24 September 2021

FIA response to the HMT Wholesale Markets Review

FIA welcomes HM Treasury's (HMT) proposals concerning the Wholesale Markets review with one of the primary goals to establish how UK markets should adapt following the UK's departure from the EU.

Resilient and robust markets are of key importance to FIA members, therefore, we support HMT's stated ambitions for MiFID requirements to remain sound and to ensure continued market integrity in the UK. FIA would like to assist identifying those areas where the MiFID requirements have not achieved the desired effects by also comparing the cost of the requirements that are subject to HMT's review.

FIA's response primarily focuses on exchange traded (and cleared) derivatives and does not address equities markets, other than on the topics of market outages and market maker agreements.

We are generally supportive of the proposals, and have the following key comments and recommendations:

Chapter 1: Trading Venues

- The regulatory framework should continue to allow various forms of trading to be licenced within the **regulated perimeter**. The existing diversity in choice of trading and execution should be preserved and would contribute to maintaining deep and liquid capital markets. As such, we recommend the avoidance of any significant changes to the existing regulatory perimeter for trading venues. Any appropriate changes or clarifications on the perimeter should be undertaken through FCA guidance after proper consultation with the industry rather than through changes in the primary legislation.
- The UK should continue to **support the emergence and development of new technology providers**, which encourage innovation and create more competition in the UK market.
- FIA members believe that high-level guiding principles, which are provided in the spirt of improving system wide risk management, should be adopted by venues when communicating with members and the wider market in the **event of an outage** while further engagement within the industry is needed to work on best practices for communication around incidents for the benefit of the trading and clearing ecosystems. Venues should rely on a **pre-designed playbook** to be made available to market participants following existing venue incident handling processes with robust fallback plans, which does not hinder the rapid technical resolution of incidents.

Chapter 4: Equity Markets

- FIA members fully support to remove the **share trading obligation** and support AFME's position.

- FIA welcomes HMT's proposal to remove the MiFID II **market making requirements** for both investment firms and trading venues. This will reduce unnecessary compliance burdens and costs for firms and trading venues. This assessment applies to equity markets and exchange-traded derivatives markets equally in all asset classes including commodity, interest rate and equity derivatives.

Chapter 5: Fixed Income and Derivatives Markets

- FIA supports HMT's proposal to revise the **scope of transactions subject to the DTO** under MiFIR to be a subset of transactions subject to the **clearing obligation under EMIR**.
- FIA members agree that **post-trade risk reduction services** should be exempt from the DTO and support ISDA's position.
- FIA members are supportive of establishing **permanent or temporary Derivatives Trading Obligation suspension and modification powers**, to allow the FCA to swiftly react to unforeseeable market disruptions.
- We agree that **transparency requirements** must be balanced to avoid damaging liquidity or undermining price discovery processes, and also concur that the regime in its current form is overly complex and cost intensive for the industry. Therefore, we support relevant amendments to legislation or FCA rulebook changes in order to remove the current factors leading to inappropriate thresholds and simplification of the waiver regime should be considered.
- FIA agrees with HM Treasury that it would be more effective to replace the **ToTV criterion** for OTC derivatives with one which more effectively identifies OTC derivatives which are standardized and by basing the definition on whether the product is **subject to the EMIR clearing obligation**, rather than any product which is cleared.
- For exchange traded derivatives, we agree that exchanges are well suited to manage pre- and post-trade transparency arrangements. We would support **a reversion to venues calculating their own thresholds** as this permits the limits to be made according to the requirements of the relevant market.

Chapter 6: Commodity Markets

The key areas that FIA members believe must be addressed in HM Treasury's commodity proposals to ensure that the overarching aims of the HM Treasury Wholesale Markets Review are met, are:

(1) **streamlining the commodities regime** in the UK and simplifying the regulatory perimeter by:

- ensuring that where a person qualifies for the **ancillary activities exemption** (or any other exemption set out in Article 2 of UK MiFID[1]), they are not subject to any authorisation requirement in the United Kingdom for the same business; and

[1] Set out in Part 1 of Schedule 3 to the RAO, which implements the exemptions in Art. 2 of MiFID II.

- **aligning the concept of a commodity future** under Article 84 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the "RAO") with that of a commodity derivative that is classified as a financial instrument in Section C of Annex I to UK MiFID[2], so that a single definition applies which is no broader than that in other jurisdictions (for example, EU member states);

(2) removal of the **Oil Market Participant** ("OMP") and **Energy Market Participant** ("EMP") regulatory status **provided that** market participants who currently hold either OMP or EMP status can continue to conduct the same business that they do currently without having to become full-scope investment firms in the UK, so they can operate on a level playing field with third country firms and are not put at a competitive disadvantage, by:

- streamlining and simplifying the commodities regime in the ways set out in (1) above; and

- either:
    - as a preferred option, reintroducing the concept of a "commodity dealer" exemption to UK MiFID (along the same lines as that which applied in Article 2.1(k) of MiFID I) and reapplying the "own account" exemption under Article 2.1(d) of UK MiFID II to all types of financial instruments, (as was the position under Article 2.1(d) of MiFID I); or

    - ensuring that the ancillary activities test ("AAT") under Article 2.1(j) of UK MiFID is sufficiently certain that commodity firms can continue to rely on it by including quantitative threshold tests, over which firms can discuss their business with the FCA from a qualitative perspective to discuss whether authorisation is required (with no requirement to do so if a firm is below the quantitative threshold and no annual notification requirement, as proposed by HM Treasury);

(3) taking all derivatives which have an underlying that is not physically settled outside scope of the position management and reporting regime, but ensuring that all such derivative financial instruments which currently fall within Section C(10) of Annex I to UK MiFID ("C(10) Instruments") (where they remain within the UK regulatory perimeter and are not excluded altogether) continue to benefit from the same treatment as commodity derivatives for other regulatory purposes (e.g. application of the ancillary activities exemption and the inside information regime applicable to commodity derivatives under UK MAR); and

(4) moving to a position management regime administered by trading venues within the scope of principles set by the FCA, with no centrally mandated hard position limits, allowing for greater market flexibility.

As a general point, FIA members would strongly urge that HM Treasury considers all of the proposals in the commodities chapter of the Wholesale Markets Review holistically in the context of the overall regulatory landscape and regulatory perimeter applicable to commodities and related markets in the United Kingdom, considering the interlinkage between different pieces of legislation and taking into

[2] Set out in Part 1 of Schedule 2 to the RAO, which implements Sections A and C of Annex I to MiFID II.

account the overall consequences of the proposals for market participants. UK MiFID II/ MiFIR does not represent the whole picture when it comes to financial regulation of the commodities markets in the UK and cannot be considered in a vacuum.

Making changes to certain elements of the applicable regulations without considering, for example, the broader UK legacy authorisation regime under Part IV of the Financial Services and Markets Act 2000 ("FSMA") and the RAO (together the "Legacy FSMA Regime") would lead to unintended consequences and create yet another level of complexity forming a barrier to potential market entrants considering setting up commodity operations in the UK, conducting commodity trading activities with UK counterparties or trading on UK trading venues, which runs counter to the aim of the Wholesale Markets Review.

If the calibration of UK MiFID exemptions[3] and the interplay between those exemptions, the proposed removal of the OMP and EMP regime and the Legacy FSMA Regime is not properly addressed, many FIA members that are UK commodity firms who currently qualify for the ancillary activities exemption under Article 2.1(j) of UK MiFID II (the "AAE") have indicated that they will exit the UK and trade from other jurisdictions, as remaining in the UK would put them at a significant commercial disadvantage to firms established elsewhere, including firms based in the EU.

Chapter 8: Reporting

- Existing reporting regimes (EMIR, MiFIR, MAR, AIFMD, and REMIT) rely upon a similar core dataset. As a result, the optimum solution to reduce complexity and duplicative requirements would be to **design one reportable dataset that can serve multiple regulatory purposes** (e.g. by providing data for systemic risk oversight as well as market abuse surveillance). This would enable firms to report just once per transaction and for regulators to then extract the relevant data required to fulfil the particular regulatory mandate.

Chapter 9: Cross Cutting Issues

- While impacts may vary across regions, climate change is a global issue which requires **global solutions.** Global derivative markets can help build a more sustainable future. Markets have shown their inherent ability to, and will continue to, innovate towards this demand for sustainable alternatives with adapted risk managing products. **The financial policy framework should use this momentum to ensure markets can adjust efficiently.**

FIA and its members are keen to engage with HM Treasury and the FCA to make this review as comprehensive and effective as possible and help to ensure that HM Treasury's stated aim of simplifying the UK regulatory regime is met.

[3] Set out in Part 1 of Schedule 3 to the RAO, which implements the exemptions in Art. 2 of MiFID II.

Chapter 2: Trading Venues

1 **Where do you think the regulatory perimeter for trading venues needs to beclarified?**

We agree with HMT's view that the current market structure for trading venues is generally sound.

The regulatory framework should continue to allow various forms of trading to be licenced within the regulated perimeter. The existing diversity in choice of trading and execution should be preserved and would contribute to maintaining deep and liquid capital markets. As such, we recommend the avoidance of any significant changes to the existing regulatory perimeter for trading venues.

With regards to the emergence of new technology providers, we believe that these providers introduce efficiencies and improve outcomes for end-investors by allowing firms to carry out their day-to-day activity more efficiently by improving the information flow, both for buy-side and sell-side firms.

We believe that the UK should continue to support the development of these platforms which encourage innovation and create more competition in the UK market. Subjecting these platforms to complex and costly regulatory requirements would likely prevent them from existing in their current form.

Such an approach would limit competition in the market, stifle innovation and will ultimately lead to increased costs for end-investors (as operational/regulatory costs are directly or indirectly passed along).

The UK should continue to encourage the development of these innovative communication systems and allow them to co-exist alongside trading venues. Providing end-investors with a diverse set of connectivity utilities offers them choice, which in turn can optimise their investment objectives, foster competition and drive costs down.

2 **Do you think it would be more appropriate for changes to be made to the definition of a multilateral system in legislation, or for the application of the existing definition to be clarified through FCA guidance?**

Therefore, we strongly support HMT's proposal to adopt a flexible approach to the trading perimeter question, in order to continue supporting innovation and remove any potential barriers to entry. Any appropriate changes or clarifications on the perimeter should be undertaken through FCA guidance after proper consultation with the industry rather than through changes in the primary legislation. We also think that it would be important for the FCA to consider this issue holistically and on a case by case basis where needed.

3 **Should the current restrictions on matched principal trading by a multilateral trading facility (MTF) be retained?**

In light of the clear obligations on operators of an MTF to identify and clearly manage the potential adverse consequences of any conflict of interest between the MTF, their owners or operators and

sound functioning of the MTF the matched principal trading restrictions could be removed. It is important both that the functional distinction between OTFs and MTFs be preserved, and equally that a multilateral system can apply for MTF status without the expense of licensing as an exchange. It is equally important for the integrity of the price formation process and for market development that, where users trade a particular instrument on a MTF, they can have confidence that the operator of the trading facility has no financial interest in the price of that instrument. This structural principle distinguishes multilateral trading facilities and exchanges from market makers, SIs and other forms of dealer.

4 **Should the current restrictions on the operation of an SI within the same legal entity of an organised trading facility (OTF) be retained?**

5 **If you answered no to question 4:**

Should new rules and disclosures be introduced to address the specific conflicts that MTFs and OTFs would be exposed to when providing matched principle trading (MPT) or operating a systematic internaliser (SI)?

