HM Treasury

Wholesale Markets Review:

Consultation Response

1 March 2022

This publication is available at: www.gov.uk/official-documents.

Any enquiries regarding this publication should be sent to us at public.enquiries@hmtreasury.gov.uk

Contents

Chapter 1
Introduction

1.1 The Wholesale Markets Review was established to improve the UK's regulation of secondary markets, taking advantage of our new freedoms in financial services following our withdrawal from the EU.

1.2 It is part of the Chancellor's broader vision to improve the competitiveness of the UK's financial services sector, while maintaining high regulatory standards, as set out in his Mansion House speech on 1 July 2021. This vision will ensure the UK has an open, green, and technologically advanced financial services sector that is globally competitive. Other steps that the government is taking to fulfil this vision and that are particularly relevant to the UK's capital markets include commissioning and taking forward recommendations from Lord Hill's review of the UK listings regime and as part of that, reviewing the prospectus regime.

1.3 The consultation closed on 24 September 2021 and was guided by four key objectives and principles:

Maintaining high regulatory standards to ensure that firms can operate in confidence and that the UK sets an international example.

Promoting openness and competitiveness to allow domestic and international investors to access the most liquid markets so that they can achieve the best prices for their investments, and to enhance the UK's position as a global hub for wholesale markets.

Delivering fair and proportionate regulation, focused on outcomes rather than prescriptive rules so firms do not face unnecessary frictions and costs.

Supporting economic growth, innovation, and wealth creation across society by ensuring that the regulatory framework can facilitate investment in both the short and long-term.

1.4 The government received 78 responses and is grateful for all the contributions made by respondents through the consultation process. Responses were received from across the financial sector including trading venues, trade bodies, asset managers, market data vendors, investment firms and insurance companies. A full list of respondents is listed in Annex A.

1.5 This document recaps the proposals in the consultation, summarises the feedback received and - in light of the evidence gathered - outlines the government's views. It is designed to be read in conjunction with the consultation document that was published on 1 July and therefore the chapters and proposals in this document largely follow the same order as the original consultation.

1.6 The final chapter sets out, at a high level, how the government and the Financial Conduct Authority (FCA) plan to take forward the various proposals. Some changes will require legislative amendments and the chapter notes that the government intends to deliver the most important changes as a priority when parliamentary time allows. Where legislative changes are needed but respondents indicated that fast implementation is not paramount, the government will wait until the outcomes of the Future Regulatory Framework (FRF) Review have been implemented to bring them forward. Where changes can be made to the parts of the regime that are already set out in regulatory rules and guidance, the FCA has committed to progress these in line with its normal processes. The government believes that this step-by-step approach will ensure that the most burdensome and unnecessary regulatory requirements are removed as soon as possible. The areas that fall within each category are identified throughout the document and summarised in the table at the end of the document.

1.7 Taken together, the package of reforms set out in this document will create a simpler and less prescriptive regime, while maintaining or improving regulatory outcomes. For example, the government will:

- Simplify the systematic internaliser regime to provide clarity and remove unnecessary regulatory burdens.
- Remove restrictions on firms' ability to execute transactions to ensure that market participants can get the best outcomes for investors.
- Reconfigure the transparency regime for fixed income and derivatives markets so that only appropriate instruments are subject to enhanced transparency requirements, removing unnecessary burdens on firms.
- Reduce the scope of the commodities position limits regime and delegate it to trading venues to ensure that market activity is not unnecessarily restricted, while ensuring that markets function efficiently.
- Ensure the FCA can help support the provision of a consolidated tape, which will better enable participants to identify the best available pricing for instruments.

1.8 The consultation also set out higher-level questions about longer-term priorities, alongside the more detailed specific and short-term policy proposals. The government will continue engaging with stakeholders, including alongside implementation of the FRF, on how the UK's regulatory and legal framework can be adapted and updated to reflect the needs of UK markets, while continuing to maintain high regulatory standards.

Chapter 2

Trading Venues

The regulatory perimeter

2.1 The consultation recognised the current ambiguity surrounding the regulatory perimeter for trading venues and asked for industry's views on whether any clarifications should be made.

2.2 Respondents agreed that the current definition of multilateral systems has created uncertainty about the perimeter and what type of firms need to be authorised as a multilateral trading facility (MTF). As identified in the consultation document, a number of respondents noted that as technology develops, new platforms are emerging that facilitate or support the bringing together of buyers and sellers and it is not clear if these firms need to be authorised to operate an MTF. Most of the respondents who made this point argued that all companies, regardless of whether they are technology-based companies, should be treated in the same way to ensure that some firms are not at a competitive advantage. These respondents called for the government to ensure fair treatment. There were also concerns about the behaviour of order management systems and the blurred lines between bilateral and multilateral trading.

2.3 Although some respondents thought that changes to legislation were necessary to clarify the perimeter, most favoured regulatory guidance instead. The rationale for this was aligned with the position outlined in the consultation proposal; namely, that the regulatory perimeter should be flexible to accommodate changes in technology and not unduly limit innovation and competition.

Next steps: The government recognises that there is a need for greater clarity about what types of firms need to be authorised as a multilateral trading facility. Given respondents' support for this to be addressed through regulatory guidance, rather than legislation, the government does not intend to amend the legal definition of a multilateral system. The Financial Conduct Authority (FCA) is working closely with HMT on the Wholesale Markets Review and has indicated that it will consult on new guidance in the first instance. It will take the outcome of this consultation into account when drafting its consultation.

Operating conditions for multilateral trading facilities (MTFs) and organised trading facilities (OTFs)

2.4 The Markets in Financial Instrument Directive II (MiFID II) introduced a number of operating conditions on multilateral trading facilities (MTFs) and organised trading facilities (OTFs). The consultation sought to understand whether these conditions were beneficial or whether they had the unintended effect of preventing new firms from entering markets, competing and innovating.

2.5 The first condition that the consultation covered related to restrictions on matched principal trading for an investment firm operating an MTF. The government wanted to understand any potential impact on market integrity if restrictions were lifted to allow matched principal trading, provided it was conducted in accordance with clear, transparent and non-discretionary rules.

2.6 The vast majority of respondents were in favour of allowing matched principal trading on MTFs. They argued that the current prohibition, which was originally introduced to avoid potential conflicts of interest if an MTF operator wished to transact on its own trading platform, is costly and unnecessary. This is because other existing rules already effectively prevent conflicts of interest, such as the obligation for MTFs and OTFs to have arrangements in place to avoid, identify and manage adverse consequences of any conflict of interest. However, some respondents caveated this view, suggesting that the prohibition should only be removed if matched principal trades are mandatorily reported using recognised 'flags'[1] as part of post-trade transparency. These respondents argued that such flagging is necessary to ensure that data is reported in a consistent way and to enable firms to identify who they are trading with, which is important for transparency.

2.7 The second operating condition the consultation explored was in relation to the restrictions that prevent an investment firm from operating a systematic internaliser (SI) and an OTF within the same legal entity. Some respondents were supportive of lifting this restriction, arguing that housing them in separate entities has created unnecessary cost and administrative burdens. However, a similar number felt that implementing this proposal would inevitably lead to conflicts of interest, even if there is a clear delineation between the different parts of the firm.

2.8 Finally, the consultation sought views on allowing OTFs to execute transactions in equities when dealing in packages. Most respondents felt this should be allowed as it would save participants costs that would otherwise be spent on trading on two separate venues when executing a package swap. However, some felt that allowing equities to be traded on OTFs would potentially reduce liquidity as equities are already traded on multiple types of venues which are specifically designed for them.

Next steps: The government believes there is a clear case for removing matched principal trading restrictions for investment firms operating a trading venue,

[1] There are currently 17 flags for equity instruments and 21 flags for fixed income and derivatives instruments as part of post-trade transparency. They help to ensure that data is reported in a consistent manner and help the market understand the context around published trade data and who the counterparty to the trade is.

while retaining obligations to prevent conflicts of interest. Similarly, the government believes it would be appropriate to allow OTFs to execute transactions in equities when dealing in packages.

In light of the concerns raised in relation to potential conflicts of interest about allowing investment firms to operate an SI and OTF within the same legal entity, the government believes that the case for this change is not conclusive, and therefore further consideration of whether the potential conflicts could be adequately mitigated is needed.

The government believes the best way to take these changes forward is through the upcoming Future Regulatory Framework implementation. Therefore, these will be matters for the FCA to consider and progress as it takes on responsibility for direct regulatory requirements which apply to firms, following the implementation of the outcomes of the FRF Review. The FCA is working closely with HMT on the Wholesale Markets Review and will take the outcome of this consultation into account when considering these issues in the future.

SME markets

2.9 The consultation noted that many small and micro-sized companies often use crowdfunding platforms and private markets to access finance instead of using SME Growth Markets. The government's understanding is that this is because the regulatory burdens and costs associated with being admitted on a public market can be disproportionate and/or are too onerous for smaller SMEs. In an attempt to bridge that gap, the consultation asked if there would be value in developing a new category of trading venue with a more proportionate framework for SMEs with a sub-£50m market capitalisation.

