iii) Intervention limits in terms of volume

Alternative maximum limits higher than the limits specified in the ESMA opinion of 25 April 2017 on convergence points are provided by the AMF for the liquid and illiquid securities segments. Bearing in mind that the framework currently governing liquidity contracts in France does not provide for any intervention limit in terms of volume, the AMF considers that the limits imposed by the new regulatory framework must be tested under real market conditions[6].

As a result, the AMF has decided to set up a two-year transitional observation period during which the liquidity contract intervention volume may represent a percentage of the average trading volume observed on the trading platform during the previous 30 trading sessions (hereinafter the “turnover”) between the limit specified by the ESMA convergence points (hereinafter “ESMA limit”) and the alternative limit (hereinafter “AMF limit”) provided that the financial intermediary documents and justifies the reasons why the interventions exceeding the “ESMA limit” were necessary for the proper functioning of the liquidity contract and did not threaten market confidence and the proper functioning of the relevant securities market.

Thus, the liquidity contract transactions may represent a higher percentage of turnover ("AMF limit") than that specified in the ESMA convergence points ("ESMA limit"):

Segment	**% o*f turnover***	
Illiquid shares	“AMF Limit” <= **50%**	between 25% ("ESMA limit") and 50% ("AMF limit"), the financial intermediary being required to document and justify.
Liquid shares	“AMF Limit” < =**25%**	between 15% ("ESMA limit") and 25% ("AMF limit"), the financial intermediary being required to document and justify.

When the interventions represent a percentage of the turnover exceeding the "AMF limit", the MAR Regulation will apply. In other words, the issuer and the financial intermediary will not benefit from the legal certainty (“safe harbour”) conferred by the established market practice.

[5]With reference to Commission Delegated Regulation (EU) 2017/567 of 18 May 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to definitions, transparency, portfolio compression and supervisory measures on product intervention and positions.
[6] This test could not be performed within the framework of adopting the ESMA convergence points.

Consequently, the AMF considers that the easing of the volume limits provided for in the market practice is not likely to threaten market confidence, given (i) the obligation to document and justify when the level of intervention is between the "ESMA limit" and the "AMF limit" and (ii) the existence of alternative limits ("AMF limits") when the intervention limits set in the ESMA convergence points are exceeded. The "AMF limits" have been set in such a way as to limit certain peaks in liquidity contract activity without jeopardising the benefits that these provide to the liquidity of the market. Their level ensures that liquidity contract interventions do not threaten market confidence.

The AMF considers that maintaining a two-year transitional period of observation is not likely to threaten market confidence either, since the terms and conditions for executing liquidity contracts will in any case be stricter than those of the accepted market practice in force since 2005. Hastily implementing the intervention limits stipulated by ESMA's convergence points - limits whose level has not undergone a prior impact assessment - could, on the contrary, destabilise the French markets, which widely use liquidity contracts (more than 400 contracts in force), including by small and medium-sized companies.

The transitional observation period is intended to enable a more accurate calibration of the intervention requirements for liquidity contracts in terms of volume without threatening market confidence. Based on the lessons learned, at the end of this two-year period, the AMF will consider modifying its market practice.

<u>b.(iv) Intervention limits in terms of price</u>

In accordance with ESMA’s convergence points, the financial intermediary may issue a purchase (or “bid”) order whose maximum price limit is the highest price between the price of the last independent transaction and the price of the highest independent purchase order. An analogous condition applies to sell (or “ask”) orders.

When the liquidity contract concerns a share on the liquid or illiquid share segment, the established market practice provides for eased restrictions whereby the financial intermediary can issue an order whose price limit makes it possible to position an order between the best bid price available (for purchase) and the best ask price available (for sale) provided that said intermediary documents and justifies that the order is necessary for the purposes of the established market practice and is not likely to threaten the smooth operation of the market in the security or market confidence.

In other words, this easing of restrictions allows the intermediary to issue an order if it brings liquidity to the market (passive orders). On the other hand, an aggressive order, i.e. an order stipulated at a price limit crossing the price range of the best offers to buy and sell (the "spread"), and consequently a liquidity-consuming order, would remain outside the scope of the established market practice.

