



Submitted by e-mail to: financial.reform@hmtreasury.gsi.gov.uk

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Consultation: A New Approach to Financial Regulation (July 2010)

Thank you for the opportunity to comment on HM Treasury's consultation on *A New Approach to Financial Regulation* ("the Consultation"). By way of background, BATS Trading Limited¹ ("BATS Europe") is based in the UK and is authorised and regulated by the UK Financial Services Authority ("FSA") as the operator of a Multilateral Trading Facility ("MTF").² We have set out below our views on the proposed new approach to financial regulation, and have focussed in the Annex to this letter on the questions in the Consultation with specific relevance to BATS Europe as a market infrastructure provider.

The establishment of an FPC

We agree it is imperative that within the UK's system of financial regulation there are clear lines of responsibility, effective information sharing arrangements and coordination, and appropriate regulatory tools to take pre-emptive action and, where necessary, address issues that have arisen in the financial system and individual firms. We support the establishment of a Financial Policy Committee ("FPC"), in particular to prevent the risk of future regulatory "underlap".

Ensuring the PRA and CPMA have equal standing

It is important that the proposed Prudential Regulatory Authority ("PRA") and Consumer Protection and Markets Authority ("CPMA") have **equal standing**. Whilst measures have been proposed in this regard, there is a concern that the CPMA may be regarded as a secondary regulator. The CPMA will be the UK's representative in Europe on the – to be formed – European Securities and Markets Authority ("ESMA") and **it is imperative that the CPMA is able to authoritatively represent the UK in European as well as in international forums.**

Whilst we agree that the PRA and the CPMA should have regards to each other's primary objective and consult with each other, we do not agree that the PRA should be the final arbiter with respect to certain decisions made by the CPMA. This clearly upsets the balance that the Government is seeking to achieve between the PRA and the CPMA. A better approach could be to place the role of arbiter with the FPC given such decisions will typically involve consideration of financial stability issues.

¹ 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, Lime Brokerage, Morgan Stanley, Merrill Lynch and Wedbush.

² BATS Europe launched its market for the trading of pan-European equity securities on 31st October 2008 and regularly matches more than 10% of the notional value traded in FTSE 100 securities and 5-8% of other major European indices.



Balancing consumer protection and markets issues in the CPMA

Within the CPMA, **equal weight must be given to consumer protection and markets issues**. This must be reflected in the CPMA's statutory objective and in its senior management arrangements. For example, the CEO of the CPMA must be able to equally and authoritatively represent consumer protection and markets issues.

The Principles of Good Regulation

Whilst each regulatory authority should have a clear statutory objective, which should have primacy, this should be supplemented by factors to which each regulatory authority should "have regards". In particular, **we support the inclusion of checks and balances similar to those currently in place in place for the FSA in the Principles of Good Regulation**. With respect to those factors currently relating to competition, whilst we agree that the regulatory authorities should not have as their statutory objective the promotion of competition or the competitiveness of the UK, we believe **it is important for the regulatory authorities to have regards to competition factors**. We will also be interested to understand how the Office of Fair Trading's current obligations under the Financial Services and Markets Act 2000 ("FSMA") will be allocated and conducted in the proposed new regulatory structure.

Rationalisation of the regulatory regimes for infrastructure providers

At present, market infrastructure providers in the UK can choose to operate under an "exempt" regime for Recognised Investment Exchange ("RIEs") and Recognised Clearing Houses ("RCHs"), collectively Recognised Bodies ("RBs"), or they can operate as authorised firms under FSMA. The historical rationale for the RB regime is that these entities are effectively quasi-self regulatory organisations to the extent that they have certain regulatory functions with respect to their users and members that differ from those obligations applicable to authorised firms. However, **the market infrastructure provider landscape has evolved** as a result of, amongst others, demutualisation, the introduction of competition, and changes to the regulatory landscape as a result of European directives. **Therefore, the original rationale for a distinct RB regime no longer exists.**

With respect to RIEs, the Markets in Financial Instruments Directive ("MiFID") has sought to create a level playing field between Regulated Markets ("RMs") – as operated by RIEs under the current UK regulatory structure – and MTFs. The regulatory requirements for both are largely similar and, where differences currently exist, the Committee for European Securities Regulators ("CESR") has recommended to the European Commission that these be aligned. We would also note the FSA has stated that it aims to apply its proportionate approach to regulation to RMs and MTFs, regardless of the fact that they sit under different legal regulatory regimes.³ **Rationalisation of the two regimes would further the aim of creating a level playing field between RMs and MTFs.**

