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FCA CP 23-32 Improving transparency for bond and derivatives markets

The Global Financial Markets Association's (GFMA) Global Foreign Exchange Division (GFXD) was formed in co-operation with the Association for Financial Markets in Europe (AFME), the Securities Industry and Financial Markets Association (SIFMA) and the Asia Securities Industry and Financial Markets Association (ASIFMA). Its members comprise 24 global foreign exchange (FX) market participants[1], collectively representing the majority of the FX inter-dealer market[2].

We welcome the opportunity to respond to the FCA's consultation on Improving transparency for bond and derivatives markets. The focus of our response is on FX products and we are only responding to Question 3.

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Q3: Is the current level of transparency in FX derivatives and single-name CDS adequate? If not, should a subset of them be included as Category 1 instruments?

Executive Summary

For the wholesale FX market, we believe that the current level of transparency is adequate.

The UK is the leading global FX centre. Volumes have grown since 1998, evidence of an already efficient and well-functioning market.

[1] Bank of America, Bank of New York Mellon, Barclays, BNP Paribas, Citi, Credit Agricole, Deutsche Bank, Goldman Sachs, HSBC, ING, JP Morgan, Lloyds, Mizuho, Morgan Stanley, MUFG Bank, NatWest Markets, Nomura, Northern Trust, RBC, Standard Chartered Bank, State Street, UBS, US Bank and Wells Fargo
[2] According to Euromoney League Tables

We believe that transparency requirements, including public dissemination of data, should be harmonised across jurisdictions.

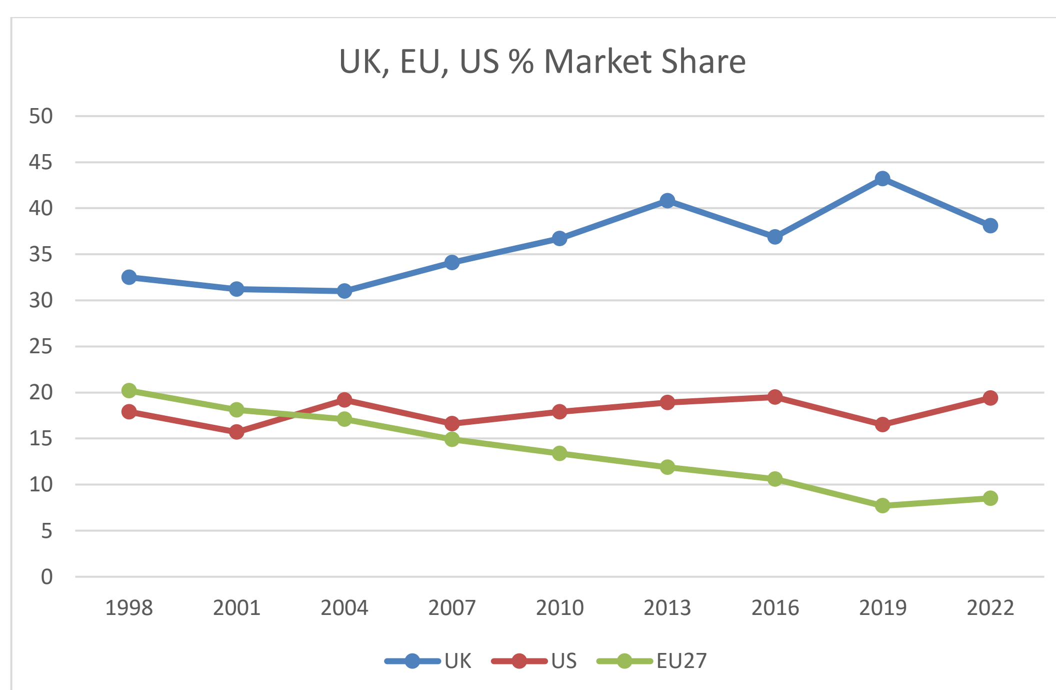
We recommend that there should be harmonised calibration obligations for Trading Venues. For example, harmonisation can be achieved via a minimum deferral of 4 weeks for all Category 2 FX products.

We do not support moving any FX to Category 1.

The global wholesale FX market is highly electronic and already typified by significant levels of transparency.

The UK is the leading global FX centre (followed by the US), and has been (as reported by BIS[3], extracted to Graph 1 below) since 1998. During that period, global turnover has increased from $959 billion to $7.5 trillion. We do not believe that this growth would have been sustained if the market was inefficient and ineffective, transparency of FX trade/market data being a key component of that.

