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Financial Conduct Authority
12 Endeavour Square
London
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Submitted via online response form

RE: CP22/12: Improving equity secondary markets

BlackRock¹ is pleased to have the opportunity to respond to CP22/12: Improving equity secondary markets, issued by the Financial Conduct Authority.

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to comment on the issues raised by this Consultation Paper and will continue to contribute to the thinking of the FCA on any issues that may assist in the final outcome.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

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¹ BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

Executive summary

We welcome the FCA's proposals for improving secondary equity markets. However, we believe **almost all issues covered in the consultation paper cannot be considered in isolation from the broader and more important objective – set out in the Wholesale Markets Review – of establishing a pre- and post-trade consolidated tape for equities and equity-like instruments** such as Exchange Traded Funds (ETFs). For example:

- We agree that the scope (in terms of exemptions) and content (in terms of definitions and flags) of equity transaction reporting would benefit from being refined. However, defining the appropriate scope of reporting and driving consistency across the market would be a critical part of developing a consolidated tape, given the need for all venues and market participants to submit coherent and consistent data to the consolidated tape provider.
- We strongly support the development of guidance for trading venues aimed at improving market-wide resilience in the event of outages. It should be possible that an outage causing an inability to trade on one venue can be mitigated by continued trading on others. However, a necessary condition of this is robust, reliable, and transparent price formation. A consolidated tape would give market participants a real-time view of where the market is trading that is not contingent on any one venue, allowing volumes to shift during outages and enhancing market-wide resilience and transparency.
- We agree with much of the FCA's assessment of the Retail Service Provider (RSP) execution model. At present, there is a lack of transparency, competition, protection against sub-optimal execution, and choice of execution venue. Retail investors therefore risk being disadvantaged versus institutional investors. Delivering a single consolidated tape of pre- and post-trade data will allow executions via the RSP process to be benchmarked against the wider market, driving best execution and better outcomes for retail investors.

As such, **we strongly recommend that future reforms to secondary equity markets are carried out in conjunction with ongoing efforts to develop a consolidated tape for the UK market.** As well as the issues outlined above, **delivering a consolidated tape would bring significant benefit to both institutional and retail investors, and market integrity in general:** markets as a whole benefit from increased transparency, improving market depth and liquidity as more and more investors feel confident to participate in markets. Moreover, from a regulatory perspective, a consolidated tape would enable better supervision and regulatory oversight of capital markets by providing real-time, up-to-date information on the state of financial market flows.

To meaningfully move on from the status quo – which has so far failed to deliver a consolidated tape – **the FCA should oversee a tender process for a single consolidated tape provider for equity and equity-like instruments, supported by mandatory contribution of data from all relevant trading venues.** We also believe **the FCA's newly established Secondary Markets Advisory Committee is well placed to advise on specifics regarding operational issues and potential business models.**

Responses to questions

Exemptions from post-trade transparency

Q1: Do you agree with maintaining the exemption for inter-funds transfers in Article 13?

Q2: Do you agree with the new definition of inter-funds transfers?

Q3: Do you agree with amending the exemption from post-trade reporting for give-ups and give-ins?

Q4: Do you think guidance to clarify further the types of give-ups and give-ins that can benefit from the exemption from post-trade transparency is required?

Q5: Do you agree with introducing an exemption for inter-affiliate trades?

Q6: Do you agree with our proposed definition of inter-affiliate trades?

Q7: Do you agree with the deletion of point d) from Article 13?

Q8: Do you agree with the proposal to introduce a deferral for all transactions within scope of Article 13 of RTS 1?

Answering questions 1-8 collectively: We agree with the FCA's proposals, however we reiterate our earlier comments regarding the paramount importance of developing a consolidated tape. Development of a post-trade consolidated tape for equities would require, among other things, a clear view on the scope of relevant trades for both a real-time and delayed feed. As such, we recommend that any revisions to the scope of post-trade is carried out in conjunction with development of a UK consolidated tape.

Alignment between Article 13, Article 2 and Article 6 in UK RTS 1

Q9: Do you agree with our proposals to align the definitions of non-price forming trades in Articles 2, 6 and 13?

Q10: Do you agree with our proposal to amend the definition of benchmark transaction to include transactions that reference to the market closing price?

Answering questions 9-10 collectively: We agree with the FCA's proposals, however reiterate our earlier comments regarding the paramount importance of developing a consolidated tape.

Improving the information content of trade reports & aggregation of flags

Q11: Do you agree with the deletion of the SI related flags "SIZE" and "ILQD" and "RPRI"?

