

Competition in the markets for services provided by a Recognised Investment Exchange: proposed amendments to REC

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We are asking for comments on this Consultation Paper by 31 January 2014.

You can send them to us using the form on our website at:
www.fca.org.uk/your-fca/documents/consultation-papers/cp13-16-response-form.

Or in writing to:

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Abbreviations used in this paper

FSMA	The Financial Services and Markets Act 2000
OTC	Over the Counter
MTF	Multilateral Trading Facility
RIE	Recognised Investment Exchanges
ROIE	Recognised Overseas Investment Exchange
The Recognition Requirements Regulations	The Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001
Recognition Requirements	The requirements specified by the Recognition Requirements Regulations
REC	The Recognised Investment Exchanges Sourcebook

1. Overview

Introduction

- 1.1** On 1 April 2013, we (the FCA) took over responsibility from the Financial Services Authority (FSA) for supervising trading infrastructure, including RIEs, ROIEs and MTFs, and for the conduct of participants in OTC markets. Our supervisory approach aims to advance our statutory objectives, which now include promoting effective competition in the interests of consumers.¹ An appropriate level of competition in the markets for services provided by trading infrastructures benefits market participants – by fostering choice and encouraging innovation, while safeguarding against excessive fees or costs of trading.
- 1.2** In relation to trading infrastructures operated by authorised firms, such as MTFs, we can take a range of steps to advance the competition objective, including the use of certain own-initiative powers.²
- 1.3** In the case of RIEs, our competition approach must function within a different, bespoke regulatory regime set out in FSMA³ and in the context of a risk-based ‘close and continuous’ supervisory approach. In light of these differences, we are making it clear how we will take competition considerations into account when supervising RIEs.
- 1.4** In this CP we:
- discuss our interest in the activities of RIEs from a competition perspective, based on our view of how those activities can affect competition between an RIE and other trading infrastructures, between users of RIE facilities, and among service providers in the broader markets for exchange services
 - describe how our particular functions and powers, as supported by our REC sourcebook, can be used to pursue those interests, and
 - set out a number of proposed amendments to REC, where we consider that further clarity on our competition approach is needed, or where we believe that changes to the way we exercise our functions will enhance our ability to advance the competition objective

1 The competition objective sits alongside two other operational objectives: securing an appropriate degree of protection for consumers; and protecting and enhancing the integrity of the UK financial system.

2 The FCA may vary a firm’s permission on its own initiative (OIVOP) or impose a requirement on a firm on its own initiative (OIREP) under section 55J or 55L of FSMA.

3 RIEs are Recognised Bodies under Part 18 of FSMA, rather than authorised persons.

Who does this consultation affect?

- 1.5** This CP will be of interest to RIEs and ROIEs, to users of their facilities and to those operating in the markets for exchange services.

Is this of interest to consumers?

- 1.6** Our proposals will be of interest to direct and indirect consumers of the services provided by RIEs and ROIEs, including issuers, exchange member firms and their clients.

Context

- 1.7** Since 1 April 2013 we have had both a new competition objective and a competition duty. Our competition objective requires us to promote effective competition in the interests of consumers, including in the markets for services provided by an RIE.⁴ Our competition duty, in contrast, requires us to discharge our general functions in a way which promotes effective competition in the interests of consumers, so far as this is compatible with acting in a way that advances our consumer protection and integrity objectives. In July 2013⁵, we set out our high-level approach to advancing the competition objective with respect to RIEs. We said:

'Stock exchanges, futures exchanges and commodity exchanges have to meet a set of regulatory requirements to be recognised as RIEs. Our role is to ensure ongoing compliance with these requirements and we will take into account our competition objective in doing so'.

- 1.8** Our proposals expand upon that statement by explaining how we will take account of competition considerations in the course of our close and continuous supervision of RIEs, within the particular framework of powers that apply to them.

- 1.9** In developing our proposals, we have taken into account:

- REC does not currently offer any guidance on how we will seek to advance the competition objective.
- The regulatory provisions of an RIE are no longer kept under review by the Office of Fair Trading (OFT) in line with a special competition regime. This places greater emphasis on our competition work.
- The FSA's historic approach to the implementation of sections 300A to 300E of FSMA⁶ (referred to in this consultation as the 'excessive requirement provisions'), which enable us to disallow an excessive regulatory provision, does not take account of the FCA's increased interest in competition issues.

⁴ In particular, services involving a regulated activity for which an RIE is exempt from the general prohibition under section 285(2) of FSMA.

⁵ The FCA's approach to advancing its objectives.

⁶ These provisions were inserted by the Investment Exchanges and Clearing Houses Act 2006, often referred to as the Balls Act.

- The activities of authorised firms operating MTFs are similar to those of certain RIEs, and pose similar risks to FCA objectives. While recognising that the regulatory regimes governing these entities are different, we aim to achieve the same competition outcomes in relation to comparable services provided by RIEs and authorised firms operating MTFs.

Summary of our proposals

1.10 We are proposing to make the following changes to REC:

- To clarify that competition considerations are among the relevant circumstances that we will take into account when determining if an RIE satisfies the Recognition Requirements. We will do this by adding a provision to REC 2.2.2.
- To clarify that proposed regulatory provisions which could affect competition in relevant product markets, by placing a material restriction or limitation (directly or indirectly) on third-party service providers, fall within the scope of an RIE's notification obligations under the excessive requirement provisions. We will do this by amending the types of regulatory provision which are excluded from a disclosure obligation under REC 3.26.
- To amend our rules governing the content of the annual report of a ROIE, to ensure such reports continue to provide us with information on events affecting competition.

