THE
INVESTMENT
ASSOCIATION

Stephen McGoldrick

Financial Conduct Authority

12 Endeavour Square

London E20 1JN

6th March 2024

Dear Stephen,

RE: Investment Association response to the FCA's CP23/32 on improving transparency for bond and derivatives markets

I am writing to you on behalf of The Investment Association (the IA). The Investment Association champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £8.8 trillion for savers and institutions in the UK and beyond. The UK asset management industry is the largest in Europe and the second largest globally.

We have read with interest the FCA's consultation paper on improving transparency for bond and derivatives markets and welcome the opportunity to respond. The IA is supportive of an appropriately calibrated transparency regime that provides greater protection against transaction risk. We recognise the importance of providing appropriate transparency to the market, although note the importance of ensuring that such transparency does not overly impact the ability of market makers to take on risk and provide a vital source of liquidity. We also note that too much transparency could exacerbate any negative liquidity impact caused by stressed conditions.

The IA acknowledges that developing a workable deferrals regime for bonds is a complex task and there will not be a perfect fit for all individual trades. We do not answer all the questions in this consultation, and instead put across our views on those areas that are of most relevance to the IA's members. We hope this will help to develop a simple but well-functioning transparency regime that could be easily interpreted and executed by market participants.

1. Bonds

The IA is supportive of a more proportionate and better-calibrated transparency for the bond market, which would contribute to the creation of a successful bond consolidated tape in the UK.

The IA members are keen to contribute to the development of a transparency regime that is practical to all market participants. In this regard, we worked closely with the Association for Financial Markets in Europe

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(AFME). The IA and AFME jointly propose the following deferral models (please see **Table 1** and **Table 2** below) for sovereign and corporate bonds.

Sovereigns

Issuer countries: We appreciate the need for simplicity in the approach taken by the FCA and propose a simple regime without further grouping by issuing country (see **Table 1**). However, we want to highlight that there is a large difference in liquidity across sovereign bonds issued by different countries.

All other instruments: Considering inflation-linked sovereign bonds' distinct liquidity feature, we strongly recommend the FCA bucketing them under 'all other instruments'. It is important to note that inflation-linked bonds are less liquid, even in normal markets. However, in stressed markets, liquidity in these instruments can be reduced still further. This was particularly highlighted by the events following the mini-budget delivered in September 2022, in which liquidity in long-dated inflation-linked gilts was severely challenged.

We also propose including, specifically, US Treasury market 'off-the-run' bonds in the 'All other instruments' bucket. This is because:

- there is a more marked differential in liquidity between 'on' and 'off'-the-run bonds in the US Treasury market than in other major sovereign bond markets and
- there exists a robust and clear definition of 'on-the-run' bonds in the US Treasury market that does not exist in such a clear way in other markets.

In terms of 'off-the-run' bonds issued by non-US countries, should the FCA be able to define a similarly robust methodology that could be used for the other liquid country markets cited in the table below, we would recommend that 'off-the-run' bonds in these markets are also included in the 'All other instruments' segment. The IA and AFME would be happy to consult further with the FCA on this point.

It will be further noted that we recommend splitting the 'All other instruments' bucket into two separate segments, defined by an issue-size threshold of below or over £2 billion. There are strong concerns from the members of IA and AFME about the breadth of security types currently within this bucket – issue types as diverse as Spanish Bonos and Dutch State Loans (Netherlands Gov bonds) on the one hand and local currency emerging markets (EM) sovereign bonds (e.g. Nigeria gov. bonds) on the other.

Our view is that having such diverse security types in the same bucket makes appropriate treatment for each extremely challenging and there are concerns over the potential effect on the trading of local currency EM sovereign bonds in the UK market. We feel that a £2 billion issue size split should confine the majority of these local currency bonds to a less liquid bucket and allow for the differentiation that we view as being required. It would have the added advantage of allocating to this less liquid bucket some of the least liquid securities from smaller EU countries.

We believe the above suggestion strikes a good balance between simplicity and workability, which serves as a good starting point for the calibration of deferrals in sovereign and other public bonds.

