

**TRAD-X**

**Market Making Scheme Description**

**– GBP IRS**

To be read in conjunction with the Market Making Agreement

**Issue 1.0 (17 January 2019)**

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## 1. Introduction

Launched in 2011, Trad-X is the multi-asset class trading platform for OTC Derivatives, providing rich functionality, low latency and a proven ability to attract deep high-quality liquidity. Trad-X has been designed to meet the demands of today's market and a globally future-proof method of trading in a shifting regulatory environment. As part of Trad-X's continuous evolution to meet these demands (and, in particular, requirements being introduced by Directive 2014/65/EU of the European Parliament and Council ("**MiFID 2**")), a new Market Making Scheme is being introduced for Trad-X, as further described in this document.

## 2. Summary

The purpose of this document is to provide an understanding of the key elements of the Trad-X Market Making Scheme. This document will be monitored and updated as the Market Making Scheme continues and develops.

## 3. Enquiries

For assistance contact Trading Operations at [trading.operations@tradition.com](mailto:trading.operations@tradition.com) or call ++44 [0207 198 1556]

## 4. Market Making Scheme Description

### 4.1 Overview

Trad-X is a multilateral trading facility (MTF) for the purposes of the Markets in Financial Instruments Directive 2004/39/EC ("**MiFID**"), as amended, and MiFID 2. In accordance with the requirements set out in Article 48(2) and (3) of MiFID 2 and in RTS 8, this document sets out the details of the Trad-X Market Making Scheme, and which supplements the Market Making Agreement which may be entered into by Market Makers wishing to pursue a market making strategy on the Trad-X market.

This document sets out the following details in relation to the Trad-X Market Making Scheme:

- The "Risk-Adjusted Average Spread" (RAAS) Mechanism (see **4.2**);
- Tenors and Evaluation Metrics (see **4.3**);
- "Exceptional Circumstances" and "Stressed Market Conditions" (see **4.4**)
- Incentives (see **4.5**).

This document should be read in conjunction with the "MiFID 2 Market Making Agreement" issued by Tradition from time to time.

## 4.2 The “Risk-Adjusted Average Spread” (RAAS) Mechanism

Tradition measures the streaming activity undertaken by Market Makers on the Trad-X platform by calculation of the Risk-Adjusted Average Spread or RAAS, a number which is used to peer-measure Market Makers.

The RAAS is calculated using the following formula:

$$\text{Ranking points per product} = [\text{qualifying hours} * \text{max}[10\text{y duration, tenor duration}] / [0.125\text{bp} + \text{mean bid-offer}]$$

*Where any individual bid-offer readings are max[0, bid-offer]*

Tradition will announce qualifying streaming size for each period at the beginning of each Quarter. Calculation will be GBP 15,000 DV01 duration in all streaming periods rounded to the nearest 5 million. This will then remain as the qualifying size for the whole Quarter.

Full RAAS reporting will be made to Market Makers at the end of each Quarter, with Market Makers additionally being informed of its monthly ranking (against all Market Makers) achieved each month.

The RAAS will be calculated as the Volume Weighted Average Price of that Market Maker's contributions on the bid side and offer side of that instrument in the minimum quote size that has been set for that period, providing the split of the size was at least half of the minimum RAAS qualifying size. i.e. GBP 7,500 DV01.

BBO reward based on best passive stream (adjusted). This is the reward earned for being BBO and works as follows: if a Market Maker is either the best bid or best offer in a stack (price/time priority) for that period of time, it will receive the same as the BBO spread of the best streamer plus 20%.

### Example:

5 Year stack

| <b>Bid</b> |      |        | <b>Ask</b> |      |        |
|------------|------|--------|------------|------|--------|
| Bank A     | 100m | 1.3670 | Bank C     | 100m | 1.37   |
| Bank B     | 100m | 1.3660 | Bank B     | 100m | 1.3760 |
| Bank C     | 100m | 1.3640 |            |      |        |

Using the case above, Bank A would get BBO spread of 0.72 which is 0.6 same as Bank C which is best passive stream plus 20%, even though it has only made a bid. As Bank C is top of offer stack but is also best passive stream, it would get BBO spread of 0.6: slightly better than Bank A as a reward for making a two way price. Again, just for illustration, Bank B gets BBO spread of 1 and is unaffected by the adjustments.

### 4.3 Tenors and Evaluation Metrics

|                       |                           | <u>Size (MM)</u> | <u>BBO (Bps)</u> | <u>Weight</u> | <u>RAAS Points</u> |
|-----------------------|---------------------------|------------------|------------------|---------------|--------------------|
| <b>Package Trades</b> |                           |                  |                  |               |                    |
| <b>1</b>              | <b>10Y vs Gilt Future</b> | <b>25</b>        | <b>0.5</b>       | <b>2</b>      | <b>234</b>         |
| 2                     | 30y vs Gilt               | 15               | 0.7              | 0.1           | 26                 |

| <b>Outright SB vs 6s</b> |            |            |            |            |          |
|--------------------------|------------|------------|------------|------------|----------|
| <b>3</b>                 | <b>2Y</b>  | <b>100</b> | <b>0.7</b> | <b>0.1</b> | <b>8</b> |
| <b>4</b>                 | <b>5Y</b>  | <b>50</b>  | <b>0.7</b> | <b>0.1</b> | <b>8</b> |
| <b>5</b>                 | <b>10Y</b> | <b>25</b>  | <b>0.7</b> | <b>0.1</b> | <b>8</b> |