2.10 Overall, respondents agreed that the current regulatory regime can represent a barrier to SME financing on public markets, particularly for companies with a lower market capitalisation. Most respondents asked the government to consider a more proportionate disclosure regime without lowering regulatory standards. However, there was no support for a new type of venue solely for SMEs due to concerns that it would overlap with the existing SME Growth Market category. Instead, a number of respondents put forward a proposal for a new venue that would operate trading windows instead of offering trading on a continuous basis. One respondent suggested that there could be value in making such a venue accessible to a wider selection of companies because access to public capital is not only an issue for micro-SMEs, and because there is a growing trend for companies looking to list at a later stage of funding. This respondent suggested that intermittent trading would help to concentrate liquidity at prescribed intervals which would benefit smaller quoted businesses who can experience low levels of liquidity when they first enter public markets, but also be beneficial for vehicles that are illiquid by nature. They argued that a new type of venue could encourage companies to use public markets at an earlier stage and act as a bridge to companies seeking a full listing.

Next steps: The government is committed to increasing firms' ability to access primary and secondary markets, while preserving appropriate levels of regulation and investor protection. In addition to the work HMT and the FCA is undertaking under the UK Listings Review, the government will continue to explore the proposal for a new type of venue for SMEs and, reflecting on the feedback received, will consider the case for expanding it to other types of businesses. In close collaboration with the FCA, the government will continue to engage market participants as it develops this policy.

2.11 A number of respondents also used this section of the consultation to outline their support for new fund structures such as the Long-Term Asset Fund (LTAF), which is intended to give professional and certain retail investors greater exposure to less liquid assets such as private equity, infrastructure and venture capital. Most stakeholders said that adequate investor protection is already in place for the LTAF but stressed the need for the FCA to proactively monitor this space. Some also highlighted the need for greater financial education for retail or potential retail investors and asked for clarity on the kinds of assets the LTAF will be able to invest in.

Next steps: Although the consultation noted that new fund structures such as a Long-Term Asset Fund (LTAF) may also facilitate investment in SMEs, LTAFs were not a specific focus of the WMR consultation. The government welcomes respondents' views on this topic and will consider these responses in the context of policy development of LTAFs.

Market outages

2.12 The consultation noted the risk around the existing ambiguity regarding the role of market operators and participants in the event of a market outage and explored three proposals to improve market resilience.

2.13 Firstly, respondents generally welcomed the government's proposal for UK authorities and industry to implement a playbook for market participants and operators to follow. This would provide guidance about what information venues are expected to communicate to the market during and after an outage, and how they may do this. A number of respondents flagged that industry has already taken the initiative and is developing its own guidance about what should happen during a market outage but added that supplementary guidance from the FCA would be welcome and ensure a cross-market solution. To ensure the regime retains its flexibility, stakeholders noted that legislative changes should not be necessary.

2.14 Secondly, the consultation recommended that UK authorities explore and set out alternative mechanisms to a closing auction during an outage. Respondents overwhelmingly agreed with this proposal.

2.15 Thirdly, the government consulted on changes to the reference price waiver (RPW) which it believes would help to mitigate risk during an outage. The vast majority of respondents supported enabling reference price systems to match trades at the midpoint with the current bid and offer of any UK or non-UK trading venue provided it has a reliable and transparent price for best execution. A full summary of responses and next steps for this proposal is included in Chapter 4 (Equities).

2.16 Finally, a number of respondents used this part of the consultation to note that there is currently an obligation on venues to resume trading within two hours of an outage. They argued that this creates pressure for a venue to return to full operation when the venue may not be ready to do so.

Next steps: The government believes that there is a case for further work to ensure market resilience in the event of an outage. Rather than legislating on this issue, the government believes that this can be best addressed by the regulators using their existing tools and working closely with firms.

In light of this, the FCA has indicated that it will discuss with market participants how it can use its current tools to clarify what should happen when there is a market outage (and whether and how to amend the requirement for venues to resume trading within two hours of an outage) as a prelude to consulting on proposals later this year. The government also welcomes the work that industry has spearheaded.

In relation to the reference price waiver (RPW), the government plans to bring forward legislative changes to delegate the pre-trade equity waivers regime to the FCA when parliamentary time allows. Once the regime is delegated, the specific changes to the RPW will then be a matter for the FCA to take forward, but it will use the responses to this consultation to inform its work. This change is also addressed in Chapter 4 (equities).

Chapter 3

Systematic Internalisers (SIs)

Definition of systematic internaliser (SI)

3.1 The consultation proposed replacing the current definition of systematic internalisers (SIs), which requires firms to carry out complex quantitative calculations on a regular basis, with a qualitative one.

3.2 Most respondents welcomed this proposal as they felt the current quantitative-based definition is complex, costly to comply with and has resulted in many firms choosing to simply opt into the regime to avoid having to undertake the calculations. Respondents that do perform the calculations noted that the thresholds are inflexible and do not achieve the aims of increasing transparency and aiding price formation.

3.3 A number of respondents noted that they would like to retain the ability to opt into the regime, even if the calculations are removed, to ensure that a firm can continue to choose to be an SI if it wants to.

Next Steps: The government is committed to clarifying and simplifying the definition of SIs to reduce costs and burdens for firms and recognises that there is strong support to move from a quantitative to qualitative definition. The government therefore intends to proceed with its plan to revert to a qualitative definition of SIs so that firms do not have to carry out complex calculations for this purpose. To deliver this the government plans to bring forward legislation when parliamentary time allows.

Reporting

3.4 The consultation also proposed determining SIs at an entity level rather than on an 'instrument-by-instrument' basis for the purpose of reporting, with a view to clarifying post-trade reporting obligations.

3.5 Respondents agreed that the current regime could be improved by removing the existing ambiguity that exists when a firm is an SI and must therefore take on post-trade reporting obligations on behalf of its clients. However, most respondents expressed a preference for determining SIs at an asset class level rather than an entity level to achieve this. They argued that this is because a firm may not want to be an SI for all asset classes (for example, they may want to be an SI for bonds but not derivatives). A significant number of respondents also highlighted that firms should continue to have the ability to opt into the regime because of the existing link to trade reporting.

3.6 Some respondents suggested going further than the proposal put forward in the consultation. They recommended separating the requirement for SIs to report transactions undertaken with investment firms, who are not SIs, from the other obligations of being an SI. Under this model, a firm could be a reporter without having to comply with any of the other regulatory obligations that are currently imposed on SIs. A firm could elect to be a reporter at either an asset class or entity level and would take on the reporting obligations. A central database would keep a register of all of the 'super reporters'. The respondents who put forward this proposal suggested that it would eliminate duplication and uncertainty over where the reporting obligation lies, and that it would require less administration for the sell-side compared to the original consultation proposal.

3.7 Some respondents suggested reverting to the reporting regime in the first Markets in Financial Instruments Directive (MiFID I) where counterparties bilaterally agreed who should take on the reporting obligation.

Next Steps: The government welcomes responses and recognises that there is appetite to simplify the reporting regime for SIs. However, most provisions on investment firms' obligations to publish trade reports are in technical standards, under the Financial Conduct Authority's (FCA's) responsibility. The FCA intends to consult on this issue in the first half of this year. The FCA has worked closely with the government on the Wholesale Markets Review and will take the outcome of this consultation into account when progressing its work.

Midpoint crossing

3.8 The consultation proposed allowing SIs to execute client orders at the midpoint within the best bid and offer for trades below Large in Scale (LIS), provided that the executed price is within the SIs' quoted prices and the execution is in a size not larger than the quoted size.

3.9 Respondents largely agreed with the proposal to allow SIs to cross at the midpoint and supported the argument put forward in the consultation that extending the tick size regime for SIs had in some cases limited SIs' ability to offer best execution to their clients.

3.10 However, a number of respondents raised concerns regarding the proposal to limit midpoint crossing to prices that are executed within the SI's quoted price because SIs can provide price improvements which are not subject to pre-trade transparency obligations. They argued that the proposal to limit midpoint trading to transparent quotes would therefore be contrary to the price improvement that an SI might offer to its clients, and hinder client best execution outcomes. Instead, feedback suggested SIs should be able to execute at the midpoint with no restrictions so that they are able to achieve better client outcomes. It was highlighted that the EU and the UK are the only jurisdictions that currently restrict midpoint trading.

Next Steps: Having reflected on the concerns raised, the government believes that specific restrictions to midpoint execution might not be required, so long as SIs consider the extent to which their use of midpoint execution is consistent with their best execution obligations.

The government plans to make this change when parliamentary time allows.

Other changes to the SI regime

3.11 Beyond the specific proposals outlined above, respondents raised other issues related to the SI regime.

3.12 A number of respondents said that they would support increasing the minimum quote size as a proportion of 'standard market size' (SMS) from the current minimum of 10% to closer to 100%. This is because they believe that the current percentage does not accurately represent an average trade that occurs on a trading venue. These respondents suggested that if the threshold is calibrated correctly it will allow SIs to manage risk more effectively and increase the accuracy of their quotes.

3.13 Others highlighted the challenges around reference data reporting and the difficulties in obtaining International Security Identifier Numbers (ISINs) for instruments that are not traded on a trading venue. This topic is discussed further in Chapter 8 (Reporting).

3.14 Most respondents also felt that the pre-trade transparency requirements, particularly for fixed income and derivatives, are complex and unwieldy and should be removed. This issue is addressed further in Chapter 5 (Fixed Income and Derivatives Markets).

Next steps: The government recognises that there is support for increasing the minimum quote size for equity SIs as a proportion of SMS and believes that the best way of implementing this change is through the upcoming Future Regulatory Framework. Therefore, this will be a matter for the FCA to consider and take forward following the implementation of the outcomes of the FRF Review. The FCA is working closely with HMT on the Wholesale Markets Review and will take the outcome of this consultation into account when considering amendments in relation to SMS.

