REPORT ON THE RESULTS OF THE PUBLIC CONSULTATION, VIA CIRCULAR LETTER 050/2018-VOP, OF DECEMBER 19, 2019, REGARDING THE RETAIL LIQUIDITY PROVIDER (RLP) AND NEW RULES FOR CROSS ORDER REGISTRATION IN AN EXCHANGE ENVIRONMENT

APRIL 09, 2019

1. INTRODUCTION

On December 19, 2018, via Circular Letter 050/2018-VOP, B3 S.A. – Brasil, Bolsa, Balcão presented for public consultation, for appreciation and comments by its participants and other stakeholders, a proposal to change the existing rule for the registration of cross orders in exchange markets, in order to unify the rules of the BM&F and Bovespa segments in the PUMA Trading System and to regulate a new type of order called retail liquidity provider (RLP).

Firstly, B3 would like to thank all the market participants - brokerage houses, investors and class associations – that sent comments regarding the public consultation. These comments are of great value and will doubtlessly contribute to the appreciation and perfecting of the market rules in question.

The public consultation had 30 respondents, categorized as follows:

- 23 of B3's Full Trading Participants (FTPs);
- Five customers that trade at B3 and develop high-frequency trading (HFT) on several markets;
- The National Association of Securities, Foreign Exchange & Commodity Brokerage Houses (ANCORD);
- FIA Principal Traders Group (FIA PTG), an international association of firms that use their own capital to trade on several exchanges around the world.

The comments of the participants that did not expressly request confidentiality are available at the www.b3.com.br portal. The rest can only be accessed by B3, BSM and CVM.

Most of the comments were related to the proposal to develop a new type of RLP order, as set forth in the table below.

Table 1 – Opinions about the RLP order

	In favor of adopting the RLP order	In favor of adopting the RLP order with significant rule adjustments	Against adopting the RLP order	Inconclusive
FTPs	17	3	2	1
ANCORD	1			
Customers (HFT)		1	4	
FIA PTG			1	
Total	**18**	**4**	**7**	**1**

Only five participants, all FTPs, commented expressly about the new rule for cross order registration, expressing different views and suggestions on the subject.

The next sections of this report are organized as follows:

- Section 2 – Main arguments against introducing the RLP order
- Section 3 – Main arguments for introducing the RLP order and suggestions for enhancing the rule
- Section 4 – Comments and suggestions related to the new rule for cross order registration
- Section 5 – B3's conclusions and next steps

Several participants made similar suggestions and/or expressed concerns about the same subject. Therefore, and to make reading easier in Sections 2, 3 and 4, B3 has interpreted and grouped these comments by subject.

2. MAIN ARGUMENTS AGAINST INTRODUCING THE RLP ORDER

Greater risk of adverse selection and its impact on price formation

2.1 In the public consultation, participants argued that as the brokerage house would gain priority to trade against a proportion of its retail flow, the market makers that trade against the book would face a greater risk of adverse selection.

2.2 Retail investors tend to be less well-informed than average on the market. In other words, it is normally less risky to trade against a flow of retail orders than against other types of flow. As the brokerage house would come to have priority for trading against a proportion of the retail flow, the flow arriving at the book would generally come to be better informed, in other words riskier for market makers.

2.3 The increased risk could push market makers to reduce traded volumes and/or increase spreads, which would be bad for all investors, including retail investors using the RLP order.

2.4 The 15% cap proposed by B3 to limit the total volume of each contract traded via RLP order might be insufficient to mitigate the risk of adverse selection and the impact of this on total liquidity and on the market's spread levels.

2.5 The brokerage house could have incentives to artificially generate trades (buying and selling at the same price), in order to increase total trading volume and in this way be able to trade more contracts via RLP, manipulating the 15% limit proposed by B3. Revenue from spreads could more than compensate the cost of the exchange fees resulting from artificially-created trades.

2.6 Due to the rule of no preemption of customer's orders at the top price level of the order book, the brokerage house could discourage order entries limited to the order book. For example, it could decide to charge more for limit orders than for aggressing order entries. The decrease in limit orders in the book could cause lower liquidity and wider spreads.

2.7 The RLP order would tend to generate a positive financial result for intermediaries and a revenue loss for market makers that trade against the book.

2.8 The RLP order could be considered to be brokerage houses free riding on prices produced by market makers in the order book.

2.9 The brokerage houses already receive revenue from brokerage fees, which is their incentive for client prospecting and for developing the customer base.

2.10 The brokerage houses' client prospecting did not generate the increased volumes observed in WIN and WDO contracts, which instead resulted from more interest in these contracts from the retail public.

2.11 The RLP order will not generate new liquidity, it will only remove from the book part of the already existing liquidity.

Conflict of interests

2.12 The RLP order would tend to accentuate the problem of conflicts of interest in the brokerage house's trading in relation to its retail customers.

