

28th February 2011

Dear Mr Buenaventura,

Chi-X Europe response to CNMV consultation on proposed reforms to Spain's securities clearing, settlement and registry system

This letter and annex is Chi-X Europe Ltd's (Chi-X) response to the Comisión Nacional Del Mercado De Valores (CNMV) public consultation on the proposed reforms to Spain's securities clearing, settlement and registry system. Chi-X is delighted to be able to support and contribute to the changing market infrastructure in Spain. Chi-X is committed to improving the quality and efficiency of European equity markets.

About Chi-X Europe

Chi-X is a UK FSA authorised securities firm operating a multilateral trading facility (MTF) for the trading of more than 1,300 of the most liquid securities across 25 indices and 15 major European markets as well as ETFs, ETCs and International Depositary Receipts in both a visible order book and the Chi-Delta™ non-displayed reference price order book. Chi-X's low-cost, streamlined operating model is designed to help trading participants achieve ultra-low execution, clearing and settlement costs, and it also provides a low-latency, high capacity trading system. Real-time market data is disseminated at no cost to trading participants.

Since launch in March 2007, Chi-X has handled more than 485 million trades, equating to a total turnover of over €3.1 trillion. In 2010 alone, trading participants saved over €170 million in price improvement. Chi-X ranked as the largest equity exchange in Europe by number of trades and the second largest by value traded in 2010 according to the Federation of European Stock Exchanges (FESE). Over the same period it represented around 27% of all electronic order book trading in UK FTSE 100 stocks and up to 25% of trading in other major European markets.

Chi-X Europe is an independent MTF owned by 19 minority shareholders who are users. It is well capitalised and profitable.

Key points of Chi-X Europe's response to the consultation

In respect of the CNMV's public consultation on proposed reforms to Spain's securities clearing, settlement and registry system, Chi-X makes the following broad points:

1. As the largest venue competing in the trading of Spanish securities we welcome the initiative that the CNMV and other Spanish authorities are taking in seeking to reform the Spanish clearing, settlement and registry system. In particular the move to a Central Counterparty (CCP) model and changes to the Registry Reference system. We believe that this will bring significant benefits to Spain and its securities markets including reductions in the overall cost of post-trade services. It will also bring Spain in line with commonly adapted practices in other European markets and allow for greater harmonisation across Europe.
2. Chi-X, as a newly established trading platform in Europe, has first-hand experience of the design and establishment of a new CCP for cash equities. In 2006 prior to Chi-X's 2007 market launch, we consulted potential users on the key attributes of a CCP that would support a low cost trading environment, while providing an efficient and robust clearing model. The feedback we received was:
 - a) Removal of counterparty risk through the novation of trades at the point of execution;
 - b) Multilateral netting of settlement obligations into a single net per security per day reducing settlement costs and operations;
 - c) Efficient risk management systems, with margin offset where appropriate and payment of obligations in standard instruments (cash, bonds, securities, guarantees);
 - d) Net settlement at the domestic CSD, ensuring securities traded on different venues are fungible with each other; and
 - e) Constrained profit model, which allows clearing fees to be set at a level which promotes efficient electronic trading.
3. Chi-X considers that all forms of ownership, both user and venue owned give rise to potential conflicts of interest. Measures should be put in place to address these conflicts through independent governance and risk management, transparent policy and pricing structures, as well as non-discriminatory access arrangements. However, we consider that a horizontal, user owned and governed model, which is independently managed and legally separated from that of its trading sources and settlement provider, will achieve structural separation. This may prove easier in ensuring competition and non-discriminatory access than behavioural constraints as would be required in a vertical ownership structure. This is also the case for the CSD.
4. We strongly recommend that the Spanish system should allow for multiple competing CCPs and also for inter-operability. Multiple competing CCPs are already established in Europe. We believe that the competition to existing CCP providers that Chi-X initiated through supporting the establishment of a new competing CCP, European Multilateral Clearing Facility NV (EMCF), has been instrumental in reducing clearing fees in Europe from an average of €0.50 to around €0.005 per trade since launch. Inter-operability for equity securities is also already operating in certain markets and is proposed under the European Market Infrastructure regulation (EMIR).
5. Effective access and inter-operability arrangements are key in providing further competition and efficiencies to reduce clearing costs. These will allow direct competition between clearers on tariffs and service. Importantly, it will allow users choice to consolidate clearing flow on to perhaps one CCP across Europe. Chi-X considers that this will facilitate the

consolidation of the clearing market into a smaller number of competing CCPs able to enjoy greater economies of scale and deliver significant cost saving to users. We support the establishment and maintenance of robust arrangements on risk controls for inter-operability for them to be considered safe and sound. In general, we are supportive of the proposed establishment of European standards in this area as considered under EMIR and also in the extensive work already conducted by the U.K., Dutch and Swiss regulators in considering inter-operable CCP arrangements for Chi-X. The Spanish system should incorporate these measures.

