



European Regulatory Developments - Position Paper

Background - BATS Chi-X Europe

BATS Chi-X Europe is the largest European equities exchange by market share and value traded and represents the combination in 2011 of the two leading pan-European multilateral trading facilities (MTFs), BATS Europe and Chi-X Europe. BATS Europe and Chi-X Europe were launched to help realise the benefits of increased competition between trading venues envisaged in the first Markets in Financial Instruments Directive (MiFID).

BATS Chi-X Europe supports competition and drives innovation in the European equities markets. BATS Chi-X Europe offers trading in more than 1,800 of the most liquid equities across 25 indices and 15 major European markets, as well as in ETFs, ETCs and international depositary receipts. In



addition, BATS Chi-X Europe's innovative smart order routing service allows cost-effective access to other MTFs and 13 primary exchanges. BATS Chi-X Europe trading participants receive world-class support including sophisticated technical port services with real-time monitoring of latency, trading activity, network connectivity and risk management.

BATS Chi-X Europe is authorised and regulated by the FSA. The company has between 20% and 25% market share of multilateral European equities market trading overall (August 2012 market share: 22.62%. Source: BATS Global Markets.)

Pre-Trade

Pre-trade transparency

MiFIR Article 4

BATS Chi-X Europe acknowledges the benefits of pre-trade transparency to financial markets. MiFID I allows certain waivers from pre-trade transparency and BATS Chi-X Europe would support the continued use of such properly calibrated waivers under the proposed new Markets in Financial Instruments Regulation (MiFIR), particularly where these waivers encourage trading to occur on regulated trading venues with central clearing. An example of this is **Negotiated Transactions** – the current MiFID waiver allows privately negotiated transactions to be formalised under the rules of a Regulated Market or MTF, provided that they meet certain price conditions. This allows what would otherwise be OTC business to become subject to formal trading venue rules and supervision and to be routed to central clearing. Removal of this waiver would force business to become less transparent – potentially moving to less well regulated alternative venues/instruments or outside the EU altogether.

The Negotiated Transaction waiver also facilitates order routing to alternative MTFs and Regulated Markets, providing users a cost effective way to direct orders to a wide range of venues, improving the likely quality of execution at a lower cost than connecting to multiple venues directly. The ability to bring the routed element of the trade on to BATS Chi-X Europe as a Negotiated Trade interposes the CCP between the Participant and the routing broker to reduce counterparty risk on both sides.

Another example is the **Reference Price waiver** - The Reference Price waiver allows investors to trade large blocks of securities while minimising market impact, and reducing the need to pay a risk premium to intermediaries for assuming the risk on their behalf. The Large In Size waiver is not sufficient to facilitate this business as it is highly unlikely that there will be an equal and opposite large order to trade with, in the same security and at the same time. The inclusion of smaller orders makes it more likely that an execution will occur. As a result, “dark” trading on MTFs has fulfilled an important need and yet only accounts for a small proportion of multilateral volume (e.g. for the month of July 2012 “dark” MTF volume accounted for 4.48% of total volume electronically executed across all Regulated Markets and MTFs in the 15 EU markets in which BATS Chi-X Europe offers trading).

Trade

Algorithmic and High Frequency Trading

MiFID II Articles 4, 17.3, 51

The development of automated trading has deepened liquidity and tightened spreads on EU markets. Indeed, the development of automated trading has been necessary to allow the continued provision of risk capital in more competitive and efficient EU equity markets. The use of technology allows investors and firms to manage their risk more closely and, therefore, commit more capital to the markets.

While innovation always presents new challenges for regulators, it is our view that the current regulatory regime, supplemented by the ESMA guidelines on Automated Trading, provides the tools required to manage those challenges.

Mandating continuous liquidity provision for a particular class of market participants could be discriminatory, and is likely to have the effect of driving liquidity away from central transparent markets. Furthermore, most liquid European markets operate open auction order books, where natural liquidity interacts without the need for intermediation by market makers. The imposition of a market making model where none is required could have the effect of increasing trading costs for end investors by creating unnecessary competition for liquidity.

It is far from optimal to manage the various risks posed by particular types of trading activity through the imposition of hard parameters in primary legislation. For instance the proposed resting period of 500 milliseconds in article 51 of MiFID II is a rudimentary solution that could have a number of unintended consequences, including a widening of spreads and an increase in costs to investors, an increase in risk for trading firms and a loss of liquidity in order books. In our view, trading venues are best placed to assess appropriate parameters based on their market model and their systems' capacity. Similarly, trading venues should be left to decide the criteria for managing order to trade ratios in their marketplace.

The market abuse regime and market surveillance obligations on markets and competent authorities already provide the tools to tackle potentially abusive behaviour. The operators of markets are best placed to manage the use of their systems and have a commercial imperative to ensure that the performance of their systems, and therefore the quality of their markets, is not compromised by any particular type of trading or order entry activity.