2.13 As the brokerage house would act as a counterparty to trades and receive the spread, it would have incentives to direct its customers to products with the RLP order, even if they were not the most appropriate for these customers.

2.14 There would also be a conflict of interests in the development of trading algorithms for customers. The brokerage house would have a dual role as it would develop the algorithm used by the customer and trade, via RLP, against the orders generated by this same algorithm. There could be incentives to develop less efficient or even "addicted" algorithms.

2.15 There would also be this dual role in the case of online forums and chat rooms for trading. The brokerage house would suggest when to get into or out of a market, as is common in these environments, but could simultaneously trade against its customers through an RLP order.

2.16 B3 must analyze customers that execute day trades in Ibovespa and US Dollar mini futures contracts. It needs to check how long they trade for, the results obtained, whether there is migration to other products or whether after a while they simply abandon the market.

Potential price improvement for customers

2.17 The RLP order would require a price improvement for the aggressing customer order whenever the bid-ask spread is equal to or greater than two tick sizes. As most of the time the bid-ask spread of WIN and WDO contracts is only one tick size, the price benefit for the customers would tend to be limited.

Other comments and suggestions

2.18 Instead of developing the RLP order, B3 should create a rebates program for retail brokerage houses, seeking to foster client prospecting, establishing targets for the brokerage houses.

2.19 The UK's Financial Conduct Authority (FCA) has prohibited payment for order flow, claiming that it is detrimental for transparency and the price formation process, resulting in worse results for customers[1].

2.20 If B3 decides to go ahead with the RLP order it should carry out a controlled experiment where it authorizes the RLP order for one of the mini futures contracts (WIN or WDO), prohibits it for the other and, after a year, compares the results.

[1] Different to the US, the concept of National Best Bid-Offer (NBBO) does not exist in the UK. It is probably for this reason that payment for order flow of retail customers is allowed in the former but not the latter.

3. MAIN ARGUMENTS FOR INTRODUCING THE RLP ORDER AND SUGGESTIONS FOR ENHANCING THE RULE

Virtuous cycle with benefits for the whole market

3.1. The RLP order's economic incentive for intermediaries would make them invest more in client prospecting, increasing the customer base and in the process market liquidity.

3.2. The RLP order would provide greater order book liquidity through overspill, whereby the retail customers' order flow increase combines with the 15% cap.

3.3. The RLP order would also enable the participation of brokerage houses with smaller retail flows, whose flows would be paid for by consolidating agents.

3.4. This is not just theory. Brokerage houses' own portfolio trading against the flow of aggressing orders from retail customers is a reality in some of the world's major markets and contributes to the strengthening of intermediation activity.

Scope of the RLP order

3.5. B3 should allow RLP orders for all the products used by retail customers. The logic that led to proposing the RLP order for Ibovespa and US Dollar mini futures contracts is the same as for the other assets and contracts traded by retail customers.

3.6. The pilot program proposed by B3 should encompass at least some of the more liquid equities in the Bovespa segment.

3.7. B3 should allow the RLP order for the S&P 500 mini futures contract.

3.8. B3 should publish a timetable for expanding the RLP order to other market segments.

3.9. The RLP order should be allowed for every type of customer, not only retail customers. Not every individual should be considered a retail customer and not every corporation should be considered a qualified and experienced customer.

RLP order implementation process

3.10. B3 should establish a minimum period before the RLP order goes into operation, so that the other brokerage houses have time to prepare themselves and to establish commercial and contractual arrangements with their customers, including preparation for payment for order flow

3.11. B3 should hold discussions with vendors, seeking the development of RLP support systems. Ideally, several vendors should provide solutions for the RLP order, avoiding concentration into few suppliers.

3.12. B3 should develop a marketing strategy for divulging the RLP order.

Best execution

3.13. The RLP order would transfer to the B3 matching engine a large part of the intermediaries' best execution obligations, generating greater legal security and lower operational risk for the intermediaries and providing greater market transparency when compared with existing internalization models in other countries.

3.14. The RLP order would not be comparable to dark pools that exist in other jurisdictions as it would be processed at the B3 matching engine, with no additional latency in the OMS of the brokerage house and with post-trade transparency in real time at "times and trades".

3.15. If the bid-ask spread were two tick sizes, the RLP order would require price improvement to only one side of the trade, that is, only the buy or the sell. If not, the gain for the brokerage house from the RLP order would be zero and the brokerage house could decide not to provide an RLP order in such circumstances. It would make no sense for the brokerage house's gain to be one tick size if the spread were closed and zero if it were two tick sizes.

3.16. There should be the creation of price improvement ranges in the RLP order when the spread is open. The wider the spread, the greater the price improvement that should be observed by the customer.