| <b>Spread/Flies:</b> |              |           |            |          |            |
|----------------------|--------------|-----------|------------|----------|------------|
| 6                    | 2x5          | 50        | 0.7        | 0.1      | 7          |
| 7                    | 5x10         | 25        | 0.7        | 0.1      | 7          |
| <b>8</b>             | <b>10x30</b> | <b>15</b> | <b>0.7</b> | <b>1</b> | <b>263</b> |
| 9                    | 5x7x10       | 50        | 0.7        | 0.1      | 7          |
| 10                   | 10x12x15     | 15        | 0.7        | 0.1      | 12         |
| 11                   | 10x20x30     | 15        | 0.7        | 0.1      | 19         |

|                   |  |  |  |  |            |
|-------------------|--|--|--|--|------------|
| <b>Total (3):</b> |  |  |  |  | <b>598</b> |
|-------------------|--|--|--|--|------------|

|                       |          | <u>Size (MM)</u> | <u>BBO (Bps)</u> | <u>Weight<br/>(1)</u> | <u>RAAS<br/>Points</u> |
|-----------------------|----------|------------------|------------------|-----------------------|------------------------|
| <b>1Year Gap Fly:</b> |          |                  |                  |                       |                        |
| 12                    | 2x3x4    | 50               | 0.5              | 0.1                   | 12                     |
| 13                    | 3x4x5    | 50               | 0.5              | 0.1                   | 12                     |
| 14                    | 4x5x6    | 50               | 0.5              | 0.1                   | 12                     |
| 15                    | 5x6x7    | 50               | 0.5              | 0.1                   | 12                     |
| 16                    | 6x7x8    | 50               | 0.5              | 0.1                   | 12                     |
| 17                    | 7x8x9    | 50               | 0.5              | 0.1                   | 12                     |
| 18                    | 8x9x10   | 50               | 0.5              | 0.1                   | 12                     |
| 19                    | 9x10x11  | 50               | 0.5              | 0.1                   | 12                     |
| 20                    | 10x11x12 | 50               | 0.5              | 0.1                   | 13                     |

|                   |     |
|-------------------|-----|
| <b>Total (4):</b> | 109 |
|-------------------|-----|

|              |            |
|--------------|------------|
| <b>TOTAL</b> | <b>706</b> |
|--------------|------------|

NOTES:

- Trad-X platform open from 08:00 to 17:00 (UTC).  
“Weight” –weighting multiple attached to the tenor based on Tradition’s assessment of the tenor’s importance to the overall liquidity of the Trad-X ecology.
- “RAAS Points” values based on 7 hours’ of streaming during open hours.
- “+/- 0.1 Bps BBO” value illustrates the addition/reduction in RAAS points resulting from a 0.1 Bps improvement/deterioration of a Market Maker’s stream.
- “Total (3) + (4)” total reflects the qualification target for **one Trading Day** of streaming activity. Each Quarter will contain a different number of Trading Days, such that the qualification target may differ each Quarter, but will be measured across the whole Quarter.

#### 4.4 Exceptional Circumstances and Stressed Market Conditions

In accordance with RTS 8:

- (i) Tradition shall make public the occurrence of “exceptional circumstances” as set out in Article 3(1)(b), (c) and (e) of RTS 8 and, as soon as technically possible, resume normal trading after the exceptional circumstances have ceased to exist; and
- (ii) for the avoidance of doubt, in such exceptional circumstances, Market Makers shall not be obliged to provide liquidity pursuant to Article 3 of RTS 8.

In Stressed Market Conditions, maximum spreads will be increased by 100 percent and the minimum quote size will be reduced by 50 percent to score RAAS points. In Exceptional Circumstances, no streaming is expected from Market-Makers.

For the purposes of this paragraph:

- “Exceptional Circumstances” shall have the meaning given to it in Article 3 of RTS 8; and
- Tradition shall declare “Stressed Market Conditions”: (a) if, in its discretion, it considers that there are significant short-term changes in price or volume in respect; or (b) in the event of market suspension, cessation or closure of the ICE Futures Europe exchange in respect of the underlying Gilt market.

#### 4.5 Incentives

In each Quarter, Market Makers meeting the RAAS qualification target (this target being a function of the expected daily RAAS score (“Total (3) + (4)”) figure in 4.3, multiplied by the number of Trading Days in the applicable Quarter) will be entitled to a brokerage credit, to be applied to the Market Maker’s Trad-X brokerage invoice for the immediately following Quarter.

The brokerage credit to be applied in Quarter  $t$  shall be:

- all qualifying Market Makers will receive a credit for 10%,

in each case, of the electronic brokerage paid by the applicable Market Maker in Quarter  $t-1$ .

The brokerage credit may only be applied in the following Quarter. Where a brokerage credit in a Quarter exceeds the brokerage payable by that Market Maker for that Quarter, remaining credit cannot be ‘carried over’ to the next Quarter.

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Version: 1.0