Chapter 4
Equity Markets

Double volume cap (DVC)

4.1 The government consulted on removing the double volume cap (DVC). Under this proposal the Financial Conduct Authority (FCA) would retain its ability to limit the amount of trading that can happen without pre-trade transparency, should there be evidence that such trading is undermining the efficiency of the price formation process.

4.2 The vast majority of respondents supported this proposal. They argued that limits on the amount of trading that can take place without pre-trade transparency are arbitrary and highlighted that there have not been any negative impacts on price formation since the FCA suspended the DVC for UK and EU securities in early 2021. In fact, some respondents noted that FCA action since 2021 has increased their ability to freely trade in liquidity pools that offer the best outcomes for investors. Only a few respondents opposed removing the DVC on the grounds that full pre-trade transparency improves market quality.

4.3 Of those that supported removing the DVC, a few respondents suggested that new measures to limit dark trading should be introduced to encourage trading on lit markets. However, no respondents provided detailed examples of what these new measures could be.

4.4 Most respondents felt that requiring the FCA to monitor markets and intervene where there is evidence that the level of dark trading could threaten market integrity would be sufficient.

Next steps: On 23 November, the Economic Secretary to the Treasury committed to bring forward legislation to remove the DVC when parliamentary time allows. However, to ensure market integrity at all times, the FCA will continue to monitor the level of dark trading and will retain its current ability to limit it – by restricting the use of the reference price and negotiated trade waivers – if there is evidence that the volume of such trading is undermining the efficiency of the price formation process.

Reference price waiver

4.5 The consultation proposed allowing reference price systems to match orders at the midpoint within the current bid and offer of any UK or non-UK trading venue that offers the best bid or offer, so long as it supports best execution.

This change was proposed in an attempt to improve execution outcomes for investors and overcome some of the barriers when there is a market outage.

4.6 Most respondents supported the government's proposal. Only three respondents opposed the change on the grounds that they think the reference price waiver should be based on the most liquid market to ensure orderly and non-discriminatory trading.

Next steps: The government believes that the amendments it proposed to the reference price waiver (RPW) will improve market integrity. As it sees this as a priority area, the government plans to bring forward legislative changes to delegate the pre-trade equities waivers regime to the FCA when parliamentary time allows. Changes to the type of benchmark that can be used for the RPW will, once delegation occurs, be a matter for the FCA to take forward.

The FCA will consult in the first half of this year on extending the concept of the most relevant market in terms of liquidity for the purposes of the RPW to include overseas trading venues. This will formalise and broaden the approach that is currently being taken in relation to EU and Swiss shares. The FCA is working closely with HMT on the Wholesale Markets Review and will take the outcome of this consultation into account when considering changes to the RPW.

The share trading obligation (STO)

4.7 The consultation set out the government's proposal to remove the Share Trading Obligation (STO). Most respondents agreed that removing the STO would allow firms to trade in the most liquid market and get the best execution for their clients. A minority of respondents opposed removing the STO and argued that it should be implemented globally on the grounds that all trading should be done on lit markets.

4.8 Some respondents raised concerns that removing the STO could lead to more trading happening on an over-the-counter (OTC) basis which they thought could negatively impact transparency. These respondents encouraged the government to think of alternative incentives to encourage trading to happen on lit venues.

4.9 Only two respondents put forward specific proposals for an alternative. One suggested mandating a certain amount of trading on trading venues prior to allowing OTC trading. The other suggested amending the STO to remove the third country element but maintaining the requirement for trading to happen on a trading venue or with an SI.

Next steps: The government believes that firms are best placed to decide where to trade to deliver the best outcomes for investors. That is why on 23 November, the Economic Secretary to the Treasury committed to bring forward legislation when parliamentary time allows to remove the share trading obligation (STO).

The abolition of the STO will not include the deletion of Article 23(2) of the Markets in Financial Instruments Regulation (MiFIR), which sits in the article dealing with the STO. This is because it helps to delineate the distinction between bilateral and multilateral trading and prevents the operation of a crossing network by an investment firm that does not have a trading venue permission.

Market making strategy for algorithmic trading

4.10 The consultation explored whether the requirement for algorithmic trading firms pursuing market making strategies to enter into market making agreements with trading venues should be removed. This was because evidence suggested that the current requirement adds cost without meaningfully contributing to improvements in market quality.

4.11 Most respondents supported this proposal and said that removing the requirement would help to simplify liquidity provision. However, a few respondents highlighted that the obligation is helpful as it can provide a valuable oversight of liquidity. For this reason, two respondents recommended maintaining the requirement and introducing more obligations on market marking.

Next steps: The government has reflected on the feedback received, and while it understands the concerns raised, believes that existing requirements already provide the right incentives for trading venues to prioritise liquidity. As such, and in line with the majority of the views, the government does not see any reason to deviate from its original proposal. Namely that the requirement for algorithmic trading firms to enter into market making agreements with trading venues when they pursue market making strategies does not fulfil any meaningful regulatory purpose and should be removed.

The government believes the best way to deliver this change is through the implementation of the Future Regulatory Framework. Therefore, this will be a matter for the FCA to consider and take forward following the implementation of the outcomes of the FRF Review. The FCA is working closely with HMT on the Wholesale Markets Review and will take the outcome of this consultation into account when considering future changes to the requirements for algorithmic trading firms.

Tick sizes

4.12 The government consulted on a number of amendments to the tick size regime with the intention of ensuring that it is correctly calibrated for UK markets and to reduce regulatory burdens.

Overseas shares

4.13 Firstly, the consultation explored allowing trading venues to follow the tick sizes applicable in the relevant primary market of a share, even where that share's primary market is not a trading venue located in the UK. Respondents were overwhelmingly supportive of this proposal and agreed with the government's rationale that the current regime, whereby the calculation of tick sizes is based on the liquidity of the most liquid share in the UK and EU, can lead to unnecessary large tick sizes and increased costs for investors. Respondents agreed that recalibrating the regime as set out in the consultation document would enable investors to access the most competitive spreads.

New shares

4.14 Secondly, the consultation proposed allowing trading venues to establish tick sizes for new shares until sufficiently robust data is available for the FCA to gather a more comprehensive picture. This was to ensure that the FCA does not have to make an estimate of the liquidity of a share. Most respondents agreed that trading venues are better placed than the FCA to calculate the tick size when a share is new to trading and said the proposed approach would lead to more competitive prices in the UK. One respondent suggested that the proposal should be coupled with a requirement for the FCA to establish a minimum tick size to avoid the risk of market arbitrage between venues. A limited number of respondents said that they did not support the proposal because of concerns that it would lead to a 'race for the bottom'.

Delegating the tick size regime to venues

4.15 More broadly, the consultation sought views on the benefits and risks of delegating the tick size regime to trading venues in the long-term, alongside proper controls and oversight from the FCA. The vast majority felt that the FCA should continue to manage the tick size regime centrally and it should not be delegated to trading venues. Most respondents said that there was a 'race for the bottom' prior to the establishment of the harmonised tick size regime and they did not want history to repeat itself.

Next steps: The government is grateful for the feedback it has received and welcomes respondents' support for improving how the tick sizes for overseas and new shares are calibrated. As rules governing the calibration of tick sizes are set out in the FCA's rulebook, it is the FCA's responsibility to take this policy forward.

The government recognises the concerns that respondents raised about delegating the tick size regime to venues in the long-term and does not intend to make any changes to the regime at this moment in time. In the future, any amendments to the tick size regime will be delivered through the implementation of the Future Regulatory Framework.

The FCA is working closely with HMT on the Wholesale Markets Review and will take the outcome of this consultation into account when considering future changes to the tick size regime.

Chapter 5

Fixed Income and Derivatives Markets

The derivatives trading obligation (DTO)

Realigning the scope of the DTO and the European Market Infrastructure Regulation (EMIR) clearing obligation (CO)

5.1 The consultation proposed bringing the counterparties in scope of the derivatives trading obligation (DTO) in line with those subject to the clearing obligation (CO). This was to correct the misalignment caused by changes that were made when the European Market Infrastructure Regulation (EMIR) Refit was implemented in 2019.

5.2 This proposal received universal support as respondents noted that the original intention behind the DTO and CO was for the counterparties in scope to be aligned. Some respondents emphasised the need to future-proof the regime so that the scope of the two obligations always remains aligned. Responses were divided between those who preferred alignment based on counterparty terms and those who advocated for it to be based on transaction terms.

Exemptions

5.3 The consultation proposed expanding the grounds for an exemption from the DTO beyond portfolio compression to all post-trade risk reduction (PTRR) services. Nearly all respondents supported this proposal provided that appropriate conditions are in place for the exemption to be applicable. Respondents noted that there is no regulatory value in PTRR services being subject to the DTO as the resulting trades are non-price forming. They also said that expanding the exemption would decrease risk by incentivising the uptake of PTRR services.

5.4 The consultation also asked whether there would be benefit in having an aligned exemption from the CO. The majority of respondents supported this proposal on the basis that PTRR trades are market risk neutral. Two respondents raised concerns that removing all PTRR services from the CO would discourage trades being cleared through a Central Counterparty (CCP) and hence exacerbate opaqueness in financial markets. However, the majority felt that this risk would be more effectively managed through increasing the use of PTRR services, and by ensuring that there are clear conditions that trades have to meet in order to benefit from the exemption.

