# Financial Services and Wholesale Markets Bill – a capital markets and wholesale analysis

**July 2022**

**The Financial Services and Markets Bill has now been introduced to Parliament.** It marks a major step forward in reshaping the legislative and regulatory regime for financial services to reflect the UK's status outside of the EU and will bolster the UK's position as a global leader in financial services, ensuring that the sector continues to deliver for individuals and businesses across the country. **It will deliver precise and incremental changes to our regulatory regime through enacting the findings of the Future Regulatory Framework Review**. Regulators will implement the highest standards while promoting growth, jobs and investment across the country **through a new secondary competitiveness objective**. In addition, to these changes, the Bill also seeks to **implement some of the outcomes following the Wholesale Markets Review and the Prospectus Regime Review**.

The proceeding sections seek to summarise key items within the Bill that pertain to UK capital markets: -

1. Wholesale Markets Review
2. Prospectus Review Regime
3. Central counterparties
4. Annex – Parliamentary process and indicative timeline

**WHOLESALE MARKETS REVIEW**

All wholesale markets review policy proposals we had expected to see within the Financial Services and Markets Bill are included. They are also all in line with UK Finance Wholesale Markets Review recommendations. The Bill and supporting documents can be found here, and further detail is included in the table below. However, in summary, the Bill:

- Removes unnecessary restrictions on where and how trading can happen (such as the double volume cap, share trading obligation and midpoint execution for SIs), so that firms have greater choice about where they can trade and can get the best price for investors.
- Simplifies the authorisation process for systematic internalisers so that firms do not have to face unnecessary costs.
- Delegates the pre-trade transparency regime for equites and the pre- and post-trade transparency regime for fixed income and derivatives markets to the FCA who are better placed to determine which instruments should be in scope are subject to transparency requirements.
- Removes unnecessary restrictions on limits on positions a person can hold in certain commodity derivatives to ensure that markets function efficiently and remove barriers that prevent liquidity building up; and
- Gives the FCA a general rulemaking power over Data Reporting Services Providers to ensure that it has the tools it needs to help the industry develop a Consolidated Tape.

| Policy | Alignment with UK Finance position | Background | Outcome – extracted from the explanatory notes | Reference |
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| **Removing the share trading obligation (STO)** | ✓ | Under the STO, no investment firm may execute a trade in shares admitted to trading on a UK RM, or traded on a UK trading venue, unless that trade takes place on a UK RM, MTF, or systematic internaliser, or an equivalent third-country trading venue. | The Bill permanently removes the STO so that firms can trade shares on any trading venue in the UK or overseas with any counterparty or on an OTC basis. This is intended to ensure that investors can get the best price for their trade. | Schedule 2<br>Transitional Amendments<br>Part 1, paragraphs 13-14<br>Amended Articles 23 and 1(2E) UK MiFIR<br>(Found on p107 of the linked PDF) |
| **Simplifying the equities pre-trade transparency waiver regime and removing the double volume cap** | ✓ | MiFID II introduced a mechanism to limit the amount of trading that happens under the reference price and negotiated price waivers: the Double Volume Cap (DVC). Research[1] has evidenced that the DVC is not an appropriate tool to protect price formation in UK markets | The Bill revokes the existing system of waivers from pre-trade transparency requirements and instead gives the FCA new rule-making powers to determine under which circumstances waivers are available and any conditions that are to be attached to their use.<br>As part of this change, the Bill removes the DVC from the MiFID II framework. Removing the DVC will therefore give firms greater choice over where they trade to get the best prices for investors.<br>The FCA will be required to monitor UK markets in order to continue its own research into assessing the impacts of trading with no pre-trade | Schedule 2<br>Transitional Amendments<br>Part 1<br>New Articles 4 and 4a<br>(Found on p98 of the linked PDF) |

[1] The FCA's Occasional Paper No 29; Aggregate market data quality implications on dark trading, 2017

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| | | | transparency. The FCA can only intervene to limit the availability of a waiver if it considers that<br>market integrity is impacted and must only do so having first consulted with HM Treasury. When considering intervention, the FCA must consider evidence from across the globe as to the impact of trading without pre-trade transparency. | |
| **Changing the definition of an SI** | ✓ | Systematic internalisers are investment firms that deal on their own account (i.e., use their own capital) when executing clients' orders outside of a trading venue on a "organised, frequent, systematic and substantial basis". Because they use proprietary capital rather than that of clients or counterparties, they are considered a counterparty of the trade and therefore take on risk. | The Bill reverts to a qualitative definition of systematic internaliser and gives the FCA the power to specify how the new definition should be interpreted. This will ensure that the regime is flexible, better able to account for market evolutions, and that it achieves its aim of increasing transparency and price formation, while removing unnecessary burdens on firms. | Schedule 2<br>Transitional Amendments<br>Part 1, paragraph 8<br>Amended Articles 2(1)(12) and (12A) UK MiFIR<br>(p103 of the linked PDF) |
| **Removing restrictions on midpoint crossing for trades** | ✓ | The tick size regime sets minimum increments ("ticks") by which prices for equity and equitylike instruments can change and limits the ability of trading venues and systematic internalisers to cross at the midpoint (i.e., halfway between the buying and selling prices). | The Bill removes the restriction on midpoint crossing for systematic internalisers for all trades. As midpoint crossing can offer price improvements for investors, this will allow systematic internalisers to achieve the best outcome for their clients. | Schedule 2<br>Transitional Amendments<br>Part 1, paragraph 9<br>Amended Article 17a UK MiFIR |

