



**HEALTHY MARKETS**  
TRANSPARENCY & TRUST

**Market Making Standards**

*Discussion Draft Proposal*

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## ABOUT HEALTHY MARKETS ASSOCIATION

Healthy Markets is an investor-focused not-for-profit coalition looking to educate market participants and promote data-driven reforms to market structure challenges. Our members, who range from a few billion to hundreds of billions of dollars in assets under management, have come together behind one basic principle: Informed investors and policymakers are essential for healthy capital markets. Healthy Markets can be found online at [healthymarkets.org](http://healthymarkets.org).

## INTRODUCTION

Market makers serve an important role in providing liquidity to securities and contribute to the overall health and efficiency of the capital markets. As the US markets have evolved from a central liquidity framework to the current fragmented system of multiple exchanges and Alternative Trading Systems, market making obligations have not kept pace with this modern framework.

Currently, market making standards in the securities markets are generally left to the market venues to develop. A firm designated as a “market maker” on one venue may not be designated as a market maker on another. Similarly, the obligations and benefits of being a “market maker” vary from venue to venue. The current framework results in inconsistent expectations for market participants and regulators. It has also arguably helped concentrate liquidity in the largest, most-liquid securities at the expense of less-liquid securities.

The Securities and Exchange Commission should consider adopting a new form of standards that could apply across market venues and asset classes. While not the primary focus of this proposal, we recommend that the Commission work with other regulators, most notably, the Commodity Futures Trading Commission, to develop cross-product standards that may more appropriately integrate different, interrelated asset classes overseen by different regulators. The SEC should consider this approach for all asset classes, but perhaps the first asset class to be covered should be NMS stocks.

## POTENTIAL “NMS MARKET MAKER” STANDARD

The SEC should consider adopting a new federal standard for NMS Market Makers which could require liquidity provisioning across various baskets of securities. In addition to requirements that encompass a breadth of securities covered, a standard could include the following requirements:

- Best Price Obligation - publish continuous, two-sided quotations “at or near the best price” during regular market hours for a specified percentage of the time during a trading day;
- Minimum Size - publish two-sided quotations at a specified minimum size (e.g., 500 shares) based on the price and ADV of the stock;
- Depth Obligations - provide depth quotations 3 to 5 levels below the Best Price Obligation at a specified minimum size;

- Spread Obligation- maintain minimum two-sided quoted spread requirements fostering a tight and liquid market;
- Best Price Obligation – maintain a minimum level of participation at the NBBO;
- Passive Liquidity Provision – provide an equal or greater amount of passive liquidity;
- Basket Obligation - meet these market making standards in a minimum number of securities. For example, in equities, the baskets could be small cap, mid-cap and large cap stocks;
- Capital Requirements - maintain higher capital requirements than other broker dealers based on their quoting obligations in addition to their existing position-based capital requirements.

Each of the above elements would aid in defining who is an NMS Market Maker and who is not and also enhance the provisioning of robust liquidity, while ensuring the financial stability of the markets. Based upon the proposed requirements, Healthy Markets preliminarily recommends the following NMS Market Maker Standards:

Metric	Tier-1 (Large Cap) (250 mm+ adv)	Tier-2 (Mid-Cap) (100mm – 250mm adv)	Tier-3 (Small Cap) (0-100mm adv)
Continuous two-sided Quotes	99%	98%	95%
Quote Size	500	200	100
Depth Obligation	5 levels	3 levels	3 levels
Quote Spread	2%	5%	10%
Best Price Obligation - NBBO participation	15%	10%	5%
Passive/Active	50/50	50/50	50/50
Basket Minimum	50	100	200
Capital Requirements	Supplement the Net Capital requirements for broker-dealers with additional capital and liquid asset requirements sufficient to protect against market disruptions. Such requirements may reflect measures of transaction volume and average outstanding orders.		

