Policy Statement PS24/14

The Financial Conduct Authority's (FCA) **Policy Statement PS24/14** outlines a refreshed approach to transparency in the bond and derivatives markets. This policy follows up on issues identified in **Consultation Paper 23/32** and is part of the broader Wholesale Markets Review (WMR). With a focus on increasing transparency and fostering liquidity, the FCA has introduced several changes, summarized as follows:

Objectives and rationale

1. **Purpose of the review**: As a post-Brexit regulatory initiative, the WMR aims to position the UK as a leading financial market by enhancing regulatory frameworks that support liquidity, efficiency, and market resilience in the bond and derivatives sectors.
2. **Challenges addressed**: The existing transparency regime was deemed insufficient for effective price formation, leading to unnecessary compliance costs without fully achieving market integrity or competition benefits. The FCA's updated policy seeks to address these gaps by adjusting requirements to better fit the liquidity characteristics of specific instruments.

Key policy changes and impact areas

1. **Updated scope for transparency**:

- **Focus on high-liquidity instruments**: The FCA's policy prioritizes transparency for more liquid assets, including UK sovereign bonds and certain liquid interest rate derivatives, while excluding less liquid or highly customized instruments like some OTC and commodity derivatives (e.g., bespoke FX options, tailored commodity swaps) and commodity derivatives (e.g., exotic energy contracts, unique metals swaps).

<u>**Included OTC Derivatives:**</u>

- Interest Rate Swaps (IRS) based on benchmarks such as SONIA (Sterling Overnight Index Average), SOFR (Secured Overnight Financing Rate), EURIBOR (Euro Interbank Offered Rate), and €STR (Euro Short-Term Rate).
- Cleared transactions in iTraxx Europe Main and iTraxx Europe Crossover indices (5-year tenor).

<u>**Excluded OTC Derivatives:**</u>

- Forward Rate Agreements (FRAs).
- Basis Swaps.
- Fixed-to-Float Swaps not referencing SONIA, SOFR, or EURIBOR.
- Certain Overnight Index Swaps (OIS) like TONA (Tokyo Average Overnight Rate).

<u>**Other Instruments:**</u>

- Bespoke or less liquid OTC derivatives not subject to clearing obligations are categorized as "Category 2" instruments.

- **Affected market participants**: This policy directly impacts trading venues, investment firms, and UK branches of foreign firms involved in the bond and derivatives markets.

2. **New pre-trade and post-trade transparency standards**:

- **Pre-trade adjustments**: Only systems that use continuous order books or periodic auctions are required to maintain full pre-trade transparency, while negotiation-based, voice, or request-for-quote (RFQ) systems are largely exempt to reduce complexity.
- **Post-trade deferrals and thresholds**: The FCA has introduced a tiered approach to post-trade transparency, with deferrals based on transaction size to ensure timely disclosure while allowing liquidity providers to manage risk effectively.

3. **Introduction of two deferral models**:

- **Model for bonds**: For bonds, transparency includes two size thresholds, allowing transactions above the second threshold an extended deferral to safeguard liquidity providers from immediate exposure.
- **Model for derivatives**: For derivatives, deferrals use a single threshold with a cap on trade size. Transactions above this cap report only price details after a deferral period, with the size remaining permanently masked to protect liquidity.

4. **Potential Revisions to the Systematic Internaliser (SI) Regime**:

- The FCA is assessing whether the SI framework, which covers firms that trade on their own account, should be reformed to enhance market integrity and price formation. Feedback on this question will be used to guide potential reforms by 2025.

Expected outcomes and benefits

1. **Enhanced market integrity and liquidity**: By targeting transparency requirements to specific asset characteristics, the FCA aims to encourage greater market participation, promote competition, and reduce borrowing costs for issuers.
2. **Improved investor protection**: These transparency improvements should allow investors to access a clearer view of liquidity and more accurate price data, particularly for larger trades.
3. **Strengthened global competitiveness**: Simplifying transparency standards is expected to improve the UK's attractiveness as a financial hub, drawing investors and reducing transaction costs.

Implementation timeline and next step

- **Key dates**: Full implementation of these rules is set for December 2025, with certain exemptions taking effect by March 2025.
- **Ongoing industry consultation**: The FCA will continue consulting with stakeholders and plans to release an additional consultation paper in 2025, using feedback from this policy statement to inform further changes.

In summary, the FCA's updated transparency framework is designed to support the UK's financial markets by promoting liquidity, maintaining competitive standards, and providing greater clarity for investors, while ensuring protections are in place for liquidity providers.