Payment for the aggressing order flow of retail customers

3.17. Only brokerage houses and financial institutions belonging to the business conglomerate of the brokerage house should be authorized to use the RLP order. The regulatory costs, operational risks and duty of suitability are all the brokerage house's. It would be inappropriate to allow institutional customers to use the RLP order to trade against the flow of retail orders from the brokerage house.

3.18. If the rules come to allow payment for the order flow originated by the brokerage house, this payment should be made solely by a single investor or a single brokerage house, which would be authorized the act as counterparty to the flow.

3.19. B3 should avoid payments for the order flow of retail customers from being made only by one or few market participants.

No preemption of the RLP order

3.20. There are brokerage houses with retail flow and high-frequency trading (HFT) flow. These tend to have a practically constant presence at the top price level of the order book. Due to the rule of no preemption of customers at the top price level of the order book, these brokerage houses may be unable to exploit adequately the RLP order, remaining at an unfair disadvantage.

3.21. To deal with this question, the institutions could have two brokerage houses within the same business group, one for retail customers and the other for HFT. However, this solution would be extremely inefficient and expensive, having unintentional consequences for the rule of no preemption of the RLP order.

3.22. B3 should adapt the no preemption rule for the RLP order. The no preemption control should be executed in two distinct customer groups, on the one hand HFT and other institutional customers and on the other retail customers. Only the orders of retail customers in the order book would not be preempted by RLP order.

3.23. B3 should limit the quantity of contracts executed by the RLP order in each trade whenever there is a brokerage house customer order at the top price level of the order book, so that the customer can improve its position in the queue.

Conditions on the use of the RLP order

3.24. Brokerage houses should be obliged to provide the RLP order to all retail customers that demand it. The rules should not allow the brokerage house to select in a discretionary manner the retail customers to which it wishes to provide the RLP, filtering only those perceived as being less efficient.

3.25. B3 should require the brokerage house using the RLP order to have a minimum presence in the trading session, especially at moments of greater volatility and/or less liquidity. The liquidity offered via RLP should not only occur at the most convenient moments for the brokerage house.

Transparency

3.26. Authorization for use of the RLP order by each brokerage house must be made conditional on compliance with a group of brokerage fee best practices: (i) the brokerage fee policy must be transparent and easy to understand by the retail customers; and (ii) the brokerage fee must be in line with the operational costs and risks incurred by the brokerage house, to favor the healthy development of the market.

3.27. The rules must foresee the brokerage house being obliged to inform customers of: (i) trades executed via RLP; and (ii) the price improvement obtained via RLP.

3.28. The rules should foresee the brokerage house being obliged to inform, at its portal: (i) the percentage of trades executed via RLP; (ii) the percentage of customers served; and (iii) the financial benefit calculated for the customers.

Cap on RLP order use

3.29. The initial cap of the RLP order should be 10%, gradually increasing to 15% in accordance with the results obtained.

3.30. The rules should foresee the temporary suspension of the RLP order for participants that breach the established cap.

3.31. The 15% cap will be reached only if (i) all the brokerage houses provide the RLP; and (ii) all the retail customers accept trading via RLP. As it is unlikely that the two conditions will always be met, B3 should think of rules for the full approval of the 15% cap, preventing a portion of the limit from remaining idle.

3.32. B3 should divulge, in real time, the breaching of the 15% RLP order cap, bearing in mind that exhaustion of the cap could impact the market in terms of liquidity and volatility.

3.33. B3 should divulge and discuss with the market the methodology for fixing the cap.

Price formation process

3.34. B3 should monitor the effects of the RLP order on the quality and liquidity of the order book, divulging a periodical report about the matter. If necessary, B3 should adjust the value of the cap.

B3 exchange fees

3.35. To stimulate development of the retail segment, B3 should grant a discount on the exchange fees charged on the brokerage house's own portfolio when there is trading via RLP order.

Other issues

3.36. The opt-in mechanism should be simplified. It should be in the customer's registration form or simply not exist, with only the opt-out existing.

3.37. BSM should carry out periodical audits in the brokerage houses' order management systems (OMS) to assure that there is no mechanism artificially holding back orders.

4. COMMENTS AND SUGGESTIONS RELATED TO THE NEW RULE FOR CROSS ORDER REGISTRATION

4.1. The rules for cross orders in the BM&F and Bovespa segments should be unified, seeking simplification of processes and operational risk mitigation.

4.2. The new cross orders rule foresees four special cases: (i) orders of a disproportionate size in relation to liquidity at the top price level of the order book; (ii) orders generated by TWAP and VWAP type algorithms; (iii) orders related to structured transactions; and (iv) orders destined for brokerage of operational errors. B3 should include another special case in the rules, that is, cross order registration involving symmetrical buy and sell trades of funds with the same manager.