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| | | Limiting systematic internalisers' ability to cross at the midpoint does not benefit price formation and can in some cases limit firms' ability to offer the best prices to their clients. | | (p103 of the linked PDF) |
| **Aligning the Derivatives Trading Obligation with the EMIR Clearing Obligation** | ✓ | The Derivatives Trading Obligation (DTO) requires financial counterparties and some nonfinancial counterparties (counterparties being entities which take up opposite sides in a financial transaction) to trade certain classes of derivatives on UK authorised trading venues, or overseas trading venues that have been recognised as equivalent.<br><br>The Clearing Obligation (CO) requires certain OTC derivative contracts (as defined in the European Market Infrastructure Regulation (EMIR)) to be cleared by an authorised central counterparty.<br><br>In 2019 EMIR was amended to alter the counterparties in scope of the CO, but the DTO was not updated to reflect that change. This has created unintentional misalignment which has led to uncertainty and complications for firms because the scope of counterparties subject to the DTO references the definition in EMIR. To mitigate this, the FCA has been using a transitional relief to address the issue. | The Bill formally realigns the counterparties (including financial, non-financial and analogous third country entities) in scope of the DTO with those in scope of the CO in EMIR. | Schedule 2<br><br>Transitional Amendments<br><br>Part 1, paragraphs 15 – 16<br><br>Amended Articles 1(3) and 28 UK MiFIR<br><br>(p107 of the linked PDF) |

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| **Exempting for post-trade risk reduction services from the DTO** | ✓ | Post-trade risk reduction services are types of trades that are made to reduce risks in derivatives portfolios without changing the market risk of those portfolios.<br><br>MiFID II provides an exemption from the DTO for the termination or replacement of component derivatives in portfolio compression. The exemption intends to enable technical trades - that reduce the risk of positions that market participants have entered into - to take place in an efficient manner. However, there are other post-trade risk reduction services, including cover rebalancing and optimisation services, that do not currently benefit from the DTO exemption. | The Bill expands the exemptions that currently apply to portfolio compression to other risk reduction services. To ensure that the right services are covered by the exemption, the Bill gives the FCA a new rule-making power to specify which post-trade risk reduction services can benefit from the exemptions listed above as well as the conditions attached to their use.<br><br>The Bill also gives the Bank of England (the Bank) a similar rule-making power, so that the same types of services can, if appropriate, be exempted from the CO as well. The Bank will be able to specify the post-trade risk reduction services that are to benefit from an exemption from the CO. The Bank and the FCA will be required to consult each other before making changes to their respective exemptions. This change aims to incentivise the uptake of post-trade risk reduction services and is intended to support market stability. | Schedule 2<br><br>Transitional Amendments<br><br>Part 1, paragraph 18<br><br>New Article 31UK MiFIR<br><br>(p110 of the linked PDF) |
| **Giving the FCA a permanent power to modify or suspend the DTO** | ✓ | The DTO is explained above. | The Bill gives the FCA a new, permanent power to modify or suspend the DTO, subject to HM Treasury approval, to prevent or mitigate disruption to markets. This power will allow the FCA to make changes to the DTO in respect of which counterparties it is imposed upon; which derivatives come within its scope; and the venues | Schedule 2<br><br>Transitional Amendments<br><br>Part 1, paragraph 17<br><br>New Article 28a UK MiFIR |

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| | | | on which transactions must be concluded by counterparties in scope of the DTO. | (p108 of the linked PDF) |
| **Simplifying the transparency regime for fixed income and derivatives** | ✓ | Although the MiFID II transparency regime intended to accommodate the specific characteristics of equity and non-equity markets, it does not go far enough in accounting for the fundamental differences between and within the two categories of markets. For example, it does not acknowledge that the nature and depth of liquidity is fundamentally different for fixed income and derivative instruments compared to equities. This has resulted in a number of bespoke illiquid instruments falling within scope of the regime, while some liquid and standardised contracts are not subject to any transparency requirements.<br><br>The vast number of exemptions from post-trade transparency requirements have made the regime overly complex and costly. It has also made it difficult for the market to view actual traded prices. | The Bill aims to reduce the complexity of the current regime and ensure that the right instruments fall within scope by delegating responsibility for calibrating the scope and firm-facing transparency requirements to the FCA.<br><br>To achieve this, the Bill removes the current regime which is set out in primary legislation and gives the FCA new rule-making powers to:<br><br>a. develop a qualitative and quantitative assessment to ensure that the right instruments are in scope of the pre- and post-trade fixed income and derivatives transparency regimes for venues and SIs;<br><br>b. specify the circumstances where pre-trade transparency requirements should apply, and what those requirements are;<br><br>c. develop a simpler post-trade transparency regime. | Schedule 2<br><br>Transitional Amendments<br><br>Part 1, paragraphs 11-12<br><br>New Articles 18a, 18b and 21 and amended Articles 8 – 11 and 18 UK MiFIR<br><br>Provision 11-12<br><br>(p105-7 of the linked PDF) |