³ Page 13 of *The FSA's Markets Regulatory Agenda* (May 2010): <http://www.fsa.gov.uk/pubs/other/markets.pdf>



Most importantly, the Government’s Consultation recognises the importance of ensuring that regulators have appropriate tools at their disposal to carry out their functions. **The FSA’s current tools with respect to RBs are far narrower – and arguably far less effective – than those available with respect to authorised firms.** In particular:

- The FSA has no rule making powers with respect to RBs. High level “Recognition Requirements” are set out in legislation; however, the FSA sourcebook is only able to supplement these through guidance.
- There is no approved persons regime for RBs and no formal mechanism by which the FSA is able to approve persons conducting what would otherwise be “controlled functions” if the RB was an authorised firm.
- The FSA has limited enforcement powers with respect to RBs, which only include cumbersome powers to direct an RB to take certain action or revocation of the entity’s RB status.

All market infrastructure providers – whether RB or authorised firm – should and currently do have obligations with respect to their regulatory functions. However, given the evolved structure of market infrastructure providers in the UK and the importance of a robust market infrastructure in ensuring market confidence and stability, **it is imperative that the Government addresses the current deficiencies in the RB regime with respect to the regulatory tools available.** Rationalisation of the two regimes would be preferable and more effective than a levelling up, as it would both correct the imbalance with respect to the regulatory tools available, and would ensure consistency; between the entities that currently operate market infrastructure as RBs and as authorised firms, and between market infrastructure providers and all other regulated firms.

Proposed tripartite model for markets regulation

It has been widely noted that the proposals in the Consultation would effectively create a tripartite model for markets regulation: primary markets under the Department for Business, Innovation and Skills (“BIS”); secondary markets under the CPMA; and post-trade under the Bank of England (“the Bank”). We have concerns regarding the extent to which the regulation of markets will be split both with respect to whether there will be effective arrangements to provide an appropriate level of coordinated regulation, including to prevent regulatory “underlap”, and the extent to which the UK’s markets interests are effectively and authoritatively represented in European and international forums.

Regulation of central counterparties

The Government has proposed that central counterparties and settlement systems will be regulated by the Bank with respect to financial stability matters and by the CPMA with respect to conduct matters, whereas exchanges and MTFs will be solely regulated by the CPMA. The Consultation sets out coordination arrangements between the FPC, the PRA and the CPMA, and provides that the Bank and the CPMA will follow the same general principles of cooperation, coordination and consultation with respect to market infrastructure providers, although little detail is provided.



The Consultation also asks whether the PRA and the CPMA should be subject to the same accountability and transparency arrangements with respect to their rule making functions. A specific similar question is not asked in relation to the Bank's proposed functions. Accountability, oversight and transparency are key facets of UK financial regulation and help to ensure confidence in the regulatory system. We believe that all of the regulatory authorities – the FPC, the PRA, the CPMA and the Bank – should be held to comparable and equally high core principles with respect to rule making, decision making and policy development.

The European Commission has recently proposed its European Market Infrastructure Regulation ("EMIR") with respect to a pan-European regime for central counterparties and the clearing of standardised OTC derivatives contracts. The UK has significant interest in this regulation and the accompanying technical standards, which will be developed by ESMA. The CPMA will be the UK's representative on ESMA and must be able to authoritatively represent the UK in European and international forums on post-trade matters. **It is imperative that there are effective arrangements in place between the Bank and the CPMA, and that the regulation of, and policy development in relation to, central counterparties and settlement systems does not become an area of regulatory "underlap".**

Primary market regulation

The Government has proposed that the UK Listing Authority ("UKLA") could be merged with other regulatory functions relating to companies and corporate information, and could sit within BIS. **We support the UKLA remaining with the other functions currently conducted by the FSA's Markets Division in the proposed new CPMA.**

The UKLA – as part of the FSA's Markets Division – plays a considerable role in ensuring market confidence and investor protection by administering the UK's listing regime and by ensuring compliance with these requirements. There is, therefore, overlap between the objectives of the UKLA and the proposed objective of the CPMA. The CPMA will be the UK's representative in Europe and, given the level of primary market regulation set by Europe, it is important that the UK has a strong voice in European forums on primary markets issues.

The Consultation recognises that there is a significant amount of detail still to be set out and that further consultation will be necessary. We look forward to participating in these consultations.

