BME SPANISH EXCHANGES COMMENTS TO THE CALL FOR EVIDENCE REGARDING THE FORMAL REQUEST FOR TECHNICAL ADVICE ON POSSIBLE IMPLEMENTING MEASURES ON THE DIRECTIVE ON MARKETS IN FINANCIAL INSTRUMENTS (DIRECTIVE 2004/39/EC)

BME Spanish Exchanges is the holding company of the Spanish Stock Exchanges, derivative market and clearing and settlement house for equity, debt and fixed income.

With respect to the Call for Evidence on the second set of mandates of the Directive on Markets in Financial Instruments, we have the following comments:

1. Section 3.5. Limit order display. (Article 22.2)

Article 22.2. provides that the obligation of making public the client limit orders may be complied with its transmission to a regulated market or MTF if so decided by Member States. In section 3.5 it is stated that it should not be understood as a best execution safe-harbour for limit orders.

We feel that statement is not so clear at the light of the Directive: the aim of that publication is "to facilitate the earliest possible execution of that order by making public inmediately that client limit order in a manner which is easily accessible to other market participants". It seems that the publicity is the way of execution.

That publication should have to comply with the execution policy but it should not be subject to additional requirements.

In addition, it must be pointed out that article 22.2 applies to eligible counterparties under article 24 and these entities do not have to comply with conduct of business rules, including best execution rules ex article 24 (recital 41).

2) Section 3.7.1 Systematic Internaliser

When defining an investment firm as a systematic internaliser the main aspect to be taken into account is if the entity has put in place the methods and infrastructure necessary to internalise orders whenever the market conditions, inventory of own positions and the principle of best execution allow them.

3) Section 3.7.2.1. Pre-trade transparency. Scope of the rule (27.1)

This section ends with the request of advice on what is to be considered a liquid market in an individual share for the purpose of article 27.

As the reference in article 27.1 is made to shares for which there is not a liquid market and the aim of the article is to identify the exceptions and not the general rule, it seems that it should be defined what are to be considered non liquid shares.

4) Section 3.7.2.2. The determination of the Standard Market Size / Classes of shares (27.1 and 2)

We have some doubts about the possibility of having access to volumes traded by non systematic internalisers because they are out of the scope of the Directive.

Nothing is commented about new listed companies. It is known that first days after an Initial Public Offering is a very actively traded period in which is very important to reflect the real Standard Market Size and Block Size.

Regarding the specific questions raised in the mandate, we have the following comments:

- Specifying the criteria for determining when the price or prices reflect prevailing market conditions

  From our point of view the prevailing market conditions are reflected by the bid-ask spread and volumes associated to the best buy and sell. In a most precise way, the depth of the most liquid market can be used as a benchmark.

- Defining the classes in which liquid shares should be grouped as well as the criteria for its revision if necessary

  The number of classes must be studied with volumes traded in the Markets including non european markets. This number must be enough to detect differences in liquidity and orders volume average, and limited to facilitate the use of this system. We prefer a semi anually revision (as in the main indexes in Europe).

- Defining what is to be considered an order large in scale compared with the normal market size and defining the SMS for each class of shares as well as the criteria for its revision if necessary

  The volume of the large order must be calculated in relation with the daily turnover or with the average order traded. In this concept it is seen as necessary to coordinate and agree the concept of traded order. We consider that an order of more than 5% of the daily turnover can be considered as a large order. This system should be combined with a minimum amount in euros (i.e. 500.000 €) for less liquid shares.

  The Standard Market Size can be 10 times lower than the order large but must also have a minimum level to preserve the concept of pre trade transparency.

  The system will need to be modified during the periods due to extraordinary events: IPOs, takeover bids, mergers, increases of capital and other events that change dramatically the liquidity of the share.

- It is very important to define what is a large order that is not going to be taken in account for the calculation of the average order. It also should be very clear that the volumes have to be calculated single counted.

- The competents authorities should coincide in the revision period and publish at the same time the class of share to which each share belongs.

<u>5) Section 3.7.2.3 Multiple quotes (27.1 and 3 and 22)</u>

When systematic internalisers publish multiple quotes and receive an order from a client it must be fullfilled following a double criteria: first price and then volume.

The client order must be at the best prices for the volumes available and then the remaining volume will be fullfilled at the next best price. This conditions, of course, run when the volume of the order is lower than the Standard Market Size and higher than the orders posted in the market by the systematic internaliser.

The best execution is also aplicable to the orders in the same systematic internaliser.

We think it is necessary in the case of multiple quotes to clarify if the best execution has to be calculated for the whole client order or by each position.

<u>6) Section 3.7.2.4. The publication of the quotes (27.3)</u>

In order to guarantee that systematic internalisers are able to publish their quotes on a regular and continuous basis they have to put in place systems that will allow them to:

1) Make available their quotes on a real time basis. Thus, information about prices offered will be available as soon as it is updated during normal trading hours.

2) Establish the quality controls and back up procedures that will guarantee that the information is reliable and, in case it is not, that the market participants are informed of such a situation.

Furthermore, all aspects related to the information system such as contract, fees, details of information to be sent and technical issues must be public and equal for all market participants as the way to make it easily accessible for all interested parties.

When using the offices of a third party or the facilities of a regulated market investments firms shall agree with those entities the commercial conditions under which the service will be provided. Investment firms shall as well be in charge of the reliability and quality of the information sent.

<u>7) Section 3.7.2.5 Withdrawal, updating and protection against multiple hits (27.3 and 5)</u>

Exceptional market circunstances that could allow the systematic internaliser to withdraw or update its quotes:

1) The trading on the instrument has been suspended
2) Announcement of a corporate action or relevant information about the instrument that leads to establish special trading conditions in all the markets or arrangements where the instrument is traded.
3) The amount of the instrument asked or offered to the systematic internaliser is disproportionate compared to the amounts available in the market for that instrument as a whole.

8) Section 3.7.2.6 Transactions exempted from the quote firmness (27.3)

Whenever trades are not related to supply and demand of a determined company or the trade is prearranged at a specific price, trades can be executed outside the market spread.

Conditions in terms of volume, price and publicity of these special trades should be agreed between different venues.

9) Section 3.7.2.7 Retail size orders (27.3)

The criteria for determining what is a size customarily undertaken by a retail investor as that size will play as an exception to be executed at the quoted price for the bigger orders from professional clients.

As orders from professional clients will be bigger than ones from retail clients, it has to be highlighted that the commented exception will only make sense if it is understood as referring to the size customarily undertaken by a retail investor when that retail investor executes large orders.

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