

27 October 2022

## **FIA EPTA response to the [Call for Evidence](#) of the UK Government's approach to delivering its net zero target: The Net Zero Review**

### **Introduction:**

The European Principal Traders Association ([FIA EPTA](#)) welcomes the opportunity to respond to the United Kingdom (UK) Government Call for Evidence on the Net Zero Review.

FIA EPTA represents 24 independent European Principal Trading Firms (PTFs) which deal on own account, using their own money at their own risk, to provide liquidity and immediate risk transfer in exchange-traded and centrally-cleared markets for a wide range of financial instruments, including shares, options, futures, bonds and ETFs. FIA EPTA's members are based in the Czech Republic, Germany, Ireland, The Netherlands and the UK (~70% of our members have been licensed by the FCA).

Our members are independent market makers and providers of liquidity and risk transfer on trading venues and to end-investors across Europe. Market making and liquidity provision (also referred to as principal trading or dealing on own account) is a distinct activity that is undertaken by non-systemic investment firms rather than banks, in a highly dispersed and varied ecosystem of independent Principal Trading Firms. These firms operate in an innovative and competitive fashion leading to a vibrant, dynamic and diverse ecosystem which massively reduces interconnectedness and increases substitutability. This fundamentally reduces systemic risk whilst improving market quality and lowering costs for retail and institutional investors alike.

FIA EPTA members welcome the actions and responsibilities taken by the UK Government during COP26 in Glasgow and the work toward the common goals of reaching climate neutrality in 2050.

FIA EPTA is committed to supporting policymakers and regulators in ensuring the success of the sustainable finance project at all levels of the capital market ecosystem. With a balanced approach, FIA EPTA members believe it will benefit the long-term stability and attractiveness of the UK capital markets. We would welcome the opportunity to provide further background to the UK Government on the issues raised in our response.

## Overarching questions:

**1. How does net zero enable us to meet our economic growth target of 2.5% a year?**

FIA EPTA decided not to answer this question.

**2. What challenges and obstacles have you identified to decarbonisation?**

FIA EPTA decided not to answer this question.

**3. What opportunities are there for new/amended measures to stimulate or facilitate the transition to net zero in a way that is pro-growth and/or pro-business?**

FIA EPTA members believe that a well-designed sustainable capital market infrastructure will benefit the growth and attractiveness of the UK in this space and will support the transition towards net-zero. This will attract other businesses and innovators to the UK to benefit from the ESG hub the UK could become. FIA EPTA members believe the UK Government should further develop the secondary markets and improve the underlying data in ESG products so that the UK will remain a global centre for green finance.

FIA EPTA members hope that the UK Government will continue to be an ambitious standard-setter, drawing on the high level of experience and professional excellence which is present within the broader UK capital markets ecosystem.

FIA EPTA members believe that the secondary markets are vital for a successful green transition to help reach net-zero. The further develop a mature sustainable secondary markets ecosystem of 'green' exchange-traded derivatives (ETDs, i.e., listed futures and options) and exchange-traded funds (ETFs), is vital for investors to adjust their portfolios, pursue their trading & investment strategies and manage their risk, at low cost. In addition, green bonds can help businesses attract capital for sustainable investments into greening products and offices and enhance innovation. An important factor in the success of these products is liquidity, FIA EPTA members are independent market makers and liquidity providers supplying the needed liquidity, supporting a smooth and stable trading environment. Market makers make sure that there is always a counterparty to buy or sell products to/from, which ensures risk management and price discovery.

For that to function well, FIA EPTA members believe that ETDs that support the transition should also be counted as such. This is an important opportunity for the UK as for now, in the EU ETDs would not be recognised as contributing to Taxonomy-aligned investment activities under SFDR. The markets for ESG products are growing and asset managers, including pension funds, are looking at ways to make their portfolios 'greener'. If the UK Government acknowledges the importance of derivatives in the transition towards net-zero it will help with the attractiveness of the UK as a global hub for trading and doing business.

