



European Securities and Markets Authority  
103, rue de Grenelle  
75007 Paris  
FRANCE

By e-mail submission

3<sup>rd</sup> October 2011

**RE: Consultation on the Guidelines on systems and controls in a highly automated trading environment for trading platforms, investment firms and competent authorities (the “Consultation Paper”); ESMA/2011/224**

Thank you for the opportunity to provide comments on the above referenced Consultation Paper. We have set out below our views in relation to the questions posed by ESMA in the Consultation Paper. We would be happy to discuss our response in more detail with ESMA or provide such data as may be required.

By way of background, BATS Trading Limited<sup>1</sup> (“BATS Europe”) is an investment firm based in the UK and is authorised and regulated by the UK Financial Services Authority as the operator of a Multilateral Trading Facility.<sup>2</sup> BATS Europe operates an Integrated Book, a Dark Book, and an Order Routing Facility so that orders which are not filled on the BATS Europe order books may be routed to other execution venues.

BATS Europe is supportive of the efforts of the European Securities and Markets Authority (“ESMA”) to provide greater clarity for competent authorities, trading platforms and investment firms with respect to the implementation of appropriate systems and controls to preserve the orderliness and integrity of the market and the stability of the financial system. On the whole, BATS Europe considers the proposed guidelines set out a sensible and achievable approach which, for the most part, codify current best practice within the industry. We do, however, consider that certain components of the proposal could be more narrowly applied without diminishing their effectiveness as it relates to accomplishing the stated goals of this Consultation Paper. If implemented in their current form, certain elements of the

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<sup>1</sup> BATS Trading Limited is a fully owned subsidiary of BATS Global Markets, Inc. Owners of BATS Global Markets, Inc. include affiliates of Citigroup, Credit Suisse, Deutsche Bank, GETCO, JPMorgan, Morgan Stanley, Merrill Lynch and Wedbush.

<sup>2</sup> BATS Europe launched its market for the trading of pan-European equity securities on 31<sup>st</sup> October 2008 and regularly matches more than 10% of the notional value traded in FTSE 100 securities and 5-7% of other major European indices.



proposed guidelines would impose obligations that are either wholly impractical or in some cases impossible to achieve, while providing little added benefit towards contributing to the efficiency, orderly functioning and resilience of trading in a highly automated environment.

Specifically, BATS Europe offers responses to the following questions:

**Q10: Do you have additional comments on the draft guidelines on organisational requirements for trading platforms to promote fair and orderly trading?**

BATS Europe is generally supportive of Guideline 3 to the extent that it reinforces the requirements for trading platforms to have rules and procedures for fair and orderly trading. We also support the requirement in Guideline 1 for trading platforms' electronic systems to have sufficient capacity to accommodate reasonably foreseeable volumes of messaging, and to undergo regular stress testing.

With respect to arrangements to preserve capacity and prevent flooding of the order book, BATS Europe has in place, and supports, limits on order entry volume within a given period of time. We consider it important that such mechanisms are transparent and predictable for participants and that they be limited to protect electronic trading systems and preserve the orderliness and integrity of the market and not used as a device to "slow down" trading for other purposes.

BATS Europe notes ESMA's discussion of the requirement for trading platforms to have automatic mechanisms to constrain trading or to halt trading to maintain an orderly market (so called "circuit breakers"). We consider that such mechanisms, when implemented with disparate standards in a fragmented market, create uncertainty for participants and can harm the price formation process by removing liquidity from some venues when it is most needed, thus exacerbating price swings across the wider market. We are supportive of a limit up/down mechanism that would create transparent, consistent and predictable price bands beyond which trades cannot occur. This would enable continuous trading within set parameters but prevent error trades from occurring beyond those parameters and, therefore, aim to prevent disorderly price declines or increases. Only in the event of a persistent 'limit up' or 'limit down' situation, would a volatility auction occur. A number of markets currently have in place volatility halt type auctions but these work in isolation and do not take into account trading on a pan-European basis. We recognise the challenges of introducing a limit up/limit down mechanism in the absence of a consolidated tape, however even the absence of a consolidated tape, we consider that the benefits of implementing a consistent methodology with consistent thresholds as preferable to the current approach. BATS Europe would be happy to work with ESMA and other market participants on an implementation proposal.