These standards, if adopted by the SEC, could supplant existing exchange based standards and could also pave the way for incentives to further promote liquidity in the market-place. These standards could be validated on a regular basis for compliance in-house or through a third party firm. Oversight and compliance with the standards may appropriately rest primarily with FINRA as part of their TMMS examinations or the development of reporting directly to FINRA.

## ROLE OF INCENTIVES

On each venue, being designated as a “market maker” or a functional equivalent typically carries with it some collection of benefits. These incentives may play a critical role in promoting

genuine market making activity, to the benefit of long term investors. The SEC should carefully consider the different incentives across market venues to ensure that these incentives serve to promote more fair and efficient markets. To the extent possible, these incentives should be standardized.

As guiding principles, incentives that promote fairness and efficient markets should be permitted, while those that create unnecessary complexity or undermine the integrity of the markets should be mitigated or prohibited.

Traditionally, market makers have been incentivized with various advantages over other market participants, such as with place, time and informational advantages or simply financial incentives such as liquidity rebates. One approach Healthy Markets believes merits further consideration is whether latency advantages could only be available to firms qualifying as National Market System Market Makers.

Other incentives that have been discussed by some include lower fees (such as a reduced Section 31 fee) or preferential tax treatment. We do not necessarily support these incentives, however.

## **CONCLUSION**

The discrepancies between market making standards across execution venues provides confusion for market participants and regulators, while also creating an array of inconsistent costs and benefits for firms providing liquidity on those venues. To reduce complexity and promote more fair and efficient markets, we recommend considering approaches to standardize expectations for “market makers” across asset classes, beginning with NMS Stocks.

## BACKGROUND: EXISTING MARKET MAKER REQUIREMENTS

Exchange Requirements	Quoting Requirement	Size Requirement	Spread Requirement	NBBO Requirement	Trading Requirement	Basket Obligation	Capital Obligation
IEX	Continuous two-sided quotes	Average order size relative to market/venue	none	Percent of Quote at NBBO	Percent of Traded Volume as Displayed Liquidity Added	none	none
Nasdaq MQP	Within min spread 90%	2500 shares each side	Within 2% of NBBO for 90% of the day	25%	none	none	none
Nasdaq OMX Helsinki	Continuous two-sided quotes: 85%	4000 Euros	4%	none	none	none	none
NYSE DMM	Continuous two-sided quotes	none	"Designated Percentage" shall be 8% for S&P500/Russell 2k, 28% for others > \$1, and 30% for others < \$1, except that between 9:30 a.m. and 9:45 a.m. and between 3:35 p.m. and the close of trading, when Rule 80C is not in effect, the Designated Percentage shall be 20% for S&P500/Russell 2k, 28% for others > \$1, and 30% for others < \$1.	Basic: 15% for symbols <1MM shares; 10% for symbols >1MM shares. "More Active": 15% for symbols >1MM shares. Quoting 20%+in <1MM share symbols gives DMM all CTATape Rev.	15% total intraday adding liquidity is threshold for pricing	none	Net Liquid Assets equal to the greater of (i) \$1,000,000 or (ii) \$125,000 for every 0.1% of Exchange Transaction Dollar Volume in each of the DMM unit's registered securities. The portion of a DMM unit's Net Liquid Assets that is derived from Excess Net Capital shall at all times equal or exceed 40% of a DMM unit's total Net Liquid Assets requirement.
NYSE SLP	Continuous two-sided quotes	none	"Designated Percentage" shall be 8% for S&P500/Russell 2k, 28% for others > \$1, and 30% for others < \$1, except that between 9:30 a.m. and 9:45 a.m. and between 3:35 p.m. and the close of trading, when Rule 80C is not in effect, the Designated Percentage shall be 20% for S&P500/Russell 2k, 28% for others > \$1, and 30% for others < \$1.	10%	Adds liquidity of an average daily volume ("ADV") of more than a specified percentage of consolidated average daily volume ("CADV") in all NYSE-listed securities. 0.15% - >0.5% results in tier 1 - 3.	none	Maintain minimum net capital in accordance with the provisions of Rule 15c3-1 under the Securities Exchange Act of 1934
BATS CLP	One sided	500 Round Lot Only	CLPs must be quoting at least one round lot at or within 1.2% of their offer (bid) to have a winning offer SET (winning bid SET).	1.20%	The three CLPs with the greatest aggregate size at the NBB (or NBO) for a security will win the SET. The CLP with the most aggregate size will win first place and be awarded three credits; second place will receive two credits, and third place will receive one credit	none	none
Aequitas	Continuous two-sided quotes: 95%	3 Board Lots	Within 3% of last-sale price	10%			Existing IROC capital requirements for dealer-members (minimum capital of \$250,000)
TSE	Continuous two-sided quotes within the spread goal	Minimum guaranteed fill	Agreed-upon spread goal with Exchange	none	none	none	Existing IROC capital requirements for dealer-members (minimum capital of \$250,000)