4.3. B3 should present a non-exhaustive list of trades that could be considered "structured transactions".

4.4. B3 should present the criterion to be used for defining "orders of a disproportionate size to top price level of the order book liquidity". This criterion could be, for example, the average liquidity of the asset or contract at the top price level of the order book. Should the book's liquidity be lower than the parameter at a given moment, the rule should allow the brokerage house to enter a cross order.

4.5. B3 should explain how cross order controls should be developed.

4.6. To ease operational processes, B3 should have a single minimum limit for the registration of cross orders, regardless of the asset type. Initially, this limit should be small and with time and the maturity of the market it could be gradually increased.

5. B3'S CONCLUSIONS AND NEXT STEPS

B3 understands that the public consultation process produced significant results and that these will contribute to considerations about and the enhancing of the market rules discussed herein.

The main criticism of the RLP order came from investors with an HFT profile. Some of these investors trade on several markets around the world, with a lot of experience with different types of products and legal frameworks.

These investors' criticisms of the RLP order had two main aspects (covered in Section 2 of this document):

- greater risk of adverse selection, which could lead to lower liquidity and higher spreads;
- greater potential for conflicts of interest in the own portfolio trading of the intermediary as counterparty to the order flow of its retail customers.

5.1 Greater risk of adverse selection

From the theoretical viewpoint, B3 agrees with the argument that the increased risk of adverse selection could cause lower liquidity and wider spreads, for reasons that are well documented in the financial literature.

On the other hand, B3 equally believes that growth to the retail investor base is also a result of the investments made by intermediaries and vendors to attract new customers, which include, for example, the enhancement of home broker systems, of trading simulators, of financial education platforms, of marketing campaigns etc. B3 also understands that the higher and more predictable that intermediation activity remuneration is, the greater the incentives will be for the brokerage houses to continue investing in client prospecting and in market development.

Seeking to mitigate future risks in the price formation process, the proposal for developing the RLP order includes a 15% cap, in other words at most 15% of the total volume of each contract could be traded via RLP and at least 85% should be traded against the order book.

There are two distinct views that can be considered. The first is that market makers that trade against the book would suffer a loss as they could trade against only 85% of the total flow of the contract, whereas they could originally trade against 100%. Furthermore, the flow that would remain in the book would on average be informed more than the original flow, with a consequent increased risk.

According to B3's proposal, the introduction of the RLP order would be accompanied by the prohibition against cross order registration involving the orders of retail customers[2]. In this way, the expected result would be the migration of these rights to the RLP order, with the full or partial reaching of the 15% limit, resulting in no or a very small impact on the order book and the market makers.

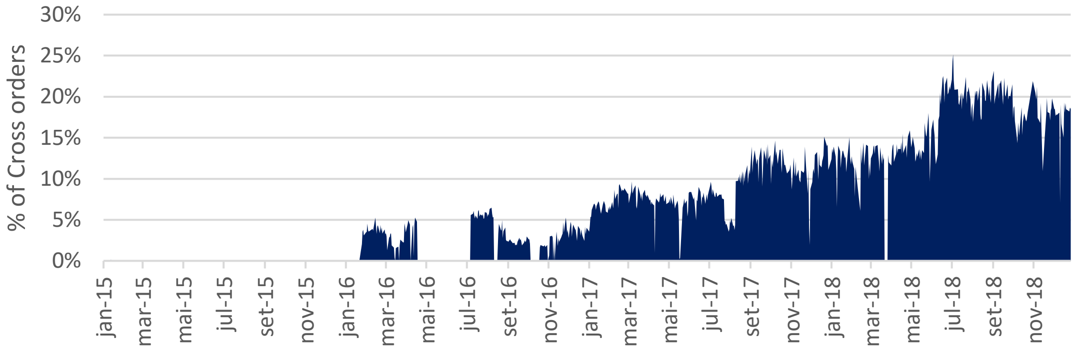
In reality, trading between brokerage houses' own portfolios and retail customers, through cross order registrations, has already been observed. In this way, market makers that trade against the book already do not trade against the full flow of contracts, but only part of it. There is currently a large volume of cross orders involving the own portfolio of the brokerage house and the orders of retail customers.

[2] The new crossing rule does not allow the registration of relatively small orders that are not (i) part of TWAP or VWAP strategies; (ii) part of structured transactions; or (iii) correction of operational errors.

The second possible view is that, complying with suitability obligations, the financial incentive to be granted to the intermediaries would boost growth of the retail investor base. Even if the RLP order initially caused a 15% drop to the flow of orders directed to the book (which as we have seen is not the case) the result would not necessarily be negative. If the new incentive granted to the intermediaries generated growth of 17.65% to the order flow, the total flow destined to the book would remain constant (85% X 17.65% = 15%). And if this growth were higher than 17.65%, the flow destined to the book would increase, a situation in which both the market makers and the intermediaries would be winners.

The graph below illustrates the relative share of cross orders (generally related to the brokerage house's own portfolio and the orders of retail customers) in the total traded volume of Ibovespa (WIN) and US Dollar (WDO) mini futures contracts.