Graph 1: BIS Triennial Survey Market Share



FX is by definition cross-border and requires regulatory harmonisation to avoid unwanted fragmentation of both the provision of liquidity and services. BIS reports[4] that *'Trading at sales desks in five jurisdictions – the United Kingdom, the United States, Hong Kong SAR, Singapore and Japan – amounted to 78% of all FX trading ("net-gross" basis)…. The share of cross-border trading in total FX turnover was 62% in April 2022, up from 56% in 2019 and closer to the 65% share in 2016'*

Central banks and regulators from jurisdictions active in the wholesale FX markets are cognisant of the benefits of effective and harmonised regulations, and we largely see alignment of the key G20

[3] https://www.bis.org/statistics/rpfx22_fx.pdf; https://www.bis.org/publ/rpfxf07t.pdf

[4] https://www.bis.org/statistics/rpfx22_fx.pdf

obligations across jurisdictions, including pre/post trade transparency requirements. This alignment enables FX to be executed between jurisdictions.

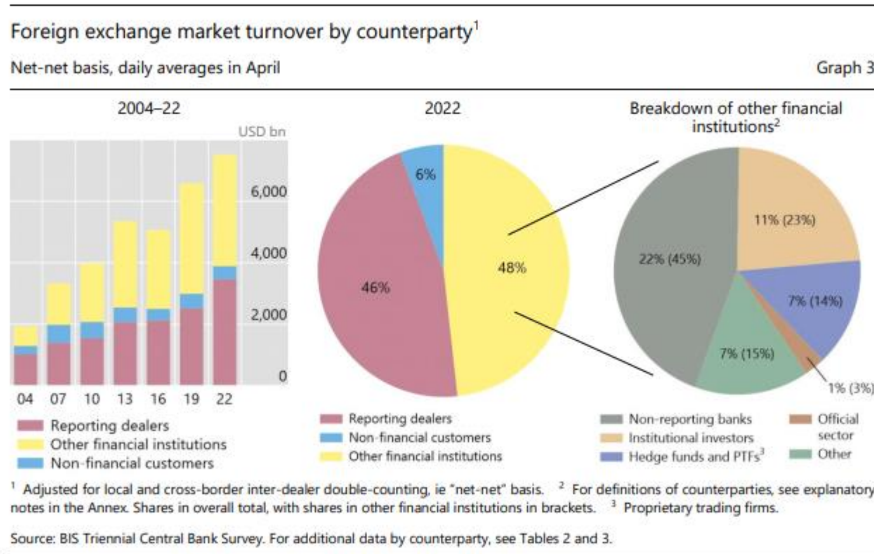
Sovereign entities, central banks and other government-sponsored entities rely on the FX market to be well-functioning and liquid, and corporations and investors regularly participate in the market for important operational needs:

- To reduce risk by hedging currency exposures.
- To pay suppliers and to be paid for services outside their home market.
- To convert their returns from international investments into domestic currencies.
- To make cross-border investments and raise funding outside home markets.

Market participants providing liquidity need to be confident that they can both provide liquidity and hedge exposures across jurisdictions, not just in one location. Should this be challenged in the UK, that provision of liquidity could be disincentivised. This will ultimately impact the end users of the global FX markets (such as corporates investing in the UK, or UK corporates growing their businesses abroad) contrary to the FCAs desire '*to strengthen the UK's position in wholesale markets*'[5].

<u>Current FX data</u>

In their 2022 Triennial Survey[6], BIS include a Graph which illustrates the types of market participants active in the global FX market, below.



BIS also include descriptions of each of these types of counterparties, and, given this description, it can be concluded that 94% of the market (reporting dealers and other financial institutions) is 'sophisticated' in nature. The remaining 6% (non-financial customers) can be deemed to be 'unsophisticated' in nature, although experience suggests that this will not be the case for many of these and they will have the same access to data as reporting dealers and other financial institutions.

We note too that BIS report that *'The share of trading with non-financial customers continued its downward trend. It accounted for 6% of total FX market turnover in 2022, down from 7% in 2019 and 9% in 2013.'* We strongly doubt that this decline is due to the availability of FX data, but are more aligned to both i) the wider geopolitical landscape and ii) general market conditions e.g. volatility.

[5] https://www.fca.org.uk/publication/consultation/cp23-32.pdf
[6] https://www.bis.org/statistics/rpfx22_fx.pdf

It is clear that the vast majority of the global wholesale market has access to the many tools available to manage their businesses, including access to data from Trading Venues, market data providers, banks and other market participants.

This also includes the ability to execute via a diverse choice of electronic channels, including RFQ, streamed liquidity, and to lesser extent algo order strategies and venue types (multi-dealer platforms, and API aggregators). There are also sophisticated TCA providers who can support any Best Execution requirements.

FX is currently exempt from any real-time pre/post transparency obligations in the UK. Any regulatory changes to this will likely increase operational risk and cost. Additional complexity could be introduced due to the regulatory desire to protect the provision of liquidity through calibrated thresholds and deferrals.

This does not seem aligned with the FCA's wider desire to simplify obligations and reduce operational costs.

