6 March 2024

FIA response to CP 23/32 - Improving transparency for bond and derivatives markets

FIA welcomes the FCA's proposals concerning the revised bond and derivative transparency regime in the UK, with one of the primary goals to establish transparency requirements that are balanced. This avoids damaging liquidity or undermining price discovery processes.

MiFID II has significantly increased transparency in the derivatives market by including derivatives on a pre- and post-trade transparency basis, while also recognising that the regime in its current form is overly complex and cost intensive for market participants.

Resilient and robust markets are of key importance to FIA members. Therefore, we support the consultation's stated aim for the transparency requirements to be streamlined so that they better reflect the nature and depth of liquidity in the market. We support removing some of the complexities in today's transparency regime (with a very wide scope in instruments and a complex system of deferrals and waivers) by introducing transparency requirements that support price formation and open, competitive, and fair markets.

FIA's response primarily focuses on exchange traded derivatives (ETD) and does not address OTC instruments.

We are generally supportive of the proposals, and have the following feedback on Q2:

Q.2 Do you agree that the transparency regime should focus on the classes of derivatives subject to the clearing obligation? If not, please explain why.

Yes. FIA agrees that the UK transparency regime should focus on the classes of derivatives subject to the clearing obligation and support the classification of ETDs as Category 2 instruments.

We support a reversion to trading venues calculating the transparency requirements and 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-equipped to manage pre- and post-trade transparency arrangements. As pointed out in our response to HMT's Wholesale Markets

Review (WMR), the MiFIR approach leads to the calculation of i.e. 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.

Prior to MiFID II, the relevant recognised investment 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 the transparency requirements and the relevant thresholds in the past, also overseen by the regulatory authority, to ensure that the right balance was struck.

Market participants should be able to feed into the process via a consultation process - including how to best manage the increasing number of Central Limit Order Books offered by investment exchanges for different order types - thus ensuring that all stakeholders can contribute to ensuring that the appropriate balance will be achieved, in the same way as previously done.

FIA recommends reinstating this approach, which worked well prior to its replacement with the MiFIR process including how to best manage the increasing number of Central Limit Order Books offered by investment exchanges for different order types. We therefore support relevant amendments to the FCA rulebook changes in order to remove the current factors leading to inappropriate transparency arrangements and thresholds.