Like volume intervention limits, when a financial intermediary issues a passive order stipulated at a price limit that is more competitive than the highest price between the price of the last independent transaction and the price of the highest independent purchase order, the established market practice provides for the requirement to document and justify that the order at this price limit was necessary for the proper implementation of the liquidity contract and was not likely to threaten market confidence. A comparable mechanism applies to sell orders.

<table>
<tr><th>Segment</th><th>Price limits</th></tr>
<tr><td>Illiquid shares</td><td rowspan="2">For purchase:
maximum intervention limit:
highest between the price of the last independent transaction and the highest independent bid.
(reciprocal principle for the sale)

Or

Price limit to narrow the spread (passive orders only) subject to documentation and justification.</td></tr>
<tr><td>Liquid shares</td></tr>
</table>

The AMF considers that maintaining a two-year transitional period of observation is not likely to threaten market confidence since the conditions for executing liquidity contracts will be stricter than those of the accepted market practice in force since 2005 on French markets. The price limits provided for in the market practice constitute a market practice that is stricter than the currently accepted practice which does not provide for any particular constraint in this area and does not prohibit aggressive orders for example.

This easing of restrictions compared to ESMA's convergence points is particularly justified when an independent order, due to its size and its price limit, causes an abrupt and sharp change in the share price. In such a situation, the difference between the highest bid order and the lowest ask order increases in similar proportions. When it concerns a highly liquid share, this variation is generally quickly corrected because market participants quickly reissue orders that replenish the order book. On the other hand, when it concerns a less liquid share, replenishing the order book can prove to be much less efficient. In this type of situation, easing the restrictions associated with the market practice compared to ESMA's convergence points is likely to strengthen market confidence.

In the same way as for the volume limits, the two-year period is intended to enable a more accurate calibration of the intervention needs of the liquidity contract in terms of price limit without undermining market confidence. At the end of this two-year period and based on the lessons learned, the AMF may consider changing its established market practice.

b.(v) Resource ceilings allocated by the issuer to the liquidity contract

Based on the same logic applied to the intervention limits in terms of volume, the established market practice provides for higher alternative ceilings (hereinafter "AMF ceilings") than those specified in the ESMA convergence points (hereinafter "ESMA ceilings") with regard to the cash resources or financial instruments that the issuers allocate to the performance of the liquidity contract when their shares belong to the liquid or illiquid securities segments.

It should be noted that the framework that currently governs liquidity contracts in France provides that the resources allocated by the issuer must be proportionate and commensurate with the needs of the market practice without specifying a ceiling; the AMF considers that the setting of ceilings should be tested under real market[7] conditions and reviewed periodically.

As a result, the AMF has decided to set up a two-year transitional observation period during which the resources allocated by the issuer may exceed the "ESMA ceilings" if they:

- remain proportionate and commensurate with the needs of the market practice,
- represent an amount less than or equal to the relevant "AMF ceiling".

In this case, the established market practice provides that the issuer must document and justify the reasons why the additional resources beyond those under the "ESMA ceiling" are necessary for the proper functioning of the liquidity contract. The "AMF ceilings" have been set as follows:

Segment	"Relative" ceiling	"Absolute" ceiling
Illiquid shares	- 750% of daily turnover - If the resources allocated by the issuer represent an amount between 500% and 750% of the average daily turnover, this must be justified and documented Or - 1.5% of market capitalisation	- €3m - If the resources allocated by the issuer represent an amount between €1m and €3m, this must be justified and documented

[7] This test could not be performed within the framework of adopting the ESMA convergence points.

	- If the resources allocated by the issuer represent an amount between 1% and 1.5%, this must be justified and documented	
Liquid shares	- 300% of daily turnover	- €30m - If the resources allocated by the issuer represent an amount between €20m and €30m, this must be justified and documented
Highly liquid shares	- 100% of daily turnover	- €50m

These thresholds were determined after examining the amounts allocated by a panel of approximately 400 issuers who have entered into a liquidity contract.

The AMF considers that the possibility of exceeding the resource limits set by the ESMA convergence points does not entail non-compliance with the requirement of Article 7 of the Delegated Regulation whereby the resources (cash or financial instruments) to be allocated to the performance of the accepted market practice should be proportionate and commensurate with the objectives of the practice.