% of Cross orders in relation to the total volume of WIN (excluding from the numerator and denominator the volume of the brokerage house's own portfolio)



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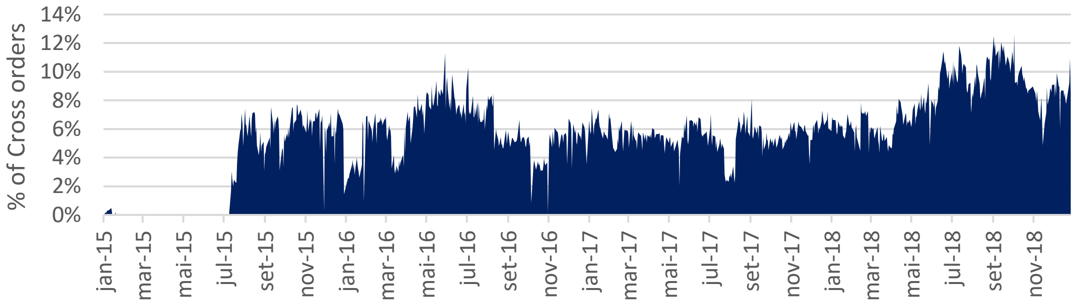


Between 2014 and 2018, the compound annual growth rate (CAGR) of WIN and WDO contracts was 70.78% and 157.36%, respectively. The table below compares the growth rates of the WIN and WDO contracts with other contracts and assets that are also traded by retail customers.

Table 2 – Growth rate of the number of contracts or trading volume

Product	2014	2015	2016	2017	2018	CAGR
WIN	**42.20%**	**29.16%**	**66.14%**	**95.24%**	**143.81%**	**70.78%**
WDO	**191.49%**	**453.11%**	**137.87%**	**60.92%**	**82.95%**	**157.36%**
FUT IBV	11.18%	-12.10%	5.58%	0.86%	23.48%	5.14%
FUT DOL	26.67%	-5.56%	-11.62%	2.09%	22.07%	5.67%
FUT DI	-27.92%	8.90%	-3.46%	18.68%	5.31%	-1.08%
ITAÚ PN	28.53%	15.04%	-8.94%	-1.65%	51.44%	14.93%
VALE ON	-38.33%	-13.44%	21.59%	21.93%	77.62%	7.05%
BRADESCO PN	18.81%	-2.20%	11.10%	-0.22%	46.72%	13.57%
AMBEV ON	27.84%	16.80%	12.66%	0.26%	28.11%	16.66%
PETROBRÁS PN	42.41%	-31.25%	16.70%	-8.76%	155.23%	21.62%
IBOV EQUITIES	4.32%	-4.90%	6.77%	10.63%	65.51%	14.17%
ETF IBOV	3.18%	36.67%	28.22%	4.00%	89.50%	28.94%

As with volume, growth to the base of investors trading WIN and WDO was also surprising, as shown in the table below.

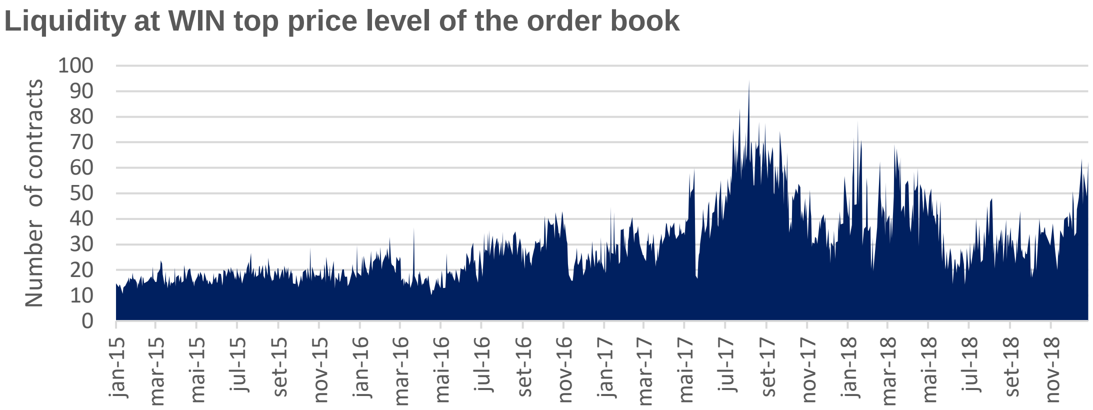
Table 3 – Growth rate of the base of investors trading the contract