Yours sincerely

Anna Westbury
Head of Compliance and Regulatory Affairs, BATS Europe



Annex

The Bank of England and Financial Policy Committee (FPC)

- *Question 1: Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?*
- *Question 2: If you support the idea of secondary factors, what types of factors should be applied to the FPC?*
- *Question 3: How should these factors be formulated in legislation – for example, as a list of ‘have regards’ as is currently the case in the Financial Services and Markets Act 2000 (FSMA), or as a set of secondary statutory objectives which the FPC must balance?*

We agree that the FPC should have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role. Similarly, the PRA and CPMA should each have a single, clear statutory objective.

Whilst each regulatory authority should have a clear statutory objective, which should have primacy, this should be supplemented by factors to which each regulatory authority should “have regards”. **We support the inclusion of checks and balances similar to those currently in place in place for the FSA in the Principles of Good Regulation.**

With respect to those factors currently relating to competition, whilst we agree that the regulatory authorities should not have as their statutory objective the promotion of competition or the competitiveness of the UK, we believe **it is important for the regulatory authorities to have regards to competition factors**. We will also be interested to understand how the Office of Fair Trading’s current obligations under FSMA will be allocated and conducted in the proposed new regulatory structure.

We support the proposal that the PRA and CPMA should have regards to the primary objective of the other, and that both should have regards to the primary objective of the FPC.

Accountability, oversight and transparency are key facets of UK financial regulation and help to ensure confidence in the regulatory system. Such arrangements include reporting, public consultation, and market failure and cost benefit analysis. It is imperative that the regulatory authorities have the correct tools and an appropriate and proportionate level of flexibility to conduct their functions, including with respect to crisis management. Nevertheless, we believe that all of the regulatory authorities – the FPC, the PRA, the CPMA and the Bank – should be held to comparable and equally high core principles with respect to rule making, decision making and policy development.



Prudential regulation authority (PRA)

- *Question 4: The Government welcomes respondents' views on:*
 - *whether the PRA should have regard to the primary objectives of the CPMA and FPC;*
 - *whether some or all of the principles for good regulation currently set out in section 2 of FSMA, particularly those relating to good regulatory practice, should be retained for the PRA;*
 - *whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and*
 - *whether there are any additional broader public interest considerations to which the PRA should have regard.*

See response to Questions 1-3 above.

- *Question 5: Is the model proposed in paragraph 3.16 – with each authority responsible for all decisions within their remit subject to financial stability considerations – appropriate, or would an integrated model (for example, giving one authority responsibility for authorisation and removal of permissions) be preferable?*

The division proposed in paragraph 3.16 would reinforce the model under which the PRA and the CPMA are operationally distinct and clearly responsible for the areas within their respective remits. However, clearly there will be a level of overlap and duplication. We await the Government's further consultation on this area.

- *Question 6: Is the approach outlined in paragraph 3.17 to 3.23 for transfer of regulatory functions and rule making sufficient to enable the PRA to take a more risk-based, judgement-focussed approach to supervision?*
- *Question 7: Are safeguards on the PRA's rule-making function required?*
- *Question 8: If safeguards are required, how should the current FSMA safeguards be streamlined?*
- *Question 9: The Government welcomes views on the measures proposed in paragraphs 3.28 to 3.41, which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable.*

See response to Questions 1-3 above.

We would also support further consideration being given to whether statutory panels should be established to whose representations the PRA should have regards (cf. the statutory panels proposed in relation to the CPMA).



Consumer protection and markets authority (CPMA)

- *Question 10. The Government welcomes respondents' views on:*
 - *whether the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC;*
 - *whether some or all of the principles for good regulation currently set out in section 2 of FSMA should be retained for the CPMA, and if so, which;*
 - *whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and*
 - *whether there are any additional broader public interest considerations to which the CPMA should have regard.*
- *Question 11. Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator.*

See response to Questions 1-3 above.

- *Question 12: The Government welcomes views on the role and membership of the three proposed statutory panels for the CPMA.*

We support the proposal to retain consultative panels and agree they provide important external challenge and accountability. Given the proposed remit of the CPMA, the Panels must be able to equally and authoritatively represent both consumer protection and markets issues.

We would note that sections 9(5)(c)-(d) FSMA provide that the Practitioners Panel should include persons representing RIEs and RCHs. **The proposed statutory Practitioners Panel for the CPMA should include persons representing market infrastructure providers, which may be RIEs, RCHs or authorised firms.** (See also below response to Question 16 on the rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses.)