The two-year transitional observation period will have no other objective than to enable the AMF to calibrate these resource ceilings as accurately as possible.

In conclusion, the AMF considers that the guarantees provided by the established market practice, both in terms of justifying any exceeding of the volume, price and resource limits, and in terms of setting a ceiling where such limits are exceeded, are likely to meet the requirements of Article 13(2)(b) of the Market Abuse Regulation, whereby the market practice should ensure a high degree of safeguards to the functioning of market forces and the proper interplay between supply and demand. The market practice will not threaten market confidence as (i) it introduces stricter conditions than the current accepted market practice, (ii) the ceilings on the extent to which the volume, price and resources limits may be exceeded have been set as accurately as possible by referencing available statistical data on existing liquidity contracts and (iii) the issuer and the financial intermediary will be required to document and justify respectively any overrun of the ESMA "resource ceiling" or the "ESMA limit" in respect of the intervention limits in terms of volume and price.

c) **Article 13(2)(c) of the MAR Regulation: Positive impact on market liquidity and efficiency** (§74to 78 of ESMA opinion)

If ESMA admits that liquidity contracts can indeed increase the liquidity of a share and ensure its regular trading, the absence of identification of the conditions under which financial intermediaries and issuers may use waivers has led ESMA to consider that the nature of the waivers does not allow for a sufficient assessment of the possible effects of the activity of intermediaries on the liquidity and efficiency of the market (§77). In particular, ESMA has considered the case where all issuers and financial intermediaries simultaneously would make use of waivers.

Consequently, the AMF has decided to abandon the waiver mechanism provided for in the notified market practice, which could have allowed the financial intermediary to not comply with the intervention limits in terms of volume and price and the issuer to not comply with the resource limits.

The AMF believes that the market practice including the conditions placed on volumes, prices and resources will limit the possible impact on the liquidity and efficiency of the market in the event of all issuers and financial intermediaries simultaneously exceeding the limits – a situation which in practice remains highly theoretical.

d) **Article 13(2)(d) of the MAR Regulation: Taking into account the trading mechanism of the relevant market and the ability of market participants to react properly and in a timely manner to the new market situation created by the practice** (§79 to 87 of the ESMA opinion)

According to ESMA, waivers which may be used during the transitional period open the way for market practices that could distort prices, in particular in a context where the notified market practice does not take into consideration any other price restriction when the waiver is used. Consequently, the waivers provided for in the notified market practice do not comply with the requirements set forth in Article 13(2)(d) of the MAR Regulation as specified in Article 6 of the Delegated Regulation (§87).

As a result, the AMF has decided to abandon the waiver mechanism provided for in the notified market practice, which could have allowed a financial intermediary to avoid price intervention limits.

The AMF considers that the new conditions placed on prices will minimise any possible disruptive effect of liquidity contracts on market prices and will ensure that market confidence is not threatened.

e) Article 13(2)(e) of the MAR Regulation: Absence of risks to the integrity of directly or indirectly related markets, whether regulated or not, in the financial instrument within the Union (§88 to 107 of ESMA's opinion)

ESMA points out that the notified market practice does not include any specific analysis or information relating to the information exchange process between the parties to the liquidity contract (the financial intermediary and the issuer), whereas such a requirement is provided for in Article 7 of the Delegated Regulation (§98).

As a result, the AMF has included in its market practice a provision requiring the financial intermediary to transmit to the issuer any information necessary to comply with its transparency obligations.

Finally, ESMA considers that the waivers relating to the resources allocated by an issuer of illiquid or liquid shares to the performance of the liquidity contract do not guarantee that they will always be proportional and commensurate with the objectives of the contract (§106).

As mentioned above, the AMF has decided to abandon the waiver mechanism initially provided for in the market practice notified to ESMA, including when it concerns the resources allocated by the issuer. **The market practice provides that the resources will now be capped and, in all cases, proportionate and commensurate with the objectives of the liquidity contract.**

These provisions in terms of transmission of information between issuers and financial intermediaries and in terms of proportionality with regard to the resources allocated to the liquidity contract are such, in the view of the AMF, as to ensure that the established market practice will not threaten market confidence.