Table 1: IA and AFME proposed parameters for sovereign and public bond deferrals

Calibration Criteria				Deferral Buckets		
Bond Type	**Issuer Country**	**Issue Size**	**Maturity Band**	**Immediate Price & Volume**	**T+2 Price & Volume**	**4 weeks Price & Volume (with Caps on Volume Publication)**
Sovereign & Public Bonds	UK, US, Germany, France & Italy	>2 Bln	0-5 Yrs	<£15 Mln	£15-50 Mln	>£50 Mln (Cap at £500 Mln)
			5+ - 15 Yrs	<£10 Mln	£10-25 Mln	>£25 Mln (Cap at £250 Mln)
			15+ Yrs	<£5 Mln	£5-10 Mln	>£10 Mln (Cap at £100 Mln)
	All other instruments^	>£2 Bln		<£1 Mln	£1-5 Mln	>£5 Mln (Cap at £25 Mln)
		<£2 Bln		<£1 Mln	£1-2.5 Mln	>£2.5 Mln (Cap at £10 Mln)
^ 'All other instruments' to include ALL Inflation-linked, FRNs, STRIPS and Bills regardless of issuer country. Also to include, specifically, US Treasury "off-the-runs".						

Corporate and other bonds

The IA is concerned that the FCA proposed models provide insufficient transparency, with the threshold for a four-week deferral being set overly high. We also question the rationale, under the proposed Model 1 (Table 10 in the CP), for most trades being bucketed within a 15-minute deferral. This insufficiently distinguishes between those trades for which immediate price and volume reporting is appropriate, and those larger trades that would benefit from a longer deferral period.

We therefore propose a simple model (**Table 2**) with three classes of transparency, which attempts to balance the need for transparency with the need to protect risk-takers, while also mitigating volatility risk in high yield. We propose replacing the 15-minute deferral with a T+2 deferral bucket, and we suggest a maximum 4-week deferral for large block-size trades with trade size threshold caps for each segment. We are aware that the proposed regime may not accurately capture the intricacies of all trades. However acknowledging the FCA's goal of a simple regime, we believe the proposed model is a clear one that can be implemented easily.

Table 2: IA and AFME proposed parameters for non-sovereign bond deferral

Calibration Criteria				Deferral Buckets		
Bond Type	**Currency**	**Issue Size**	**IG / HY**	**Immediate Price & Volume**	**T+2 Price & Volume**	**4 weeks Price & Volume**
Corporates, Covereds, Convertibles & 'Others'	GBP, EUR & USD	>£500Mln	IG	<£1 Mln	£1-5 Mln	>£5 Mln (Cap at £25 Mln)
			HY		£1-2.5 Mln	>£2.5m (Cap at £10 Mln)
	All other instruments			<£500k	£500k-£2.5 Mln	>£2.5m (Cap at £10 Mln)

2. Derivatives

Scope

The IA believes that only those derivatives subject to the derivatives trading obligation should fall in the scope of the transparency regime, as these are the most liquid instruments.

Should the FCA determine however that as proposed the transparency regime will apply to certain derivatives subject to the clearing obligation, we would recommend the exclusion of broken-dated/broken-tenor swaps. These are bespoke and illiquid, and there is limited benefit to the market by making these instruments transparent. Reporting of these instruments would be complex and may give an inaccurate picture of transparency within the market.

We are also supportive of the decision not to include FX derivatives and single-name CDS within the list of category 1 instruments.

OTC Derivatives

The IA's members have expressed a preference for the FCA's proposed Model 2 for OTC derivatives (Table 16 in the CP). However there are concerns that longer deferral periods may be needed for certain larger trades to avoid a negative impact on prices.

In addition, members have noted that the last basket (30 to 50 years) covers a greater maturity span than the other baskets and more pertinently in the less liquid part of the curve. Therefore we suggest the cap for real-time disclosure be reduced from under £15 million to under £10 million, with a corresponding decrease in the EOD threshold and the EOD cap reduced from £25 million to £20 million.

Unique Product Identifiers

Finally, the IA welcomes the FCA's introduction of requirements for Unique Product Identifiers (UPIs) for OTC derivatives. However, our members have noted concerns about whether it will be possible to set up UPIs in time to meet reporting requirements for immediate or 15-minute transparency. We would welcome further guidance from both the FCA and the Association of National Numbering Agencies (ANNA) as to the procedures being put in place to ensure this can be achieved.

We appreciate the FCA's effort in taking up the challenging task of improving transparency in the bond and derivatives market. We await with interest the FCA's response to our response and would be happy to discuss further with the FCA the suggestions we proposed here.

Yours sincerely

Galina Dimitrova
Director, Investment and Capital Markets