6 **Do you think that OTFs should be allowed to execute transactions in packages involving derivatives and equities under their rules and systems?**

7 **What would be the risks and benefits of allowing this approach?**

8 **Do you agree that the existing regulatory requirements for disclosure at admission to trading (for MTFs and SME Growth Markets) are disproportionate for small-sized issuers?**

9 **What principles and/or types of information should be considered when developing requirements for disclosure at issuance to ensure requirementsare proportionate?**

10 **How far should these be determined by the venue operator versus regulation, and what other features may provide proportionate assurancesaround the quality of issuers admitted to a venue (e.g. role of advisors inprocess)?**

11 **Would the creation of a new category of trading venue be an appropriatemeans to facilitate access to public markets for very small firms? What size of firms would be appropriate for a new trading venue?**

12 **If you answered no to question 11:**
Would the facilitation of the creation of new market segments be a moresuitable intervention?

13 **If you answered yes to question 11 or 12:**

What should the market cap of companies that can trade on the new tradingvenue and/or segment be?

14 **Do you believe intermittent rather than continuous trading would increaseliquidity?**

15 **Do you think that additional measures, such as new funds structure are needed to stimulate**

institutional investors to invest in SMEs?

16 **What, if any, further forms of investor protection do you deem appropriatefor this proposed new category of trading venue?**

17 **Do you believe that regulatory or industry guidance about how venues should operate and what they should communicate during an outage would be useful?**

Industry guidance and other standardisation are useful tools for venues as well as market participants when it comes to the appropriate and effective communication management during outages.

Industry or regulatory guidance could be beneficial on the basis of high-level principles like standardised communication to the market, also considering the diverse ecosystem of trading venues operating in the UK markets i.e. in terms of asset classes covered. A standardised approach should also take into consideration differing operational procedures across exchanges which could make it difficult for a more detailed 'play-book' to efficiently cover different types of outage scenarios in terms of causes, length and complexity. We are supportive of the view that venues should retain some level of flexibility in dealing with outages.

FIA members believe that high-level guiding principles, which are provided in the spirt of improving system wide risk management, should be adopted by venues when communicating with members and the wider market in the event of an outage while further engagement within the industry is needed to work on best practices for communication around incidents for the benefit of the trading and clearing ecosystems:

- Implementation of effective communication to market participants who are responsible for managing own and client risks to enable effective onward information and incident handling. A more detailed approach should be discussed and agreed at an industry level.
- Development of principles aimed at improving risk management of outages / incidents for the entire market – venues/CCPs, execution brokers, clearing members and clients. Outages may affect trading and clearing processes, and all participants need to have access to appropriate information due to the inter-connectedness and links.
- In order to improve risk management processes, appropriate incident follow up should be implemented to ensure a "lessons learned" exercise and how any incident was rectified, also to enable operations teams for proper onward information within firms and post-mortem analysis (for own operational risk management purposes). However, FIA members recognise the form this takes will depend on the root cause of the incident and any guidance on this aspect will therefore need to be flexible.

Venues should rely on a pre-designed playbook to be made available to market participants following existing venue incident handling processes with robust fallback plans, which does not hinder the rapid technical resolution of incidents.

18 **Do you have views on a fail-safe mechanism to ensure that the market has access to the key closing benchmarks during an outage in a primary exchange? What role do you see UK authorities playing to deliver this?**

We are supportive of further engagement between trading venues, industry participants and UK regulatory authorities on the feasibility of a ‘fail-safe mechanism’ with regards to holding closing auctions during outages. We recommend a degree of flexibility for any future industry/standardised approach with a focus on developing suitable and resilient fallbacks. During an outage, exchanges will not be able to produce closing prices on the basis of a market mechanism which is unavailable due to the outage.

Today, UK futures exchanges already provide a variety of fallback procedures under their rulebooks and operational procedures that enable the publication of settlement prices also during times of trading platform unavailability. Therefore, regulatory or industry guidance should be flexible and ensure a consistent and clear messaging with regards to trading venues’ fallback procedures and should set out the standards that venues should follow during an outage. This will facilitate clear messages and reflect that outages might have many causes, different impacts, different urgencies to resolve and different resolutions depending on the facts. to the market. When outages happen, it is in everyone's interests always to resolve them expeditiously. To help achieve this, industry guidance could also set out that where alternative venues for relevant products are available, then these venues could help fill any temporary gaps.

However, we note that for some contracts, particularly with underlyings in commodities traded on UK markets, there may not be an analogous alternative (at least in the UK).

19 **What other steps do you think UK authorities could take to ensure marketresiliency in the event of an outage?**

It remains of key importance to ensure that any future standardised approach relating to outages is aligned with ongoing operational resilience work-streams led by regulatory authorities. This will ensure a proportionate approach and avoids unnecessary duplication of requirements that could unintentionally and negatively impact trading venues and market participants globally.

In addition to guidance on communication during an outage there is information that would help venue members assess the venue’s operational stability and better prepare for outages. The following information should be sent to venue members on a regular basis:

- Relevant management information/metrics on both minor incidents and more significant outages that have occurred where this may benefit wider markets for the distinction between an incident and an outage. Where relevant this should include information on follow-up actions.
- The venue’s maximum trading/clearing volume capacity along with an explanation of maximum capacity values have been estimated. Visibility of maximum capacities would allow members to understand the amount of spare capacity that exists compared to peak volumes and to better anticipate possible issues during periods of high volume.

Chapter 3: Systematic Internalisers

20 **Do you agree that the definition for SIs should be based on qualitative criteria?**

21 **If you answered no to question 20:**

Do you think the definition should be amended in another way?

22 **If you answered yes to question 20:**

Do you think that regulatory guidance should be used to support the definition in legislation?

23 **Do you currently opt-in to the SI regime?**

24 **Should SIs be determined at entity level instead of on an instrument by instrument basis, for reporting purposes?**

25 **What would be the risks and benefits of adopting such an approach?**

26 **Do you agree with the government's proposal to allow SIs to execute at the midpoint for all trades, provided the executed price is within the SI's quoted price?**

27 **Do you think any other changes are needed to increase the effectiveness of the SI regime?**

28 **Do you think that the double volume cap (DVC) should be deleted?**

29 **Do you think alternative incentives are needed to encourage lit trading?**

30 **Should reference price systems be able to match orders at the mid-point within the current bid and offer of any UK or non-UK trading venue that offers the best bid or offer, to aid best execution?**

31 **Do you consider SIs quotes useful?**

32 **Do you think that the ability of SIs to execute clients' orders at mid-point would incentivise SIs to provide meaningful quotes?**

33 **If you answered yes to question 32:**

What incentives could UK authorities introduce to encourage you to report more trades, while maintaining fair competition with market operators

Chapter 4: Equity Markets

34 **Do you think that the share trading obligation (STO) should be removed?**

Yes. FIA agrees with HMT that the way the STO restricts trading is not appropriate, effective or conducive to price formation or stability. We hence fully support HMT's proposal to remove the STO, enabling firms to focus on achieving best execution for their client. Members support AFME's position.

35 Do you think that the requirements for algorithmic liquidity providers and trading venues to enter into binding market making agreements should be removed?

Yes. FIA agrees that the MiFID II market making requirements have limited impacts on enhancing market quality and impose unnecessary cost and burdens on both algorithmic trading firms and trading venues and should be removed. This assessment applies to equity markets and exchange-traded derivatives markets equally in all asset classes including commodity, interest rate and equity derivatives.

MiFID II market making requirements were introduced to assist with keeping up market liquidity in times of financial crisis, market stress or extreme price volatility. Such a requirement raises concerns that market making firms are placed in a position to provide the same or a similar degree of liquidity regardless of macro-economic and associated market conditions, and in the face of breaching their own prudential financial requirements and controls, including internal risk tolerances and risk limits.

Instead, non-obligatory incentive schemes could be a more suitable way of filling gaps in liquidity (typically in less liquid exchange-traded derivatives or in less liquid parts of the maturity curve of such derivatives). These incentive schemes enable trading venues to facilitate the provision of liquidity in products in which liquidity is diffuse because of its characteristics and to increase liquidity in new and nascent futures contracts which in time may evolve into the benchmarks of the future or which may form part of a broader complex of related futures contracts (e.g. in energy markets). Furthermore, the requirements under MiFID II and UK legislation for exchanges to offer non-discriminatory and transparent access already means that market maker programmes or similar incentive schemes will be made available on equal terms for those who qualify, be available to those who qualify and wish to get involved and their existence and key terms will be made known to members of the market.

Therefore, FIA welcomes HMT's proposal to remove the MiFID II market making requirements for both investment firms and trading venues. This will reduce unnecessary compliance burdens and costs for firms and trading venues.

36 What would be the impact of such a removal for you and/ or the market you operate in?

37 Do you think the scope of the tick size regime needs to be recalibrated for overseas shares to ensure that firms can trade at the best prices in the UK?

38 Do you think trading venues are better placed to establish tick sizes for new shares until sufficiently robust data is available?

39 What are the potential benefits and risks of delegating the setting of tick sizes, in general, to trading venues? What safeguards would be needed to avoid arbitrage issues?

40 Are there any other parts of the equity regime that you think could be operated more effectively by the market, while upholding high standards?

Chapter 5: Fixed Income and Derivatives Markets

41 **Do you agree that the scope of the derivative trading obligation (DTO) should be revised to bring it in line with the scope of the clearing obligation following the changes introduced by the European Market Infrastructure Regulation (EMIR) REFIT? What risks/ benefits do you see with this approach?**

FIA supports HMT's proposal to revise the scope of transactions subject to the DTO under MiFIR to be a subset of transactions subject to the clearing obligation under EMIR. The revised approach would deliver greater legal clarity with respect to whether contracts could be subject to the DTO while also providing alignment on a more dynamic basis, i.e. amendments to the scope of the clearing obligation or relevant Level 2 legislation would be reflected in the scope of the DTO.

42 **Do you think that all post-trade risk reduction services should be exempt from the DTO?**

FIA members agree that post-trade risk reduction services should be exempt from the DTO and support ISDA's position.

43 **If you answered yes to question 42:**

a) **Do you think that there should also be an aligned exemption from the EMIR clearing obligation for trades resulting from post-trade risk reduction services?**

FIA members support ISDA's position.

b) **What conditions do you think should be met for the exemption to be applicable?**

FIA members support ISDA's position.

44 **Do you think the FCA should be given the power to modify or suspend the DTO quickly under certain circumstances, on a permanent rather than temporary basis?**

FIA members are supportive of establishing permanent or temporary Derivatives Trading Obligation suspension and modification powers, to allow the FCA to swiftly react to unforeseeable market disruptions. We agree that there should be a pre-defined criteria and reasonable notice should be given to the industry before suspending, although we appreciate that there may be cases where it has to be suspended on short notice.

Modifications under this power should not include any proposals to expand the DTO, and this process should remain subject to the existing review and consultation process prior to finalising any changes. Where any necessary modifications are considered by the FCA under the new powers, the potential operational impact on firms should be taken into account to ensure sufficient time is allowed for any impacted systems and controls to be adapted, or otherwise the FCA should ensure that any publication of emergency changes are accompanied by appropriate forbearance periods.

FIA recommends making any modification to the DTO, for example a proposal to introduce a new DTO subject to industry consultations before introducing any new requirements.

45 **Do you think that the current transparency requirements support price formation and open,**

competitive and fair markets? Please separate your answers by fixed income (please treat sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (please distinguish between OTC and exchange-traded derivatives (ETDs) where relevant).