6. We consider that the Spanish system should allow for CCP services to be provided by CCPs located in other European states. While Chi-X is authorised and incorporated in the U.K., its CCP, EMCF, is established and supervised in the Netherlands. While EMIR will establish the right of CCPs to passport their services within the EU, the current reform of the Spanish system should anticipate this, subject to adherence with internationally accepted standards and regulatory co-operation. Spanish requirements for CCPs should seek to mirror those of internationally accepted standards and EMIR to ensure European harmonisation.
7. Chi-X supports appropriate mechanisms to ensure that settlement discipline is maintained. For centrally cleared trades the CCPs should, as part of their activities, maintain a disciplined settlement regime and should do this through a variety of measures, including:
 - a) Penalise the offending party for failing to settle, through financial measures and a buy-in / sell-out process. Any financial penalties should not be too punitive as this will increase the overall cost of trading and have a detrimental impact on investors' willingness to invest in Spain; and
 - b) Compensate the aggrieved party who has not received their stock or cash. It is important that these measures should be standardised where multiple CCPs operate together.

With a European market structure supporting competing CCP providers and with the same securities traded across different venues, Chi-X also considers that there should be a degree of harmonisation across competing CCPs and with the CSD (for non CCP trades) to reduce the potential for arbitrage or disadvantage.

8. Chi-X believes it is important that the introduction of a CCP model is accompanied by changes to the registry system, therefore allowing the full efficiencies of a multilateral netting system to be realised. In our opinion the cost of settlement and registry will be significantly reduced by the elimination of Registry References (RR), as market participants trading in Spain will be able to fully benefit from market level netting, both in terms of settlement netting (versus the CCP) and the reduction in bilateral collateral required.

In particular, the RR system is preventing effective competition taking place at the trading level. The current requirement to put through trades on the Bolsas Y Mercados Espanoles (BME) or the proposed Chapter V arrangements, in particular with the fee proposals set out by Iberclear, do not allow for fair competition between the BME and other platforms seeking to trade Spanish securities, such as Chi-X. The presence of such barriers to competition is demonstrated by the very low market share obtained by such competitors compared with elsewhere in Europe despite the high trading fees charged by the BME. The absence of such competition denies Spanish investors and issuers lower transaction costs, tighter spreads

and improved liquidity that has resulted elsewhere. This is not only the case for the top 5 Spanish stocks but even more so for others which could benefit from greater liquidity and international trading interest. As MiFID and European competition law already provides for equality of treatment, the CNMV and other Spanish authorities need to act now to ensure that this is the case.

In the annex to this letter I have included our detailed response to the consultation questions. Chi-X has limited its specific remarks to the conditions in establishing a CCP and the issues around ensuring competition at the trading and also at the clearing level.

We hope that you find these responses useful in your deliberations and look forward to working with you on these issues.

Yours sincerely,

ANNEX

1. What do you think of curtailing the assignment process?

Chi-X supports the proposal to curtail the current assignment process. This will allow for harmonisation of Spanish post-trade arrangements with those prevalent in the rest of Europe. We also consider that overall processing costs should fall and greater netting benefits can be obtained. It will also allow for the potential of competition in clearing to ensure that efficiencies are passed on to the ultimate users. Such a post-trade system based on international standards should allow for the protection of investor interests to be preserved.

2. Do you think the aggrieved party should receive the penalty imposed, eventually, to the party in breach?

Yes. Chi-X supports appropriate mechanisms to ensure that settlement discipline is maintained. For centrally cleared trades the CCPs should as part of their activities maintain a disciplined settlement regime and should do this through a variety of measures, including:

- c) Penalise the offending party for failing to settle, through financial measures and a buy-in / sell-out process. Any financial penalties should not be too punitive as to being a barrier to entry.
- d) Compensate the aggrieved party who has not received their stock or cash. It is important that these measures should be standardised where multiple CCPs operate together.

It is important that the regime is not too punitive as this will increase the overall cost of trading and have a detrimental impact on investors' willingness to invest in Spain.

