Consultation response

FCA Consultation Paper 22/12 – Improving Equity Secondary Markets

16 September 2022

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the **FCA's consultation paper on Improving Equity Secondary Markets**.

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

Chapter 3, Post-trade transparency

Q1: Do you agree with maintaining the exemption for inter-funds transfers in Article 13?

Yes, AFME agrees with maintaining the exemption for inter-funds transfers.

Q2: Do you agree with the new definition of inter-funds transfers?

AFME agrees with the FCA's suggestion to fix this provision and sees no reason why a buy-side investment firm would have to report a trade it does to transfer beneficial ownership between its clients. However, AFME notes that not all buy-side firms are in position to or chose to make such transfers themselves and will typically involve a sell-side firm. The involvement of a sell-side firm can make it easier to establish a price at which the inter-fund transfer should occur or the process may be practically simpler from a systems perspective. For example, where the transfer would attract stamp duty and require the payment of the PTM levy, involving a sell-side firm would ensure that all appropriate books and records are kept and taxes paid. Given that involving a sell-side firm to help achieve the change in beneficial ownership does not change the nature of the transaction, it would be helpful to also allow this exemption to cover the sell-side when offering this service to their clients (the clients would be UK IFs, UK UCITs, UK AIFMs and their third country equivalents).

Therefore we would propose the following changes:

" b) transactions ~~executed by~~ *involving* an investment firm when providing the investment service of portfolio management[1] which transfers the beneficial ownership of financial instruments from one collective investment undertaking to another ~~and where no other investment firm is a party to the transaction~~."

[1] [Including for a management company as has been defined in section 237(2) of FSMA, a UK AIFM as defined in the AIFM Regulations, or a third country AIFM as defined in the AIFM Regulations], The FCA may determine that this drafting requires further work to ensure that the exemption works properly for providing this service to all types of buy side client.

Q3: Do you agree with amending the exemption from post-trade reporting for give-ups and give-ins?

AFME agrees with the FCA that RFMD are distinct from benchmark trades and that their reporting does not provide information of value to the tape. We agree with the FCA that the exemption should be expanded to also incorporate RFMD activity. However, we are concerned that the definition as proposed by the FCA may not necessarily capture all give-up/in activity. This is owing to the specificity of the drafting regarding "hedging a derivative position", as some give-up can also be conducted for the purposes of safekeeping. Explicit reference to "hedging a derivative position" inadvertently sets up a requirement for the executing broker to have a look-though to what the prime broker will do onwards with the give-up before knowing whether it can avail of the exemption for reporting, which would seem impracticable. We also feel it is important to take account of any third country dimension to such activities.

We propose alternative drafting:

"give-up transaction' or 'give-in transaction' means a transaction where:

i) an investment firm passes a client trade to, or receives a client trade from, another investment firm *or third country firm* for the purpose of post-trade processing; *or*

ii) *following a request for market data, an investment firm passes a trade to, or receives a trade from, another investment firm or third country firm.*

A request for market data refers to a request for illustrative pricing for financial instruments. For the purposes of ii) an investment firm passes a trade following a request for market data in instances where it creates an own account position (which may involve sourcing a proprietary cash equity position) following a request for market data from a third party, which position it subsequently offers to, and is accepted by, another investment firm or third country firm. For the purposes of ii) an investment firm receives a trade from another investment firm or third country firm following that investment firm's or third country firm's receipt of a request for market data, in instances where it is offered and it accepts a position which it holds as a custodian or on its own account as a hedge to a derivative, in each case, for a third party."

Q4: Do you think guidance to further clarify the types of give-ups and give-ins that can benefit from the exemption from post-trade transparency is required, and, if so, what issues do you think it should cover?

Should the definition remain as the FCA proposes then firms would likely require further guidance clarifying:

- Whether or not the EB is expected to have further sight on the prime broker's activities and, if not, what documentation or guarantees are required between the executing broker and the prime broker in order that the executing broking can benefit from this exemption when giving up a trade;
- That the definition covers a trade given up that is ultimately held in custody;
- That the definition covers a third country institution firm.