Overall, MiFID II has indeed significantly increased transparency in the derivatives market by including derivatives on a pre- and post-trade transparency basis. However, for ETD commodities, it introduced binding laws in areas that previously were administered directly by regulated markets. Many unsound calibrations in the RTS have in fact impeded rather than improved transparency. Price formation is an essential part of the regulated markets' business model. However, as HMT rightly points out, only an appropriately calibrated transparency regime can achieve the objectives as the purpose of pre-trade transparency requirements is to give investors current orders and executable quotes before the trade is executed, in order to facilitate price formation and to help investment firms/ banks provide best execution.

Therefore, we agree that transparency requirements must be balanced to avoid damaging liquidity or undermining price discovery processes, and also concur that the regime in its current form is overly complex and cost intensive for the industry.

Pre-trade transparency specify that trading venues should publish information concerning current bid and offer prices and the depth of trading interests at those prices advertised through their systems. MiFIR provides certain exemptions from the general requirement to publish pre-trade transparency data, which are necessary, to preserve an orderly price discovery process and to allow nascent and niche markets to develop. These exemptions are respectively implemented through pre-trade transparency waivers for:

- Orders above a certain volume threshold (Large in Scale waiver or 'LIS');
- Indications of interest in request-for-quote (RFQ) and voice trading systems above a size specific to the instrument (SSTI);
- Derivatives not subject to the trading obligation and instruments classified as illiquid, regardless of their volumes (Illiquid Instrument waiver or 'IL').

For ETD products a flawed methodology for the IL and LIS waivers should be addressed particularly on commodity derivatives markets but not exclusively. In addition, we are of the view that LIS thresholds should also be recalibrated for some ETDs.

A more cautious approach in particular with respect to commodity derivatives is recommended as these instruments are regularly used by real economy businesses to manage their commercial as well as financial risks. And whilst some products, such as the ICE Futures Europe Brent Crude Futures, have developed into global benchmarks, most commodity derivatives markets remain relatively illiquid. An appropriately designed Block Trading Policy is essential for their further development.

The current pre-trade transparency regime does not sufficiently take into account the above considerations. In addition, the methodology for calculation of thresholds setting boundaries of the pre-trade transparency regime, including Illiquid Instrument and Large In Scale (LIS), should be improved. It results in a number of illiquid derivative contracts being wrongly classified as liquid and being subject to very high LIS thresholds. The consequences of the above are particularly visible in

commodity derivatives markets, thereby forcing larger volumes to be executed in bilateral transactions.

We support relevant amendments to legislation or FCA rulebook changes in order to remove the current factors leading to inappropriate thresholds (e.g. using notional values, which are highly reliant on market prices). Prior to the implementation of MiFIR, the above-mentioned problems were addressed by the relevant UK derivatives exchange determining LIS thresholds by estimating the aggregate volume which market makers and other liquidity providers typically quote in the central order book at the best bid and offer

Beyond commodity derivatives markets, we consider that the transparency requirements would deserve re-calibration, in particular for some ETD products and sub-asset classes. MiFIR sets out the methodology for calculating LIS thresholds and determining illiquid instruments. Members have consistently reported that the transparency regime is not calibrated appropriately to match the economic characteristics of certain products that are actually traded and that this could significantly impair liquidity in those markets. In general, particularly for equity derivatives (but not only) instruments, a 'crude' taxonomy applies to a heterogeneous asset class, characterised by low liquidity, such that this asset class is treated as homogeneous and deemed liquid. We would therefore encourage to conduct liquidity assessment based on selling and buying interest rather than the current static determination.

For specific exchange traded equity derivative products, it would be sensible to assess whether temporarily lower LIS thresholds could be established, taking into consideration that on-venue trading accounts for only a minimal share of overall trading volumes in these specific products.

For ETDs, we agree that the SSTI thresholds should be reconsidered and that simplification of the waiver regime should be considered.

Historically, and prior to the implementation of MiFIR, the above-mentioned problems were addressed by the relevant UK derivatives exchange determining LIS thresholds by estimating the aggregate volume which market makers and other liquidity providers typically quote in the central order book at the best bid and offer. The exchange could also take other factors into account, such as the typical size of a cargo which needed to be hedged in the underlying physical market. Doing so helped the exchange to establish a baseline above which it is likely to prove difficult for market participants to execute business in the central order book without experiencing price slippage, execution delay or both. The baseline indicated where the LIS threshold should be set. If that threshold were to be set significantly above the baseline, a liquidity gap would develop in which it would be difficult for business to be executed in an efficient manner (i.e. business caught within the liquidity gap would be too large to be matched by on-screen market makers on the one hand and would not qualify for execution within the LIS facility on the other). Alternatively, if the threshold were set significantly below the baseline, there would be a concern that business would be drawn away from the central order book and into the LIS facility instead, thus reducing transparency.

The exchanges actively managed the process of setting LIS thresholds, overseen by their regulator, to ensure that the right balance was struck. Market participants were also able to feed into the process,

thus ensuring that all stakeholders could contribute to ensuring that the appropriate balance was achieved. FIA would recommend reinstating this approach, which worked well for 20 years prior to its replacement with the flawed MiFIR process.

46 **Do you think that using traded on a trading venue (ToTV) is a useful criterion for determining the scope of transparency requirements for non-equity instruments, and in particular OTC derivatives? Please separate your answers by fixed income (please treat sovereign bonds, high-yield bonds and investment grade bonds separately) and derivatives (please distinguish between exchange treaded and OTC derivatives)**

No. The concept of ToTV only works effectively in the context of Transferable Securities, given that the application of the concept is inextricably linked to the use of ISINs as an instrument identifier within the MiFID II schema. It does not work in relation to OTC derivatives which typically have different ISINs to economically similar products which are traded on a trading venue. FIA agrees with HM Treasury that it would be more effective to replace the ToTV criterion for OTC derivatives with one which more effectively identifies OTC derivatives which are standardized and by basing the definition on whether the product is subject to the EMIR clearing obligation, rather than any product which is cleared.

47 **If you answered no to question 46:**

Do you think the concept of ToTV should be removed for OTC derivatives, and the scope of the transparency regime determined on the basis of whether the instrument is cleared? If so, what definition of 'cleared' should be used?

FIA members recommend not to base the determination on the basis whether an instrument is cleared or clearable as this could lead to confusion and make the regime more complex. Instead, a more suitable approach, with as basis in clearing, would be to make the determination based on the EMIR clearing mandate, in addition to ETDs. For the most liquid OTC derivatives the determination of the clearing obligation scope in turn already follows from an objective assessment by the FCA of a range of factors, including the range of available venues, product standardisation, volume and active market participants. The scope of products subject to the clearing obligation is well defined based on clear parameters, and well understood by market participants. Adopting a scope based on whether an instrument is cleared would introduce a significant additional degree of implementation complexity and would require knowledge of whether any market participant had cleared a particular instrument at any point in time. In our view this complexity is not merited as the additional products captured would not be sufficiently liquid or, crucially, standardised to justify application of the transparency regime.

48 **Do you think there is another option to determine the scope of the fixed income and derivatives transparency regime? Please separate your answers by fixed income (please treat sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (please distinguish between exchange traded and OTC derivatives).**

In order to launch a transparency regime for OTC derivatives focused on providing meaningful transparency we would recommend starting with a narrow scope, defined by products subject to the

derivative trading obligation, and assess the efficacy of the regime before considering expanding to products subject to mandatory clearing.

49 **What instruments do you think should be in scope of the fixed income and derivatives transparency regime? Please consider fixed income (please treat sovereign bonds, high-yield bonds and investment-grade bonds separately) ETCs, ETNs, structured finance products, emission allowances and derivatives (please distinguish between exchange traded and OTC derivatives).**

There are situations where transparency is more confusing than helpful to the market and the determining factor whether to subject instruments to transparency requirements should be based on liquidity and size of the transaction. Therefore, we recommend applying transparency requirements to the most liquid contracts and smaller contracts.

50 **What changes do you think are needed to enable liquidity calculations to work effectively? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-grade bonds) and derivatives (ETDs and OTC derivatives).**

The calculations need to be relevant for the market to which they are being applied. Liquidity can depend on the type of underlying asset and can vary between contracts even within the same asset class. In addition, the way in which a market is structured can influence the liquidity of certain contracts. For example, the prompt date structure used on the LME means that certain contracts will have fluctuating liquidity during the course of one month. Therefore, bespoke liquidity calculations will need to be created, in conjunction with the venues, in order to ensure that the new liquidity calculations can take account of the particular characteristics of commodity contracts.

51 **Do you think it would be preferable to move away from regular liquidity calculations towards a mix of qualitative and quantitative criteria? For example, on a sectoral basis? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (ETDs and OTC derivatives).**

Yes. We think this could be a helpful move and could support some of the concerns raised in question 50 above.

52 **How do you currently use pre-trade transparency? Is pre-trade information on bonds and derivatives valuable? Please differentiate between fixed income (sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (ETDs and OTC derivatives), and each trading method (for example RFQ, and order book).**

53 **Is there a case for removing MiFID II pre-trade transparency requirements for any asset class? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (ETDs and OTC derivatives).**

54 **If you answered yes to question 53:**

Do you think that RFQ, bilateral negotiations and indications of interest provide sufficient information for markets to function effectively? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives

(ETDs and OTC derivatives).

55 **How do you use pre-trade quotes streamed by SIs? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment- grade bonds separately) and derivatives (ETDs and OTC derivatives).**

56 **For SIs, what impact do you think removing pre-trade transparency requirements would have on your business? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (ETDs and OTC derivatives).**

57 **Do you have any other comments on the pre-trade transparency regime?**

Whilst the regime has not met its intended aims, financial firms and trading venues have invested considerable time and effort in ensuring compliance with the relevant requirements. Therefore, any changes should take this into account and should not impose further significant technology change or costs on firms.

58 **How do you currently use deferrals? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (ETDs and OTC derivatives).**

59 **Which asset classes should deferrals apply to? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-gradebonds separately) and derivatives (ETDs and OTC derivatives).**

60 **Do you agree that the deferral regime would benefit from being simplified?**

61 **What do you think the optimum deferral length is? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (ETDs and OTC derivatives).**

62 **What are your views on the government's proposal to delete the size specificto the instrument (SSTI), package order, and EFP deferrals? Do you think it would lead to more meaningful transparency? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (ETDs and OTC derivatives).**

63 **Do you think volume masking and/or aggregation helps to encourage realtime publication? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (ETDs and OTC derivatives).**

64 **What are the risks and benefits of allowing trading venues to calculate LISthresholds for ETD post-trade reporting?**

We would support a reversion to venues calculating their own thresholds as this permits the limits to be made according to the requirements of the relevant market.

For ETD, we agree that exchanges are well suited to manage pre- and post-trade transparency arrangements. As noted above, the MiFIR approach leads to the calculation of extremely low LIS thresholds for the most liquid exchange-traded derivative products and much higher LIS thresholds

for less liquid products. The MiFIR methodology is based on a statistical analysis of post-trade data to which a set of generic and arbitrary metrics is applied, which take no account of available liquidity in the exchange's central order book or the operation of the underlying physical market on which the exchange's products are based.

This creates two risks:

- Business in the most liquid products could be drawn away from the central order book and into the LIS facility instead, thus reducing transparency; and
- Business in the least liquid products could fall into a liquidity gap between the central order book and the LIS facility, frustrating the execution of such business and undermining the usage of exchange-traded derivatives.

