

Single Market: Financial Services and the Free Movement of Capital

- HM Treasury call for evidence

Introduction

By way of background, BATS Chi-X Europe is the largest European equities exchange by market share and value traded. We support open and fair competition and drive innovation in the European equities markets. We make available for trading more than 3,600 European equities across 25 indices and 15 major European markets, as well as ETFs, ETCs and international depositary receipts, and offer a listings venue for exchange traded products.

BATS Chi-X Europe ("BATS") is the brand name of BATS Trading Limited, a subsidiary of BATS Global Markets Inc., which is a leading operator of stock and options markets in the U.S. and Europe. BATS is a Recognised Investment Exchange regulated by the UK Financial Conduct Authority ("FCA"). BATS is also one of four equal shareholders in the new pan-European clearing house EuroCCP N.V. created through the merger of EMCF and EuroCCP. The transaction was completed on Dec. 6, 2013, and the new entity is the largest pan-European equities clearing house.

Please find below our answers to this call for evidence:

1. How have EU rules on financial services affected you or your organisation? Are they proportionate in their focus and application? Do they respect the principle of subsidiarity? Do they go too far or not far enough?

Like many organisations working in the financial services industry, BATS has been increasingly affected by EU regulation, but it should also be noted that were it not for European legislation and regulation it would have been almost impossible for BATS' business to have established itself in the first place. Indeed our ongoing success, and the associated benefits to users of the UK and broader EU equities markets that that success is built upon, are dependent upon the open access and passporting rights that EU financial services regulation is intended to deliver. That said, in the past few years the level of regulation has increased substantially as the EU seeks to implement G20 commitments. There is no doubt that financial services is amongst the most heavily regulated industries in the world and EU regulation has a substantial impact on everything we do.

Whether the plethora of EU rules is proportionate depends on one's viewpoint. For politicians and many EU citizens, failures in the financial sector caused the financial crisis and therefore significant (re)regulation would seem appropriate. For those organisations being impacted by regulation, the sheer amount of new regulation is complex to understand and costly to implement and will have far reaching consequences for many organisations.

BATS is supportive of proportionate regulation. In other words, regulation that ensures stable, transparent and clean markets, and that protects investors and consumers. BATS also supports the objectives of harmonised regulation, where practical, and its consistent application across Europe.

Nevertheless, there are undoubtedly examples where regulation has not been created using objective criteria, has not been implemented at the national level consistently and where there has been a lack of empirical evidence as to its impact. Changing sub-optimal regulation after implementation is difficult and can take considerable time to remedy.

Three examples of proposed regulation that would impact markets directly where little or no research or empirical data was gathered prior to draft legislation being published include proposals to regulate high frequency trading, to limit dark book trading through waiver caps and to introduce a European financial transaction tax. These proposals will have far reaching consequences as to how markets behave and yet the proposals appear to address perceived, rather than actual, failures and lack detailed consideration of the negative impacts versus tangible benefits.

The additional concern here is that such regulation can disproportionately impact certain member states, whilst hardly affecting others. This often means that the debate about the benefits/drawbacks of a certain regulation can become skewed rather than being objective. For example, a member state that does not expect to be materially impacted by a new regulation may devote little time to the issue and yet its vote could have a direct impact on whether the regulation is approved or not. Some form of mechanism during the approval process to take account of this potential imbalance of impact could be appropriate.

2. How might the UK benefit from more or less EU action? Should more legislation be made at the national or EU level? Should there be more non-legislative action, for example, competition enquiries?

As an organisation that is pan-European, BATS strongly supports the single market in financial services. The passporting of services across Europe is crucial for employment, growth and a successful EU. EU action that is focused on this and seeks to harmonise regulation, where appropriate, is desirable. Nevertheless, as mentioned above, the impact of regulation differs between member states and this should be taken into consideration by policy makers. In other words, whilst harmonisation should be the aim, it may not always be appropriate for a regulation to be mandatory for all member states but could be implemented, exceptionally, via enhanced co-operation procedures; or there may be detailed elements of a Directive or Regulation that can be left to member states and competent authorities to consider, taking into account the particularities of their home market.

Whilst this can be seen as a solution for the proposed European FTT, careful consideration does need to be given to the potential distorting effects that can happen when regulation is not applied uniformly to all member states.

We don't believe that there is a need for more legislation at the national level – for the single market to operate effectively in financial services, legislation has to be made primarily at EU level. Where we believe there is an issue, on occasion, is with the quality of that legislation.

In relation to non-legislative action, BATS would support intervention by authorities where market failures are found. For example, regulation has failed to deliver a consolidated tape in Europe and this has led to unabated monopolistic behaviour being seen by incumbents. Whilst further regulation is being proposed in MiFID 2, intervention by DG Comp could have potentially brought about a much earlier change in behaviour leading to an industry solution.

3. How have EU rules helped or made it harder to achieve objectives such as financial stability, growth, competitiveness and consumer protection?

Generally, EU rules do promote these objectives and efforts around a banking union and an EU resolution regime are important steps to bringing about greater stability in financial markets. In addition, DG Comp plays an important role in promoting competition across Europe. That said,

national initiatives are also important, particularly around local competition issues and consumer protection that do not have a wider EU impact. Nevertheless, we are supportive of an overarching EU legal framework to promote these objectives.