Q5: Do you agree with introducing an exemption for inter-affiliate trades?

Yes, AFME agrees with introducing an exemption for inter-affiliate trades.

Q6: Do you agree with our proposed definition of inter-affiliate trades?

Yes, AFME broadly agrees with this definition. However, although generally associated with an market side trade, inter-affiliate transactions for intragroup risk management purposes do not always take place within

the centralised booking model framework. In addition, a transfer between entities may be triggered by a requirement to comply with a regulatory obligation. For example, respecting the restrictions on foreign ownership of airlines stock may require the movement of such a position within the group. Therefore, we would like to suggest the below amendment to the proposed wording:

"*Inter-affiliate transaction' means a transaction between entities within the same group carried out ~~exclusively as part of centralised booking~~ for intra-group risk management purposes to transfer risk accumulated as a result of previously executed transactions or where necessary to comply with regulatory requirements*"

We would welcome confirmation from the FCA that the proposed definition supersedes previous Brexit guidance that UK investment firms executing OTC transactions concluded with EU investment firms are required to report these through a UK APA, such that if the EU firm is an affiliate and the trade is executed in the context of intra-group risk management purposes then no reporting is required.

Q7: Do you agree with the deletion of point d) from Article 13? If not please explain why.

Yes, AFME agrees with the deletion of point d) from Article 13.

However, as we also note in our response to Question 9 below, the way in which different provisions are currently phrased means that it is not always straightforward to match existing RTS 1 exemptions which are proposed to be deleted to RTS 22 exemptions which are to be referenced going forward. We would welcome the FCA's inclusion of a statement in the policy statement amending RTS 1 to the effect that the deletion of any specific exemption from RTS 1 was not intended to reduce the scope of RTS 1 exemptions, as any deletion is adequately compensated for by the other changes made by the FCA to RTS 1, including in particular the cross-references to the exemptions in Art 13 of RTS 1, which in turn incorporates the exemptions listed in Art 2(5) of RTS 22.

Q8: Do you agree with the proposal to introduce a deferral for all transactions within scope of Article 13 of RTS 1? If not, please explain why.

Based on AFME's understanding that this deferral is available, but not obligatory, to firms choosing to pursue these changes ahead of any formal change in primary legislation, then AFME is supportive of the proposal.

Q9: Do you agree with our proposals to align the definitions of non-price forming trades in Articles 2, 6 and 13? If not, please explain why.

AFME agrees with the proposal to align the definitions and welcomes the clarity this will bring in the long run. We believe that this change will result in a clearer regime which will, in turn, contribute to addressing some of the issues around the reporting and identification of non-price forming and non-addressable transactions.

However, as we note in our response to Question 7 above, the way in which different provisions are currently phrased means that it is not always straightforward to match existing RTS 1 exemptions which are proposed to be deleted to RTS 22 exemptions which are to be referenced going forward. We would welcome the FCA's inclusion of a statement in the policy statement amending RTS 1 to the effect that the deletion of any specific exemption from RTS 1 was not intended to reduce the scope of RTS 1 exemptions, as any deletion is adequately compensated for by the other changes made by the FCA to RTS 1, including in particular the cross-references to the exemptions in Art 13 of RTS 1, which in turn incorporates the exemptions listed in Art 2(5) of RTS 22.

AFME welcomes the consideration that the FCA has given to aligning the definitions in RTS 1 (including in relation to Article 2, should the Share Trading Obligation (STO) not have been repealed in line with the

government's preferred timetable). AFME hopes that a smooth and quick progression for the enactment of the Financial Services and Markets Bill and its repeal of the STO would render the implementation of changes to RTS 1, Article 2 unnecessary and that firms would therefore avoid a duplication of effort in this regard.

Today there are varying views in the market about how certain transactions should be reported (including in circumstances where the trades are exempt from the STO). Given that going forward there will be no STO, this may raise questions on determining if a trade should be considered an SI trade or OTC. In order to have a clean tape and a clear view of liquidity it would be helpful for the FCA to provide guidance on how off-venue transactions should be reported (including those that were previously exempted from the STO).