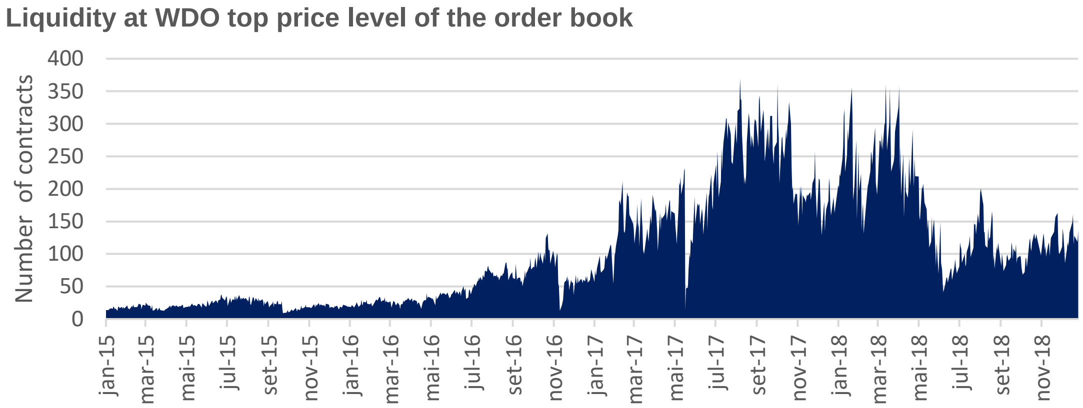
Product	2014	2015	2016	2017	2018	CAGR
WIN	**22.99%**	**31.30%**	**53.32%**	**55.15%**	**87.92%**	**48.49%**
WDO	**103.92%**	**299.67%**	**102.69%**	**38.83%**	**71.37%**	**108.39%**
FUT IBV	-8.41%	-14.81%	2.34%	5.58%	13.97%	-0.80%
FUT DOL	11.39%	9.44%	-0.70%	9.03%	22.00%	10.00%
FUT DI	-0.34%	-1.21%	-1.49%	-1.01%	5.55%	0.27%
ITAÚ PN	33.00%	23.87%	-4.14%	-5.94%	28.34%	13.77%
VALE ON	-11.44%	10.04%	17.97%	-20.50%	28.86%	3.32%
BRADESCO PN	-3.19%	33.90%	1.93%	-15.56%	44.93%	10.09%
AMBEV ON	58.66%	-30.64%	6.48%	-4.90%	51.33%	11.02%
PETROBRÁS PN	51.41%	13.78%	17.23%	-21.17%	81.47%	23.64%
IBOV EQUITIES	-18.20%	3.81%	36.10%	20.58%	17.03%	10.28%
ETF IBOV	-4.38%	-8.04%	11.33%	8.56%	184.38%	24.76%

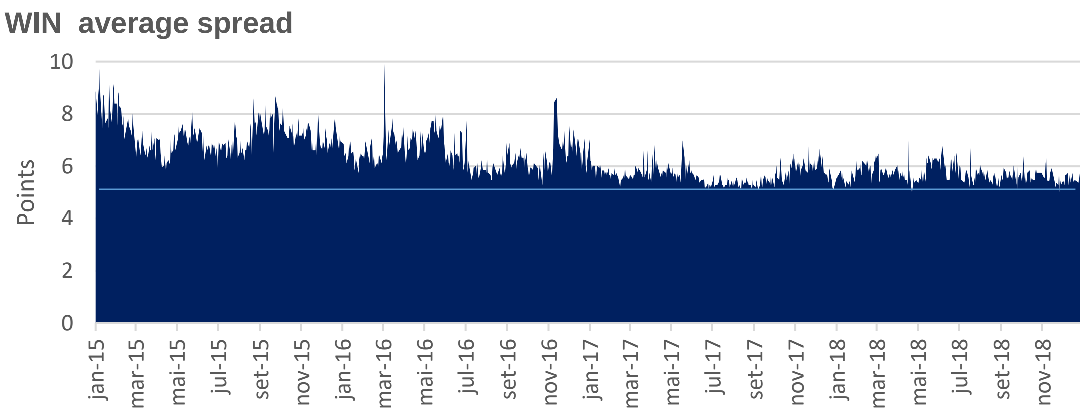
Despite the significant proportion of cross orders in total trading volume and with the exception of determined periods marked by abnormal volatility[3], there has been a significant improvement to the quality of the WIN and WDO markets in recent years, that