Prior to MiFID II, the relevant exchange would determine LIS thresholds by estimating the aggregate volume which market makers and other liquidity providers typically quote in the central order book at the best bid and offer. The exchange could also take other factors into account, such as the typical size of a cargo which needed to be hedged in the underlying physical market. Doing so helped the exchange to establish a baseline above which it is likely to prove difficult for market participants to execute business in the central order book without experiencing price slippage, execution delay or both. The baseline indicated where the LIS threshold should be set. If that threshold were to be set significantly above the baseline, a liquidity gap would develop in which it would be difficult for business to be executed in an efficient manner (i.e. business caught within the liquidity gap would be too large to be matched by on-screen market makers on the one hand and would not qualify for execution within the LIS facility on the other). Alternatively, if the threshold were set significantly below the baseline, there would be a concern that business would be drawn away from the central order book and into the LIS facility instead, thus reducing transparency.

The exchanges actively managed the process of setting LIS thresholds, overseen by their regulator, to ensure that the right balance was struck. Market participants were also able to feed into the process, thus ensuring that all stakeholders could contribute to ensuring that the appropriate balance was achieved. FIA recommends reinstating this approach, which worked well for 20 years prior to its replacement with the flawed MiFIR process.

Chapter 6: Commodity Markets

Introduction

FIA members fully support the overarching aims of the HM Treasury Wholesale Markets Review to produce a more effective, proportionate and less burdensome regime for the commodity markets in the UK.

FIA members support many of the of proposals made by HM Treasury and generally consider that the Wholesale Markets Review is an important step to improve the conditions under which market participants operate in financial markets in the United Kingdom. This represents a great opportunity to strengthen the United Kingdom as a commodity trading hub and enhance the competitiveness of the UK as a place to conduct commodities and related market activities.

FIA priority issues and suggestions

The key areas that FIA members believe must be addressed in HM Treasury's proposals to ensure that the overarching aims of the HM Treasury Wholesale Markets Review are met, are:

(1) streamlining the commodities regime in the UK and simplifying the regulatory perimeter by:

- ensuring that where a person qualifies for the ancillary activities exemption (or any other exemption set out in Article 2 of UK MiFID[4]), they are not subject to any authorisation requirement in the United Kingdom for the same business; and

- aligning the concept of a commodity future under Article 84 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the "RAO") with that of a commodity derivative that is classified as a financial instrument in Section C of Annex I to UK MiFID[5], so that a single definition applies which is no broader than that in other jurisdictions (for example, EU member states);

(2) removal of the Oil Market Participant ("OMP") and Energy Market Participant ("EMP") regulatory status **provided that** market participants who currently hold either OMP or EMP status can continue to conduct the same business that they do currently without having to become full-scope investment firms in the UK, so they can operate on a level playing field with third country firms and are not put at a competitive disadvantage, by:

- streamlining and simplifying the commodities regime in the ways set out in (1) above; and

- either:
  - as a preferred option, reintroducing the concept of a "commodity dealer" exemption to UK MiFID (along the same lines as that which applied in Article 2.1(k) of MiFID I) and reapplying the "own account" exemption under Article 2.1(d) of UK MiFID II to all types of financial instruments, (as was the position under Article 2.1(d) of MiFID I); or

  - ensuring that the ancillary activities test ("AAT") under Article 2.1(j) of UK MiFID is sufficiently certain that commodity firms can continue to rely on it by including quantitative threshold tests, over which firms can discuss their business with the FCA from a qualitative perspective to discuss whether authorisation is required (with no requirement to do so if a firm is below the quantitative threshold and no annual notification requirement, as proposed by HM Treasury);

(3) taking all derivatives which have an underlying that is not physically settled outside scope of the position management and reporting regime, but ensuring that all such derivative financial instruments which currently fall within Section C(10) of Annex I to UK MiFID ("C(10)

[4] Set out in Part 1 of Schedule 3 to the RAO, which implements the exemptions in Art. 2 of MiFID II.

[5] Set out in Part 1 of Schedule 2 to the RAO, which implements Sections A and C of Annex I to MiFID II.

Instruments") (where they remain within the UK regulatory perimeter and are not excluded altogether) continue to benefit from the same treatment as commodity derivatives for other regulatory purposes (e.g. application of the ancillary activities exemption and the inside information regime applicable to commodity derivatives under UK MAR); and

(4) moving to a position management regime administered by trading venues within the scope of principles set by the FCA, with no centrally mandated hard position limits, allowing for greater market flexibility.

As a general point, FIA members would strongly urge that HM Treasury considers all of the proposals in the commodities chapter of the Wholesale Markets Review holistically in the context of the overall regulatory landscape and regulatory perimeter applicable to commodities and related markets in the United Kingdom, considering the interlinkage between different pieces of legislation and taking into account the overall consequences of the proposals for market participants. UK MiFID II/ MiFIR does not represent the whole picture when it comes to financial regulation of the commodities markets in the UK and cannot be considered in a vacuum.

Making changes to certain elements of the applicable regulations without considering, for example, the broader UK legacy authorisation regime under Part IV of the Financial Services and Markets Act 2000 ("FSMA") and the RAO (together the "Legacy FSMA Regime") would lead to unintended consequences and create yet another level of complexity forming a barrier to potential market entrants considering setting up commodity operations in the UK, conducting commodity trading activities with UK counterparties or trading on UK trading venues, which runs counter to the aim of the Wholesale Markets Review.

If the calibration of UK MiFID exemptions[6] and the interplay between those exemptions, the proposed removal of the OMP and EMP regime and the Legacy FSMA Regime is not properly addressed, many FIA members that are UK commodity firms who currently qualify for the ancillary activities exemption under Article 2.1(j) of UK MiFID II (the "AAE") have indicated that they will exit the UK and trade from other jurisdictions, as remaining in the UK would put them at a significant commercial disadvantage to firms established elsewhere, including firms based in the EU.

FIA and its members are keen to engage with HM Treasury and the FCA to make this review as comprehensive and effective as possible and help to ensure that HM Treasury's stated aim of simplifying the UK regulatory regime is met.

65 Do you think that the scope of the 'commodity derivatives' regime should be narrowed to derivatives that are based on physical commodities?

The key point for FIA members is that any narrowing of the scope of the "commodity derivatives" regime should ensure at a minimum that instruments that no longer fall within the term "commodity derivatives" should either (i) fall outside the UK regulatory perimeter altogether or, (ii) in circumstances where they are still classified as derivatives (not securities) and remain regulated products in the UK, they should continue to benefit from the same exemptions, in particular from authorisation requirements, as those that currently apply to commodity derivatives, emissions

[6] Set out in Part 1 of Schedule 3 to the RAO, which implements the exemptions in Art. 2 of MiFID II.

allowances and derivatives on emissions allowances (subject to our answers on the other questions in this chapter with regard to amendments to the Legacy FSMA Regime and the effect of the proposed removal of the OMP and EMP regulatory statuses). This is particularly relevant in the context of those types of instruments which are commonly traded by commodity market participants, such as (without limitation) derivatives on any of the following: climactic variables, carbon offsets or permits, other environmental products or certificates including guarantees of origin and renewable energy certificates, transmission rights, capacity allocation rights, freight rates and commodity indices. Otherwise, the risk is that this kind of exotic commodity trading is treated more strictly than the traditional commodity trading activities. Also, a more open approach here would allow the regime to accommodate future commodity market developments, for example the emergence of renewable energy markets such as hydrogen markets.

If the intention behind HM Treasury's proposal reflects an attempt to align the interpretation of the "commodity derivative" definition under UK MiFID II/ MiFIR for the purpose of any position management or reporting regime with the position set out in the joint ISDA/GFMA/FIA/EFET/European Federation of Energy Traders letter to ESMA (22 February 2017) entitled "Scope of Section C(10) contracts which are 'commodity derivatives' for the purposes of MiFID II" (the "Joint Association Letter"), FIA members would support this approach, subject to the points in (i) and (ii) above. The Joint Association Letter sets out the classes of C(10) Instruments that are not commodity derivatives and therefore not within the scope of position limits and reporting regimes: those being options, futures, swaps, forward rate agreements and other derivative contracts relation to inflation derivatives (C(10)); an index or measure based on actuarial statistics; and other derivative contracts that do not exhibit the profile of, or a direct relationship to, a commodity as described elsewhere in the letter. If HM Treasury's proposal is aimed at aligning the UK approach to this with the effect that all such C(10) Instruments would fall outside the position limits and reporting regimes, this would be welcomed.

As a general point, FIA members believe it would be helpful for HM Treasury to specify what aspects of the "commodity derivatives" regime would be narrowed under these proposals. The definition itself is used across several pieces of legislation and guidance, so amending this could have significant consequences for FIA members and the broader regulatory regime.

If HM Treasury's proposals go further than taking all derivatives which have an underlying that is not physically settled outside scope of the position management and reporting regime, FIA members believe that an industry-led review, supported by external counsel, would need to be conducted to fully understand the impact this would have across all affected legislation, rules and guidance. FIA members are not opposed to this amendment in principle, however, they strongly believe that this would need to be preceded by a comprehensive review and consultation process, working through the consequences of such a change to avoid unintended adverse consequences for the industry.

66 **Do you think that financial instruments which refer to commodities as a pricing element but are securities in their legal form, should be removed from the regime?**

Yes, FIA members strongly agree that these should be removed. This is because their link to the underlying market for physical commodities, and the potential for them to be used to commit market abuse, is weak.

This would also be in line with the approach taken in the EU27 under the new regime introduced by the MiFID Quick Fix[7], with which FIA members agree on this point.

Further background:

FIA has advocated for the removal of securitised instruments from the definition of "commodity derivatives" under MiFID II for some time. Securitised commodity derivatives are transferable securities: the bank acts as an issuer, submits a prospectus under the prospectus regime and targets a large panel of investors including retail and wholesale investors.

Unlike derivatives, securitised commodity derivatives are subject to custody and to notary functions administered by Central Securities Depositaries. Securitised commodity derivatives are not subject to EMIR as onshored in the UK ("UK EMIR").

It is not possible for an instrument to be both a security and a derivative. If they were both, it would not be possible to resolve the resulting clash between the application of legislation applicable to securities (notably, the UK's prospectus regime) and UK EMIR and the differing pre and post-trade transparency regimes). FIA considers that the inclusion of securitised derivatives in the definition of "commodity derivatives" contradicts the principle that transferable securities (section C(1) , Annex I of UK MiFID II) are not derivatives (sections C(4) to C(10), Annex I of UK MiFID II) and therefore are not subject to the same legal regime as derivatives and creates confusion between transferable securities and derivatives in UK MiFID II. Therefore, we agree with removing them from this definition.

We also note that securitised commodity derivatives are already subject to the market abuse regime under Regulation (EU) No 596/2014 as onshored in the UK ("UK MAR") and can only be admitted to trading on a regulated market if it is possible to have an orderly market in trading in these instruments (Article 51(1) of UK MiFID II). In addition, since there is no possibility of physical delivery or physical settlement of a commodity in relation to these instruments, they are not capable of having the same impact on physical commodity markets as derivatives falling within sections C(5), C(6), C(7) and C(10), Annex I of UK MiFID II[8] (subject to our answer to Question 65), and consequently the potential for them to be used to commit market abuse with regard to commodities markets is weak.

67 **Do you think economically equivalent OTC commodity derivative contractsshould be removed from the commodity derivatives regime?**

Yes, FIA members strongly agree that the concept of economically equivalent OTC commodity derivatives contracts ("EEOTC") should be removed. This concept has not worked well and removing it will provide legal certainty.

However, FIA members note that HM Treasury's proposal would permit trading venues to "take account" of relevant OTC contracts when monitoring markets. The meaning of this is unclear.

The ability for a venue to take account of OTC contracts should be clarified and restricted to what is absolutely necessary to maintain orderly markets on that venue. FIA members (both market

[7] Directive (EU) 2021/338

[8] Set out in Part 1 of Schedule 2 to the RAO, which implements Sections A and C of Annex I to MiFID II.

participants and exchanges) would not support trading venues or CCPs being required to monitor OTC positions.

