Competition in Trading and Post-Trading Services
The benefits, the challenges and the opportunities

Presentation to CVM – June 29th, 2012
Introduction & Overview

- **Oxera Report is thoughtful, comprehensive and accurate**
  - Brazil is clearly ready to support and benefit from competition
  - Soundest approach begins with competition in trading services
  - Introduction of competition must reflect unique nature of Brazil

- **Next steps for regulators and policy-makers are clear**
  - Mandate framework for access to CBLC for new exchanges
  - Require continued broker oversight by a single regulator
  - Promote dialogue and communication to facilitate transition

- **With the right approach, cost of competition can be managed**
  - Give clear guidance to market participants as early as possible
  - Require continued consolidation of “utility” market functions
  - Facilitate exchange efforts to assist broker & investor transition
Oxera Report Conclusions

- **Brazil is clearly ready for exchange competition**
  - Sufficient scale for multiple trading platforms to compete efficiently
  - Trading rules at the exchange level not an impediment
  - Unique features of the market can still be supported

- **Cost savings one of several benefits of competition**
  - Helps satisfy the needs of a wider variety of investors
  - Stronger incentives to innovate
  - Potential increased liquidity, especially where markets are linked

- **Transition plan will drive the cost-benefit analysis**
  - Little benefit of CCP/CSD competition relative to costs at this time
  - Avoid duplication of other facilities where economies of scale exist
Key Oxera Recommendations

- Introduce price monitoring and benchmarking immediately
  - Provides near-term visibility into current higher costs
  - Oxera states this is “more likely to be effective if the necessary pre-conditions for (competition) are put in place at the same time.”

- Prepare for an “open access” clearing model
  - Open CBLC CCP/CSD to competitors on fair terms
  - Vertical model of competition seen as too costly and risky

- Address issues to support multiple-exchange environment
  - Market regulation function of BSM
  - Other regulations “required to ensure a well-functioning market”
    - Market data
    - Best Execution

Report states the status quo - “do nothing”- is not an alternative
Direct Edge Perspective

- Oxera report thoughtful, comprehensive and accurate
  - Complexity of the analysis does not undermine conclusions
  - Benefits are clear, costs depend on implementation

- Recommendations consistent with our intended approach
  - Operate as a registered exchange under Instruction No. 461
  - Clear and settle all transactions through CBLC
  - Coordinate and synchronize with BVMF to ease transition

- Spirit of the report consistent with our business principles
  - Introduce competition but incorporate what makes Brazil unique
  - Act as a respectful, responsible and positive member of the market
  - Avoid increased systemic or operational risk wherever possible
The Path Forward – Overview

- Regulators and policy-makers must give clear guidance
  - This will allow all market participants to properly prepare
  - Can establish frameworks that avoid needless duplication
  - Details need not be clear, but the path forward must be certain

- Approach should allow for the introduction of competition
  - Avoid unnecessary conditions in an evolutionary process
  - Access to the existing CCP/CSD is the primary operational issue
  - Must be involved where necessary absent market cooperation

- Principles should take cost-benefit into consideration
  - Continued consolidation of utility functions and structural principles
  - Maintaining proper level of supervision and regulation

The right approach will preserve market integrity and control costs
The Role of Regulation in Facilitating Competition

- Competition cannot flourish without regulatory support
  - New entry investment would be discouraged by unacceptable risks
  - Incumbents unlikely to see the benefit of voluntary coordination
  - Market participants would be wary absent certainty

- Ensuring access to CBLC is primary evidence of this need
  - “entry by… a trading platform **would be difficult, if not impossible**, without the cooperation of CBLC” [Oxera – emphasis added]
  - Our efforts to negotiate access on a voluntary basis unsuccessful

- Involvement can properly balance competing priorities
  - Introduce a clear timetable for open access to CBLC
  - Minimize disruption to BVMF in integrating clearinghouses
  - Coordinate parallel efforts to prepare the market

Without action by regulators, competition will not come to Brazil
Competition and Clearing – Fair Access Precedents