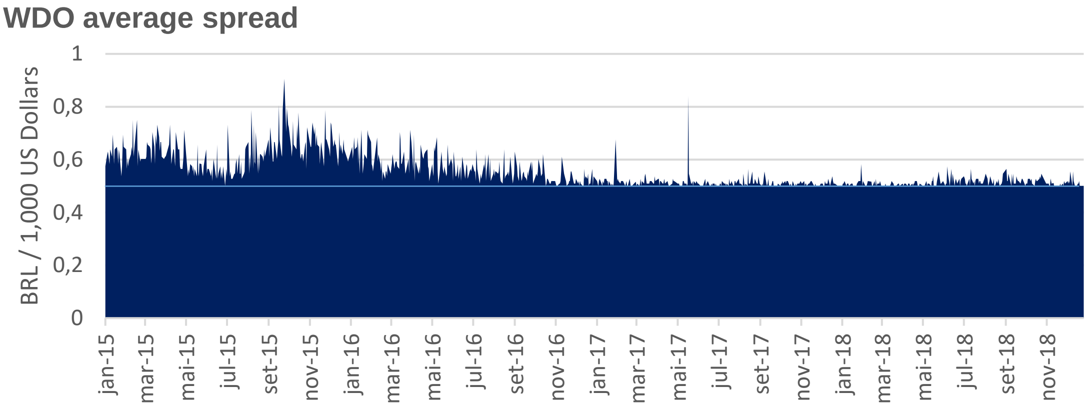
[3] For example, the truckers strike in June 2018.

is, increased average liquidity at the top price level of the order book and lower average spreads, according to the following graphs.









In recent years, considering the widest range of metrics (volume growth, investor base growth, average liquidity at the top price level of the order book, average spread) the WIN and WDO markets were the main success stories observed by B3.

The pure and simple prohibition of cross order registration involving retail customers' orders does not seem the most appropriate solution for these markets. B3 rather proposes the prohibition of these cross order with the concomitant introduction of the RLP order, with a 15% cap.

The RLP order has the following advantages in relation to cross orders:

- concentration of the entire logic of trade execution in the B3 matching engine, with elimination of the latency and the complexity of the brokerage houses' OMS;
- assurance of obtaining the same or better price for customers (best execution);
- assurance of no preemption of orders of brokerage houses' customers at the top price level of the order book (mitigation of conflict of interests);
- democratization of access to the product by all brokerage houses, due to development of the technology by B3;
- possibility of payment for the order flow by third parties, enabling the participation of brokerage houses with lower retail flows;
- greater simplicity of BSM and CVM's supervision processes due to greater simplicity of the brokerage houses' OMS;
- global cap of 15%, non-existent in the case of cross orders, assuring sound functioning of the price formation process.

5.2 Conflict of interests

B3 considers as significant comments received during the public consultation, regarding the risk of increasing potential conflicts of interests when introducing the RLP order.

Potential conflicts of interest arise in practically all the areas of activity of the brokerage houses, as well as in the case of the sale of financial products by managers linked to the banking network, and are inherent to these activities.

The important thing is to guarantee, through the appropriate tools, that there is information about the brokerage houses' activity and that distortions and excesses are avoided, as set forth in CVM Instructions 505 and 539.

B3 understands that the appropriate tools for dealing with the question of conflicts of interest are (i) educating and guiding investors; (ii) transparency about the financial products provided; (iii) appropriate suitability rules; and (iv) periodical BSM audits.

This educational role is the responsibility of the intermediary. B3 will create an incentives program for the intermediaries to develop educational initiatives focused on this public.

To assure transparency, the brokerage house should publish, at least, the following information monthly at its portal:

i. volume traded by the intermediary using the RLP order;

ii. products for which the brokerage house allows the RLP order, whether traded against own portfolio or by payment for the order flow;

iii. percentage of customers served by the RLP order;

iv. number of customers that have some type of benefit with the RLP order;

v. number of retail customer contracts and orders executed against the RLP order;

vi. number of orders improved;

vii. number of contracts improved.

To contribute to transparency, at its portal B3 will publish risk metrics associated with regular and day trades, including among other things the probability of losses in day trades involving mini contracts. The webpage of the brokerage house that divulges the information set out above and the mechanism used by the brokerage house for the opt-in must have a link directed to the B3 portal containing this content.

B3 also feels that BSM should dedicate special attention to the supervision of trading algorithms, particularly when orders generated by these algorithms have as a counterparty the own portfolio of the brokerage house via RLP.

In the same way, BSM should monitor the brokerage houses' OMS to assure that there are no mechanisms for holding back orders artificially.

5.3 Suggestions to enhance the RLP order and the new rules for cross order registration

Most of the brokerage houses and the National Association of Securities, Foreign Exchange & Commodity Brokerage Houses (ANCORD) declared themselves broadly favorable to introducing the RLP order and to the new rules for cross order registration. However, these brokerage houses and ANCORD also made several suggestions for enhancing the proposed rules.

After analysis of the subjects presented, B3 decided to incorporate some of these suggestions into the final version of the rules to be submitted to CVM.

B3's main considerations are set out below in relation to suggestions for enhancing the RLP order and the new rules for cross order registration.

Scope of the RLP order

B3 agrees that the logic of proposing the RLP order for the WIN and WDO contracts will also apply to other products traded by retail customers. In this regard, the RLP order could be extended to trading in equities, equity futures, ETFs, BDRs and the S&P 500 mini futures contract, for example.