68 **Are there any other instruments that you think should be deleted from the commodity derivatives regime?**

As a general point, the definition of a commodity derivative under UK MiFID II/ MiFIR and the corresponding concept of a commodity future under the RAO differ. If certain products are removed from scope of the UK MiFID commodity derivatives regime, FIA members' strong preference is that the two concepts are aligned so that a contract which no longer falls within scope of being a derivative, financial instrument under the UK MiFID regime will fall completely outside the UK regulatory perimeter. This would address a long-standing issue of the complexity of the UK regulatory regime as it applies to commodities caused by the Legacy FSMA Regime being broader in its application than the UK MiFID II regime.

In addition to the points raised in our answer to Question 65, FIA members suggest that if HM Treasury's aim of simplifying the UK regime is to be achieved, there should only be one applicable definition of a commodity derivative in the UK rather than two sets of definitions with an override.

This would require an amendment to the definition of "futures" under Article 84 of the RAO, which is broader than the definition of "commodity derivatives" in Article 2(1)(30) of UK MiFIR. The definition under Article 84 brings physical forward activity within the regulatory perimeter, creating a two-tier regulatory regime in the UK that is broader than that of any jurisdiction in the EU27 and arguably puts UK firms and commodity markets at a competitive disadvantage.

Please see our answers to Question 80 and 81 for further details on the Legacy FSMA Regime and the effect that this has in the context of the HM Treasury's proposal to remove the OMP and EMP regulatory statuses.

69 **What would be the risks and benefits of transferring responsibility for position limits from the FCA to trading venues?**

FIA members are in favour of:

- no strict position limits on all physical and agricultural contracts (as proposed by HM Treasury), instead focusing on position management; and
- transferring responsibility for position management to trading venues, in accordance with principles set by the FCA, where the trading venues are already subject to oversight from the FCA.

This has the benefit of flexibility and would enable trading venues to enhance liquidity in contracts with oversight from the FCA. This represents a more dynamic approach than that which is currently in place and HM Treasury's proposals (which would have the effect of applying position limits to more contracts than under the new regime under the MiFID Quick Fix).

FIA members support a more dynamic approach, which would see the transfer of responsibility away from the FCA setting fixed position limits back to the position prior to MiFID II, when trading venues had increased responsibility for setting controls to ensure orderly trading, settlement and delivery, subject to oversight by the FCA. Trading venues are best placed to conduct these tasks and have

operated sophisticated, effective and successful position management regimes since long before the prescriptive position limits regime under MiFID II came into force.

Benefits of position management by trading venues

Position management regimes operated by exchanges are proportionate and efficient. They focus on a limited number of benchmark contracts and the time period right before expiry rather than on the entire maturity curve. This approach has contributed to preventing market abuse and excessive speculation which could negatively impact global prices, while at the same time allowing new products to develop.

UK trading venues successfully operate position management regimes that predate the MIFID II position limit regime. Under the Position Management structure, the default situation for all futures contracts is that there is no pre-set limit on the size of position that may be held. Exceptions to this general approach exist at the exchange's discretion and limits may be assigned to individual contracts. These are typically determined, revised, and applied by the venue where, in its view, it would improve market order, orderly delivery, or for any other market reason. The overarching principle is that the potential adverse impact of a position should be evaluated not against a fixed limit, but according to the risk that it represents to orderly trading. This risk is sometimes, but not always necessarily, a function of the size or open interest share of the position. Similarly, positions below a trading venue's limit, or those which appear comparatively modest compared to other market participants' positions, are not always necessarily low risk.

An effective, trading venue administered position management regime can take all of these factors into account and provide a more holistic and flexible approach compared to a regime of strict position limits. It can allow for changes in deliverable supply, which can be reflected dynamically, taking into account the nature of the market, the prevailing market conditions and the individual trader.

Trading venues monitor positions and have the rulebook tools to intervene, whether based upon or pre-defined thresholds or on an ad hoc basis, on any large or unusual position. UK clearing houses also have extensive position management tools. UK trading venues' position management activities are already required to comply with their obligations to maintain orderly markets and occur under the oversight of the FCA and Bank of England. These position management structures were considered sufficient and effective prior to the introduction of the complex and rigid position limits regime under MiFID II.

Risks of hard-wired position limits

The primary risk of strict and hard-wired, government-set, position limits is that this hampers the efficient operation of the market where trading activity, which is neither abusive nor contributing to a disorderly market, might take a participant past one of the limits. FIA members believe that the current regime has had a dampening effect on the markets for less liquid contracts and hampers the ability of UK venues to develop new contracts. FIA members would therefore urge HM Treasury to seize this opportunity to take an ambitious approach and move beyond the existing MIFID II position limits regime to a more dynamic and flexible position management approach.

70 **What specific factors do you think should be addressed in the framework of requirements that UK authorities would provide for trading venues?**

FIA members believe that principles that UK authorities would provide for trading venues should:

- provide trading venues with discretion to set accountability levels as and where they deem it necessary and appropriate to do so (under the oversight of their regulators), which is in line with UK MiFID II Art. 57(8) laying down the powers for trading venues to establish position management controls;
- set out in guidance what outcomes trading venues should achieve through their internal position management and controls, in line with outcomes already set out in the FCA's principles and objectives (e.g. market conduct and market integrity) and regulations such as UK MAR which address market integrity and market manipulation issues;
- have flexibility as a guiding principle and focus on outcomes rather than detailing inputs and processes as well as being aligned with global best practice reflecting the global nature of these markets, thus avoiding imposing unnecessary burdens on trading venues and market participants while ensuring a more dynamic regime which would benefit those who rely on commodity markets to manage the price risk inherent in their business in the underlying physical markets; and
- clarify the ability for venues to take account of OTC contracts and restrict this to what is absolutely necessary to maintain orderly markets on that venue, discouraging gold-plating of the basic requirements and making it clear that trading venues are not required to monitor OTC contracts.

FIA members do not support UK regulatory authorities setting position limits automatically on any contracts. Trading venues should have responsibility for position management, in accordance with principles set by the UK authorities, where the trading venues are already subject to oversight from the UK authorities.

Accordingly, FIA members believe that any proposals:

- would benefit greatly from flexibility for trading venues to avoid substantial burden on both the venue and market participants and avoid hampering development of markets;
- should not prescribe the level at which monitoring requirements and accountability levels should apply; and
- should adhere to the principle that any amended regime should not be more onerous or create more administrative burden on members than the current regime and should, at an absolute minimum, be no more onerous or rigid than the approach taken in the MiFID Quick Fix.

It is important to note that positions are already monitored and investigated as part of sophisticated market surveillance arrangements, for example under UK MAR. Therefore, we caution HM Treasury not to mandate a highly prescriptive process with little room for trading venues' discretion. We believe that the only way for accountability levels to properly function would be on the condition that

discretion is given to the trading venue to determine on which contracts to set those accountability levels, when to actively monitor them (spot month and/or other month or even closer to delivery) and whether indeed to request additional information if an accountability level is exceeded. If not, the position management controls will put a heavy burden on both the venues' market surveillance departments and trading participants' compliance departments.

71 **Do you think that the scope of contracts that are automatically subject toposition limits should be limited? If yes, do you think that it should be limitedto contracts that are critical or significant, which includes those that are physically settled, and agricultural?**

FIA members believe that no contracts should automatically be subject to rigid position limits set by the FCA. Instead, trading venues should be responsible for position management and be able to decide whether or not to set limits, subject to outcomes based guidelines on parameters for the exercise of that discretion set by the FCA. The focus should be on managing the market abuse risk, which arises less so the result of a position but rather as a result of the underlying behaviour.

The FCA's existing oversight of trading venues already enables it to require venues to act if position management is not effective.

FIA members do not agree with HM Treasury's proposal to require position limits for all physically settled and agricultural contracts. Following recent legislative and regulatory developments in the EU, position limits will only continue to apply to critical or significant commodity contracts in EU regulated markets rather than including all physically settled contracts (i.e. where "critical and significant" contracts under the MiFID Quick Fix are defined as meaning contracts where the sum of all net positions of end position holders constitutes the size of their open interest and is at a minimum of 300 000 lots on average over a one-year period).

Rather than retaining position limits for more contracts than the EU, the FIA would encourage HM Treasury to seize this opportunity to adopt a more dynamic and market-led approach to that in the EU, by reverting to a position management approach, which served the UK market well prior to MiFID II.

Principles relied on by trading venues in determining appropriate thresholds for position management can include:

- pricing and price trends in the relevant markets;
- traders' positions in related products;
- concentration, taking into account position size and direction, relative to the rest of the market, compared to peers of comparable type, and to participants' own position history;
- position development over time before, during and, where applicable, post-expiry;
- seasonality;
- open interest and sectoral developments across products;
- activity in products with related underlyings;

- inventory holdings in the underlying commodity or instrument, where this can be ascertained;
- incentive scheme participation; and
- the extent and quality of engagement of the market participant with the trading venue and their responses to enquiries.

72 **Do you think that the UK commodity derivatives regime should allow position limits exemptions for liquidity providers?**

FIA members would support adoption of exemptions for liquidity providers. In this instance, FIA members believe that any such exemptions should go further and apply to all liquidity providers and market makers in the broader sense of these terms (including not only mandatory liquidity providers but also those firms who have voluntary liquidity arrangements in place with trading venues and both formal and informal market making activities carried out by firms), rather than applying them only to firms that fall within the narrower meaning of these specific terms in RTS 8. They should be available to both financial counterparties and non-financial counterparties as both often fulfil important liquidity, funding and hedging roles, contributing to well-functioning markets.

HMT correctly identified in its consultation paper at paragraphs 6.14, 6.15 and 6.16, that hedging is an important part of risk mitigation. Market-making by regulated entities such as banks is an important component in this market which increases liquidity.

Banks' ability to offer liquidity is a function of both the ability to face clients / counterparties directly, as well as the ability to enter into related hedging trades, both on- and off-exchange. Regulated firms often hedge on a portfolio basis, which means the market-making and hedging strategies are more nuanced than a simple 1-2-1 relationship between client / counterparty trade, and hedge.

Any proposal regarding position limit exemptions should be considered in terms of the cost of compliance, including prior investment in existing systems, and potential investment in monitoring / implementing any solution. A hedging exemption that requires a counterparty-by-counterparty / trade-by-trade decision-making process will make it very difficult for regulated banks to make use of the exemption in practice, particularly given the portfolio-level hedging that is employed by banks.

Regulated banks have multiple counterparties that regularly wish to enter into on-exchange trades, in sizes that would cumulatively be larger than position limits. Such counterparties will be broad (e.g., corporates, hedge funds, asset managers), and will enter into trades for a variety of reasons. As a market-maker, banks could facilitate these trades by entering into futures position as principal with these counterparties directly, or alternatively enter into OTC trades. The risk resulting from these trades (both futures and OTC), in the role as market makers, can either be warehoused in part or in full, or hedged in futures or OTC products. Banks' role in this regard can be seen as the provision of liquidity in a principal capacity to the market.

One model which is a useful reference point is the ICE Futures Europe Expiry Limit model, which works as described above when it comes to the exemption process eligibility and application. The exchange retains the right to query the composition and intention behind the positions.

We recommend considering a position exemption regime, or a regime that allows certain market participants (e.g., market makers, defined broadly) to request an increase in position limits, from the body who will be tasked with setting position limits (regulator or exchanges) depending on the outcome of the consultation paper. Based on the above, the regime should not require a formal liquidity provision agreement, or client-by-client / trade-by-trade assessments to be made. Instead, market-makers should have the ability to apply for position limit exemptions or increases based on the fact that their business model is market-making.