Q12: Do you agree with the deletion of the agency cross flag "ACTX", the duplicate trade flag "DUPL" and the algorithmic trade flag "ALGO"?

Q13: Do you agree with the proposal of identifying "benchmark", "portfolio" and "contingent" trades with one single flag, "TNCP"?

Q14: Do you agree with our proposal to aggregate the three negotiated transactions flags into one single flag, "NETW"?

Q15: Are there any other flags that we should consider removing, amending or adding?

Q16: Do our proposals to modify the flags for trade reporting impact your systems for transaction reporting?

Q17: Do you agree with the proposed changes to the reporting fields?

Q18: Are there other changes that you suggest we should make to the fields of reported transactions?

Answering questions 11-18 collectively: We agree with the FCA's proposals, however reiterate our earlier comments regarding the paramount importance of developing a consolidated tape. In our view, present issues with flagging of post-trade data are not as a result of existing requirements, but rather due to the fact that they have been inconsistently applied by market participants. Developing a consolidated tape would require – among other things – standardised reporting from venues to the tape, including how flags should be interpreted and applied. We therefore recommend that any exercise to revise flags takes place in conjunction with eider efforts to develop a consolidated tape for the UK.

Designated reporter regime

Q19: Do you agree with our proposal to create a regime where firms will be able to opt in as designated reporters at an entity level?

Q20: Do you agree that the FCA should maintain the register of designated reporters for firms to determine who reports OTC trades?

Answering questions 19-20 collectively: We agree with the FCA's assessment that the current system of reporting creates operational complexity and room for error. While the current system is now embedded and functions well, the proposed changes to the regime would simplify the reporting logic and potentially reduce risk. Therefore, in principle, we support the changes.

Any potential reduction in cost and complexity is contingent upon entities electing to become designated reporters. However, if few or no entities opted in and that the mandatory reporting requirement for Systematic Internalisers was removed, the proposed regime would increase reporting obligations for a number of buy-side firms beyond its current level. This would require significant changes to existing reporting infrastructure, and would therefore represent a net cost to the industry versus the status quo.

To minimise operational risk and excessive changes to firms' reporting architecture, we recommend that the proposed designated reporter regime should mandate firms with the regulatory permission of "dealing in investment as principal" to identify as designated reporters for a given asset class. Alternatively, we would recommend the FCA issue strong guidance that it expects sell-side brokers or dealers to become designated reporters.

We also recommend allowing non-UK brokers/dealers to take on designated reporter status for in-scope UK TOTV instruments. This would help to alleviate frictions as of end-March 2022 whereby the buy-side submits more PTT reports than it previously when trading OTC with a EU domiciled Broker. This is because after 31 March (when the FCA's standstill direction expires) we can no longer rely on EU brokers' status as a Systematic Internaliser under EU MIFIR, requiring the buy-side to carry out reporting for OTC transactions itself.

Implementation of changes to post-trade transparency

Q21: Do you agree with the proposed implementation timetable? If not please explain your answer.

A six-month implementation period may prove too short for some of the proposed changes to post-trade transparency. In particular, the designated reporter regime – for the reasons outlined above – may require new reporting infrastructures, depending on how it is implemented. We would welcome further clarity on this proposal before implementation timelines are decided. Separately, we recommend that changes to the scope and content of

post-trade reporting are carried out alongside the development of the UK consolidated tape.

The reference price waiver and order management facility waiver

Q22: Do you agree with the proposal to change the definition of the MRMTL to allow trading venues to derive the price from a non-UK venue provided that the price is transparent, robust and offers the best execution result?

Q23: Do you agree with the proposal to change the definition of the MRMTL for the purpose of the tick size regime?

Q24: Do you agree with the proposal to delegate the decision to set a minimum size threshold for reserve and other orders to trading venues using the OMF waivers?

Answering questions 22-24 collectively: We agree with the FCA's proposals, however reiterate our earlier comments regarding the paramount importance of developing a consolidated tape.

Tick size

Q25: Do you agree with the proposal to allow trading venues to adopt the minimum tick size of the primary market located overseas when that tick size is smaller than the one determined based on calculations using data from UK venues?

Yes. The primary objective of the tick size regime is to prohibit venues competing through economically insignificant tick increments, and thereby attracting order flow to venues that may have thinner trading volumes, leading ultimately to higher costs for end-investors. A primary market located overseas is likely to have the highest volume of trading in a given security and is therefore most relevant from the perspective of securing best execution for end-investors.