## BACKGROUND: SELECTED RESOURCES

- Government office for Science, Minimum obligations of market makers:  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/289034/12-1069-eia8-minimum-obligations-of-market-makers.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/289034/12-1069-eia8-minimum-obligations-of-market-makers.pdf)
- BATS Exchange Rulebook:  
[http://cdn.batstrading.com/resources/regulation/rule\\_book/BATS\\_Exchange\\_Rulebook.pdf](http://cdn.batstrading.com/resources/regulation/rule_book/BATS_Exchange_Rulebook.pdf)
- Nasdaq Market Quality Program: <http://www.nasdaqtrader.com/Trader.aspx?id=MQP>
- NYSE Rules: <http://nyserules.nyse.com/NYSE/Rules/>
- Nasdaq OMX Guidelines for Market Making:  
[http://www.nasdaqomx.com/digitalAssets/86/86486\\_guidelinesformarketmaking1july2013.pdf](http://www.nasdaqomx.com/digitalAssets/86/86486_guidelinesformarketmaking1july2013.pdf)
- Aequitas NEO Exchange DMM program:  
<https://aequitasneoexchange.com/en/trading/designated-market-makers/dmm-obligations-benefits/>
- Toronto Stock Exchange Trading Rule amendments related to market making:  
[https://www.osc.gov.on.ca/en/Marketplaces\\_xxr-tse\\_20110916\\_rfc-market-making.htm](https://www.osc.gov.on.ca/en/Marketplaces_xxr-tse_20110916_rfc-market-making.htm)
- TMX Market maker responsibilities:  
[http://apps.tmx.com/en/trading/products\\_services/market\\_system.html](http://apps.tmx.com/en/trading/products_services/market_system.html)
- London Stock Exchange Derivatives market making obligations:  
[https://www.lseg.com/sites/default/files/content/documents/LSEDM%20-%20Market%20Making%20Obligations%203.3\\_1.pdf](https://www.lseg.com/sites/default/files/content/documents/LSEDM%20-%20Market%20Making%20Obligations%203.3_1.pdf)
- The Specialists participation in quoted prices (Panayides):  
<http://depot.som.yale.edu/icf/papers/fileuploads/2384/original/04-05.pdf>
- Providing Liquidity in a High-Frequency World: Trading Obligations and Privileges of Market Makers (Dolgopolov):  
[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2032134](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2032134)
- Linking the Securities Market Structure and Capital Formation: Incentives for Market Makers (Dolgopolov):  
<http://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=1459&context=jbl>
- Liquidity Enhancement for Small Public Companies Act, H.R. 6127  
<https://www.congress.gov/bill/112th-congress/house-bill/6127/text>
- Release No. 34-69195; File No. SR-NASDAQ-2012-137, Approval to Establish a Market Quality Program <https://www.sec.gov/rules/sro/nasdaq/2013/34-69195.pdf>