Members agree with reporting of hedging details to the FCA.

73 **Do you think that the UK commodity derivatives regime should introduce a‘pass through’ hedging exemption to enable investment firms to support awider range of hedging practices?**

FIA members agree with the introduction of a "pass through" exemption, but believe that this should be broadened to apply to any investment firm or other financial entity providing hedging services in addition to the liquidity provider exemption proposed by HM Treasury (see our answers to Question 72 and 74).

74 **Do you think any other activities should be exempt from the regime?**

FIA members support extension of the position limits exemption to include not only mandatory liquidity providers but also those firms who have voluntary liquidity arrangements in place with trading venues and both formal and informal market makers (see our response to Question 72 and 73).

75 **Are there areas of the UK's position reporting regime which could be improved?**

FIA members would strongly oppose any changes to the position reporting regime in the UK for market participants. The current regime generally works well with no significant issues and FIA members are concerned that any changes would lead to operational complexity, increased costs and having to obtain different reference data from clients depending on where they are trading, all of which should be avoided. FIA members are therefore in favour of maintaining the existing position reporting regime for market participants.

One area where FIA exchange members have indicated that the current position reporting regime could be improved is the Commitment of Traders reports ("CoTR"); to increase flexibility to allow them to decide whether these reports provide a genuinely valuable source of market data.

Under the current CoTR regime, there is an obligation for trading venues to make public weekly aggregate position reports once 20+ open position holders exist in a given contract. This results in trading venues having to publish CoTRs for relatively specialised and illiquid contracts. FIA members have indicated that the trading data on these contracts are of limited value and producing the CoTRs imposes unnecessary costs and a high regulatory burden on the relevant trading venue. The current inclusion criteria also mean that for some contracts where the deliverable supply is very large there are no equivalent position reporting requirements. In this case, trading venues may decide to publish their own reports outside of the MIFID II requirements if there is a clear public benefit to doing so.

FIA believes that the position reporting regime with respect to COTRs would benefit from greater flexibility and would therefore recommend a more principles based approach which puts exchanges at the forefront of COTRs with appropriate oversight from the FCA and should be outcomes based rather than restricted by strict thresholds. Trading venues are well-placed to take a view on whether CoTRs provide a useful data source to market participants. However, any such amendment should not (i) impact the current static data members are required to report or (ii) lead to a divergence between exchanges as to what information exchanges require from members.

76 **Do you think that the ancillary activities test (AAT) should revert to a qualitative assessment of the activities performed by a market participant?**

FIA members would support a revision of the ancillary activity test ("AAT"), but they firmly believe that reverting to a purely qualitative test is the wrong approach.

Whatever approach is taken a key point for FIA members is that if a firm qualifies for the AAE (or any other exemption under Article 2 of UK MiFID II), it should not be required to be authorised in the UK for the same activity.

Preferred approach

FIA members would support:

- the reintroduction of a "commodity dealer" exemption (similar to that under Article 2(1)(k) of MiFID I[9]) for those firms dealing on own account in commodity derivatives that do not form part of a wider group engaging in other MiFID II investment services or banking activities, and the reapplication of the Article 2(1)(d) own account dealer exemption[10] to commodity derivatives, emissions allowances and derivatives on emissions allowances for customers of the market engaging in own account dealing who do not qualify for the "commodity dealer" exemption. These tests are objective and are preferred to a reversion to the purely qualitative wording under the old Article 2(1)(i) (as set out in MiFID I); and
- disapplication of the MiFID override set out in Article 4(4) of the RAO and amendment of the exclusions under the RAO, so if a firm either qualifies for an exemption under Article 2 of UK MiFID II or conducts relevant regulated activities "with or through" an authorised or exempt person, it would be outside of the scope of the authorisation requirement in the UK (see our answers to Questions 80 and 81 for suggested amendments to the relevant exclusions under the RAO and the Legacy FSMA Regime).

Alternative approach (less preferred)

[9] Article 2.1(k) of MiFID I provided an exemption for "*persons whose main business consists of dealing on own account in commodities and/or commodity derivatives. This exception shall not apply where the persons that deal on own account in commodities and/or commodity derivatives are part of a group the main business of which is the provision of other investment services within the meaning of [MiFID I] or banking services under [the Banking Directive]*".

[10] Article 2.1(d) of MiFID I provided an exemption for "*persons who do not provide any investment services or activities other than dealing on own account unless they are market makers or deal on own account outside a regulated market or an MTF on an organised, frequent and systematic basis by providing a system accessible to third parties in order to engage in dealings with them*".

As a less-preferred alternative approach, FIA members would support an amended AAT with clear, quantitative thresholds for determining when an activity is regarded as ancillary and the ancillary activities exemption ("AAE") clearly applies, without the need for any further discussion with UK regulators if a firm is below one of the following thresholds, either that its:

- net outstanding notional exposure in commodity derivatives for cash settlement or emission allowances or derivatives thereof for cash settlement traded in United Kingdom, excluding commodity derivatives or emission allowances or derivatives thereof traded on a trading venue, is below an annual threshold of EUR 3 billion (de-minimis threshold test);
- size of trading activities undertaken in the United Kingdom accounts for 50 % or less of the total size of the other trading activities of the firm's group; or
- estimated capital employed accounts for not more than 50 % of the capital employed at group level for carrying out the main business.

If a firm is above all of the above alternative thresholds, rather than being automatically required to become authorised, FIA members would support firms being able to discuss the qualitative nature of the firm's business with the FCA and enter into a dialogue about whether they need to become authorised.

No discussion with, or notification to, the FCA should be required if a firm is below the quantitative threshold.

Concerns with a purely qualitative test

Legal Uncertainty

As a general point, many members are concerned about the legal uncertainty associated with a purely qualitative, as opposed to a quantitative test.

It is likely to be difficult for members to rely on an exemption with little or no objective criteria. A return to a qualitative AAT along the lines of the previous test under Article 2(1)(i) under MiFID I would do away with all quantitative elements of the test in order to determine whether an entity qualifies for the AAE, including the De Minimis Threshold.[11] Some FIA members who currently rely on the AAE will no longer be able to do so and would not qualify for any other exemptions (unless the exemptions under Articles 2.1(d) and 2.1(k) are reintroduced as suggested). In particular, if there is a return to a qualitative understanding of what is "ancillary" to an entity's (or group's) main business, the following types of firm that currently qualify for the AAT as formulated in the UK would no longer be able to rely

[11] The tests for whether activities are "ancillary" are detailed in Commission Delegated Regulation (EU) 2017/592, which has been onshored in the UK by ("RTS 20"). Currently, under Article 3(2)(b) of RTS 20, by way of derogation from the general ≤10% of group activity requirement, where the size of relevant trading activities is equal to or more than 50 % of the total size of the trading activity of the group, ancillary activities shall be considered to constitute a minority of activities at group level where the size of the trading activity for each of the asset classes referred to in Article 2(1) of RTS 20 accounts for less than 20 % of the threshold for each relevant asset class (the "De Minimis Threshold"). For example, a group trading in metals derivatives must fall under 20% of the applicable 4% threshold (so where its activity remains below 0.8% of the overall metals market size (as published), this requirement to fall below the De Minimis Threshold.

on the AAE:

- an entity which deals as principal on own account for non-hedging purposes where that comprises more than 50% of its activities, but which does so only as a customer of the market without providing any investment services and is below the MiFID De Minimis Threshold; and
- an entity which conducts investment services which comprise more than 50% of its activities, but where these are below the MiFID De Minimis Threshold and where that entity is part of a group whose main activities are not the provision of investment or banking services.

Firms who could not rely on a qualitative AAT would need authorisation. Such authorisation is likely to be onerous for commodities dealers given HM Treasury's proposed removal of the OMP and EMP regime (as noted in our answers to Questions 80 and 81 below) and the end of the exemption and then transitional period for commodities firms under the capital requirements. Such firms are likely to consider relocation out of the UK. We believe that these outcomes would run counter to HM Treasury's stated aims of simplifying the UK's regulatory regime and removing from the scope of authorisation those firms that pose the least systemic risk.

Preference for a quantitative test

FIA members believe that a quantitative test would provide a greater degree of legal certainty rather than the qualitative test set out in prior iterations of the AAT. It was largely unused by commodity market participants given the lack of legal clarity around how much (if any) speculative trading in commodity derivatives a firm could conduct while relying on the ancillary exemption. Much of the burden in establishing monitoring against a quantitative test is in the initial set-up and resourcing for what is, in many firms, a largely automated process. Provided the data is available to measure against the quantitative test, this form of objective and legally certain test is preferable to FIA members.

77 **Do you think that the basis of the AAT should be expected activity, ratherthan historic activity?**

No, FIA members have raised concerns with this approach. Basing the AAT on expected activity does not provide legal certainty, which is required when a firm relies on an exemption. Any quantitative calibration of the AAT would necessarily need to be calculated based on figures for historic activity. A purely qualitative approach is too uncertain for firms to rely upon, as noted in our answer to Question 76.

78 **Do you agree that the annual notification requirement should be abolished?**

Yes. FIA members are supportive of the proposal to remove the annual notification requirement for the AAT as currently drafted and believe that these notifications provide little value to market participants or the FCA in their current form.

It would be helpful to have a communication from the FCA to confirm that the AAE will apply to those firms who satisfy the AAT without the need for firms to notify the FCA while the proposals from the HM Treasury consultation are finalised, in a similar vein to that which it has provided in respect of

position limits (see the FCA's supervisory statement on UK MiFID II position limits).

79 **Does the continued existence of the separate Oil Market Participant (OMP)and Energy Market Participant (EMP) regimes for commodity derivative market participants serve any meaningful purpose?**

Based on the existing UK regulatory regime the OMP and EMP regulatory statuses do continue to serve a meaningful purpose for many FIA members, as they allow commodity market participants to conduct activities in the commodities markets without being required to be regulated as full-scope investment firms.

The OMP and EMP regimes would no longer be required, **provided that:**

- the UK's regulatory regime is amended so that a person that qualifies for the AAE is no longer required to also satisfy an exclusion under the RAO to remain outside scope of the UK authorisation requirement under Part IV of FSMA; and
- this leads to the outcome that our members (former OMPs and EMPs) are permitted to continue to do the same business that they do today, equivalent to their peers in the EU and other jurisdictions, without needing to become fully authorised firms in the UK.

If the OMP and EMP regimes are removed without addressing both of these points by amending the Legacy FSMA Regime, this will lead to some market participants currently using these regimes exiting the UK and the UK will consequently lose commodities trading business to the EU27 (and other markets).

Example of current use of OMP and EMP regimes

Currently many commodity firms holding OMP or EMP regulatory status do so due to the definition of 'futures' under Article 84 of the RAO. This definition brings all physical forward activity within the regulatory perimeter, creating a two-tier regulatory regime in the UK that is broader than that of any jurisdiction in the EU27 and arguably puts UK firms at a competitive disadvantage - so a firm can qualify for an exemption under MiFID II, but still need to either become authorised in the UK or rely on an exclusion under the RAO to conduct the same business in the UK.

The definition of 'futures' under Article 84 necessitates firms undertaking physical commodity optimisation around refining and marketing assets to apply a purposive test and assess their physical commodity business, on a line by line basis, to determine whether a given transaction meets the indicative factors to qualify as being for 'commercial purposes' or not. Where firms are unable to clearly make this determination, they must seek authorisation under Part IV of FSMA or make use of an exclusion under the RAO (together the "Legacy FSMA Regime"). Qualifying for an exemption under MiFID II is not sufficient to remain outside the scope of the Legacy FMSA Regime.