FCA powers

5.5 The consultation proposed granting the Financial Conduct Authority (FCA) the power to modify or suspend the DTO under certain conditions, in order to protect market functioning and resilience. There was unanimous support for this proposal. Many respondents noted that the FCA's recent use of the Temporary Transitional Powers to modify the application of the DTO has helped to limit disruption for market participants. For this reason they believe it would be beneficial for a permanent power, that is similar in nature, to be conferred on the FCA. Some respondents noted the importance of being given adequate warning before the scope of the DTO is modified, wherever possible.

Next steps: The government welcomes the clear support for its proposals related to the DTO and to exempt PTRR services from the CO. It intends to bring forward legislation when parliamentary time allows to deliver these changes.

Transparency

Scope

5.6 The consultation asked for views on the appropriateness of the 'traded on a trading venue' (ToTV) concept to determine the scope of the transparency requirements for fixed income and derivative instruments.

5.7 Respondents generally agreed that relying on ToTV to determine which over-the-counter (OTC) derivatives are in scope of the regime is not effective because OTC derivatives are bespoke by nature. There was also broad support for the government's proposed approach to determine the scope of the transparency requirements based on whether an instrument is centrally cleared. The determination of what counted as 'cleared' generated some debate. For example, some respondents highlighted that the inclusion of 'voluntarily cleared' derivative contracts within the scope could create ambiguity and disincentivise clearing. Many suggested that limiting the scope to trades that are subject to the EMIR CO or the DTO would be an alternative solution.

5.8 There was some recognition that ToTV was not as problematic for bonds as for derivatives. However, although ToTV for sovereign, investment grade and high yield bonds is generally thought to be well understood, respondents suggested that there is a wider problem with newly-issued bonds. A limited number of respondents raised concerns over the operational costs of removing ToTV completely.

Liquid market determination

5.9 The consultation suggested replacing the current liquidity calculations with a qualitative and quantitative assessment to determine the liquid classes of financial instruments. It further proposed to use this information in line with how it is currently used for OTC derivatives in scope of the DTO.

5.10 Respondents agreed that the current liquidity calculations are too complex and do not reflect market liquidity. They also generally agreed with the government's approach. A few respondents raised concerns over the potential cost versus benefits of making any changes. However, most noted that further consideration would be needed about the detail of the qualitative and quantitative criteria and asked UK authorities to engage with the sector about this point in the future.

Pre-trade transparency

5.11 The government proposed recalibrating the pre-trade transparency regime for fixed income and derivative markets by limiting the scope of the regime to systems such as electronic order books and periodic auctions.

5.12 The vast majority of respondents suggested going further by removing the pre-trade transparency regime completely. However, most recognised that maintaining it for the limited number of systems that already operate under full transparency, such as order books in respect of derivative transactions, would not have any significant impact while addressing the main burden for firms.

Post-trade transparency

5.13 The overwhelming majority of respondents agreed with the government's suggestion that post-trade transparency has been significantly more helpful than pre-trade transparency in supporting price formation in fixed income and derivatives markets. To improve the effectiveness of the post-trade regime, the government consulted on streamlining the deferral regime.

5.14 Most respondents agreed with the government's proposal to simplify the deferral regime and generally supported the proposal to remove, for example, the size specific to the instrument (SSTI) deferral. However, a large majority signalled that any changes to the SSTI would have to be considered alongside a review of the large in scale (LIS) threshold. Some respondents highlighted that changes to the post-trade transparency regime, and the deferral regime in particular, would support the emergence of a consolidated tape for fixed income instruments.

5.15 The majority of respondents supported the principle of allowing volume masking to encourage timely disclosure against market risk but noted that volume masking is only effective if the scope and length of the deferrals are calibrated correctly. A few respondents also said that volume masking is not needed for OTC derivatives because they are relatively liquid compared to bonds. Very few respondents opposed volume masking on the grounds that all trading information should be disclosed in real time.

5.16 The consultation also asked for views about reverting to the pre- Markets in Financial Instruments Directive II (MiFID II) situation, whereby trading venues calculated LIS thresholds for exchange traded derivatives (ETD) post-trade reporting. This would be done in conjunction with the FCA setting out principles for trading venues. The few respondents that engaged with this question were generally supportive, although one stakeholder raised concerns that this might create unfair competition between trading venues and systematic internaliser (SIs), and among trading venues themselves.

Next steps: The government welcomes the overall support for the proposals relating to the transparency regime for fixed income and derivatives markets. Transparency is key to price formation and best execution. However, it is clear that the current regime – which is modelled on the one for equities markets – does not appropriately cater for the specific and often bespoke nature of fixed income and derivatives markets. That is why on 23 November, the Economic Secretary to the Treasury confirmed that the government's objective is to ensure that financial instruments are subject to appropriate transparency requirements that reflect their specific nature.

In line with the government's broader objective to return responsibility for designing and implementing regulatory requirements to the expert regulators, it is the government's intention that the FCA should be responsible for recalibrating the scope and setting the firm-facing transparency requirements. To enable this, the government plans to delegate the transparency regime for fixed income and derivatives to the FCA when parliamentary time allows. This means that specific changes to transparency requirements will be a matter for the FCA to consider and take forward. The FCA is working closely with HMT on the Wholesale Markets Review and will take the outcome of this consultation into account when considering amendments to the transparency regime for fixed income and derivatives markets.

Chapter 6
Commodity Derivatives

Scope of the regime

Definition of commodity derivative

6.1 The consultation proposed amending the definition of 'commodity derivatives' in the Markets in Financial Instruments Regulation (MiFIR) to ensure that it only captures the right instruments.

6.2 The majority of respondents supported excluding exotic derivatives and legal securities from the definition of commodity derivatives in MiFIR. Beyond this, the feedback was divided about how broad the proposed definitional change should be. Some respondents raised concerns that an amendment could lead to broader, unintended consequences, noting the difficulties posed by varying and interconnected definitions across different pieces of legislation. For example, they noted the growth in products linked to net zero, and the importance of future-proofing the regime to prevent these contracts from being unintentionally excluded. They also questioned whether changes to the MiFIR definition of 'commodity derivatives' could inadvertently impact firms' broader needs to become authorised. Building upon this argument, some respondents noted that the regulatory perimeter under the Financial Services and Markets Act (FSMA) and the commodity derivatives regime should be streamlined, and that there would be benefit in having one consistent definition of 'commodity derivatives'.

Next steps: The government recognises the complexities and inconsistencies around the use of the definition of 'commodity derivatives' across regimes. This is a multifaceted issue and the government intends to undertake further analysis to ensure that the regulatory perimeter under FSMA and commodity derivatives regime are both clear and coherent. The government therefore does not intend to make any immediate changes.

Inclusion of economically equivalent over-the-counter (OTC) contracts

6.3 The consultation proposed excluding economically equivalent (EE) over-the-counter (OTC) contracts from being automatically captured by the commodity derivatives position limits regime, given the difficulties in identifying EE OTC contracts.

6.4 All but one respondent supported removing EE OTC contracts from the scope of the position limits regime, arguing that this would remove an element of legal uncertainty and reduce compliance risk for firms. However, a few respondents raised concerns that trading venues may be required to take a more active role in monitoring OTC markets for the purposes of assessing whether certain contracts should be subject to position limits.

Next steps: The government agrees that economically equivalent over-the-counter contracts should not be automatically within scope of the commodity derivatives position limits regime. This change will be taken forward as part of the broader amendments to the position limits regime, as explained below.

Position limits regime

Position limits

6.5 The consultation proposed to (i) transfer responsibility for the setting of position limits from the Financial Conduct Authority (FCA) to trading venues, and (ii) revoke the requirement that position limits should be applied to all exchange-traded commodity derivatives and EE OTC contracts. This was in order to remove unnecessary restrictions and simplify the regime.

6.6 Since 9 July 2021, and in line with the consultation proposal to limit the scope of contracts that are automatically subject to position limits, the FCA has used its powers to stop taking supervisory or enforcement action in relation to commodity derivative positions that exceed position limits on cash-settled commodity derivative contracts (unless the underlying commodity is an agricultural product)[1].

6.7 The majority of respondents indicated strong support for the proposal to transfer responsibility for position limits to trading venues and agreed that trading venues are better placed to respond more quickly and effectively to evolving market dynamics. While most respondents felt that there was little risk associated with the proposal, two respondents highlighted concerns that trading venues would not have enough visibility over the entire market to set limits effectively. Many respondents highlighted that the FCA should ensure consistency through outcomes-based regulation of the trading venues, while avoiding unnecessary burdens.

6.8 There was universal support for reducing the scope of the position limits regime. In fact, many respondents felt that the proposal to limit the scope of the regime to physically settled and agricultural contracts did not go far enough. These respondents thought that the scope should be narrowed further than the FCA's current supervisory approach because not all physically settled and agricultural contracts are subject to volatility or pose a risk to the pricing of the underlying commodity or the settlement process. Some of the respondents who argued for this suggested abandoning the automatic application of position limits on all contracts on the grounds that they believe

[1] https://www.fca.org.uk/news/statements/statement-supervision-commodity-position-limits

there are enough safeguards in place, without position limits, to manage risk in commodity derivative positions. They cited the extensive position management controls applied by trading venues as an example of these.

Next steps: On 23 November, the Economic Secretary to the Treasury announced that the government will bring forward legislation when parliamentary time allows to revoke the requirement for position limits to be applied to all exchange-traded contracts, and to transfer the setting of position limits from the FCA to trading venues.