**4. What more could government do to support businesses, consumers and other actors to decarbonise?**

FIA EPTA members believe the UK Government should target a long transition period to help businesses prepare for the green transition and make reductions towards net-zero. Conversely, our members believe that too short a transition period risks slowing the green transition and damaging capital markets, with a knock-on impact on the UK's wider financial infrastructure. That being said, we believe that the UK Government should continue from the outset to work on the transition, delays will harm the stability later on in the process. In addition, to creating a transparent and clear timeline so that businesses and consumers know what is expected. For net-zero to succeed, businesses should be incentivised to create transition plans on how they will execute this.

The energy markets are more important than ever. With the extreme volatility that hit the gas and energy markets since the Russian invasion and war in Ukraine; impacting citizens with extreme price shifts, it is needed to adjust these markets and make them more resilient and less volatile. FIA EPTA members believe that when more market participants have access to these products it will improve competition and will make markets more resilient.<sup>1</sup> For well-functioning exchange-traded markets to operate efficiently, they need a large number of market participants, including not only the buyers and sellers of the underlying commodities but also independent market makers, like FIA EPTA members, that provide liquidity for trading.

For that to function well, more trading participants should be allowed in these markets and structured similarly to traditional products which will benefit the markets from the risk management functions and the confidence that creates. A benefit market makers add to markets is that they continually provide liquidity in all market conditions, not just when they desire in a solid centrally cleared structure ensuring financial stability in case of market disruptions.

FIA EPTA members believe that traditional companies can play a vital role in the transition, and at this point in time, we are not in favour of de-listing/de-investing in companies that are currently deemed 'brown' as these companies have large funds to invest in greening their products and investing in climate solutions. However, the UK Government should set out clear goals and timelines and make businesses accountable to work toward climate neutrality and support companies that work on climate solutions. Reliable and meaningful data is regarded as very important for this, for the UK Government to assess progress, as for (end) investors who base their investment decision on data and ratings.

This was also the conclusion from a research paper that FIA EPTA published in June 2022 based on feedback from 35 buy-side participants.<sup>2</sup> FIA EPTA members believe ESG research products have not yet reached a sufficient level of maturity and comparability to allow

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<sup>1</sup> FIA, *A Futures Industry Perspective: How EU Policymakers Should Respond to the Energy Crisis*, September 2022, [https://www.fia.org/resources/futures-industry-perspective-how-eu-policymakers-should-respond-energy-crisis?utm\\_source=FIAMWeb&utm\\_medium=HPHE](https://www.fia.org/resources/futures-industry-perspective-how-eu-policymakers-should-respond-energy-crisis?utm_source=FIAMWeb&utm_medium=HPHE).

<sup>2</sup> *Redefining Value in ESG: The Myriad of Paths to the Summit*, June 2022, <https://wearemarketmakers.com/redefining-value-in-esg-download-the-report/>

investors to fully understand the products. As ESG is an ever-growing concept of which more and more characteristics are part; FIA EPTA members believe that it should be clear on which ESG characteristics an ESG rating is based to make meaningful investment decisions. This is also recognised by regulators such as the [FCA](#) who are working on greater clarity, and FIA EPTA members strongly support this.

**5. Where and in what areas of policy focus could net zero be achieved in a more economically efficient manner?**

FIA EPTA members believe that the financial markets play an important role in getting society towards net-zero. For this to function well, stable, transparent and efficient markets are needed. In our response to this CfE FIA EPTA make several suggestions for this and how it would improve the attractiveness and completeness of the UK.