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| **Simplifying the position limits regime** | ✓ | Firms which fall within the commodities regime are required to comply with a number of requirements that are specific to commodity derivatives markets, such as position limits, as well as the transparency and trading requirements that apply to all derivative market participants. | To simplify the regime and ensure that position limits apply to the correct contracts, the Bill revokes the requirement for the FCA to apply position limits to all commodity derivative contracts that are traded on a trading venue and economically equivalent OTC contracts, and transfers responsibility for setting position limits from the FCA to trading venues.<br><br>To ensure that appropriate regulatory oversight is maintained, the Bill grants the FCA a power to develop a framework to outline how trading venues should apply position limits and position management controls. This will provide guidance on factors that venues should take account of when setting limits and granting exemptions, for example, under which conditions they should review the case for position limits in particular contracts. It also gives the FCA the ability to require trading venues to set position limits on contracts which pose a clear threat to market integrity, and the ability to intervene directly, where absolutely necessary. | Schedule 2<br><br>Transitional Amendments<br><br>Part 4, paragraphs 45 – 49<br><br>(p117 of the linked PDF) |
| **Empower the FCA to make requirements for consolidated tape providers** | ✓ | A consolidated tape (CT) is the aggregation of unified post-trade reports for financial instruments from trading venues and APAs, and then the consolidation of these into a continuous electronic live data stream. | The Bill gives the FCA a general rule-making power in relation to DRSPs to enable the FCA to replace the provisions in retained EU law relating to the regulation of DRSPs, and to ensure that the FCA has an effective way of upholding and enhancing standards in the future. This will allow | Chapter 2<br><br>New Regulatory Powers<br><br>Clause 11 |

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| | | | the FCA to act as the market evolves, including through the trading of new types of asset classes and trading that uses new forms of technology.<br><br>The rule-making power will also help ensure that the FCA has the necessary tools to facilitate the development of a consolidated tape. | (p16 of the linked PDF) |

**THE PROSPECTUS REGIME REVIEW**

The Bill will enable HMT to reform the UK prospectus regime in line with the outcome of the Prospectus Regime Review, published on 1 March 2022. Unlike the WMR, these reforms will be implemented through the future regulatory framework process. The relevant retained EU law will therefore be repealed and replaced by appropriate regulatory rules, in this case, *Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC,* and a number of subsequent statutory instruments.

HMT has advised that the Prospectus Regime will be among the first set of rules to be reformed using new Future Regulatory Framework powers.

UK Finance responded to HMT's Prospectus Regime Review consultation in 2021. Our positions and recommendations are generally well-aligned with the HMT's outcome and proposed direction.

We look forward to further detailed consultation by the FCA, once it receives the necessary powers.

**CENTRAL COUNTERPARTIES (CCPs)**

The Bill sets out the main features of a special resolution regime for CCPs. The regime is intended to address a situation where all or part of the business of a CCP has encountered, or is likely to encounter financial difficulties.

The Bill also provides the Bank with powers to direct a CCP to take measures which address impediments to the effective exercise of the stabilisation powers. It is envisaged that these powers should be available for the Bank to use when performing its day-to-day functions of CCP supervisor and resolution authority, should such measures be necessary.

The five special resolution objectives, which the Bank must have regard to in using (or considering using) the stabilisation powers are:

a. To protect and enhance the stability of the financial system of the UK (by preventing contagion and maintaining market discipline);
b. To protect and enhance public confidence in the stability of the financial system of the UK;
c. To maintain the continuity of clearing services;
d. To protect public funds;
e. To avoid interfering with property rights in contravention of a Convention right (the meaning of which is in the Human rights Act 1998).

The Bill also stablishes the concept of a “systemic third country CCP”. It enables the Bank to establish whether an overseas CCP is a systemic third country CCP according to set criteria. Where the Bank has determined a firm to be a systemic third country CCP, it has the power to apply its domestic rulebook, in part or entirely, to these firms. The Bank also has further powers to apply domestic rules to non-systemic overseas CCPs and CSDs.

**ANNEX – FINANCIAL SERVICES AND MARKETS BILL: PARLIAMENTARY PROCESS AND INDICATIVE TIMELINE**

**Queen's Speech**

10 May

**Financial Services and Markets Bill introduced to Parliament**

20 July

**Bill's passage through both Houses of Parliament**

Second reading expected late September – TBC

**Bill receives Royal Assent (i.e. becomes law)**

Expected before the end of the Parliamentary Session, in late April 2023

**Regulators take forward individual reforms once they receive new powers**