As part of this proposal, the government will provide the FCA with the necessary discretion to determine which contracts trading venues will be required to set position limits on, in line with the UK's G20 commitment, and to set limits directly on OTC contracts, if needed. The government will also give the FCA the necessary powers to establish a framework to support trading venues in setting position limits. This will ensure that there is a consistent approach across the market. The FCA is working closely with HMT on the Wholesale Markets Review and will take the outcome of this consultation into account when progressing this work.

Position limit exemptions

6.9 The consultation proposed creating position limit exemptions for (i) all liquidity providers, and (ii) investment firms offering risk-mitigation services to clients. The latter exemption would apply even when the risk being hedged against arises off-exchange or arises on a different trading venue from the one being used to hedge the risk. The aim of these proposals was to make it easier for non-financial firms to enter into hedging trades, while removing unnecessary restrictions that prevent liquidity building.

6.10 In December 2020[2], the FCA published a supervisory statement outlining that it would not take supervisory or enforcement action for the next year against liquidity providers who exceeded position limits where the positions are held to fulfil the liquidity providers' obligations on a trading venue. In December 2021, the FCA announced that this approach would continue while the scope of the regime was being considered as part of the Wholesale Markets Review[3].

6.11 Almost all respondents supported the two exemptions that were proposed in the consultation, with some calls to expand the grounds for exemptions even further. For example, a few respondents suggested that the FCA could consider individual position limits exemptions via application, and many noted that the definition of 'liquidity provider' should be kept broad and include voluntary liquidity providers.

---

2 https://www.fca.org.uk/publication/documents/supervisory-statement-mifid-end-transition-period.pdf

3 https://www.fca.org.uk/news/statements/statement-supervision-commodity-derivatives-position-limits

Next steps: The government intends for exemptions from position limits to be taken forward as part of the broader changes to the position limits regime as outlined above.

Position reporting

6.12 The government asked for views on changes that could be made to improve the current position reporting regime.

6.13 Most respondents noted that the position reporting regime generally works well, especially given the high operational costs associated with the implementation of existing reporting frameworks.

6.14 However, a small number of respondents provided examples of specific areas where requirements could be tweaked to reduce burdens for firms. For example, one respondent suggested amending the definition of "end client" to align the UK definition with the US regime. Another recommended simplifying the role of exchanges in position reporting.

Next steps: The government does not intend to make any standalone changes to position reporting given the vast majority of respondents believe that the current regime works well. Furthermore, the government does not wish to impose additional costs and disruptions. The government and the FCA will keep this area under review.

Ancillary activities test (AAT)

6.15 The consultation proposed a number of measures to simplify and streamline the ancillary activities test (AAT), which helps to determine whether firms participating in commodity derivatives markets need to be regulated.

Reverting to a qualitative assessment

6.16 The consultation proposed reverting from the current quantitative form of the AAT, which was implemented as part of the second Market in Financial Instrument Directive (MiFID II), to a principles-based assessment. It suggested that this could be modelled on the approach that was in place prior to 2018. This would take into account the nature of a firm's business more holistically than the current test.

6.17 Most respondents agreed with the issues that were identified in the consultation about the AAT. However, the consultation did not seem to be clear enough that the 'qualitative' approach to the test was meant to mirror the pre- MiFID II approach. As a result, many respondents expressed some concern that a new qualitative test might create some legal uncertainty for firms. This led them to suggest returning to the approach that was in place prior to MiFID II, which allowed commercial firms to be exempted from the regime through what was known as the "commodity dealer exemption"[4].

Changing the basis of the test from historic to expected activity

6.18 The consultation also proposed changing the basis of the test to take account of expected activity. The rationale behind this proposal was to reduce the legal risk which arises from solely focussing on backward-looking activity. Many respondents cautioned against restricting the test to expected activity only, given the inability of firms to predict their business models with any degree of certainty.

Abolishing the annual notification requirement

6.19 Finally, the consultation proposed abolishing the annual notification requirement given the limited value it provides and the significant burden it places on firms who have to produce it, and the FCA who processes it. Respondents agreed with the position in the consultation and were supportive of removing the requirement.

Next steps: The government agrees with respondents that revoking the current ancillary activities test, re-introducing the "commodity dealer exemption" and removing the annual notification requirements would represent significant improvements to the current regime.

The government believes that this approach should alleviate concerns about expected activities being used as the sole basis of the test.

The government intends to bring forward secondary legislation under existing powers to enact this change.

The oil market participant (OMP) and energy market participant (EMP) regimes

6.20 The consultation proposed abolishing the oil market participant (OMP) and energy market participant (EMP) regimes and bringing affected firms into the scope of MiFIR to simplify the regime.

6.21 Responses to this proposal were mixed. A few respondents expressed the view that there is some value in the OMP and EMP regimes, for example because they offer appropriately tailored requirements to specific firms. Some respondents flagged concerns that abolishing the OMP and EMP regimes could require firms that currently use them to gain authorisation as investment firms, which would decrease the attractiveness of conducting their business in the UK. However, most respondents were content with abolishing these regimes as long as firms can continue their existing activities without requiring additional authorisation.

4 As contained in Article 2(1)(k) of MiFID.

Next Steps: Responses demonstrated that this is a complex issue and that changes in this area could have unintended effects in relation to how firms are authorised and the requirements they have to comply with. Given this, the government and FCA will continue to review this part of the regime and will not be making any imminent amendments. Any future changes will be considered alongside amendments to the regulatory perimeter.

Chapter 7
Market Data

Consolidated tape

7.1 The government proposed making a number of changes to legislation to enable a private sector tape to emerge.

7.2 All respondents supported the government's proposal to help facilitate the emergence of a consolidated tape (CT), and the majority of respondents agreed that the private sector is best placed to run it.

7.3 While some argued that amending legislation would be sufficient, a number of respondents suggested that UK authorities should play a more active role in ensuring a tape emerges, for example by organising a tender process and appointing a consolidated tape provider (CTP) for each asset class. They suggested that a tender process would make it easier for UK authorities to ensure that the correct governance arrangements are in place, help mitigate conflicts of interest, and ensure that the costs for firms connecting to a tape and accessing data from a tape remain low. Some specifically argued that multiple CTs per asset class would not help standardise data or provide a consolidated view of the market. This contrasted with feedback from other respondents, who argued that allowing multiple tapes would stimulate competition and drive innovation.

7.4 Only a very limited number of respondents suggested that there should be a single publicly run CT per asset class.

Scope

7.5 The consultation suggested that the government should focus on developing a CT for fixed income markets before developing one for equity markets because data for the former is less standardised. It also suggested that a CT for fixed income markets would not need to cover pre-trade data because it is not widely used by traders.

7.6 Respondents agreed that there is a more pressing case for a fixed income CT, however most respondents argued for a fixed income and an equities CT to be developed simultaneously. A few respondents argued that an equity CT should be developed first because market data for that part of the market is more standardised and it would therefore be easier to introduce.

7.7 All respondents supported a post-trade only CT for fixed income markets on the basis that pre-trade data is not used to aid price formation. Respondents generally felt that an equities CT should cover pre- and post-trade data because traders use both sets of data to make investment decisions. However, a number of respondents caveated that post-trade should be prioritised if it is not possible to cover both initially, as it plays a more significant role in aiding the price formation process.

7.8 Most respondents did not see any value in a delayed CT. Those that supported a delayed CT generally argued that it would be more beneficial for fixed income markets. However, one respondent expressed support for a delayed equity CT as they felt that the biggest beneficiaries would be retail investors, who largely rely on delayed data because of cost.

7.9 A few stakeholders suggested that the government should consider a CT for exchange traded funds (ETFs) and derivatives once an equity and fixed income CT has been established but did not see their development as a priority.

Specific legislative changes

7.10 The government consulted on five specific legislative changes to facilitate the emergence of a CT:

- <u>Firstly, on introducing a mandatory requirement for trading venues and Approved Publication Authorities (APAs) to provide data to a CT</u>. Nearly all respondents supported this proposal and highlighted its importance to ensure that operating a CT is commercially viable. However, a few respondents raised concerns about the cost implications of having to connect to multiple CTs.
- <u>Secondly, on removing the requirement for CTs to provide 100% coverage of equity and 80% coverage of fixed income trading activity.</u> Most respondents agreed with this proposal. However, some said that a CT should aim to cover as close to 100% of the market as possible and did not see why the current thresholds could not be met if mandatory contributions were introduced.
- <u>Thirdly, on removing the requirement for CTPs to provide data streams for free after 15 minutes.</u> Most respondents supported removing this requirement and argued that it did not have any direct benefit on the market. A few respondents suggested that the requirement should be removed for APAs and trading venues as well as CTPs, however the majority of respondents did not support removing it more broadly. On the other side of the spectrum, respondents who opposed the government's proposal argued that retail and non-professional investors currently benefit from this obligation and removing it, even for CTPs, could risk disadvantaging them.
- <u>Fourthly, on simplifying and standardising the fixed income deferrals regime.</u> Nearly all respondents supported this proposal and provided detailed comments in their responses to Chapter 5 (Fixed Income and Derivatives Markets). However, a limited number of respondents stressed that removing commercial barriers – rather than legislative ones – should be the priority. As such, they argued that changes to the transparency regime should take place once a CT has emerged.
- <u>Finally, the government suggested introducing new governance requirements to ensure that CTs operate in a transparent and accountable way</u>. All respondents supported this proposal.