- FIA EPTA members believe that the UK Government should create a clear and transparent timeline for the transition so that companies and consumers know what is expected. Which should start immediately; delays will harm stability later on. The transitional period needs to be functional and spread out over many years so the transition can happen smoothly, to ensure stability. Starting too late, or transitioning to rapid will both impact the stability of financial markets, and will, therefore, have a greater impact on consumers. Regulation that supports the transition should be targeted appropriately and fit for purpose.
- FIA EPTA members believe that transparent and harmonised ESG data is vital for the uptake of ESG/green products. FIA EPTA members support the FCA in their review and ideas to regulate the ESG data. (end)Investors rely on this data when making their investment decisions, unreliable data could have a negative effect on how these products are perceived or even worse, could create a negative effect on the ESG/sustainable markets if the data would not be perceived as reliable. This will create more resilient and stable markets for ESG/Green products.
- FIA EPTA members believe that the secondary markets should be developed further to support the green transition and achieve net-zero. The secondary markets help market participants manage their risks and help with price discovery. Exchange Traded Derivatives (ETDs) play an important role in this. Under the taxonomy regulation in the EU ETDs are, for now, never counted as green. FIA EPTA members believe this is a mistake and it does not recognise the way ETDs are used and contribute to stable financial markets. In addition, please see questions 3 and 10.

**6. How should we balance our priorities to maintaining energy security with our commitments to delivering net zero by 2050?**

The importance of energy security has been more visible than ever as the war in Ukraine and the cost for citizens have increased enormously. As 2050 is still a long time away, FIA EPTA members believe the UK Government should set out a clear timeline and goals of what is expected of public and private (market) participants. This will give stakeholders time to adjust and make plans for the transition to reach net-zero by 2050. The UK Government should address issues around environmental and social issues while keeping in close contact with industry and interest groups. This is key to a smooth green transition where all sectors should work together toward common goals.

We also believe the UK Government should partner with large emitters as they have large funds to invest in 'greening' their products and invest in climate solutions products/technologies. FIA EPTA members further believe companies should be incentivised to work on the transition and should only reprimand stakeholders who are actively not working on their transition plans. FIA EPTA members believe that if the UK Government delays these plans it will be harder to achieve the goals as it will take a long time to make the transition. For this to function well, transparent and harmonised data is needed, and FIA EPTA members would urge the UK Government to continue with the plans to bring ESG data/rating providers into the scope of regulation.

**7. What export opportunities does the transition to net zero present for the UK economy or UK businesses?**

FIA EPTA decided not to answer this question.

## Questions for businesses:

**8. What growth benefits/opportunities have you had, or do you envisage having, from the net zero transition?**

FIA EPTA decided not to answer this question.

**9. What barriers do you face in decarbonising your business and its operations?**

FIA EPTA decided not to answer this question.

**10. Looking at the international market in your sector, what green opportunities seem to be nascent or growing?**

FIA EPTA members are based in Europe but most are active globally. There is a clear growing interest in ESG products, if the UK would position itself well but sound 'green' regulation the UK could become a hub for transitional finance. FIA EPTA members believe that the UK should work together with other jurisdictions to develop a regulatory base of how sustainability regulation should be accomplished. In addition, we believe that targeted divergence could mean that the UK would be an attractive place for transitional finance.

FIA EPTA members believe that the UK could better utilise its deep capital markets, especially the secondary markets to facilitate this growth. The secondary markets enable asset holders to effectively manage their fiduciary duty regarding their sustainable holdings (e.g. to buy or sell ESG products on behalf of end-investors, insurance holders, or pension participants) and to enable sound financial risk management for these end-investors.

To support a mature and healthy secondary markets ecosystem of exchange-traded derivatives (ETDs) and ETFs based on underlying assets needs to be developed alongside the primary and secondary markets for sustainable shares and bonds. This will foster a liquid market for sustainable investment and provide for greater risk management which is needed to ensure that Sustainable Finance is fully embedded into the mainstream of the financial markets ecosystem. As independent market makers and liquidity providers, FIA EPTA members have the expertise and the commitment to supporting this development.