- **Canada – Maple acquisition of TMX Group and CDS**
  - Existence of neutral CCP/CSD was key driver of competition
  - Fair and non-discriminatory access to clearing is a condition for Ontario Securities Commission and CCB to approve the merger

- **Europe – NYX/DB1 Merger and Derivatives Clearing**
  - Failure to offer access on existing heavily traded contracts was a major driver of formal rejection of the merger

- **Australia – Chi-X and access to ASX Clearing**
  - Government supported open access to systemically important clearing and settlement facility owned by monopoly exchange
  - Competition successfully introduced in late 2011
Direct Edge Perspective

- Definitive regulatory support for competition essential
  - Market participants can better manage strategic and tactical plans
  - Coordination efforts and new structures take time to develop
  - Will reduce implementation costs and bring benefits to market earlier

- Mandate open access to CBLC no later than January 2014
  - Allows incumbent to complete clearinghouse integration
  - Provides ample time for CVM, market participant preparation
  - Cooperation between future competitors early helps avoid risk

- Begin other implementation efforts in parallel
  - Start with principles that can be consistently applied
  - Promote active dialogue and input from market participants
Implementation Principles

- **Avoid “one size fits all” approaches**
  - As Brazil is unique, so is each market participant
  - Low-cost options to take advantage of competition will be available
  - Brokers can choose to develop proprietary solutions as they wish

- **Preserve “utility” functions of market structure**
  - Continued consolidated MRP and other market-wide mechanisms
  - Common “tick” sizes, market hours and auction functionality

- **Allow exchanges and vendors to ease the transition**
  - Permit exchange-to-exchange routing functionality
  - Recognize that vendors will introduce products to help brokers
  - Keep certain aspects of market structure consistent
Managing Implementation Costs

- A broker’s business model will determine any investment
  - Allowing brokers to differentiate is a benefit of competition
  - Exchange competition will allow brokers to better differentiate
  - Market participants do not need protection, they need clarity

- Exchange competition will unleash vendor competition
  - Brokers and investors will see new features in existing platforms
  - Managed network providers will facilitate low-cost connectivity

- Example -- Direct Edge and Smart-Order Routing
  - Brokers will get the best price in all circumstances
  - To be offered at no incremental cost
  - Direct Edge to bear direct cost of connection and functionality

Competition-related costs can be minimized if the broker chooses
Market Structure Considerations

- **Synchronize new markets to existing rules and practices**
  - Market hours, tick sizes, circuit breakers
  - Listing market retains auction function to ensure price formation

- **Establish market-wide standards for best execution**
  - Clear rules-based or principle-based directions to guide brokers
  - Phase-in compliance to ease transition

- **Develop mechanisms for price/quote transparency early**
  - Options for ensuring wide availability of data
    - Industry Utility (Consolidated Tape Association – US)
    - Exchange (TMX Group – Canada)
    - Multiple Vendor (Australia, Japan)

**Basic market structure aspects should not be part of competition**
Market Integrity Considerations

- **BSM should continue in its primary supervisory role**
  - Could continue as BVMF subsidiary or as an independent entity
  - Various cost allocation models can be explored

- **Maintains strong oversight, reduces potential conflicts**
  - Exchange markets still maintain essential compliance functions
  - Single authority to coordinate with exchanges and inspect brokers

A single regulator is good economically and for investor protection
Conclusion

- The benefits of competition are clear and achievable
  - Oxera report provides validation of exchange competition
  - Competition can be introduced while preserving unique features
  - Direct Edge stands ready to contribute in a responsible manner

- Definitive statement on access to clearing is essential
  - Market participants can better manage strategic and tactical plans
  - Timing can still allow for all parties to achieve other objectives
  - Cooperation between future competitors helps avoid transition risk

- The right approach will ensure an optimal result
  - Make intentions known early and clearly
  - Announce sound principles that control costs and protect markets
  - Provide flexibility that will ease any anxiety over transition

Conservative and transparent.
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