7.11 Some respondents used this part of the consultation to suggest that the current requirement in legislation for market participants, operators and data reporting services providers to make data available on a 'reasonable commercial basis' (RCB) is not working. They argued that this is because the Financial Conduct Authority (FCA) does not have sufficient enforcement powers and asked for the FCA to be given appropriate enforcement powers to control the cost of market data. Several respondents also called for careful consideration to be given to the licensing regime to ensure clarity regarding data ownership and to avoid the misuse of data. Respondents also outlined their support for a cost recovery model.

Next Steps: The government welcomes the views of respondents. Given the important role that data plays in helping markets to function efficiently, the government agrees with the need to improve the quality and usability of market data and remains committed to help progress the emergence of a consolidated tape. Although it understands the concerns some respondents raised in relation to having a framework that could allow for multiple tapes, the government believes that competition would help to deliver the overall aims identified.

In line with the government's broader objective to return responsibility for designing and implementing regulatory requirements to the expert regulators, it is the government's intention that the FCA should be responsible for setting the requirements for consolidated tape providers. As such, the government intends to make the necessary legislative changes to ensure that the FCA has all the necessary tools to take this forward when parliamentary time allows.

Whilst the government continues to believe that it is more of a priority to develop a consolidated tape for fixed income data, the FCA will consider how best to enable the development of a consolidated tape for any asset class and for either pre- and post-trade data, or both. The FCA is working closely with HMT on its Wholesale Markets Review and will take the outcome of this consultation into account when progressing this work. The FCA will further consult on specific changes to support the development of a consolidated tape as soon as possible after it takes on responsibility for the relevant regulatory requirements, following the implementation of the outcomes of the FRF Review.

Other changes to market data

7.12 The consultation asked respondents if they had further suggestions in relation to market data reforms. Respondents recommended making clarifications to the concept of 'reasonable commercial basis' (RCB) and the unbundling of data. They also called on the FCA to investigate the cost of market data and to publicly support data standards.

Next Steps: The government welcomes responses to these questions. Most of the issues raised here relate to parts of the regime that fall within the FCA's remit. The FCA is working closely with HMT on its Wholesale Markets Review and will take the outcome of this consultation into account when considering future changes to the market data regime.

On 11 January 2022, the FCA published a feedback statement entitled 'Accessing and Using Wholesale Data', which sets out findings on the use of wholesale data and proposed next steps. The FCA will undertake a significant programme of work to better understand the extent to which there are high data costs and complex licensing terms that are creating harm to users, and where appropriate, address the potential harms. The FCA will conduct an information gathering and analysis exercise in Spring 2022. This will focus on the pricing of trading data, underlying costs and the terms and conditions of the sale of trading data. Depending on the evidence that is gathered as part of this exercise, the FCA will then consider whether further guidance or alternative policy options are needed.

To improve the usability of trade data, the FCA will consult on changes to equities and non-equities trade reporting standards over the course of 2022.

Chapter 8

Reporting

Overlap in reporting requirements

8.1 The government asked for views on possible duplicative reporting requirements. Participants provided high level comments and noted that there is overlap, in particular for trade and transaction reporting requirements between the European Markets Infrastructure Regulation (EMIR) and the Markets in Financial Instruments Regulation (MiFIR). Other pieces of EU retained legislation were also mentioned, for example the Securities Financing Transaction Reporting Regulation (SFTR), the Short Selling Regulation, the Money Market Funds Regulation and the Market Abuse framework. However, no respondent provided a comprehensive list of the overlaps between all pieces of legislation that impact their business.

8.2 Respondents were split as to what to do next. Some strongly opposed any action to mitigate these overlaps as implementing the reporting systems has represented a significant cost to industry. Others suggested targeted changes, such as requiring single-sided reporting for derivative transactions. Broader actions such as a more comprehensive review and global harmonisation of reporting standards were also raised.

8.3 Most respondents also agreed that intervention was needed to find a long-term solution to mitigate duplicative reporting requirements under MiFID and SFTR for firms undertaking securities financing transactions with a member of the European System of Central Banks.

Investor protection reports

8.4 Following the recent regulatory and legal changes to investor protection reports for professional clients under the second Markets in Financial Instruments Directive (MiFID II), the government used this consultation to seek views on the appropriateness of the current rules for retail clients.

8.5 On the 10% loss reporting rule, most respondents indicated that this was generally not conducive to increased investor protection levels, especially when dealing with discretionary clients or leveraged financial instruments; and the majority called for its removal. Some recognised that these reports retain some value for contingent liability transactions.

8.6 In relation to the use of electronic communications to comply with reporting obligations, the majority believed that electronic communications should become the default for trades with retail clients, though all respondents agreed that investors should be given the opportunity to opt in.

8.7 Other issues were raised including: a broad review of costs and charges disclosures; greater clarity on the boundary between advice and guidance; reducing the frequency of reports on portfolio management activity statements; and restricting the scope of product governance requirements.

Financial instrument identifiers

8.8 The consultation asked for views on the use of International Securities Identification Numbers (ISINs) for reporting purposes, specifically if an alternative identifier could be made available for identifying derivatives to overcome the issue with absolute tenors.

8.9 Respondents generally agreed with the position in the consultation, that the ISIN generation process does not operate well for certain non-standardised derivatives. The respondents who reported issues with ISINs highlighted recurring problems including: multiple ISINs being created for comparable instruments or indeed the same ISIN for different instruments; templates not catering for innovative or complex products; high costs for reference data; global discrepancies and duplication with Unique Product Identifiers (UPIs); and a lack of competition in ISIN provision. Some respondents called for a more comprehensive review of instrument identifiers.

8.10 In general, respondents noted that the use of ISINs has resulted in increased complexities in reporting, with end-users experiencing reduced levels of transparency and higher costs for firms. Some respondents suggested that amendments to the ISIN generation process or adopting alternative global standards such as the unique product identifier (UPI), could lead to improvements.

Next Steps: The government is grateful for respondents' views and input to this chapter.

In relation to securities financing transactions (SFTs), the Financial Conduct Authority (FCA) recently consulted on widening the existing exclusion of SFTs from reporting under the Market in Financial Instruments Regulation (MiFIR) to also include SFTs where the counterparty is a member of the European System of Central Banks (ESCB) or Bank of England, effective from 31 March 2022. This would ensure that SFTs would be reportable under the Securities Financing Transactions Regulation (SFTR) only. SFTs, where the counterparty is the Bank of England, would not be reportable under either regime.

As for any changes related to investor protection reports, the government will continue to engage relevant stakeholders in 2022, including consumer groups and retail-facing bodies, before taking any decision regarding next steps.

On ISINs, the government believes that further work is required to improve outcomes in this area. Some of this work has already begun. The FCA recently proposed that over-the-counter (OTC) derivatives should be identified using a

UPI in its recent consultation on changes to reporting requirements under the European Market Infrastructure Regulation (EMIR). The potential changes proposed to the transparency regime, particularly in relation to the concept of 'traded on a trading venue' (ToTV) for derivatives, would also mitigate issues that arise from the requirement to use ISINs to identify over-the-counter (OTC) derivatives for transparency purposes. UK authorities will also continue to use the UK's position as a global financial centre to influence a harmonised approach to the development and adoption of data standards, with a particular focus on identifier for OTC and non-standardised derivatives.

Chapter 9
Cross-cutting

9.1 To ensure capital markets regulation continues to deliver in the short as well as the long-term, the consultation sought suggestions from market participants on further steps the government could take to support the four themes that the Chancellor set out in his vision for financial services in July 2021. Namely that the UK should be an open and global financial centre; at the forefront of technology and innovation; a world-leader in green finance; and a competitive marketplace promoting effective use of capital.

Technology

9.2 Responses to this question touched on multiple topics. Respondents flagged some key themes which UK authorities could consider when setting frameworks around technological innovation, including the need for:

- Regulation to be 'technology-neutral' and based on outcomes, principles, and risks.
- Guidance on the application of existing rules for new and developing technologies.
- A consistent review of requirements to ensure that they account for technological developments.
- Regular engagement with industry to keep abreast of new developments.
- Global coordination to ensure consistent standards.

9.3 Responses raised the importance of supporting developments in distributed ledger technology (DLT). Many expressed support for the Kalifa Fintech Review and the introduction of a Financial Market Infrastructure (FMI) sandbox to support the introduction of DLT. On the digital assets side, some feedback noted the need for a definition or taxonomy of different DLT systems/ crypto assets.

9.4 Other points that respondents raised included but are not limited to: the need to develop and attract talent; ensure market infrastructure keeps pace with innovation; incorporates machine learning where beneficial; and promotes diversity within the fintech industry.

Green finance

9.5 Respondents welcomed steps the government has taken so far, most notably on its intention to become the first G20 country to make Taskforce for Climate-related Financial Disclosures (TCFD) aligned disclosures mandatory across the economy. Respondents also supported the direction of travel in respect of green taxonomy and the launch of Green Gilts.

9.6 A number of respondents highlighted:

- The importance of international cooperation and the need for consistent standards across jurisdictions.
- The importance of issuing clear and complete guidance on environmental, social and governance (ESG) reporting standards, including data requirements and definitions.
- The role of voluntary carbon markets in supporting the green transition. Some respondents advocated for the scaling of carbon markets, disclosures on carbon exposures, support for innovation such as derivatives products to help market participants manage climate-related risks. Suggestions to link the UK and EU's Emissions Trading Schemes (and potentially with other jurisdictions in the future) were also made.
- Potential amendments to the European Markets Infrastructure Regulation (EMIR) to avoid unnecessary restrictions on UK energy market firms to provide liquidity to renewable energy products.