Last year, FIA EPTA published its Principles on Sustainable Finance and ESG to explain how we believe our members can contribute to the sustainability goals<sup>3</sup>.

To give an example, FIA EPTA members would like to note an issue with ETDs in the EU. FIA EPTA members believe that the sustainable/ESG ETDs market would have much potential for the UK to grow. For now, the current Taxonomy and Sustainable Finance Disclosure Regulation (SFDR) proposals<sup>4</sup> in the EU would in effect restrain the use of listed derivatives by market participants and restrict the amount of capital that can be made available for a sustainable transition. Listed derivatives are a key component of mature secondary markets. The recent growth in demand for listed ESG derivatives demonstrates that these products are a core component of sustainable investment strategies, especially since the availability of liquid and transparent derivatives significantly reduces funding and financing costs for equity and bond issuers in primary markets.

In the current EU SFDR draft ETDs would not be recognised as contributing to Taxonomy-aligned investment activities, and yet would still need to be included in the denominator as part of the total assets of the product or portfolio. This proposed approach would unduly disincentivise the use of derivatives in the affected financial products since any exposures to derivatives could only ever contribute negatively to the Taxonomy alignment ratio. This would make it more difficult for end-users to use exchange-traded derivatives for managing their financial risks and in the process undermine the goal of having safe, liquid, and efficient markets that can support the green transition.

FIA EPTA members believe that this area provides a good example of where targeted divergence from current EU proposals could provide the UK with stronger green outcomes and a more competitive Sustainable Finance sector, and we see this as a good opportunity for the UK to develop the growth of the sustainable derivatives markets.

**11. What challenges has the net zero transition presented to your business?**

FIA EPTA decided not to answer this question.

**12. What impacts have changing consumer choices/demand had on your business?**

FIA EPTA members, who act as market makers and liquidity providers on exchanges and MTFs do not interact directly with consumers. However, with the growing demand of consumers to invest themselves or via their pension funds/assets managers in sustainable products and companies there is a growing need for market makers in these products.

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<sup>3</sup> FIA EPTA Principles on Sustainable Finance and ESG, June 2021: <https://www.fia.org/epta/resources/fia-epta-publish-principles-sustainable-finance-and-esg>.

<sup>4</sup> Draft Regulatory Technical Standards with regard to the content and presentation of disclosures pursuant to Article 8(4), 9(6), and 1(5) of Regulation (EU) 2019/2088 (JC/2021/50).

A recent FIA EPTA survey found two-thirds of our member firms are expanding their activities in the ESG space<sup>5</sup>. While market making firms surveyed are most active in supplying liquidity in ESG futures (50%), they are starting to see a growing demand from both institutional and retail investors in ESG exchange-traded funds (45%).

In this way, market making firms can play a key role in facilitating the green transition by providing constant liquidity and making ESG products more attractive and available to other market participants. This helps minimise the cost of investing in ESG products, which can help investors reorient capital to sustainable investments. We would call on the UK Government, therefore, to seek to optimise conditions for the availability and adoption of exchange-traded green finance products, which can be a useful additional tool for both professional and retail end-investors to direct their capital to the green transition while managing their financial investment risks.



**13. What impacts have decarbonisation/net zero measures had on your business?**

FIA EPTA decided not to answer this question.

**14. What more could be done to support your business and/or sector to decarbonise?**

FIA EPTA decided not to answer this question.

**15. Do you foresee a role for your business within an expanded UK supply of heat pumps, energy efficiency, electric vehicles, hydrogen economy or clean power?**

FIA EPTA decided not to answer this question.

<sup>5</sup> <https://www.fia.org/marketvoice/articles/two-thirds-european-market-makers-plan-expand-esg-liquidity-provision>

**16. For clean power industry: what barriers to entry have you found in deploying new plant and technologies?**

FIA EPTA decided not to answer this question.

**17. How many green jobs do you estimate will be created in your sector by 2030?**

FIA EPTA decided not to answer this question.