Q10: Do you agree with our proposal to amend the definition of benchmark transaction to include transactions that reference to the market closing price? If not, please explain why.

AFME agrees with the notion that trades referencing the closing price fall within the definition of a benchmark transaction. However, taking into consideration the features and importance of activity at the close, AFME believes it would be helpful to differentiate these transactions from other benchmark activity and we suggest that a separate definition for transactions benchmarking a single time/price point and a separate flag, "BECL", should be available. This definition should only capture those transactions which are pre-determined to happen at the market closing price (rather than inadvertently capturing transactions which simply "happen to" close at market closing price). AFME members do not believe that the addition of this flag would be costly or complex to implement for the regulator and is likely to decrease costs across the broader industry by reducing the effort required to identify and filter transactions in liquidity analysis.

This will also provide some level of comparability with trades conducted and reported as BENC in the EU. ESMA has confirmed in its final report on RTS 1 (once endorsed) that activity to be flagged as BENC will only include transactions executed in reference to a price calculated over multiple time instances and will not include those benchmarked to a single time/price point reference. Maintaining a separate UK definition and flag for close benchmark activity from other benchmark transactions (eg VWAP/TWAP) will allow for some consistency, particularly for activity in EU instruments.

Q11: Do you agree with the deletion of the SI related flags "SIZE" and "ILQD" and "RPRI"? If not, please explain why by distinguishing your current use of each flag.

Yes, AFME agrees with the deletion of these flags.

Q12: Do you agree with the deletion of the agency cross flag "ACTX", the duplicate trade flag "DUPL" and the algorithmic trade flag "ALGO"? If not, please explain the value these flags offer, how providing practical examples.

Yes, AFME agrees with the deletion of these flags.

Q13: Do you agree with the proposal of identifying "benchmark", "portfolio" and "contingent" trades with one single flag, "TNCP"? If not, please explain why and set out your preferred approach.

While we acknowledge the FCA's approach that seeks to improve the information content of trade reports by simplifying trade flags and other reporting fields, AFME does not agree with the proposal of identifying "benchmark", "portfolio" and "contingent" trades with one single flag, "TNCP". AFME members believe there is value in recognising the distinct features of these trades and it would be helpful to differentiate this activity through adding "PORT" and "CONT" flags, in line with our response to Question 10 above (in which we also recommend the creation of a new flag for benchmarks on the closing price).

This will provide some level of comparability and consistency, particularly for activity in EU instruments, conducted and reported as "BENC", "PORT" and "CONT" in the EU, given that ESMA has confirmed, in its final report on RTS 1, that (once endorsed) it will delete the TNCP flag in favour of adding PORT and CONT flags. Furthermore, AFME members do not believe that the addition of these flags would be costly or complex to implement for the regulator and is likely to decrease costs across the broader industry by reducing the effort required to identify and filter transactions in liquidity analysis.

Should the FCA not agree with our proposal and proceed with its proposal to only have one flag for these trades, we would ask it to look at the definition it proposes in Table 4 (in Appendix 1 of the CP, p10 of 17) again. The definition refers to Article 2 (for off venue transactions) and Article 6 (for on-venue transactions). It is noteworthy that Article 2 will be deleted in the fullness of time. This might suggest that the flag can only be used for such transactions if they are brought on venue. As is the case today, those flags should be able to be available for off venue (SI / OTC transactions). A better approach to defining TNCP would be to introduce a definition into article 1 of "contingent trades" (leveraging the existing definition in Article 2(c)), and referring in Table 4 to "trades that are portfolio trades, contingent trades and benchmark trades". This avoids having to refer to either Article 2 or Article 6.

As we note in our response to Question 9 above, there remain varying views in the market about how certain transactions should be reported, it would be helpful for the FCA to provide guidance on how off-venue transactions should be reported (including those that were previously exempted from the STO).

