

Dear Darine,

We enclose the collective response of the member firms of UK Finance to [FCA CP24/14 – Consultation on the derivatives trading obligation \(DTO\) and post-trade risk reduction services \(PTRRS\)](#), produced with advisory support from Freshfields Bruckhaus Deringer LLP.

UK Finance and its members are strongly supportive of the continued focus from the Financial Conduct Authority (FCA) and HM Treasury (HMT) on improving the regulatory environment for UK capital markets. Significant progress has been made to date, notably through the Wholesale Markets Review and Financial Services and Markets Act 2023, on progressing an expansive programme of reforms which drive proportionality, efficiency, simplification, and support the UK's competitiveness.

The FCA's proposals for the DTO and PTRRS in the present consultation represent another step in this important agenda. We are pleased to confirm, save for the points set out in this response, that the FCA's proposals are in the main supported by our members. We commend the FCA's endeavours, for example through its proposed use of powers to suspend or modify the DTO, to support ongoing stability in derivatives trading. Phasing in regulatory changes and associated implementation periods in the right way supports the UK's operating environment for wholesale banking. Given the resource and cost implications borne by market participants managing cross-jurisdictional change programmes, we call on the FCA to provide sufficient implementation timelines for the changes proposed.

We thank you in advance for your consideration and would be happy to discuss any component of our response. UK Finance remains committed to assisting policymakers in the reform of UK wholesale and capital markets.

If you have any questions in relation to the information within our submission, please do not hesitate to get in touch.

Kind regards,

Yvonne Deane Harte

Director, Secondary Markets & Post-Trade Policy

UK Finance

Chapter 3 – Changes to the classes of derivatives subject to the DTO

Question 1: Do you agree with the liquidity analysis set out above? If not, please explain why and provide supporting data where possible.

Yes.

Question 2: Do you agree with our proposal to bring into scope the stated SOFR derivative products? If not, please explain why and provide supporting data where possible. In particular, do you have views as to whether 12-year SOFR products should be brought into scope?

Members are generally supportive of bringing the stated Secured Overnight Financing Rate (SOFR) derivative products into scope of the DTO. However, there are some concerns with bringing 12-year SOFR products within scope of the DTO as the 12-year tenor is less liquid than the other tenors. The fact that there is no USD SOFR 1100 ICE Swap Rate published for a 12-year tenor indicates that there is a lower degree of activity for 12-year tenor products and that this particular tenor is therefore less liquid (relative to other tenors for which an ICE Swap Rate is available). As such, UK Finance is of the view that these 12-year SOFR products should not be brought into scope of the DTO, although we appreciate that such products may sit on the edge of the DTO scope.

Should, at a later date, the liquidity analysis provide evidence there is a sufficient increase in the liquidity of the 12-year tenor (so much so it is included in the ICE swap rate or be akin to the liquidity of an in-scope tenor), the FCA should consider bringing the 12-year tenor into scope of the DTO. Similarly, and applicable to all in-scope tenor groups, should the continued analysis of liquidity over an extended period of time show a particular tenor has consistently decreased, and remains at a decreased level, the FCA should also consider removing the tenor group from the scope of the DTO. Similarly, the FCA should continue to monitor the scope of application of the DTO in other key jurisdictions (in particular, for SOFR, the US, but also the EU) and consider any further adjustments to the UK DTO scope should any issues for firms subject to the UK DTO result from actual or expected misalignment.

To the extent that 12-year SOFR products are brought within scope, UK Finance would support an approach that ensures international consistency, especially with the CFTC, which in its made-available-to-trade (MAT) determination for certain SOFR OIS has made the 12-year SOFR product subject to its trade execution requirement for spot starting swaps and IMM swaps with a par fixed rate, but this does *not* apply to IMM swaps with a standard coupon rate.

Separately, we note that anything beyond 30 years is generally considered illiquid (please see ISDA data provided in its [response](#) to FCA CP23/32).

Question 3: Do you agree with the implementation timeframe, for the amendment of the scope of the DTO to enter into effect 3 months after the publication of our policy statement? If not, please explain what transition period is needed and why.

Members consider that an implementation period of at least six months would be preferable in order to give members sufficient time to implement the proposed changes. We understand that this approach would be consistent with that suggested by ISDA.

Chapter 4 – Exemptions for post-trade risk reduction services

Question 4: Do you agree with the descriptions provided for portfolio compression, portfolio rebalancing, and basis risk optimisation? If not, why not?

Our members agree with the proposed descriptions of “Portfolio Compression” and “Portfolio rebalancing”. However, we believe the proposed scope for “Basis Risk Optimisation” is too narrow and would instead propose the language set out below:

“Risk hedging

4.23 Derivatives are highly customisable but generally have structures with varying durations or expiry, periodic payments and fixings of cash flows or settlement on a transaction-by-transaction basis. Over time, the accumulation of trades leaves second and third order risks in a trading book which require hedging. Examples include basis risk, reset risk, and strike risk.

4.24 Multilateral risk hedging works to efficiently reduce these risks. An independent third-party vendor brings together multiple parties and identifies mutually beneficial trades which are executed at mid-market and hence are not price forming.

4.25 These services do not materially change the overall market risk of a portfolio, but efficiently hedge second and third order risks. The efficiency increases with the level of participation.”