With a European market structure supporting competing CCP providers and with the same securities traded across different venues, Chi-X also considers that there should be a degree of harmonisation across competing CCPs and with the CSD (for non CCP trades) to reduce the potential for arbitrage or disadvantage. In many instances deliveries and receipts of stock / cash will be to different CCPs and will often be inter-linked and contingent on each other. To ensure participants are not financially disadvantaged for failing to deliver to one CCP, through not receiving stock from another CCP, any future CCP and settlement system should have in place measures that address the following points:

3. Do you consider that the elements described above are sufficient to enable CCPs to be managed professionally, independently of their ownership structure? Do you consider additional factors should be added?

Ownership and conflict management

Chi-X considers that all forms of ownership, both user and venue owned give rise to potential conflicts of interest. Measures should be put in place to address these conflicts

through independent governance and risk management, transparent policy and pricing structures, as well as non-discriminatory access arrangements. However, we consider that a horizontal, user owned and governed model, which is independently managed and legally separated from that of its trading sources and settlement provider, will achieve structural separation. This may prove easier in ensuring competition and non-discriminatory access than behavioural constraints as would be required in a vertical ownership structure. This is also the case for the CSD.

Transparency of prices will assist in the management of conflicts of interest and competition with a CCP and CSD required to publicly disclose the prices and fees associated with services provided, including discounts and rebates and the conditions to benefit from these reductions.

We would agree that the legal form of a CCP should not be restricted to a *Sociedad de Sistemas* to allow for CCP services to be provided by entities from other European states (see below).

CCP numbers

We strongly consider that the Spanish system should allow for multiple competing CCPs and also for inter-operability. Multiple competing CCPs are already established in Europe and inter-operability for equity securities is proposed under EMIR.

In addition, as Iberclear is a monopoly provider owned by the incumbent trading platform, the BME, there should not be a replication of this structure at the clearing level. Allowing for multiple CCPs should ensure that competition is maintained at the clearing level. In addition, there is the potential for cross-subsidisation to distort competition at the trading level where lower trading fees recouped through higher clearing and settlement charges.

MiFID and competition in trading, significantly due to new entrants such as Chi-X, has dramatically reduced direct trading costs and lowered some clearing costs. However, further progress is needed in reducing clearing and settlement costs.

Effective access and inter-operability arrangements are key in providing further competition and efficiencies to reduce clearing costs. These will allow direct competition between clearers on tariffs and service. Importantly, it will allow users choice to consolidate clearing flow on to perhaps one CCP. Chi-X considers that this will facilitate the consolidation of the clearing market into a smaller number of competing CCPs across Europe able to enjoy greater economies of scale and deliver significant cost saving to users.

Chi-X has worked with EMCF as its CCP in a single CCP structure since launch to offer participants access to over 15 European market segments. We believe that this competition to existing CCP providers has been instrumental in reducing clearing fees in Europe from an

average of €0.50 to around €0.005 per trade since launch. Chi-X has always had a non-exclusive arrangement with EMCF and throughout 2009 and 2010 has been working with LCH.Clearnet Ltd, SIX x-clear and EuroCCP to implement a multi CCP model interoperating with EMCF.

There is extensive experience of access and interoperability in the market place, both in Europe¹ and elsewhere. These have operated without problems. While inter-operability has also worked in derivative markets², it is particularly manageable in equities. Cash equities are fully fungible products, with short settlement periods (generally T+3) and, delivery versus payment. In addition, trading venues which can only use one CCP are subject to significant single point of failure presenting systemic risk. Chi-X supports the establishment and maintenance of robust arrangements on risk controls for inter-operability for them to be considered safe and sound. In general, we are supportive of the proposed establishment of European standards in this area as considered under EMIR. There is also extensive work already conducted by the U.K., Dutch and Swiss regulators in considering the inter-operable arrangements referred to in the preceding paragraph.

CCP nationality and location

We consider that the Spanish system should allow for CCP services to be provided by CCPs located in other European states. While Chi-X is authorised and incorporated in the U.K., its CCP, EMCF, is established and supervised in the Netherlands. As referred to above we are also considering inter-operable CCP services from CCPs based in the U.K. and Switzerland. While EMIR will establish the right of CCPs to passport their services within the EU, the current reform of the Spanish system should anticipate this, subject to adherence with internationally accepted standards and regulatory co-operation.

4. Do you think it should be legally binding to channel multilateral trades in equities listed in the stock exchanges via a CCP?

We do not believe this should be legally binding. The use of a CCP for clearing of multi-lateral trades provides many advantages, including novation, multilateral netting, dedicated risk model, and anonymity. However this should not be legally binding on the venue or participants as this may restrict different business models. Many exchanges and MTFs have segments which are not cleared through a CCP (for example some SME securities) or allow participants to elect this for specific trades (self-trade clearing suppression). In addition, a CCP may consider that certain securities are not suitable for clearing.