Separately, AFME would like to highlight scenarios relating to benchmark trades where a price is not known at the time where the transaction takes place (for example transactions executed at a volume weighted average price). For these transactions, AFME would support the FCA clarifying that these transactions can be reported at the end of the trading day (at the time at which the execution price is known and can be published).

Q14: Do you agree with our proposal to aggregate the three negotiated transactions flags into one single flag, "NETW"? If not, please explain why.

Yes, AFME agrees with the FCA's proposal to aggregate the three negotiated trade flags into one single flag.

Q15: Are there any other flags that we should consider removing, amending or adding?

Noting our response to questions 10 and 13 above, we propose the addition of "PORT" and "CONT" and a closing benchmark flag.

Q16: Do our proposals to modify the flags for trade reporting impact your systems for transaction reporting? If yes, could you describe how and what problems maintaining the flags for transaction reporting would cause?

AFME Members have raised some concern about the added complexity brought about by the lack of ongoing comparability of flags for trade and transaction reporting following these proposals. We look forward to engaging with the FCA on whether and how these regimes should become more aligned in the future.

Q17: Do you agree with the proposed changes to the reporting fields? If not, please explain why.

Yes, AFME agrees with the proposed changes to the reporting fields.

Q18: Are there other changes that you suggest we should make to the fields of reported transactions?

AFME has no further comments.

Q19: Do you agree with our proposal to create a regime where firms will be able to opt in as designated reporters at an entity level? Please explain your answer.

AFME welcomes the FCA's proposal to create a regime where firms will be able to opt in as designated reporters, thereby decoupling the reporting requirement from the obligations under the Systematic Internaliser regime. We also support the existence of a single golden source of this information which will significantly simplify reporting (reducing operational complexity and increasing confidence in the tape) and lower ongoing costs with maintaining the reporting infrastructure.

AFME would prefer to maintain the ability for firms to opt in at an entity or at a class of instrument level, using here the existing MiFID 13 top level designations[2]. An entity level only approach raises operational complexity and level playing field concerns for smaller firms where they may undertake ad hoc or occasional trades in classes of instruments outside of their key markets. Today such firms can opt into the regime (and build reporting infrastructure) for the class(es) of instruments in which they are specialists while conducting ad hoc trades in other classes of instruments with SIs (to ensure they do not require reporting infrastructure for such ad hoc trades). Were they to have to opt in at entity level, they would have to also build reporting infrastructure for classes of instruments that they may only trade very infrequently.

Q20: Do you agree that the FCA should maintain the register of designated reporters for firms to determine who reports OTC trades? Please explain your answer.

Yes, AFME agrees that the FCA should maintain the register of designated reporters. A single golden source of this information which will significantly simplify reporting. This will reduce operational complexity, improve the accuracy of reported transactions (largely eliminating double or non-reporting), and increase confidence in the OTC tape. It will make it easier for the FCA to investigate and enforce the rules and lower firms' ongoing reporting infrastructure maintenance costs. AFME recommends that the FCA discusses further with the APA community for a smooth integration within their systems, especially with APAs that have been using the existing private SI register since 2018.

Q21: Do you agree with the proposed implementation timetable? If not please explain your answer.

AFME does not agree with the proposed 6 months for implementation. Regarding the designated reporter regime and as with any new regulatory concept, implementation will require a coordinated effort across a large number and range of firms, including an ensuing process of discovery of firms' intentions to opt in and it is therefore likely that 6 months will be too short. We believe that firms on the buy side will also require more time to implement this change and therefore propose the implementation timeframe for the designated reporter regime is extended to 12 months.

In relation to the other changes to post trade transparency, we would note that these changes are broader in nature than the flagging amendments proposed under ESMA's review of RTS 1 and, therefore, will also require more time to affect the necessary systems and logic changes than that which was originally available through the EU process. We hope that the FCA's changes to RTS 1, Article 2, would become unnecessary if there is a smooth and quick progression for the enactment of the Financial Services and Markets Bill and its removal of

[2] As set out in RTS1 and RTS2: a) Equity and Equity like, b) Bonds (all bond types except ETCs and ETNs), c) Bonds (ETC and ETN bond types), (d) Equity derivatives, e) Interest rate derivatives, f) Credit derivatives, g) Structured finance products, h) Foreign exchange, i) Securitised derivatives, j) Commodity derivatives, k) C10 derivatives, l) Emission allowances, m) Emission allowance derivatives.

the Share Trading Obligation and that firms would therefore avoid a duplication of implementation effort in this regard.

