



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

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 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

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



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)

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

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



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