- *Question 13: The Government welcomes views on the proposed funding arrangements, in particular, the proposal that the CPMA will be the fee- and levy-collecting body for all regulatory authorities and associated bodies.*

No comment.

- *Question 14: The Government welcomes views on the proposed alternative options for operating models for the FSCS.*

No comment.



Markets and infrastructure

- *Question 15. The Government welcomes views on the proposed division of responsibilities for markets and infrastructure regulation.*

It has been widely noted that the proposals in the Consultation would effectively create a tripartite model for markets regulation: primary markets under BIS; secondary markets under the CPMA; and post-trade under the Bank. We have concerns regarding the extent to which the regulation of markets will be split both with respect to whether there will be effective arrangements to provide an appropriate level of coordinated regulation, including to prevent regulatory “underlap”, and the extent to which the UK’s markets interests are effectively and authoritatively represented in European and international forums.

Regulation of central counterparties

The Government has proposed that central counterparties and settlement systems will be regulated by the Bank with respect to financial stability matters and by the CPMA with respect to conduct matters, whereas exchanges and MTFs will be solely regulated by the CPMA. The Consultation sets out coordination arrangements between the FPC, the PRA and the CPMA, and provides that the Bank and the CPMA will follow the same general principles of cooperation, coordination and consultation with respect to market infrastructure providers, although little detail is provided.

The Consultation also asks whether the PRA and the CPMA should be subject to the same accountability and transparency arrangements with respect to their rule making functions. A specific similar question is not asked in relation to the Bank’s proposed functions. Accountability, oversight and transparency are key facets of UK financial regulation and help to ensure confidence in the regulatory system. We believe that all of the regulatory authorities – the FPC, the PRA, the CPMA and the Bank – should be held to comparable and equally high core principles with respect to rule making, decision making and policy development.

The European Commission has recently proposed its European Market Infrastructure Regulation (“EMIR”) with respect to a pan-European regime for central counterparties and the clearing of standardised OTC derivatives contracts. The UK has significant interest in this regulation and the accompanying technical standards, which will be developed by ESMA. The CPMA will be the UK’s representative on ESMA and must be able to authoritatively represent the UK in European and international forums on post-trade matters. **It is imperative that there are effective arrangements in place between the Bank and the CPMA, and that the regulation of, and policy development in relation to, central counterparties and settlement systems does not become an area of regulatory “underlap”.**



Primary markets regulation

The Government has proposed that the UKLA could be merged with other regulatory functions relating to companies and corporate information, and could sit within BIS. **We support the UKLA remaining with the other functions currently conducted by the FSA's Markets Division in the proposed new CPMA.**

The UKLA – as part of the FSA's Markets Division – plays a considerable role in ensuring market confidence and investor protection by administering the UK's listing regime and by ensuring compliance with these requirements. There is, therefore, overlap between the objectives of the UKLA and the proposed objective of the CPMA. The CPMA will be the UK's representative in Europe and, given the level of primary market regulation set by Europe, it is important that the UK has a strong voice in European and international forums on primary markets issues.

- *Question 16. The Government welcomes views on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses.*

At present, market infrastructure providers in the UK can choose to operate under an “exempt” regime for RIEs and RCHs, collectively RBs, or they can operate as authorised firms under FSMA.

In its 2000 Discussion Paper on the regulation of the market infrastructure,⁴ the FSA noted that:

“Factors that may influence an entity to opt for RIE (or RCH) status include greater flexibility in the regulatory regime, tax advantages and a general regulatory environment that incentivises (and sometimes even requires) market participants to use their facilities.”

The historical rationale for the RB regime is that these entities are effectively quasi-self regulatory organisations to the extent that they have certain regulatory functions with respect to their users and members that differ from those obligations applicable to authorised firms. However, **the market infrastructure provider landscape has evolved** as a result of, amongst others, demutualisation, the introduction of competition, and changes to the regulatory landscape as a result of European directives. **Therefore, the original rationale for a distinct RB regime no longer exists.**

With respect to RIEs, MiFID has sought to create a level playing field between RMs – as operated by RIEs under the current UK regulatory structure – and MTFs. The regulatory requirements for both are largely similar and, where differences currently exist, CESR has recommended to the European Commission that these be aligned. We would also note the FSA has stated that it aims to apply its proportionate approach to regulation to RMs and MTFs, regardless of the fact that they sit under different legal regulatory regimes.⁵