It is therefore not clear who will gain additional benefit from the provision of FX data through the FCA's Category 2 pre- and post-trade proposal, especially when considering that:

- The Category 2 proposal to allow Trading Venues to determine their own compliance with regulation, and the lack of harmonisation, this could result in which may have an unpredicted market structural impact.
- The challenge to ensure that any pre trade thresholds are calibrated effectively to protect the provision of liquidity.
- The global nature of the FX market and the unknown impact of the real-time provision of data in the UK.
- That pre-trade data is likely to be less useful given the fast paced nature, operating characteristics and size of the global FX market.
- The cost/complexity to build and manage any new FX processes versus any expected benefits.

<u>FX Price</u>

The price at which a FX transaction is executed is largely bespoke to that counterparty, and public reporting of a price does not mean that that price is available to other counterparties.

FX trading is largely bilateral (versus being cleared or exchange traded) which tends to result in counterparty-specific considerations such as capital and credit being a major factor in pricing. When these are combined with trade-specific considerations (such as notional, tenor, currency pair and liquidity) it results in a price that is not generally relevant to other counterparties. Post-trade data is more helpful when comparing 'like-to-like' products/trades, which is not the case for FX given the bespoke nature of FX pricing.

<u>Trading Venue Calibration</u>

For Category 2 instruments, the proposal is that Trading Venues will provide the pre-/post-trade public reporting, noting that pre-trade will be not required for voice and RFQ systems. For those systems required to publish data, similarly to Voice/RFQ systems, the price published will not be available for the whole market for execution – and those that could trade at that price will already have access as members of the central limit order book (CLOB).

Trading Venues will be required to perform their own deferral calibrations based on their (and not the whole) market activity, and thus it can be expected that the transparency provided will not be harmonised across the UK marketplace.

For FX, we think this principle-based, asymmetric approach is sub-optimal, especially in light of the FCA's goal of simplifying the existing processes. The outcome of this, due to the expected lack of harmonisation between venues, could result in data for the same FX trade being either/or:

- Published by one venue and not another.
- Published in the UK and not in other jurisdictions.
- Not reflective of the full trading landscape.

The implications of this could result in a disadvantage to the liquidity provider, potentially influencing their decisions commit liquidity to make markets.

We recommend that, if the FCA continues with this approach for FX and other Category 2 instruments, they produce a minimum standard by which each Trading Venue should comply with. For example, harmonisation can be achieved through a 4-week minimum deferral for all Category 2 FX products.

Other jurisdictions

As noted above, BIS report that *'Trading at sales desks in five jurisdictions – the United Kingdom, the United States, Hong Kong SAR, Singapore and Japan – amounted to 78% of all FX trading ("net-gross" basis).'*

Therefore, it is highly likely that a FX transaction will be required to be reported in more than 1 jurisdiction. The public dissemination of FX transaction data is summarised in Table 1 below.

Table 1: Regulatory Landscape of the Pre and Post Trade Publication of FX data

Jurisdiction	Pre Trade Public	Post Trade Public
UK (as proposed under Cat 2)	Y	Y
EU	N	N
US	N	Y*
Japan	N	N
HK	N	N
Singapore	N	N

- *US: Under Dodd-Frank Act (DFA) Part 43, FX Options and NDFs have real-time public post trade dissemination obligations. FX Forwards and Swaps are excluded[7].

- New Part 43 parameters (including currencies, block sizes and deferrals) were due to go-live in December 2023, were delayed to July 2024[8] and subsequently recommended by the CFTC

[7] https://www.federalregister.gov/documents/2012/11/20/2012-28319/determination-of-foreign-exchange-swaps-and-foreign-exchange-forwards-under-the-commodity-exchange
[8] https://www.cftc.gov/PressRoom/PressReleases/8809-23#:~:text=The%20letter%20states%20DMO%20will,effect%20on%20January%201%2C%202021

> Global Markets Advisory Committee (GMAC) for further delays *'to at least December 4, 2024'*[9], stating '*However, the CFTC's new post-initial block and cap sizes that will require compliance starting July 1, 2024, may negatively affect market liquidity and could significantly raise trading and hedging costs for buy-side market participants and end users such as pension and other retirement plans.*'
>
> '*The GMAC recommends extending the compliance date for the post-initial block and cap sizes for all asset classes to at least December 4, 2024. The GMAC further recommends that, during the extension period, the Commission engages with market participants in discussions and analysis to ensure the post-initial block and cap sizes are appropriately tailored, including with respect to current market and macroeconomic conditions.*'

Finally, in line with other OTC derivatives, we support the submission of the International Swaps and Derivatives Association (ISDA) with respect to the questions on SI and UPI.

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We greatly appreciate you giving us the opportunity to share our views on the guidance and request the opportunity to discuss these with you in more detail in person. Please do not hesitate to contact Andrew Harvey on+44 203 828 2694, email aharvey@eu.gfma.org, should you wish to discuss the above.

Yours sincerely,

James Kemp
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[9] CFTC Global Markets Advisory Committee Advances Key Recommendations | CFTC