In practice, many commodity groups have structured themselves so that they can rely on the "with or through" condition to the application of relevant exclusions under the RAO. They do this by obtaining a non-MiFID OMP or EMP Part IV FSMA authorisation for one UK entity within the group. This then allows other group entities to deal on own account in Article 84 futures (that are not also MiFID instruments) and satisfy the "through" limb of the test to rely upon exclusions under the RAO for various types of regulated activity, e.g. dealing on own account, dealing as agent and arranging, etc.). It is easier to put in place this structure to ensure that an exclusion is always available for group companies than having to assess each transaction on a trade by trade basis to work out whether another exclusion would apply, which may not be possible in practice and could lead to significant legal uncertainty.

Without any amendment to the Legacy FSMA Regime, the removal of the OMP/ EMP regime would mean that commodity groups would not be able to continue to operate this structure without their current OMP/ EMP entity having to become a full-scope authorised firm in the UK and becoming subject to increased capital requirements under MiFIDPRU. This would put UK firms at a significant competitive disadvantage to third country entities conducting the same business. As a result, many FIA members who currently hold OMP/ EMP status have indicated that if the OMP/EMP regime is removed without any amendment to the Legal FSMA Regime, they intend to leave the UK and trade from other jurisdictions.

The effect of this is a dual permission regime in the United Kingdom, whereby firms considering conducting commodities business in or from the UK must consider their MiFID II activities and any relevant UK MiFID II exemptions and also the Legacy FSMA Regime and any available exclusions thereunder and then structure themselves accordingly.

If HM Treasury's aim of lessening the regulatory burden upon OMP/EMP firms is to be achieved, then the definition under Article 84 would either require reworking or further guidance be provided to firms, perhaps by way of additions to the FCA's Perimeter Guidance Manual, to outline when the commercial purposes test can be successfully met. In the absence of one of these measures the elimination of the OMP/EMP regime would mean that firms currently holding either designation would still require Part IV authorisation. With the imposition of prudential requirements this would mean former OMP/EMP firms would be subject to greater, not less, regulatory oversight and burden, contrary to the stated aims of the review. In addition, these prudential requirements could also be significant depending on the legal and operational structure of certain energy groups, leading to increases in regulatory capital allocation taking financial resources away from other activities, such as investment in new initiatives and infrastructure.

FIA members believe that, as an alternative to amending the definition under Article 84, an amendment to the existing UK MiFID II regime to clarify that where a firm qualifies for the ancillary activity exemption (or any other exemption under Article 2 of UK MiFID II/MiFIR), they need not also qualify for an exemption under the Legacy FSMA Regime for those activities benefitting from this exemption. This would achieve the stated aim of removing firms posing little systemic risk from the regulatory perimeter whilst also streamlining the authorisation and exemption criteria.

FIA would appreciate further discussions with HM Treasury and the FCA on how the AAT is designed and its interaction with the Legacy FSMA Regime. FIA members understand that any amendments to the Legacy FSMA Regime would require changes to the RAO.

Without this amendment to the Legacy FSMA Regime, removal of the non-MiFID OMP and EMP regulatory statuses would mean that many commodity firms who currently use a group entity authorised as an OMP or EMP to ensure that their trading entities (and counterparties) can satisfy the "with or through" test set out in various exclusions in the RAO would need to become full-scope UK MiFID II investment firms or would need to drastically change their trading and booking models. In many cases, this could involve engaging third party authorised firms to intermediate trades between two commodity trading entities both of which qualify for the AAE, thus unnecessarily increasing the bureaucracy and costs associated with doing business in the UK as against doing the same business in the EU.

Please see our answer to Question 81 for further details and suggested amendments to the RAO.

80 **Do you think that the OMP and EMP regimes should be removed as particular regulatory statuses from the UK's regulatory perimeter?**

The suggestion appears to be positive, provided that:

- an entity that is currently a non-MiFID OMP/EMP that can take advantage of the AAE in its current form can continue to do so under the new AAT, however that is formulated; and
- any entities who qualify for the AAE (or another exemption under Article 2 of MiFID II) do not also need to satisfy an exclusion from the FSMA Part IV authorisation requirement under the RAO to remain outside scope of the UK authorisation requirement.

It is only if these two points are both resolved that a firm currently authorised as an OMP or EMP would no longer need to be FCA authorised (unless it was to change its business model or another exclusion applies).

If the RAO is amended so that an entity that qualifies for the AAE does not also need to rely on an exclusion from the Legacy FSMA Regime, that would be extremely helpful and would simplify the UK regulatory regime significantly.

In those circumstances, FIA members would agree that the OMP and EMP regimes should be removed, as long as this leads to the outcome that former OMPs and EMPs are permitted to continue to do the same business that they do today, equivalent to their peers in the EU and other jurisdictions, without needing to become fully authorised firms.

The UK OMP and EMP regimes are the most restrictive, when comparing regimes with comparable jurisdictions such as the US, Singapore, Switzerland and the EU27.

81 **Do you think any changes would need to be made to the MiFID II regime, if the OMP and EMP regimes are removed as particular regulatory statuses?**

Yes. The key point is to ensure that removal of the OMP and EMP regulatory statuses results in market participants who hold this status being able to continue to conduct the same business that they do currently without having to become full-scope investment firms in the UK, so they can operate on a level playing field with third country firms and are not put at a competitive disadvantage.

To achieve this:

- the RAO would need to be amended so that where a person qualifies for the ancillary activities exemption (or any other exemption set out in Article 2 of UK MiFID), they are not subject to any authorisation requirement in the United Kingdom for the same business (see below for suggested amendments to achieve this);

- the concept of a commodity future under Article 84 of the RAO should be aligned with that of a commodity derivative that is classified as a financial instrument in Section C of Annex I to UK MiFID, so that a single definition applies which is no broader than that in other jurisdictions (for example, EU member states); and

- any amendments to the exemptions in Article 2 of UK MiFID II would need to ensure that those who currently use the OMP or EMP regulatory statuses and qualify for the current form of the AAE are not faced with a situation where they have no available exemption in the UK, by:

    - reintroducing the “commodity dealer exemption” 2.1(k); and

    - reapplying the “own account” exemption in Article 2.1(d) to all kinds of financial instruments, including those currently covered by the AAE in Article 2.1(j).

FIA members are supportive of HM Treasury’s stated aim to streamline and simplify the UK regulatory perimeter and remove from scope those firms and activities that pose the least systemic risk, however they do not believe that removing the OMP/EMP categorisation from the FCA Handbook will achieve the stated aim on its own. On the contrary, without other amendments to the UK regulatory perimeter, this could have the opposite effect and result in increased costs and operational complexity for groups who currently include an OMP/EMP. Linked to the question above, EMP/OMP firms need to be able to make use of UK MiFID II exemptions to ensure that they do not need to be authorised in the UK and should not be put at a competitive/regulatory disadvantage to third-country firms.

Suggested amendments to the RAO

Accordingly, in circumstances where a person qualifies for the AAE, we propose that the RAO is amended so that:

- where that person is dealing on own account in commodity futures or options bringing them within scope of Article 14 of the RAO, they would not be required to additionally satisfy the conditions currently set out in Article 16(a) or (b) to rely on the exclusion in Article 16 if they qualify for an exemption under Article 2 of UK MiFID II in respect of that regulated activity;

- similarly, where that person is dealing as agent in commodity futures or options bringing them within scope of Article 21 of the RAO, they would not be required to additionally satisfy the conditions currently set out in Article 22(1) and (2) to rely on the exclusion in Article 22 if they qualify for an exemption under Article 2 of UK MiFID II in respect of that regulated activity;
- where that person is arranging transactions or making arrangements with a view in commodity futures or options bringing them within scope of Article 25(1) or 25(2) of the RAO, they would not be required to additionally satisfy the conditions currently set out in Article 29(1) or (2) to rely on the exclusion in Article 29 if they qualify for an exemption under Article 2 of UK MiFID II in respect of that regulated activity; and
- where a person is dealing on own account, as agent or arranging transactions etc. in commodity futures or options and is currently relying on the overseas persons exclusion under Article 72 of the RAO to do so, it would not be required to additionally satisfy the conditions currently set out in Article 72(1) for own account dealing, Article 72(2) for dealing as agent, Articles 72(3) or (4) with regard to arranging or making arrangements with a view, to rely on the exclusions in Article 72 if they qualify for an exemption under Article 2 of UK MiFID II in respect of that regulated activity.

Chapter 7: Market Data

82 **Do you agree that the government should take action to encourage the development of a CT?**

We agree with HMT's scope of developing a CT for fixed income asset classes noting also that there is a clear lack of demand for a CTP for derivatives markets. Frequently traded derivatives are predominantly used by sophisticated market participants for risk management purposes. Therefore, the use case for retail investors seeking to have a better view of the market or finding liquidity is, unlike for equity and bonds, rather limited.

If you answered yes to question 82:

83 **Do you think a fixed income tape should be prioritised?**

84 **Do you think that it would be beneficial for a fixed income CT to include post-trade data only, or would there be value in a tape covering pre-tradedata too?**

85 **Is there any value in a delayed data CT for fixed income markets?**

86 **Is it valuable for an equity CT to include pre- and post-trade data?**

87 **Is there any value in a delayed data CT for equity markets?**

88 **Should the government amend legislation to enable a market-led privatesector CT to develop, or do you think UK authorities should be actively involved in creating a CT?**

89 **What are the legislative barriers for a private sector-led CT to emerge? Doyou agree with the**

legislative changes identified above? Are there additionalchanges that UK authorities should be considering?

90 **Do you see any risks with removing the obligation for CTs to provide datafor free after 15 minutes?**

91 **What are the potential advantages and disadvantages of multiple private-sector CTs for each asset class?**

92 **Do you have any suggestions on further areas that UK authorities should be considering when making changes to market data, especially in relation to requirements that are set out in legislation?**

The standardisation of data submission (frequency, content and format) is essential as well as the reduction of market data costs and the administrative burden of reporting entities. Increasing data quality without further increasing associated costs of consuming data is a precondition to make any CTP economically viable.

Chapter 8: Reporting

93 **Where do the current regulatory reporting regimes for wholesale marketscontain duplicative reporting requirements?**

The use of data reported in compliance with MiFID II/MiFIR requirements is a crucial element to the effective functioning of all regulatory bodies. Some of the data contained in transaction reports has given regulators a strong foothold to assess potential cases of market abuse and gain 'better insight into the trading business of firms.

Regulatory reporting regimes have become a cornerstone of post-financial crisis reform, with trade and transaction reporting improving regulatory oversight of systemic risk and potential instances of market misconduct. That being said, the rollout and evolution of these regulatory reporting regimes across global markets has been fractured and inconsistent, resulting in a myriad of obligations which threaten to reduce the accuracy and completeness of data which has become crucial for regulators and policymakers. Duplication and overlaps across reporting regimes result in increased costs to reporting entities. Duplicative reporting requirements relate to instances where a data attribute is being reported multiple times across regimes, albeit in different formats and for different purposes.

In recent years, policymakers and National Competent Authorities have taken steps to harmonise global reporting frameworks. One successful method used has been through the adoption of common identifiers (eg. ISIN, LEI, UPI). While FIA commends these efforts, duplicative reporting continues where firms are required to continue to report underlying static data even when a valid identifier has been reported.