Question 5: Do you agree that eligible post-trade risk reduction services should not be subject to the best execution, the obligation to seek authorisation as a trading venue, and the derivatives trading obligation? If not, please explain why.

Yes.

Question 6: Do you agree with the three characteristics identified to determine eligible post-trade risk reduction services? If not, please explain why.

Yes.

Question 7: Are there any additional characteristics we should consider including for “eligible post-trade risk reduction services”? If yes, please explain which characteristics and why.

No.

Question 8: Do you agree portfolio compression, portfolio rebalancing and basis risk optimisation are eligible post-trade risk reduction services? If not, please explain why.

Yes. However, please note the broader description of ‘risk hedging’ we have proposed in response to Question 4.

Question 9: Do you agree with the conditions included for providers of eligible risk reduction services to fulfil for the definition of an eligible agreement if using the exemptions in Article 31 UK MiFIR? If not, please explain why.

Yes.

Question 10: Do you agree with the condition that providers of post-trade risk reduction services shall maintain complete and accurate records of all risk reduction exercises they organise or participate in, and for such records to be made promptly available to the FCA upon request? If not, please explain why.

UK Finance is generally supportive of imposing an obligation on service providers that requires them to maintain complete and accurate records of all risk reduction exercises they organise or participate in, and for such records to be made promptly available to the FCA upon request.

However, members have concerns about unintended consequences of making compliance with such a record-keeping obligation a condition that must be satisfied in order for “post-trade risk reduction services” to be “eligible post-trade risk-reduction services”. Our members are concerned that an investment firm, who would otherwise rely on the exemption, could find itself in breach of a relevant obligation because the post-trade risk reduction service provider had not complied with applicable record-keeping requirements. This breach would be beyond the control of the investment firm, and indeed it would not know that the exemption was no longer available. Such a circumstance would unfairly affect the investment firm, preventing investment firm from relying on an exemption due to a fault of the service provider which is outside its control. As such, members are supportive of introducing record-keeping requirements as an obligation on the service provider, rather than a condition that must be satisfied for both parties to have access to the exemption under Article 31(1) of UK MiFIR.

This approach would align with the record-keeping obligation under Article 31(3) UK MiFIR as currently drafted, which imposes a separate record-keeping requirement applicable to firms providing portfolio compression (which is not a condition that must be satisfied for

Question 11: Do you agree with maintaining a form of public disclosure for PTRR services? If not, please explain why.

Yes.

Question 12: Do you agree with the information required to be disclosed under the proposed condition of public disclosure by providers of PTRR services? If not, please explain why? Please include any additional information you consider necessary for inclusion in our public disclosure requirement.

Yes.

Question 13: Do you agree with our proposal to introduce a notification requirement for firms operating a PTRR service as laid out above? If not, please explain why.

Yes.

Question 14: Do you agree with our proposed implementation timeline for the changes in Handbook to apply to risk reduction services? If not, please explain why. Please include any additional factors you would like us to consider.

The implementation timeline is primarily a concern for PTRR service providers. We note however that investment firms using PTRR services currently have a post-trade transparency reporting obligation for the trades resulting from the use of those services. Such investment firms will have to build to exclude those trades from their reporting. We consider that three months may provide inadequate time to make such required changes. We therefore propose that a six-month implementation period may be more appropriate.

Chapter 5 – FCA power to suspend or modify the DTO

Question 15: Do you agree that we should use our UK MiFIR Article 28a power of direction to achieve an outcome equivalent to that achieved by the TTP as outlined above? If not, please explain why.

We commend the FCA's use of temporary transition powers to date to modify the application of the DTO to facilitate stability in derivatives trading following the UK's departure from the EU.

UK Finance accordingly supports the FCA's above proposals. In particular, our members agree that the FCA should use its UK MiFIR Article 28a power of direction to achieve an outcome equivalent to that achieved by the TTP (as outlined in the CP). Article 28a of UK MiFIR was inserted by Schedule 2, Part 1, para 17 of FSMA 2023, which is not yet in force, and no commencement order has yet been published. We recommend that it is essential therefore that the Statutory Instrument required by HM Treasury to bring this provision into force is delivered in time to ensure a smooth transition after the TTP expires on 31 December 2024.

We note that the FCA is considering setting out the direction in the FCA Handbook using its new powers under the Smarter Regulatory Framework, which would eliminate the requirement to publish a statement every 6 months setting out the purpose of the direction. We strongly urge the FCA to take this approach – this would result in a more secure and stable regime giving market participants who rely on this relief certainty.

If this approach is not taken and the requirement for the FCA to publish a statement every 6 month continues, our members request that the industry is given a reasonable period of notice to adjust and comply with the relevant rules in the event the FCA is unable to give the required statement.

About UK Finance

UK Finance is the collective voice for the banking and finance industry. Representing more than 300 firms across the industry, it seeks to enhance competitiveness, support customers and facilitate innovation. Our primary role is to help our members ensure that the UK retains its position as a global leader in financial services. To do this, we facilitate industry-wide collaboration, provide data and evidence-backed representation with policy makers and regulators, and promote the actions necessary to protect the financial system. UK Finance's operational activity enhances members' own services in situations where collective industry action adds value. Our members include both large and small firms, national and regional, domestic and international, corporate and mutual, retail and wholesale, physical and virtual, banks and non-banks. More information is available on our [website](#).

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Freshfields Bruckhaus Deringer

Freshfields assisted UK Finance in preparing this response.

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