4. Is the volume and detail of EU rule-making in financial services pitched at the right level? Has the use of Regulations or Directives and maximum or minimum harmonisation presented obstacles to national objectives in any cases?

The financial services industry is currently subject to a high volume of new EU rule making. Whilst this is understandable in the context of the financial crisis and various scandals, only time will tell whether the level of new regulation is justified and whether it is effective and useful. It should be remembered that large parts of the financial services industry functioned normally throughout the recent crisis and their actions did not contribute to the problems or scandals. For example, market infrastructure functioned properly, including the critical role of post-trade services.

There is a risk that policy makers are engaged in a wholesale change to financial services regulation without necessarily being sure that relevant regulations need changing or that new regulation is going to bring tangible benefits. For example, early MiFID proposals such as minimum resting times or order to trade ratios would have been new rules that would have had uncertain benefits and a number of potential downsides. The parameters for these proposals were not based on any clear evidence but if implemented at Level 1 would take away discretion or further consideration at Level 2. This trend can also be seen with the proposed caps on the use of pre-trade transparency waivers under MiFIR. Again, no substantive evidence was gathered as to whether such caps will benefit markets and whether the proposed level of the caps is appropriate. In fact, there are clear downsides to having a cap at the level of the venue as it takes away investor choice, increases costs (as investors have to potentially access alternative liquidity pools) and penalises competitive venues, as it is those that will hit the caps first.

We would therefore argue that the increasing use of Regulations and more precise parameters being drafted at Level 1, without a clear grounding in evidence, increases the possibility of unintended consequences and, at the extreme, poorly drafted regulation. As mentioned earlier, subsequently changing Directives and Regulations to remedy shortcomings is not a quick or easy task. We would advocate more meaningful, including independent third party, impact assessments being undertaken when radical changes to market structure are being proposed.

5. How has the EU's approach to Third Country access affected the ability of UK firms and markets to trade internationally?

No comment.

6. Do you think that more or less EU-level regulation in the area of retail financial services would bring benefits to consumers?

No comment.

7. What has been the impact of the shift towards regulation and supervision at the EU level, for instance with the creation of the European Supervisory Authorities? Should the balance of supervisory powers and responsibilities be different?

There are clear benefits to having European regulatory bodies to oversee national regulators actions and to ensure a harmonised approach to regulation across the EU. We believe that the ESA's should

be doing even more to ensure that national regulators are consistently implementing EU agreed standards. We do, however, have some concerns with the shift of front line supervision to the EU level. Perhaps the biggest concern is that the ESAs are not currently funded or staffed to deal with all the complex problems and responsibilities that they are being asked to take on, indeed the financial and logistical implications of the wholesale transfer of powers that is envisaged by some is likely to make such a transfer impossible. As we know, frontline regulation is not easy to get right and in our view it would be better to let experienced national regulators deal with frontline issues, with the ESAs stepping in where there are problems or issues that need dealing with at the EU level.

In addition, the ESAs may be too remote to have a full understanding of the consequences that new regulation could have at the national level.

In conclusion, we believe that front line regulation should be managed at the national level with the ESAs and other European bodies taking a larger role in ensuring consistency of implementation by national regulators and acting as escalation and quality control points.

8. Does the UK have an appropriate level of influence on EU legislation in financial services? How different would rules be if the UK was solely responsible for them?

The UK should have considerable influence on EU financial services legislation bearing in mind its importance to the UK and that London is a key financial centre in Europe. However, it appears that the UK has lost some influence over the recent past due to (i) being partly blamed, in some quarters, for the financial crisis; (ii) having a relatively weak political position in the European Parliament; and (iii) its intention to hold a referendum on EU membership. This loss of influence is material at the Level 1 stage of legislation where we have seen repeated examples of proposed regulations that would negatively impact the UK financial services industry in particular – e.g. caps on bonuses. At the Level 2 stage, the UK's expertise in the technical details can be more influential.

It is difficult to know whether rules would be more proportionate if the UK was solely responsible for them, but it is possible as it would take account of local practices and experiences, and the competitive effect on UK firms. It is also worth noting that the traditionally pro-competitive stance of the UK, along with certain other member states, does help limit Directives and Regulations from becoming blunted by historic national interests.

9. How effective and accountable is the EU policy-making process on financial services legislation, for example how effective are EU consultations and impact assessments? Are you satisfied that democratic due process is properly respected?

BATS is increasingly engaged in the EU policy making process and we do have the opportunity to take part in consultations etc. However, as mentioned earlier, we do have some concerns about the qualitative assessment of whether a new law/regulation/rule is actually needed and what the impact of it will be.

Separately, we would observe that a due democratic process is inherently constrained by the way that policy and decision making at the EU level is structured – i.e. through compromises between three EU institutions. In addition, decisions are materially influenced by lobbying, special interest groups and national interests – for example, as seen in relation to open access to clearing in MiFIR. In reality, the process cannot really be called “democratic” as people within the EU are generally far removed and largely unable to influence the policy making and decisions being made in Brussels – though we note that this is an issue that is understood and beginning to be addressed by politicians.

10. What has been the effect of restrictions placed on Member States' ability to influence capital flows into and out of their economy, for example to achieve national public policy or tax objectives?

No comment.

11. What may be the impact of future challenges and opportunities for the UK, for example related to non-membership of the euro area or development of the banking union?

No comment.

12. Do you have any further comments about issues in addition to those mentioned above?