The success of a derivative reporting regime should not be assessed in a silo, but rather it must be evaluated alongside other reporting regimes which impact the same or similar derivative contract. Supervisory reporting in its current form remains inefficient. EMIR reporting was designed with a focus

on OTC derivatives, yet it also included ETDs within the scope of reporting. This has resulted in the inclusion of mandatory reporting fields that, whilst appropriate for OTC derivatives (such as 'effective date'), are not a feature of ETD contracts. Such fields are nonetheless mandatorily required to be completed for ETD contracts which has led to a common market practice of populating such reportable fields with default values. These manufactured values bring no benefit to regulatory oversight. Historically, ETD markets have always been fundamentally more transparent than their OTC counterparts as ETDs have always been traded, cleared and regularly reported to regulators. Adopting the same reporting requirements for both OTC and ETD has had a negative impact on data quality and resources which could be used to improve the accuracy and completeness of information reported under MiFIR, EMIR, REMIT and other reporting regimes.

Existing reporting regimes (EMIR, MiFIR, MAR, AIFMD, and REMIT) rely upon a similar core dataset. As a result, the optimum solution to reduce complexity and duplicative requirements would be to design one reportable dataset that can serve multiple regulatory purposes (e.g. by providing data for systemic risk oversight as well as market abuse surveillance). This would enable firms to report just once per transaction and for regulators to then extract the relevant data required to fulfil the particular regulatory mandate. A 'report once' regime would eliminate inconsistencies in interpretation which can arise across different pieces of reporting legislation. Furthermore, this would also prevent duplication of fields such as the trade economics of the transaction which would remain the same, regardless of the reporting regime being used.

There is some degree of duplication in MIFIR transaction reporting with the Short Selling Regulation (SSR). The current requirement to include short selling flags in transaction reports has proved ineffective and impractical because of fundamental differences in the way short positions are defined and assessed under SSR when compared to the transaction level reporting required under MiFIR. We strongly urge HMT to remove the short selling flag requirements from MiFIR transaction reporting to address this inefficiency which currently creates unusable data. We note that ESMA is proposing to remove this requirement from EU MiFIR.

94 **Is intervention needed to mitigate against duplicative reporting for firms undertaking securities financing transactions (SFTs) with members of theEuropean System of Central Banks?**

95 **Do you think the 10% loss reporting rules for portfolios and contingent liability transactions offer effective investor protection? If not, how do youthink the rules in this area should be revised?**

96 **Do you think electronic communication should become the default meansof communication for disclosures and reporting to retail clients, and, if so,what protections are needed for retail clients around such a change?**

97 **Are there any other changes to the conduct rules in the MiFID delegatedregulation that you think could be made to reduce costs whilst continuingto offer meaningful investor protection?**

98 **Do you think other changes are needed to ensure that the reporting regime correctly balances investor protection and transparency?**

99 **Have you experienced any issues with the utilisation of International Securities Identification Number (ISINs) as identifiers?**

100 **Do you have any suggestions on how the use of identifiers could beimproved?**

Given that derivatives markets are global, it is critical that, where appropriate, the regulatory framework applicable to them is globally consistent, whilst also leaving room to address issues which may be specific to a particular region or market. Global reporting regimes have been implemented in an inconsistent manner and at different paces. Furthermore, inconsistent methodologies have been applied by Europe when determining whether or not to recognise third-country regulation as being "equivalent" to European regulation. The equivalence process itself is opaque, with little objective guidance provided to help third-country regulators determine whether, and how, their regulations will be deemed sufficient for equivalence to be granted.

The easiest way to mitigate the risks of regulatory arbitrage and to ensure internationally coherent regulation is to: (i) agree sufficiently granular global standards; (ii) move forward on the same timetable as our immediate peers; (iii) implement regulation in a consistent manner globally; and (iv) have the means to pro-actively identify regulatory conflicts and overlaps. In addition, regulators and legislators should ensure that rules reflect differences between ETD and OTC derivatives.

The Unique Product Identifier (UPI) is not viable for reporting ETDs under MiFIR. All derivatives traded on, or admitted to trading on, a Trading Venue are expected to have a valid ISIN. Furthermore, the concept of the UPI was designed for complex, customisable contracts (OTCs). As such, FIA remains confident that the ISIN provides the most granular method of identification for ETD reporting and, where available, the ISIN should be used to accurately identify the exchange traded derivative.

When adopting and implementing the use of global standards and identifiers, policymakers must ensure they provide clarity on methods used to generate and disseminate identifiers. The Trading Venue Transaction Identification Code (TVTIC) (MiFIR) and Position Unique Trade Identifier (Position UTI) (EMIR) are two examples where policymakers failed to ensure consistent implementation of the rules. This has had a negative impact on the accuracy of reported data. A brief overview of each identifier is set out below:

TVTIC –

The TVTIC is a code generated by trading venues and disseminated to both the buying and selling parties for the purpose of reporting under MiFIR. Since go-live, investment firms have faced challenges when obtaining and reporting TVTIC and this has primarily been due to the inconsistent approach taken by Venues when generating and disseminating the Code. Examples of how Venues provide the TVTIC include (i) within the executed trade message, (ii) within an end of day file, and (iii) by providing members with a concatenation logic which allows members to establish the TVTIC independent of the Venue.

The FCA is aware of issues relating to TVTIC and have acknowledged this within Market Watch 65 from September 2020 where the FCA confirm they have '…*identified inconsistent dissemination of TVTICs by trading venues to investment firms. We recommend that trading venues review their procedures for the generation and distribution of TVTICs to ensure they facilitate the consistent reporting of a unique code to be used by both the buying and selling parties.'*

Due to this, FCA confirmed that they have '*encountered investment firms failing to report the TVTIC accurately. This includes instances where the field has been left blank, reported with an internal code, or reported with a code that fails to follow any guidelines provided by the respective trading venue.'*

Position UTI –

Given the nature of ETDs (individual buy/sell trades compressed into an end-of-day position at the end of each business day) systemic risk for ETDs is best reflected and assessed at position level. To date, successful pairing and matching (reconciliation) rates for Position-level reporting remain relatively low. The primary reason for this is due to issues relating to the Position UTI (PUTI). For cleared trades, the CCP generates and disseminates the PUTI to Clearing Members. Unfortunately, policymakers provided no further guidance or requirements on this process which resulted in each CCP devising its own way to generate and send the PUTI to its members. This resulted in a multitude of methods being used (some CCPs provided the PUTI to Clearing Members in a file while others used a logic which was shared with Clearing Members so the Clearing Member could generate the same unique P-UTI as the CCP). Clearing Members struggled to align their operational build in line with multiple CCPs using different methods to obtain the PUTI. These obstacles to obtain and report the PUTI means that the two sides of the position cannot be paired. Industry-led initiatives have been key to improve this process and establish a consistent mechanism for the dissemination of the PUTI.

The objective of any identifier must be to improve the efficiency and accuracy of data while also reducing the burden on reporting entities. This can be achieved by removing the need to report underlying reference data. As previously noted, supervisory reporting requirements require further harmonisation to improve the quality of reported data and reduce the burden and cost on reporting entities. Existing reporting obligations require firms to report an identifier for both counterparties and contracts (LEI and ISIN) as well as parts of the data that sit underneath the identifier. This is both duplicative and problematic as firms are required to build not only to the identifiers but also the data that sits beneath them.

Chapter 9: Cross Cutting Issues

101 **What further steps can UK authorities take to enable firms to take advantage of technological innovation in capital markets?**

102 **What further steps can UK authorities take to support the wholesalemarkets sector as we move towards a low carbon economy?**

The global economy faces real and immediate risks from climate change. These risks include direct financial risks from extreme weather, as well as the transition risks associated with fundamental changes in how the world does business. In July 2021, the UK Met Office reported that the UK's climate continues to warm, with 2020 the first year to have temperature, rain and sunshine rankings all in the top 10. While impacts may vary across regions, climate change is a global issue which requires global solutions. Global derivative markets can help build a more sustainable future.

As noted by the UK Government's Office for Science in a June 2021 report, the UK's greenhouse gas emissions in 2020 were 51% below 1990 levels. This means the UK is over halfway to meeting its target of 'net-zero' emissions by 2050. Derivatives markets are naturally innovative and have already influenced sustainable finance strategies around the globe through their support of new products and trading venues. Policymakers should encourage market-driven experimentation through flexible laws and regulation, and partner with industry stakeholders to avoid overly rigid or restrictive regulation.

Derivatives exchanges have a long history of developing and enforcing standards for commodity contracts. In recent years, some exchanges have begun building sustainability standards into their operations. These derivatives exchanges have unique knowledge of the underlying marketplace and have built trust with market participants through a history of communication and transparency. Regulators can play an important role by supporting this industry-led process and acknowledging the existing standards that underpin our markets.

Derivatives exchanges continue to develop exchange traded derivatives contracts to support sell- and buy-side firms with additional tools to implement sustainability-driven mandates and complement their efforts on the capital allocation angle, with ESG instruments in the risk transfer markets. These derivatives have the potential to (i) optimise allocation of capital to support or complement investment into sustainable projects and activities and (ii) represent a flexible solution to attend the demand from investors towards new sustainable investment strategies, while also managing undesired sustainability risks, trade longer-dated maturities, align their ESG investment mandates and to manage the granularity of the client's risk exposure while reducing trading costs. To support this, a mature secondary markets ecosystem of exchange-traded derivatives and ETFs, based on underlying assets, is developing but needs time to be mature alongside the primary and secondary market for sustainable shares and bonds. This will foster a liquid market for sustainable investment and risk management which is needed to ensure that Sustainable Finance is fully embedded into the mainstream of the financial market's ecosystem.

Markets have shown their inherent ability to, and will continue to, innovate towards this demand for sustainable alternatives with adapted risk managing products. The financial policy framework should use this momentum to ensure markets can adjust efficiently. They have already begun a transition to more sustainable products with the various exchanges having listed sustainable contracts in parallel or in addition to traditional contracts. There is room for more products and innovations. Markets react to supply and demand from investors and market participants, who have recently been much more focused on sustainable products.

As noted above, the risks associated with climate change are global and must be tackled with global solutions. Derivative markets are global, yet face fragmented regulatory landscapes across jurisdictions — and sometimes, even within a single country. This fragmented landscape, impacts the role that derivative markets can play to meet the urgent and substantial work that lies ahead. With that in mind, we encourage the UK Government to start the process of linking the UK Emissions Trading System (UK ETS) with the EU's Emissions Trading System (EU ETS). By aligning align decarbonisation pathways in this way, the advantages are clear in terms of liquidity, price discovery, and the ability to attract abatement from across Europe rather than just the UK. It would also create a level playing field in terms of carbon pricing, avoiding competitive distortions, and leading to aligned

cost implications for industry across the UK and the European Economic Area (EEA). This would be beneficial for international commerce, minimise the risk of carbon leakage, and lower the costs of achieving Net Zero

It is crucial for any sustainability-related laws to acknowledge existing industry-led solutions and the disparate regulatory and legal burdens currently in place in order to avoid complexity and confusion. Regulators, global standard-setters and lawmakers can play an important role by encouraging consistency in policy actions across jurisdictions and acting deliberately with enough time to accommodate legitimate industry concerns before rolling out any new regulation.

103 **How do companies harness retail investment whilst ensuring investor protection?**

104 **How do companies take advantage of the globalisation of information to reach investors?**

105 **Is there a role for UK authorities to play to facilitate retail access tocapital markets, while continuing to offer high standards of investor protection?**

About FIA

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. Our membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from about 50 countries as well as technology vendors, law firms and other professional service providers.

Our mission: To support open, transparent and competitive markets, protect and enhance the integrity of the financial system, and promote high standards of professional conduct.