B3 feels it would be more prudent to test the functioning and impact of the RLP order on the market starting with a smaller list of products. Furthermore, WIN and WDO are the only traded contracts that currently have a significant volume of cross orders involving the brokerage house’s own portfolio and the orders of retail customers.

This is a pilot program and, in B3’s view, a 12-month period should be enough to assess the impact of the RLP order on the brokerage houses, customers and the quality of the order book.

Best execution

Regardless of the suggestions received, B3 understands that during the initial phase of the program in the situations in which the spread is open, there should always be a price improvement for the customers. B3 is committed to assessing the suggestions received and eventually discussing with CVM and BSM the enhancement opportunities for new phases of the program.

Third party payment for order flow of retail customers

In contrast to some of the brokerage houses, B3 believes that third-party payment for the order flow of retail customers should not be prohibited, for several reasons.

First, there is no risk of noncompliance with best execution principles bearing in mind that the RLP order would guarantee, by the nature of its makeup, that the same or a better price would be obtained by the customers.

Second, the brokerage house’s own portfolio trading as a counterparty to the retail customers via the RLP order could expose it to market risks. In determined situations, it could be more efficient to sell the order flow to a third party that has more scale, capital and/or know-how.

B3 also believes that payment for order flow would be particularly important for brokerage houses with lower retail flows, which might not have the sufficiently constant and symmetrical flow necessary for the sound functioning of the RLP order from the viewpoint of the intermediaries.

Rule for no preemption of the RLP order

B3 is sensitive to the argument that there are brokerage houses that have a flow of retail customers and also a flow of HFT investors, which could render these brokerage houses’ full approval of the RLP order unfeasible. However, considering CVM Instruction 505, B3 feels that there cannot be the separation of customers into distinct groups.

Bearing in mind the operational and financial impact for the brokerage houses, B3 will assess with CVM whether HFT, whose characteristic is always at the top price level of the order book, could upon the authorization of these customers be specifically assessed as an exception to the no preemption rule. Should this exception be approved, its implementation will occur at a future phase of the program.

Conditions for use of the RLP order

B3's understanding is that the brokerage houses that opt to use the RLP order must provide it to all retail customers (individual investors) that demand it, without being able to filter or select customers in a discretionary manner.

Furthermore, B3 understands that the brokerage house must indicate, through periodical reports provided to the customers, the percentage of trading session time in which it provided liquidity through the RLP order.

RLP order cap

B3's understanding is that brokerage houses exceeding the maximum limit of contracts traded via RLP in a determined month should be subject in the immediately subsequent month to an adjusted cap to compensate the excess. If the excess is greater than the limit, clearing should occur in the following months until the total excess is cleared, which could make RLP order provision impossible for a month or more.

Exchange fees charged by B3

When using the RLP order, the own portfolio would have a significant volume of day trades. In this way, the brokerage house's own portfolio could be classified in one of B3's discount policies. Depending on the product and volumes traded, these discounts could vary from 29% to 92%.

The same would hold for the account of the customer authorized by the brokerage house to use the RLP order.

Opt-in and opt-out

While understanding that the RLP order makeup means retail customers would always obtain the same or a better price than the book, B3 feels the opt-in requirement is necessary for greater transparency regarding the characteristics of the product.

New rule for cross order registration

For the special cases foreseen in the new rule for cross order entry, B3 did not consider "symmetrical buy and sell trades by funds with the same manager" as most of these trades should observe the criterion of "orders that are disproportionate to liquidity at the top price level of the order book".

In response to one of the suggestions presented, B3 will present a non-exhaustive list of trades that could be considered "structured transactions".

B3 will also explain the criterion to be used for the definition of "orders that are disproportionate to liquidity at the top price level of the order book" and understands that in the hypothesis of book liquidity being lower than the parameter at a given moment the brokerage house that possesses the two sides of the trades should execute an unintentional cross order.

Rebate as an alternative form of market incentive to the RLP order

B3 has assessed a rebate of exchange fees as an alternative to RLP. B3's view is that the RLP order could create an additional source of revenue for the brokerage houses, with positive impacts on market liquidity, given the cap, which ends up benefitting all of the customers. The benefit to be obtained by the brokerage houses through the RLP order, by the metrics analyzed, could be greater than an exchange fee rebate.

B3 feels the rebate does not resolve concerns associated with conflicts of interests. As mentioned previously, mitigation of this risk is executed in the case of the RLP order through (i) suitability assessment; (ii) transparency of this product's risk characteristics; (iii) investor education; and (iv) BSM activity.

5.4 Next steps

Having successfully concluded the public consultation process, B3 will make the necessary adjustments regarding the RLP order and cross order registration rules, subsequently submitting them for approval by the Securities & Exchange Commission of Brazil (CVM), as set forth in CVM Instruction 461, of October 23, 2007.