Retail investors

9.7 The consultation asked open questions about how UK authorities and companies can harness the benefits of retail investment and facilitate retail access to capital markets, whilst continuing to offer high standards of investor protection.

9.8 Some high-level objectives which respondents suggested UK authorities should take into account included:

- Striking the right balance between investor protection and competitiveness by attracting international retail activity.
- Enhancing investor protection through measures to improve education and financial literacy.
- Ensuring retail investors have access to consolidated market data so that they can have a cross market view. Some respondents noted that improving access to information is especially pertinent in the context of markets becoming increasingly globalised.
- Delineating clearly between regulation targeted at retail and wholesale investment services.
- Helping retail investors to take part in the initial public offering (IPO) process.
- Making sure that regulation is appropriately future-proofed so that retail investors are able to take advantage of new innovative developments.

9.9 Respondents also highlighted some specific policy suggestions to strengthen the UK's regime for retail investors. These included:

- Making changes to the Financial Promotion Order (FPO). For example, multiple respondents noted that exemptions in the FPO should be modernised in order to allow increased choice for high net worth individuals (HNWIs) receiving wealth management services in the UK and to give UK companies better access to investors.

- Reviewing the Packaged Retail and Insurance-based Investment Products (PRIIPs) regulation.
- Making opt up thresholds to professional clients more flexible and removing the need for annual attestations for advised and portfolio-managed clients.
- Removing non-complex products from the scope of the product governance regime, to facilitate greater retail access.
- Facilitating retail investors' access to private markets through the Long Term Asset Fund (LTAF).
- Ensuring greater alignment between FS sources of regulation (MiFID II, the UK PRIIPs regulation, and regulatory provisions on Undertakings for the Collective Investment in Transferable Securities (UCITS)) and alternative investment fund managers, for example, with regard to the way product cost information is calculated and presented.

9.10 The feedback outlined above constitutes a non-exhaustive summary of the points which were raised in response to this chapter of the consultation.

Next Steps: The government welcomes respondents' input to this section of the consultation, which is important to ensure that the UK's approach enables firms and regulators to address the challenges and opportunities of the future, as well as the present. The government will continue to consider these points.

Of particular note, the Long Term Asset Fund (LTAF) fund structure was launched by the Financial Conduct Authority (FCA) in November 2021 and the government is consulting[1] until 9th March 2022 on changes to the Financial Promotions Order (FPO) exemptions for high net worth individuals and sophisticated investors.

[1] Financial_Promotion_Exemptions_Con.pdf (publishing.service.gov.uk)

Chapter 10
Delivery

10.1 As set out in the consultation document, the regulatory framework underpinning secondary markets sits across primary and secondary legislation (including retained EU law), and regulators' rules and guidance.

10.2 The Wholesale Markets Review consultation explained that the government's intention was to consult on specific changes to its wholesale markets regime alongside broader changes to the regulatory framework through the Future Regulatory Framework (FRF) Review. This is in recognition of the fact that some parts of the regime merit swift improvement, either through changes to existing legislation or regulators' rules. On 23 November 2021, the Economic Secretary to the Treasury committed to bring forward legislation when parliamentary time allows on areas where legislative amendments are most urgently needed.

10.3 However, the government believes that a number of other changes will be best delivered following the implementation of the FRF Review. The FRF Review provides an opportunity to ensure that, having left the EU, the UK authorities maintain a coherent, agile, and internationally respected approach to financial services regulation that is right for the UK. The government published a consultation on 9 November 2021 setting out its proposals and seeking views. That consultation closed on 9 February 2022.

10.4 As set out in the FRF consultation, the government intends, as a general approach, to take a power to repeal retained EU law, and specifically the direct regulatory requirements which apply to firms. This repeal will enable the appropriate regulator to replace those provisions with their own rules. For any areas where the regulators' existing rule-making powers are not broad enough to be able to replace the relevant requirements in retained EU law, the government has set out its intention to provide the regulators with the necessary additional powers.

10.5 In many instances, the government would expect the regulators to initially replace the repealed provisions with rules that are similar to those which are currently in place. However, for the changes identified through the Wholesale Markets Review, this approach will allow the regulators to ensure that the rules are properly tailored for UK markets, and appropriately reflect their objectives. Therefore, as part of the process of establishing the comprehensive FSMA model in this way, the Financial Conduct Authority (FCA) will have the opportunity to make the appropriate rule changes to implement some of the proposals set out below. This approach will ensure the UK maintains a coherent, agile and internationally-respected approach to financial services regulation that delivers appropriate protections and promotes financial stability.

10.6 The FCA is working closely with HMT on the Wholesale Markets Review and will take the outcome of this consultation into account when considering changes to its rules and guidance. The FCA has also indicated that it will start consulting in stages on areas which currently form part of their rules and do not depend on any legislative changes.

10.7 Finally, there are a small group of proposals where the consultation raised broader or more nascent policy questions. The government believes that more thought, analysis and engagement will be needed on these issues and intends to continue engaging with market participants.

10.8 A full breakdown of how the government indicatively intends to deliver each proposal is included in the table below. The nature of the delivery vehicle (e.g. primary legislation) may be subject to change as the legislative process unfolds.[1]

Chapter 1- Trading venues	
Proposal	*Delivery*
Clarify the regulatory perimeter	Financial Conduct Authority (FCA) guidance
Remove matched principal trading for investment firms	Delivered as part of the implementation of the outcomes of the Future Regulatory Framework (FRF) Review
Enable organised trading facilities (OTFs) to execute transactions in equities when dealing in large packages	Delivered as part of the implementation of the outcomes of the FRF Review
Enable an investment firm to operate a systematic internaliser (SI) and OTF within the same legal entity	The government believes that the case for change was not conclusive and further consideration is needed
Develop a new venue/segment for micro small and medium sized enterprises (SMEs)	The government believes that the case for change was not conclusive and will engage relevant stakeholders on this in 2022
Develop a playbook for market operators and participants to follow when there is a market outage, and alternative mechanisms to a closing auction during market outages	FCA guidance
Chapter 2- Systematic Internalisers (SIs)	
Proposal	*Delivery*
Amend the definition of SIs	Primary legislation when parliamentary time allows
Amend the reporting regime for SIs	FCA rules
Allow midpoint crossing	Primary legislation when parliamentary time allows

[1] Note, where the table states that a change will be taken forward through primary legislation it may also require, depending on the nature of the change, the making of secondary legislation or exercise of regulatory powers.

Allow a more proportionate approach to setting the minimum quote size in respect to standard market size (SMS)	Delivered as part of the implementation of the outcomes of the FRF Review
Chapter 3- Equity Markets	
Proposal	*Delivery*
Remove the double volume cap (DVC)	Primary legislation when parliamentary time allows
Delegate the pre-trade transparency waivers regime to the FCA	Primary legislation when parliamentary time allows
Remove the share trading obligation (STO)	Primary legislation when parliamentary time allows
Remove the requirement for algorithmic firms to enter into market making agreements with trading venues	Delivered as part of the implementation of the outcomes of the FRF Review
Allow trading venues to follow the tick size applicable to the primary market of a share, even when that market is overseas	FCA rules
Allow trading venues to establish tick sizes for new shares until sufficiently robust data is available	FCA rules
Delegate the tick size regime to venues	The government believes that the case for this change was not conclusive and further consideration is needed
Chapter 4- Fixed income and derivatives markets	
Proposal	*Delivery*
Realign the scope of the derivatives trading obligation (DTO) and EMIR clearing obligation (CO)	Primary legislation when parliamentary time allows
Exempt post-trade risk reduction (PTRR) services from the DTO	Primary legislation when parliamentary time allows
Exempt PTRR services from the CO	Primary legislation when parliamentary time allows
Give the FCA a power to amend the scope of the DTO in certain circumstances	Primary legislation when parliamentary time allows
Delegate the pre- and post-trade transparency regime for fixed income and derivatives markets to the FCA	Primary legislation when parliamentary time allows
Chapter 5- Commodity derivatives	
Proposal	*Delivery*
Amend the definition of a commodity derivative	The government believes that the case for change was not conclusive and further consideration is needed
Remove economically equivalent over-the-counter contracts from the scope of the position limits regime	Primary legislation when parliamentary time allows

Revoke the requirement that position limits be applied to all exchange-traded contracts and transfer the setting of position limit controls from the FCA to trading venues	Primary legislation when parliamentary time allows
Amend the position reporting regime	The government believes that the case for change was not conclusive and is not considering changes to this part of the regime
Amend the ancillary activities test	Secondary legislation
Chapter 6- Market data	
Proposal	*Delivery*
Empower the FCA to make requirements for consolidated tape providers with the aim of facilitating the emergence of one or more consolidated tapes	Primary legislation when parliamentary time allows
Chapter 7- Reporting	
Proposal	*Delivery*
Amendments to investor protection reports	The government believes that the case for change was not conclusive and would like to continue engaging relevant stakeholders on this in 2022
Amendments to product identifiers	The government believes that the case for change was not conclusive
Chapter 8- Cross cutting	
This government used this section of the consultation to explore respondents' views on longer-term issues that may impact UK secondary markets. The government welcome responses to this part of the consultation and will consider them in future policy work.	