⁴ <http://www.fsa.gov.uk/pubs/discussion/D02.pdf>

⁵ Page 13 of *The FSA's Markets Regulatory Agenda* (May 2010): <http://www.fsa.gov.uk/pubs/other/markets.pdf>



There do, however, remain differences between the two regimes in the UK. For example, RIEs can – and currently do – operate both RMs and MTFs. By contrast, regardless of whether an investment firm which operates an MTF meets the same regulatory standards, it is prevented by the current regulatory structure from operating an RM. Similarly, the UK’s Listing Rules restrict listing to markets operated by an RIE, even though the markets operated by these entities may be RMs or MTFs.⁶ **Rationalisation of the two regimes would further the aim of creating a level playing field between RMs and MTFs.**

Most importantly, the Government’s Consultation recognises the importance of ensuring that regulators have appropriate tools at their disposal to carry out their functions. **The FSA’s current tools with respect to RBs are far narrower – and arguably far less effective – than those available with respect to authorised firms.** In particular:

- The FSA has no rule making powers with respect to RBs. High level “Recognition Requirements” are set out in legislation; however, the FSA sourcebook is only able to supplement these through guidance.
- There is no approved persons regime for RBs and no formal mechanism by which the FSA is able to approve persons conducting what would otherwise be “controlled functions” if the RB was an authorised firm.
- The FSA has limited enforcement powers with respect to RBs, which only include cumbersome powers to direct an RB to take certain action or revocation of the entity’s RB status.

All market infrastructure providers – whether RB or authorised firm – should and currently do have obligations with respect to their regulatory functions. However, given the evolved structure of market infrastructure providers in the UK and the importance of a robust market infrastructure in ensuring market confidence and stability, **it is imperative that the Government addresses the current deficiencies in the RB regime with respect to the regulatory tools available.** Rationalisation of the two regimes would be preferable and more effective than a levelling up, as it would both correct the imbalance with respect to the regulatory tools available, and would ensure consistency; between the entities that currently operate market infrastructure as RBs and as authorised firms, and between market infrastructure providers and all other regulated firms.

As a final point, under the current regime, there is provision to recognise overseas exchanges and clearing houses on the basis on equivalence and reliance on the home supervisory authority. With respect to exchanges, this has generally been used in a limited fashion to establish a physical presence in the UK and conduct marketing activities. By contrast, there are overseas clearing houses that currently provide clearing services to UK RMs and MTFs, for example, Netherlands-based European Multilateral Clearing Facility NV (“EMCF”) and Swiss-based SIX x-clear AG (“x-clear”); both of which are Recognised Overseas Clearing Houses (“ROCHs”).⁷

⁶ LR 2.2.3 R: <http://fsahandbook.info/FSA/html/handbook/LR/2/2>

⁷ It is interesting to note that, prior to applying for and receiving ROCH status, EMCF provided clearing services to UK-based MTFs under the overseas person exclusion in article 72 of the Regulated Activities Order.



Within the EEA, the arrangements for non-UK RBs have effectively been superseded by the pan-European requirements for RMs and MTFs under MiFID, and will be by the pan-European regime for central counterparties under EMIR; thus removing the need for a recognition regime for non-UK EEA RMs, MTFs and central counterparties. That said, it is important to continue to retain the ability to allow a central counterparty from a comparable third country to be able to provide clearing services for UK-based RMs and MTFs.

- *Question 17. The Government would welcome views on whether the UKLA should be merged with the FRC, as a first step towards creating a companies regulator under BIS.*
- *Question 18. The Government would also welcome views on whether there are other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies regulator.*

See response to Question 15 above.

Crisis management

- *Question 19: Do you have any overall comments on the arrangements for crisis management?*
- *Question 20: What further powers of heightened supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention, as described in paragraph 6.17?*
- *Question 21: What are your views about changes that may be required to enhance accountability within the SRR, as described in paragraphs 6.21 to 6.24?*

See response to Questions 1-3 above.

Impact assessment

- *Question 22: Annex B contains a preliminary impact assessment for the Government's proposals. As set out in that document, the Government welcomes comments from respondents on the assumptions made about transitional and ongoing costs for all types of firm. In particular, comments are sought from all types and size of deposit-taking, insurance and investment banking firms (including credit unions and friendly societies), and from groups containing such firms.*

No comment.