European Securities and Markets Authority (ESMA)
CS 60747
103 Rue de Grenelle
75345 Paris Cedex 07
France

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RE: Exemption for market making activities and primary market operations under Regulation (EU) 236/2012 of the European Parliament and the Council on short selling and certain aspects of Credit Default Swaps (ESMA/2012/580)

Thank you for the opportunity to provide comments on the above referenced consultation. BATS Chi-X Europe has a keen interest in promoting effective market making and liquidity provision, since it enhances liquidity in securities markets. We have set out below our views and are happy to discuss our response in more detail with ESMA or provide such data as may be required.

By way of background 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.

Based in London, 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 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 the brand name of BATS Trading Limited, a subsidiary of BATS Global Markets Inc., a leading operator of stock and options markets in the U.S. and Europe. BATS Chi-X Europe is authorised and regulated by the FSA.

BATS Chi-X Europe offers responses to the following questions.

Q1: Do you agree with the above approach regarding the definition and scope of the exemption for market making activities? Please, explain.

We agree with the suggested scope of the exemption for market making activities. However more thought needs to be given to the distinction between “market making activities” and “proprietary trading”, given that market making is a form of proprietary trading. A more useful distinction might be between “market making activities” and “other proprietary trading activities”.

Q2: Do you agree that when determining the RCA for notification purpose the third country entity should be assessing the turnover in relation to its market making activities as defined in Article 2(1)(k) of the Regulation? Please, explain

Yes, we agree because it provides a third country entity with a single competent authority to which it should address a notification and it is in line with the definition of the relevant competent authorities for EU persons.

Q3: Do you agree with general principles applicable to persons intending to make use of the exemption under Article 17(1) of the Regulation? Please, explain.

We agree with most of the general principles. However, we disagree strongly with the proposed requirement that firms have separate middle and back office arrangements for market making business. A firm must be able to identify the activity to which the exemption applies – e.g. through the use of separate internal trading or clearer accounts for market making business. As long as market making activity can be identified, and there are rigorous internal controls (as there will be given the audit and compliance requirement) there is no reason to prescribe how a firm should organise its back and middle office.

In addition, it is not necessary that a firm maintains its records of orders and transactions relating to its market making activities for which it requests the exemption separately from its records of its other proprietary trading activities. It is, once again, sufficient that a firm is able to identify its market making activities and has proper internal controls that ensure that adequate recordkeeping is maintained.

Q4: Do you agree with principles applicable to persons carrying out market making activities in accordance with Article 2(1)(k)(i) of the Regulation? In your view which of the two options in paragraph 44 should apply to quotes entered when carrying out market making activities? Do you see another alternative to the two options proposed? Please, provide explanations.

We agree with the principles applicable to persons carrying out market making activities in accordance with Article 2(1)(k)(i) of the Regulation. Option 2 (be conducted at prices that fall within a maximum acceptable spread) should apply to quotes because it is more practical to implement, more straightforward to enforce and in line with market making programmes in major European markets.

Q5: Do you agree with the principles applicable to persons carrying out market making activities in accordance with Article 2(1)(k)(ii) of the Regulation? Please, explain.

We generally agree with the principles but consider that it is not relevant that the competent authority takes into account the scale of activity for which the exemption is notified relative to overall proprietary trading of the firm. The activity should be judged independently of a firm's other businesses. The comparison proposed could have an anomalous impact. For example, a minor market making function within a small firm that has no other business would always qualify (if the other requirements were met) whereas a large market making function, that happened to be operated within a much larger firm that also had significant additional proprietary trading businesses may not. The scale of other activities is not relevant since companies ought to be treated equally on the basis of the activity being performed for which the exemption is sought. Furthermore, the Regulation requires no such comparison.

Q6: Do you agree with the qualifying criteria for the comparable size of orders? Please explain.

It is important that credible sizes of orders are posted by market makers or liquidity providers. For activity on trading venues, the venues will have the best view of appropriate minimum size requirements based on liquidity and other trading characteristics. Accordingly, where trading venues set minimum quote or order requirements for market making or liquidity provider programs, additional guidelines are not necessary.

Average Trading Size is an unhelpful measure as it does not relate directly to the liquidity in an instrument, and in particular the amount of risk that a market maker or liquidity provider is being asked to assume.

Where a trading venue's market making or liquidity provision scheme does not stipulate a minimum order or quote size, firms should provide quotes or orders in reasonable size given the liquidity of and trading characteristics of the instrument for which the exemption is being claimed.

Q7: Do you agree with the qualifying criteria for competitive price of orders? Please explain.

Yes we agree.

Q8: Which option do you favour? Please, justify.

We favour option number two (a percentage of the price of the instrument), because it is in line with existing market making schemes and it is easier to monitor and enforce option two than option number one.

Q9: Do you agree with the qualifying criteria for ongoing presence on the market? Do you think different criteria should apply when conducting market making activities in sovereign debt? Please explain.

We broadly support that the market making activities should on a monthly basis be undertaken for at least 90% of the overall trading time on a given financial instrument. However venues should have discretion to depart from that standard in response to specific circumstances without risking firm's eligibility for the exemption. Latitude should be given where firms are restricted for compliance and operational reasons.

Q10: Do you agree with the ESMA approach towards assessment of notification of intent to make use of the exemption? Please explain.

Yes we agree.

Q11: Would you agree that frequency and systemic basis of the activities exempted under Article 2(1)(k)(ii) capacity should be assessed against the same qualifying criteria as applicable to systemic internalisers under Article 21(1) of the Commission Regulation (EU) No 1287/2006? Please, provide explanations.

No. A firm may conduct a mixture of on and off trading venue market making activity, supplementing its activities on trading platforms with OTC client facilitation activity. This may well not meet the systematic internaliser definition in MiFID, particularly if these trades are large in size and therefore not subject to MiFID pre trade transparency requirements. Furthermore, this activity may be conducted under the rules of a trading venue, even if not executed via the order or quote book. Firms should not be prevented from conducting business under the rules of a trading venue if they wish to claim the exemption.

Q12: In your opinion, what would be the most appropriate qualifying criteria in terms of percentage to assess scale of activity eligible for exemption under Article 2(1)(k)(ii) capacity in comparison to overall proprietary trading?

Please see answer to question 5. We do not believe it is relevant or appropriate to assess market making activity relative to other proprietary trading activity.

Q13: Do you agree that the above information needs to be provided in the notification form? Should historical data be also provided with the notification form? Please, provide justifications.

Yes.

Q14: Do you agree with 6 months after application of the Guidelines period for revising and assessing notifications made before entry into force of the Guidelines? Please explain.

Yes.

Q15: Do you agree that a list of market makers and authorised primary dealers published on the ESMA website according to Article 17(13) should at least include the above information? What additional information should be included? Please justify.

Article 17.13 of the Short selling regulation requires that a list of market makers and authorised primary dealers who are using the exemption is published and kept up to date on ESMA's website. The regulation does not require the other information suggested in the consultation to be disclosed. Therefore we consider that information listed in article 17.13 of the Short selling regulation is enough and the consultation ought not to exceed what is defined in the regulation.