Furthermore, we believe it would be helpful for the timeline to take account of a coincidence of implementation changes both in the UK and in the EU, noting the currently delayed endorsement of ESMA's conclusions on RTS 1 amendments. We propose a minimum of 9 months for implementation of the post trade transparency changes in the UK and hope that the FCA may allow this to coincide with the timeframe for similar but not identical changes in the EU.

Chapter 4, Waivers from pre-trade transparency

Q22: Do you agree with the proposal to change the definition of the MRMTL to allow trading venues to derive the price from a non-UK venue provided that the price is transparent, robust and offers the best execution result?

AFME supports the proposal to amend the definition of MRMTL, and we note that the drafting could be further improved by allowing venues to not just refer to the third country venue of first admission, but also to the third country market with the highest turnover for that financial instrument.

We believe that allowing trading venues to derive prices from non-UK venues will ensure that market participants accessing UK trading venues have access to prices established by the deepest pools of liquidity in a given share.

With respect to the separate proposed change raised within the WMR, AFME recognises that changes to UK MiFIR are required to permit the use of reference prices that are composite prices from multiple venues, however we would like to take this opportunity to voice our support for this proposal. This would be a welcome change which would boost market resilience in UK equity markets by increasing the likelihood that a reference price could continue to exist in the event of primary market outage.

Q23: Do you agree with the proposal to change the definition of the MRMTL for the purpose of the tick size regime?

AFME supports the proposal to change the definition of the MRMTL for the purpose of the tick size regime. However, we believe that the proposed wording within the new Article 2A of RTS 1 could be amended also to ensure that it captures instances where a share is listed on a UK and third country trading venue (such as IAG) and instances where a share is listed on more than one third country venue (such as ABB) and it is appropriate to apply the tick size in the relevant third country venue denominated currency. To account for these scenarios, AFME proposes the amendment below:

"(2A) Paragraph 1 shall not apply to ~~By way of derogation from paragraph 1, where~~ a share or a depositary receipt that is admitted to trading or traded on a third country trading venue.~~, t~~Trading venues may apply to orders in these instruments a tick size that is applied by a UK or third country trading venue, and may have more than one tick size in instances where shares or depositary receipts are traded in different currencies ~~Where a share or depository receipt is admitted to trading on more than one third country trading venue, trading venues may apply tick sizes from any of these third country trading venues.~~"

Q24: Do you agree with the proposal to delegate the decision to set a minimum size threshold for reserve and other orders to trading venues using the OMF waivers? Please explain why.

AFME agrees with the proposal to delegate the decision to set a minimum size threshold for reserve and other orders to trading venues using the OMF waivers. We agree with the FCA that venues should have the power and the responsibility to set thresholds that are appropriate to the type of financial instrument and considering the market in which it is traded. We agree this approach strikes the right balance between achieving a high level of transparency while allowing trading venues to tailor appropriately the size thresholds to market dynamics.

Chapter 5, Tick size

Q25: Do you agree with the proposal to allow trading venues to adopt the minimum tick size of the primary market located overseas when that tick size is smaller than the one determined based on calculations using data from UK venues? Please explain your views.

Yes, AFME supports the proposal to allow trading venues to adopt the minimum tick size of the primary market located overseas when that tick size is smaller than the one determined based on calculations using data from only UK venues.

AFME agrees that doing so is operationally simpler than performing ad hoc calculations, achieves an outcome that delivers a level playing field with overseas exchanges and avoids the application of tick sizes which are overly wide compared with primary markets.

Chapter 6, Improving market-wide resilience during outages

Q26: Do you agree with the above proposals to be included in the FCA/industry guidance for trading venues? If not, please explain why.