Improving market-wide resilience during outages

Q26: Do you agree with the proposals to be included in the FCA/industry guidance for trading venues?

Q27: Are there other areas we need to consider for the guidance?

Answering Q26 & 27 collectively. We agree with the FCA's proposal. However, a real-time consolidated tape will play a critical complementary role to updated guidance on outages, and make markets more resilient. It should be possible that an outage causing an inability to trade on one venue can be mitigated by continued trading on others. However, a necessary condition of this is robust, reliable, and transparent price formation. A consolidated tape would give market participants a real-time view of where the market is trading that is not contingent on any one venue, allowing volumes to shift during outages and enhancing market-wide resilience and transparency.

Q28: Is the current arrangement for an alternative closing price on the primary market appropriate?

Q29: Is an alternative closing auction needed?

Q30: Do you agree with the above proposals to be included in the FCA/industry guidance for market participants?

Q31: Are there other areas we need to consider for the guidance?

Answering questions 28-31 collectively: Under current arrangements, outages can leave the market without a clear closing price. We believe clearer rules or arrangements in the event of outages would help to mitigate confusion and unnecessary knock-on disruption of processes that rely on a definitive closing price. In the first instance, rules should cover fall-back options, before considering more complex options such as processes for failing-over to other venues, or back-up auction facilities.

We believe an alternative closing auction merits further consideration, however the primary focus should be on processes for dealing with outages, fallback prices, and development of a consolidated tape as a market-wide point of reference.

The UK market for retail orders

Q32: Do you think the RSP system works well for retail clients?

We acknowledge FCA's findings that there is room for improvement in the Retail Service Provider (RSP) execution model for retail investors. We see four main areas of concern:

1. **A lack of transparency** around consolidated transactions data (i.e. the lack of a consolidated tape), costs & charges levied during order intermediation, and limited disclosure requirements on order execution quality.
2. **Limited competition** to ensure best execution of retail orders.
3. **A lack of protection against sub-optimal execution** outcomes during heightened market volatility, compared to market participants that are able to utilise centralised order book trading on exchanges. This includes a lack of guaranteed execution by the RSPs (instances of which are particularly high in fast-moving markets), and absence of price control mechanisms (or volatility safeguards) which exist on exchanges.
4. **Limited choice of execution venue** (including the inability to get orders executed on-exchange) creates an uneven playing field compared to more sophisticated market participants.

Q33: Do you have any suggestions for changing the regulatory regime as it applies to the execution of orders by retail clients?

To modernise UK equity market structure, promote more competition for retail orders, ensure safeguards against market volatility, and enhance the transparency and reporting of retail order execution, we recommend:

1. **Delivering a consolidated tape and transparency on intermediation costs:** A lack of consolidated transaction data limits retail investors' awareness, confidence and participation in capital markets, and creates an uneven playing field versus institutional investors who have the resources to consolidate data and monitor execution themselves. Delivering a single consolidated tape provider of pre- and post-trade data is therefore critical, and will allow executions via the RSP process to be benchmarked against the wider market, driving best execution and better outcomes. We also recommend exploring ways to improve transparency of costs and other charges levied by different service providers throughout retail investment process, from order placement on a brokerage platform to its execution and settlement.
2. **Improving competition, order handling, and reporting practises for retail orders:** Retail investors should benefit from, and contribute to, overall market liquidity.

Currently, the RSP model facilitates single-execution and single-settlement of retail orders by the chosen RSP on a bilateral agency basis. While retail trades are reported on the London Stock Exchange ex-post, they do not necessarily benefit from access to LSE's (or other exchanges') order book whereby orders interact with market-wide liquidity. Retail orders executed via the RSP model are also marked as 'Off Order Book – On Exchange' which leads retail investors to believe their orders have been executed on exchange, which may not necessarily be the case. Retail investors should be given the option to choose whether their orders are executed on an exchange or the RSP network, with clear disclosures about the actual execution venue.

3. **Implementing volatility guardrails for retail orders:** Trades executed on-exchange benefit from safeguards during periods of heightened market volatility. Under the RSP model, these are not currently available. To enhance the resiliency and fairness of retail order execution at the time of heightened market volatility, we recommend taking steps to ensure RSPs implement similar controls.

Conclusion

We appreciate the opportunity to address and comment on the issues raised by the Consultation Paper and will continue to work with the FCA on any specific issues which may assist in the ongoing review of secondary equity markets.