5. Do you think the reform should be addressed on a joint basis so that the CCP handles both equities and fixed-income securities?

¹ For example, LCH.Clearnet Ltd and SIS x-clear in Europe.

² For example, EDX and OMX derivatives markets clearers.

We do not believe that the Spanish system should require a CCP to address both equity and fixed-income securities. To do so may restrict competition in the provision of CCP services. However, should a CCP chose to support multiple asset classes the CCP can deliver cost reductions and synergies through areas such as margin / collateral offsets, pricing power and reduced technical requirements, through a single provider. Any additional complexities or risks through combining multiple assets should be taken into account in this process. However there should not be an obligation on the CCP to support all asset classes.

6. Do you think the use of the CCP should be optional in markets where trading is not multilateral (e.g. fixed-income outside the electronic platforms, block trades, OTC trades in equities)?

Chi-X believe the centralised clearing of the above trading styles, asset classes through a CCP should be optional, both to the participants engaging in this activity and on the CCP required to support it.

7. Do you consider that the conditions set out above about the CCP's corporate governance are sufficient?

Chi-X supports the proposals in the consultation. These are broadly in accordance with international standards such as CPSS-IOSCO³ and the proposals under EMIR. As referred to in question three, we consider that all forms of ownership, both user and venue owned give rise to potential conflicts of interest. Measures should be put in place to address these conflicts through independent governance and risk management, transparent policy and pricing structures, as well as non-discriminatory access arrangements.

8. Do you think it is necessary that the CCP have access to overnight liquidity from the Eurosystem?

Chi-X believes that in the usual course of business a CCP should not have the need for access to central bank money. However in line with draft European commission regulation (EMIR) published in September 2010, we would support a structure which provides access to both commercial and central bank liquidity.

9. Do you consider the proposed mechanisms for managing failed transactions to be appropriate?

Yes. Chi-X agrees with the approach taken, However the CNMV may wish to look at harmonising buy-in dates with other markets to allow participants to benefit from standardised timelines. We feel it is important that any measures introduced are adopted by all CCPs in a multi-CCP regime. Differences in process and / or fines may lead to settlement arbitrage by clearing members / settlement agents.

³ 2004 CPSS-IOSCO Recommendations for Central Counterparties
<http://www.bis.org/publ/cpss61.pdf>

As per our response to questions two, financial penalties imposed by the CCP for failure to settle should be applied at an appropriate level and should not have a significantly negative impact or lead to a barrier to entry for investors or participants.

10. Do you consider appropriate the proposed model of settlement by balances and the elimination of the RR?

Chi-X supports a model of settlement by balances as a way of moving towards a process used in other European markets and one that will support T2S.

11. Do you consider it necessary to impose solvency requirements on participants in the proposed settlement system?

No comment.

12. Do you consider the participant's proprietary account should be used to cover shortfalls in securities in its customers' accounts?

No comment.

13. Do you consider that the proposed failed transaction management mechanisms are appropriate?

Chi-X agrees with the approach taken, with this being managed by the CCP (in the case of CCP transactions) and the CSD or venue for non-CCP transactions. Chi-X also feel the acceptance of partial settlements within the settlement system are an important aspect in managing settlement risk. This is often used by the CCP or CSD as a tool to increase the efficiency within the settlement cycles and reduce participant risk to unsettled trades. Partial settlements are available in most European markets Chi-X operate in, either through the national CSD or as a CCP function.

14. Do you consider that there should be a mechanism of alternative compensation?

As per our response to question two, penalties and compensation should be used as part of the fail fee mechanism. In our view compensation and penalties for failing to settle should be treated separately by the CCP or settlement system, although part of the fail fee may be used as compensation towards the party who has not received stock or cash. Participants who do not receive stock or cash as the result of a failed settlement should be compensated appropriately, as they themselves may be subject to fail fee charge due to failing to make an onward settlement. Compensation levels should be appropriate and should be treated separately from a penalty system designed to discourage settlement failures.

15. Do you consider it appropriate to establish a penalty system so as to discourage settlement failures?

Chi-X supports a model that encourages timely settlement of market obligations through a penalty system. As per our response to question two, this may be achieved through a variety of measures, including fail fees for failing to settle on value date and buy-in / sell outs of unsettled trades on an industry agreed timeline. However, the mechanism should not be too punitive as to discourage participants and investors into the market.

16. Do you think that the CSD should publish information on trades where settlement failed? If so, in what degree of detail and how often?