Annex A

List of Respondents[1]

1.	AFME
2.	All Options NL
3.	Alternative Investment Management Association (AIMA) and Alternative Credit Council (ACC)
4.	Aquis
5.	Association of British Insurers (ABI)
6.	Aviva
7.	Baillie Gifford
8.	Bank of America
9.	Barclays
10.	BlackRock
11.	Bloomberg
12.	BNY Mellon
13.	Building Societies Association
14.	CBI
15.	CBOE
16.	Charles Stanley & Co
17.	Citadel
18.	Citi
19.	Commodity Markets Council Europe
20.	EDF trading
21.	Ediphy
22.	Electronic Debt Markets Association (EDMA)
23.	Euroclear
24.	EuroMTS limited
25.	European Federation of Energy Traders
26.	EVIA
27.	Federation of European Securities Exchanges (FESE)
28.	FIA
29.	FIA EPTA
30.	FICC Markets Standards Board (FMSB)
31.	Finbourne Technology

[1] Note, four respondents have asked to remain confidential and are not included in this list

32.	FIX Trading Community
33.	Gazprom Marketing & Trading Limited
34.	GFMA (Global FS division)
35.	GFMA CWG
36.	Hargreaves Lansdown
37.	HSBC
38.	Intercontinental Exchange (ICE)
39.	ICMA
40.	IHS Markit
41.	ING
42.	Interactive Investors Limited
43.	Invesco
44.	Investment Association
45.	IPSX
46.	ISDA
47.	ISO/TC 068/AG2 "Standards Advisory Group" (ECB)
48.	Janus Henderson
49.	Killik & Co
50.	Legal and General Investment Management
51.	LME and LME clear
52.	LSEG
53.	M&G
54.	Managed Funds Association
55.	Market Structure Partners
56.	MarketAxess
57.	Norges Bank
58.	OSTTRA
59.	PIMFA
60.	Quoted Companies Alliance (QCA)
61.	ScaleUp Institute
62.	Schroders
63.	Singer Capital Markets
64.	SIX
65.	SmartStream
66.	St James Place Wealth Management
67.	T. Rowe Price
68.	TD securities
69.	TP ICAP
70.	Tradeweb
71.	UK Equity Markets Association (UKEMA)
72.	UK Finance
73.	Unicredit
74.	Virtu Financial

Annex B
Glossary

Term	Definition
Algorithmic trading	A form of trading in financial instruments which is executed via computer programs that utilise algorithms (a set of defined instructions) to automatically determine individual parameters of orders such as timing, price or quantity with almost no or limited human intervention.
Ancillary Activities Test (AAT)	The test which determines whether a firm trading in commodity derivatives needs to be authorised as an investment firm.
Approved Publication Authorities (APA)	A person authorised under MiFID II to publish trade reports on behalf of investment firms.
Best execution	The requirement for an investment firm to take all sufficient steps to obtain the best possible result for their clients when executing orders.
Client	Any natural or legal person to whom an investment firm provides investment or ancillary services.
Commodity derivative	Derivatives with a commodity identified as their underlying asset.
Consolidate tape (CT)	A continuous electronic live data stream providing price and volume data of bids and offers, and/or executed trades in financial instruments taking place on trading venues and bilaterally.
Consolidated tape provider (CTP)	A person authorised to operate a CT.
Deferral	The delay by an investment firm or trading venue of the publication of executed trades so as not to expose counterparties to the trade to undue risk.
Derivatives	A financial contract that derives its value from the price of an underlying asset(s), indices or other measures.
Derivatives Trading Obligation (DTO)	The requirement for certain persons to trade in-scope derivatives on UK trading venues or third country venues that have been deemed equivalent by HM Treasury.
EMIR REFIT	Legislation updating the European Markets Infrastructure Regulation (EMIR) with a view

	to making it simpler and less costly for firms to comply with.
Energy Market Participant (EMP)	A firm authorised by the FCA which is restricted to carrying out activities related to investments linked to energy.
European Market Infrastructure Regulation (EMIR)	Legislation establishing requirements in relation to OTC derivatives, CCPs and trade repositories. It aims to improve transparency and reduce the risks associated with the derivatives market.
Exchange traded commodities	A form of exchange traded product which invest in underlying commodities or follow commodity indices.
Exchange traded derivatives	A derivative such as a future that is traded on an Exchange and cleared by a CCP.
Financial Conduct Authority (FCA)	The conduct regulator for financial services firms and financial markets in the UK.
Fixed Income	Securities that pay investors fixed payments until maturity date.
FSMA	FSMA Financial Services and Markets Act 2000.
Hedging	The practice of using a financial instrument such as a derivative to mitigate against risks inherent to other assets.
High yield bonds	Bonds rated BB, B, CCC, CC or C.
Illiquid	A situation where, for a financial instrument or a class of financial instruments, there are not ready and willing buyers and sellers on a continuous basis.
International Securities Identification Number (ISIN)	A 12-character, alphanumeric code which uniquely identifies a financial instrument and provides for the uniform identification of instruments for trading or settlement purposes.
Investment grade bonds	Bonds rated AAA, AA, A or BBB.
Large-in-scale	A MiFID transparency threshold above which an order or trade is deemed sufficiently large to benefit from a pre-trade transparency waiver or post-trade deferral.
Liquid	A situation where, for a financial instrument or a class of financial instruments, there are ready and willing buyers and sellers on a continuous basis.
Liquidity	Concept that reflects how easy it is to buy or sell a financial instrument, usually without affecting the prevailing price.
Lit venue	A trading venue where bids and offers prices are publicly disclosed prior to execution.
Market outage	A market situation where a trading venue's technical system fails to operate.
Market maker or liquidity provider	A firm that holds itself out on the financial markets on a continuous basis as being willing to deal on its own account by buying

	and selling financial instruments against its own proprietary capital at prices.
Matched Principal Trade (MPT)	A transaction where the facilitator interposes itself between the buyer and the seller to the transaction in such a way that it is never itself exposed to market risk throughout the transaction, with both sides executed simultaneously, and where the transaction is concluded at a price where the facilitator makes no profit or loss, other than a previously disclosed commission, fee or charge for the transaction.
MiFID	Markets in Financial Instruments Directive.
Multilateral Trading Facility (MTF)	A multilateral system operated by an investment firm, a qualifying credit institution or a market operator that brings together multiple third party buying and selling interests in financial instruments in accordance with non-discretionary rules.
Non-price forming	A trade that does not contribute to price formation.
Oil Market Participant (OMP)	A firm authorised by the FCA that is restricted to carrying out activities related to investments that are linked to oil.
Organised Trading Facility (OTF)	A multilateral trading system operated by an investment firm, a qualifying credit institution or a market operator in which multiple third-party buying and selling interests in bonds, structured finance products, emissions allowances or derivatives can interact in the system.
OTC	Over-the-counter trading of financial instruments outside the systems and rules of a trading venue.
Package	A transaction composed of multiple financial instruments that are interlinked and where the execution of each component is simultaneous and contingent upon the execution of all the others.
Position limits	Restrictions on the maximum size of a net position that a person can hold.
Post-trade transparency	The obligation to publish the details of a trade report after execution.
Pre-trade transparency	The obligation to publish in real time bids and offers for financial instruments.
Price formation	The process whereby the price of a financial instrument reflects all the available information based on supply and demand.
Prospectus	Document to be published when securities are offered to the public or admitted to trading on a regulated market.
Reasonable commercial basis (RCB)	The requirement to make market data available under charges which are based on

	the cost of such data and in a fair, and non-discriminatory manner.
Regulated market (RM)	A multilateral system operated by a Recognised Investment Exchange that brings together multiple third party buying and selling interests in financial instruments in accordance with non-discretionary rules.
Regulatory perimeter	The determination of which activities or instruments require FCA authorisation or are subject to FCA oversight.
Share Trading Obligation (STO)	The obligation for shares to be traded on UK trading venues and systematic internalisers, or third country trading venues that have been deemed equivalent by HM Treasury.
SME	Small and medium sized enterprise.
Sovereign bonds	A debt instrument issued by a sovereign issuer.
Systematic Internaliser (SI)	An investment firm which on an organised, frequent, systematic and substantial basis deals on its own account when executing client orders outside of a regulated market, UK MTF or UK OTF, without operating a multilateral system. Or an investment firm that has chosen to opt-in to the systematic internaliser regime.
Temporary Transitional Powers (TTP)	The powers which HM Treasury gave UK financial regulators under the EU Withdrawal Act, to make transitional provisions to financial services legislation for a temporary period to help firms adapt to their new requirements following the onshoring process.
Tick size	The minimum increment by which the price of a financial instrument can move up or down.
Traded on a trading venue (ToTV)	A concept which brings OTC instruments that equivalent to instruments traded on a trading venue into the scope of various requirements that apply to venue traded instruments. ToTV is used to impose specific transparency reporting requirements on instruments that are traded on trading venues.
Trading venue (TV)	A regulated market, a multilateral trading facility or an organised trading facility.
Transaction reporting	Reports of executed trades that must be made to the FCA under MiFID II.
Transparency	The disclosure of trading interests and executed trades to market participants.
Volatility	The fluctuation in the market price of a financial instrument.
Waiver	Regime under which pre-trade transparency requirements can be modified.

HM Treasury contacts

This document can be downloaded from www.gov.uk

If you require this information in an alternative format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

Email: public.enquiries@hmtreasury.gov.uk