Exchange and MTF fees

MiFID II Article 27, 51.5a EP compromise text

The fees charged by trading venues should be transparent, non-discriminatory and should not incentivise disorderly trading behaviour. However, markets should be free to develop pricing schemes, including discounts and rebates if considered appropriate, that they feel will incentivise desired trading behaviour and reward those firms who enhance market quality through, for example, the provision of passive liquidity on order books or market making programs. It is through the development of new pricing schemes by new entrants that trading fees more generally have been greatly reduced since the implementation of MiFID.

Subject to regulatory oversight by competent authorities, the provision of transparent rebates or discounts should not be considered as an inducement or an impediment to best execution; indeed the availability of a rebate may allow an investment firm to provide better execution by reducing explicit transaction costs, as long as this saving is passed on to the client.

Market controls

MAD/R, MiFID Articles 67 & 68

The development of a competitive market place for execution has created new challenges for market supervisors. In particular, supervision teams must be aware of activity on other trading venues to be able to fully understand the activity on their own market. A genuine **consolidated tape**

is a prerequisite for more effective supervision. Currently, the main barrier to a consolidated tape is the high cost of market data. We support efforts to bring down the cost of market data and speed up the creation of a consolidated tape through appropriate regulation.

While markets have always been subject to extreme volatility events, the proliferation of trading venues has made the management of those events more important. The development of technology and the increasing sophistication of the risk management controls and tools at venues have also made the management of disruptive events more possible – e.g. limit up/down controls and circuit breakers. What is now required is a common understanding about thresholds, tolerances and controls and how they should be applied per instrument or class of instruments to ensure that responses to those events are co-ordinated and effective. In relation to cross-market surveillance, BATS Chi-X Europe supports the proposal that the competent authority of the primary listing venue for a given instrument should be responsible for such activity (unless a significant proportion of trading activity is carried out on an alternative venue) but is concerned that such responsibility should not be delegated to commercial entities or to the primary listing venue due to confidentiality and conflict of interest reasons. If a competent authority does not have the resources to carry out this function, we would recommend that it delegates this task to another competent authority. In addition, we would recommend that requests for a venue's data should be via the home competent authority to ensure quality control and efficiency.

Post-trade

The need for open access to CCPs and their interoperability

MIFIR Article 28

Currently, the lack of open access to certain CCPs restricts where investors can trade and hold their positions, resulting in higher costs and inefficiencies for them. In order to facilitate investor choice and competition at the trading level, open access to CCPs is needed. Discriminatory access at the clearing level prevents achievement of a fully integrated EU single market. Article 28 of MiFIR ought to provide for genuine open-access to CCPs regarding both equities as well as derivatives clearing. As vertical silos make competition in derivatives trading so difficult for new entrants, trading and clearing fees remain high.

The period of time that a CCP is permitted to decide whether or not to allow access to a trading venue in Article 28 of MiFIR should be as short as reasonably practical in order to avoid stifling product innovation, customer choice and competition between trading venues. Furthermore, where a request is received from an appropriately authorised and regulated trading venue, access should only be refused on exceptional grounds. Open access to CCPs benefits investors and the economy. In addition, open access to CCPs reduces systemic risk because if one CCP faces difficulties, it is easier to move clearing to an alternative CCP.

Clearing costs remain a frictional cost borne by investors, potentially restricting EU growth. Enabling open access to CCPs is likely to reduce costs, improve services and allow greater product opportunities for investors. Interoperability in equities clearing, as offered by BATS Chi-X Europe, has gone a long way to reducing clearing costs and reducing the systemic risk from a failure of a CCP. It may be that interoperability in derivatives clearing is some way off but a “preferred” clearing model is clearly achievable in the short term if regulatory barriers are avoided in MiFIR.

Benchmarking

MiFIR Article 30/MAR

Many heavily traded products are based upon widely referenced benchmarks that were developed during periods of time when there was a de facto monopoly. While trading has now been liberalised, venues are able to use historic ownership of these benchmarks to effectively prevent competition in index based products. Allowing open access to index licences under reasonable commercial terms would allow the development of choice for investors and help to drive down costs.

The recent LIBOR controversy has highlighted the need for benchmarks to be based, at least in large part, on actual market transactions. Indeed, many indices and benchmarks do not represent a complete picture of market activity in those instruments since significant volumes and prices on alternative trading venues are often ignored by the incumbent index provider. We would recommend that Section VI in MiFIR and the text in MAR should be amended accordingly to mandate the inclusion of a trading venue's volumes where it accounts for a market share above a certain percentage - e.g. 5%.

BATS Chi-X Europe is keen to continue to contribute to the development of regulatory policy in the EU to ensure safer and better markets for investors and participants. We are available to engage in further discussion on any of the topics contained in this Position Paper.

Please contact Mark Hemsley, CEO (email: mhemsley@batstrading.com) or Adam Eades, Head of Legal and Regulatory Affairs (email: aeades@batstrading.com)