AFME members are, in principle, supportive of the FCA's proposals establishing clear expectations of venue operators and market participants when responding to market outages. We look forward to working together with the FCA and other stakeholders to develop the most suitable guidance.

AFME members also welcome the FCA's plan to amend the reference price waiver regime to allow dark venues to consolidate prices from other markets as a way to contribute to market resilience.

Q27: Are there other areas we need to consider for the guidance?

The FCA's paper highlights they have "considered the concerns about Article 15 (2) of RTS 7 requiring trading venues to resume services within or close to two hours", but are not "currently persuaded of the case for a change".

AFME members consider that requiring venues to restart operations within 2 hours from an outage can lead to additional and unnecessary disruptions when venues are not ready to do so. However, we note that the appropriate application of this provision is that the trading venue should be prepared to recover within the 2 hours but should not restart within this timeframe unless ready to resume orderly trading.

Paragraph 6.8 of the consultation quite correctly identifies 'coordination problems' as a barrier to firms continuing to trade on alternative trading venues. However, it is not clear from the consultation that any of the proposed areas of guidance will solve for this critical issue. AFME members believe that the coordination problem is one where there are natural barriers (legal risks and conflicting interests) to the industry reaching a consensus on a solution without FCA facilitation. AFME would therefore request further engagement with the FCA to explore ways in which it may provide the necessary leadership to facilitate a solution.

Similarly, it is of critical importance to identify the specific protocols to identify the closing price when an outage prevents the closing auction from taking place (see response to question 28 below).

Q28: Is the current arrangement for an alternative closing price on the primary market appropriate?

AFME members are of the view that the current arrangements are inadequate. Given the continued growth of activity conducted at the closing price, the level of resilience in this part of the trading day should leave no space for ambiguity as to how the closing price will be determined.

Under the current arrangements, the London Stock Exchange notes they would *"adopt contingency procedures to derive final prices. This would include using the mid of Best Bid / Offer immediately before outage for SETS and SETSqx securities with registered Market Makers or the last order book Execution for securities traded on the International Order Book."*

We would suggest that the FCA includes in guidance its expectations on more robust contingency scenario planning by the primary market, including a decision waterfall illustrating solutions for such possible scenarios.

Q29: Is an alternative closing auction needed?

The closing auction and settlement price determination problem requires more consideration to ensure consistent adoption across the industry of a mechanism to deliver realistic prices. AFME believes that the industry (participants and venues) and regulators should continue to work together to ensure that the market can close where the majority, if not all market participants, can access both trading and settlement as well as utilise for benchmark calculation and derivatives settlement where relevant.

We do not yet have a clear view on whether this should occur on a secondary venue offering a closing auction function or through a previously established waterfall of contingency scenarios within the primary venue and we welcome further discussion amongst industry stakeholders on the matter to come to a concrete proposal.

Regulators can play a role in ensuring that individual business interests can be transcended in the name of better systemic resilience by participating in and facilitating this dialogue. Furthermore, regulators can aid the discussion by setting expectations for timelines of both agreement and implementation of the agreed mechanism by the industry at large. Following implementation regulators should also play a role by ensuring that the mechanism as agreed remains functional and operative.

UK authorities could therefore make provisions that require primary markets to recognise, as the official closing reference price, an industry agreed alternate closing reference price in the event that a market outage has prevented the establishment of a closing reference price in the usual manner.

Q30: Do you agree with the above proposals to be included in the FCA/industry guidance for market participants? If not, please explain why.

AFME members are, in principle, supportive of the FCA's proposals establishing clear expectations of venue operators and market participants when responding to market outages. We look forward to working together with the FCA and other stakeholders to develop the most suitable guidance.

Q31: Are there other areas we need to consider for the guidance?

AFME has no further comments.

Chapter 7, The UK market for retail orders

Q32: Do you think the RSP system works well for retail clients? If not, please explain your views.

AFME defers to participants directly involved in this market to respond.

Q33: Do you have any suggestions for changing the regulatory regime as it applies to the execution of orders by retail clients?

AFME defers to participants directly involved in this market to respond.

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