**Q13: Do you have additional comments on the draft guidelines on organisational requirements for investment firms to promote fair and orderly trading?**

BATS Europe is generally supportive of Guideline 4, which would require investment firms to have adequate policies and procedures to ensure that their trading activities comply with relevant regulatory



requirements and manage the risks relating to those trading activities. However, as discussed in more detail below, we believe that certain components of the detailed guidelines in section 2, as proposed, would impose requirements that some investment firms would be unable to meet; for example, due to their position in a transaction chain where the investment firm would not have access to the requisite information. BATS Europe considers these guidelines will be problematic for an investment firm acting in any role other than as the firm originating an order (a “Non-Originating Investment Firm”) in this manner, and, as such, that these guidelines should instead, be imposed on the firm responsible for the origination of the order. By doing so, BATS Europe believes that this guideline will better achieve its intended outcome.

In particular, under the first paragraph in section 2 of Guideline 4, investment firms would be required to automatically block or cancel orders that appear to be duplicative. BATS Europe believes that, without specific guidance on what constitutes a duplicative order, it is not possible for an investment firm to make an independent determination that an order appears to be duplicative. First, determining the threshold at which point a series of orders becomes duplicative is highly problematic. For example, many clients intentionally submit series of orders that are exactly the same. These orders may come in succession or may be interspersed with varying orders. BATS Europe believes that it is not possible to identify a meaningful point at which these orders suddenly ‘appear to be duplicative’ and all subsequent orders should be blocked or cancelled, especially given the knowledge that many clients are submitting such orders intentionally. Additionally, given the large number of data fields associated with each order, it is very difficult to establish whether an order should be included in the determination of whether an order is duplicative. More specifically, is a slight change in one data point associated with an order, such as an order identical to the order preceding it except for having a different number of shares, enough to differentiate the order from those orders previously received that it should not be included in the determination of whether the series of orders ‘appear to be duplicative’? While the goal of blocking or cancelling duplicative orders is a reasonable one, BATS Europe proposes that, because of the associated threshold and definitional complications, ESMA consider amending the proposed guideline to remove the language referring to blocking or cancelling orders that appear to be duplicative.

Additionally, under the second paragraph in section 2 of Guideline 4, investment firms would be required to determine whether a client has adequate funds or holdings of the relevant financial instrument to complete the transaction and automatically block or cancel orders that fail the test. BATS Europe considers that Non-Originating Investment Firms will not be in a position to effectively make this determination. They would, for example, only have knowledge of those transactions that occur on or through that investment firm. The investment firm would not have insight into a client’s initial positions or trading activity that is conducted on or through other investment firms or trading platforms. Without knowledge of a client’s positions elsewhere, a Non-Originating Investment Firm is incapable of knowing whether a client has adequate funds or holdings of, or access to, the relevant financial instrument to complete the transaction. Accordingly, BATS Europe urges ESMA to reconsider the proposed drafting of this guideline.



Similarly, BATS Europe is also concerned about the language in the third paragraph in section 2 of Guideline 4, which would require investment firms to automatically block or cancel orders for any financial instrument that a trader does not have permission to trade. BATS proposes that ESMA considers amending the proposed guideline to make clear that it does not apply to Non-Originating Investment Firms.

BATS Europe is supportive of the proposed guidelines that would require investment firms to implement policies and procedures to block or cancel orders that do not meet set price or size parameters. We consider that such policies and procedures will help to mitigate the risks associated with the entry of erroneous orders that could disrupt the market. However, for the reasons stated above, BATS Europe believes that the proposed detailed guidelines requiring information to which an investment firm may not have access, should not apply to Non-Originating Investment Firms acting between the entry of an order and its execution.

**Q20: Do you have additional comments on the draft guidelines relating to organisational requirements for trading platforms whose member/participants or users provide DMA/SA?**

BATS Europe is supportive of Guideline 7 to the extent that it requires trading platforms to implement rules related to Sponsored Access. We would like to set out how BATS Europe views these organisational requirements with respect to Sponsored Access *vis à vis* those of DMA.

BATS Europe considers that Sponsored Access providers should ensure that its business is organised appropriately, including with suitable systems and controls, and that those persons accessing the trading platform are adequately skilled and conversant with the rules of the platform and their regulatory requirements.

We are supportive of a requirement for trading platforms to implement proportionate rules with adequate systems and controls to appropriately manage sponsored access activity in accordance with the guideline.

With respect to DMA, BATS Europe considers that a member/participant firm providing DMA services must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems; and to observe proper standards of market conduct for all activity conducted in its name. A firm accessing a trading platform via the membership/participation of another firm would pass through that firm's electronic systems, such as, without limit, that firm's risk management controls, therefore the trading platform does not and should not require the orders to be differentiated. Furthermore, a trading platform is unable to manage or enforce a member/participant's DMA relationship beyond implementing rules that require the members/participants to behave as described in the Guideline.



Yours faithfully,

A handwritten signature in black ink, appearing to read 'Paul O'Donnell'.

Paul O'Donnell  
COO, BATS Europe  
**BATS ... Making Markets Better**