Publishing and informing participants of failed trades will add to transparency in the market which should lead to a quicker resolution through involvements in buy-in / sell-out auctions. Any publication of failed settlements should be anonymous and should not include participant information, but should be reported on a daily basis.

- 17. Do you have any other legal comments on this issue?**
- 18. Do you agree with the introduction of the pro rata rule into Spanish law as the method for resolving securities shortfalls in the event of insolvency of a participant?**
- 19. Do you agree with introducing this rule? If so:**
- 20. Do you consider that a rule such as the one proposed should be formulated such that all the securities in the insolvent firm's proprietary account may be used to cover any overall shortfall in securities in third-party accounts? or, on the contrary**
- 21. Should the attachment of securities in the proprietary account be limited to the shortfall in third-party accounts of the same class of security?**
- 22. Which of the optional modes of record-keeping do you believe might be a suitable alternative to consider, and which do you believe should be ruled out?**
- 23. Do you agree with the need for harmonised discipline that regulates the accounts and book-entries, and that variations used by participants should be valid vis-à-vis the system?**
- 24. Do you agree with these general principles on the distribution and identification of tasks and responsibilities between Iberclear and the participants?**
- 25. Do you agree with the proposed approach to control, cross-checks and daily and regular verification?**
- 26. Do you agree with the proposed approach to dealing with corporate/financial transactions?**
- 27. Do you consider that this is the right approach or can you propose substantial changes?**
- 28. Do you agree with the foregoing approach?**
- 29. Do you agree that the participants of the settlement system should cover shortfalls in securities in their customers' accounts out of their proprietary accounts?**

Chi-X has no comments on questions 17-29.

30. In your opinion, does any other aspect of finality need to be considered at this time?

Chi-X notes that in most European equities markets finality is achieved through the settlement process. As a pan-European trading platform, we would support harmonisation in this respect.

31. Which of the three options for the time of finality at the CSD do you consider to be most appropriate from the standpoint of protecting the system?

No comment.

32. Do you think overall system costs will be lower than at present?

Chi-X expects that as a result of harmonisation with other European settlement practices and by introducing netting efficiencies into the system, through a CCP and a system of settlement balances, the market will see reductions in overall system costs and the potential to achieve EU wide economies of scale.

As the CSD function is likely to remain a monopoly, it is important that appropriate oversight is maintained by the CNMV and Spanish competition authorities. In particular the charges of Iberclear for settlement are higher than many comparable CSDs in Europe (see below). Improvements in efficiency may reduce costs but these will only be passed onto users if there is appropriate supervision. In addition, as Iberclear is a monopoly provider owned by the incumbent trading platform, the BME, there is the potential for cross-subsidisation to distort competition at the trading level where lower trading fees are recouped through higher settlement charges.

As an indication for comparison we have listed below the settlement charges incurred by our Central Counterparty, EMCF, on other markets in the Eurozone:

Market	Settlement charge*
Spain	€3.50 (BME max); €16.9 (current MTF via Put Through); Unlimited (proposed MTF under Chapter V)
France	€1.70
Germany	€1.23
Italy	€3.06
Netherlands	€1.70
Portugal	€3.50

*Settlement charge incurred by EMCF includes CSD charges and any costs incurred in accessing the CSD. These are passed on at cost to clearing members

33. In your opinion, will eliminating RRs make settlement and registry processes cheaper?

Yes, in our opinion the cost of settlement and registry will be significantly reduced by the elimination of RRs, as market participants trading in Spain will be able to fully benefit from market level netting, both in terms of settlement netting (versus the CCP) and the reduction in bilateral collateral required.

34. Do you think the changes to be introduced by the reform will reduce the number of entities performing these activities?

Chi-X believes that the proposed reforms will lead to economies of scale within the market, a consequence of this may be rationalisation amongst firms undertaking this activity.

35. What other changes do you think the reform may produce in the current configuration of post-trade activities?

Chi-X believe Power of Attorney (POA) structures may be a function that is requested by market users, but is not addressed within this consultation. In other European Settlement systems there is the functionality for the CCP to have a level of control over the settlement instructions for which they are responsible, which is achieved through a POA. POA structures allow the CCP to automatically instruct matching instructions within the settlement system on behalf of their members to whom they are settling against. This is often provided as an optional function but brings with it the benefits of automation and greater efficiency.

36. Do you consider the introduction of non-settling market members to be a good idea?

37. Do you think separating settlement from custody/registry activities may be beneficial for some entities?

Chi-X has no comment to questions 36-37.