1.11 We believe these changes to be limited in nature. If implemented, our proposals would complement new functions that the Government has proposed to give us under broader competition legislation, with respect to financial sector activities, as part of an effective overall competition toolkit. These new functions would take effect in April 2015 and so, in the meantime, our proposals will serve as an interim step.

Equality and diversity considerations

1.12 We have assessed the likely equality and diversity impacts of the proposals and do not think they give rise to any concerns, but we would welcome your comments.

Next steps

1.13 Please send us your comments by 31 January 2014. We will consider your feedback and publish our amended rules and guidance in a Policy Statement.

2. Our interest in the activities of RIEs from a competition perspective

- 2.1** In this chapter, we set out our views on how the activities of RIEs can affect competition between market participants who are users of their facilities, and between RIEs themselves and other service providers competing in the same product markets. By setting out the nature of our interest, we are then able to measure the effectiveness of our current supervisory approach under REC, and identify potential areas for change.
- 2.2** RIEs are operators of markets for the trading of financial instruments.⁷ They are responsible for setting and policing the rules that govern their members when using those markets. So the RIEs' quasi-regulatory role is critical in ensuring that their participants are able to compete with each other fairly when offering services in exchange-traded products, by means of RIE facilities. Under our competition objective, we therefore have a fundamental interest in supervising any RIE activity that could discriminate between its members in relation to their access to, or use of, those facilities (for example, through an RIE's fees or charges).
- 2.3** We note that the competition objective has a broader reach than the markets for services provided by authorised persons such as exchange member firms. It also captures the markets for services provided by RIEs themselves, when carrying out regulated activities falling within the scope of their exchange licences.⁸
- 2.4** In this consultation, we are not seeking to define the product markets in which RIEs operate.⁹ However, in broad terms, the RIEs and the ROIEs we have currently recognised provide services in a range of distinct product markets. The types of service provided include:
- the admission to trading of listed and unlisted¹⁰ securities
 - the trading of financial instruments¹¹ – RIEs offer trading services in a broad range of instruments; including equities, bonds, structured finance products, emissions allowances and derivatives contracts

⁷ UK RIEs operate Regulated Markets, as defined by MiFID, and can offer multilateral trading facilities.

⁸ Under section 285(2) of FSMA, an RIE is exempt from the general prohibition in relation to the regulated activities it carries on for the purpose of its business as an investment exchange, or which relate to the provision by the exchange of services designed to facilitate the provision of clearing services by another person.

⁹ The discussion set out in this CP is provided for illustration and should not be construed as an FCA view on the range or scope of any particular product market.

¹⁰ The shares of SMEs, some bonds and most derivative contracts are examples of unlisted financial instruments. Admission to trading, or 'primary market' services enable issuers to raise capital (for example, through IPOs and rights issues).

¹¹ 'Trading Services' have previously been described by the OFT in the following terms: 'Trading services comprise the buying and selling of financial instruments either on multi-party trading venues (Regulated Markets (RMs) or Multi-Lateral Trading Facilities (MTFs) or bilaterally between two counterparties also known as over-the-counter (OTC). A bilateral trade may be subsequently reported to a trading venue. Effectively a trading venue brings together buyers and sellers of securities' (ME/5464-12).

- the provision of market data, and
 - in certain cases, ancillary services such as the licensing of technology
- 2.5** We note that not all services provided by an RIE will necessarily involve a regulated activity and hence fall within the ambit of the competition objective. For example this may include providing market data products and licensing technology systems. However, an RIE's market data services are subject to our oversight under specific provisions of MiFID (as discussed in the next chapter), and we note that the structure of these services can have an impact on the ability of others to compete in markets for trading services.¹²
- 2.6** The competitive landscape for the markets in exchange services continues to evolve at a rapid pace, facilitated in part by developments in the regulatory environment.¹³ Over the last decade, the emergence of new technologies, such as smart order routing, the increased market power of exchange customers¹⁴, and a high level of merger activity have provided an impetus for this change.
- 2.7** We believe that an appropriate level of competition between market infrastructure providers, across the range of activities described at paragraph 2.4 above, can generate significant benefits for market participants by fostering choice and encouraging innovation, while also safeguarding against excessive fee and/or cost increases. Examples of such benefits may include a greater variety of trading functionalities, order types and tariff structures, and the creation of new products. A choice of trading environments also provides market participants with options in the event that any given venue experiences disruption to its services. These benefits would be placed at risk if an entity in a position of market strength, in a relevant product market, were to exploit that position for the purpose of stifling or distorting competition, or if trading venues agreed to split up the market between them.
- 2.8** An RIE is, in principle, in a position to develop a position of market strength through its regulatory functions, for which it receives statutory immunity under the legislative framework.¹⁵ The RIE is responsible for setting, monitoring and enforcing the market rules which a customer is required to accept in order to gain access to its facilities.¹⁶ Further, while acknowledging the range of competitive constraints to which RIEs are now subject, RIE markets continue to play an important role in the efficient trading of - and price formation in - a range of financial instruments.
- 2.9** In the context of the markets for services provided by exchanges, we believe that where the ability and the incentive existed, a position of market strength could be exploited through practices that would carry a cost to market participants. Such practices could, in theory, take the form of excessive increases in price, discriminatory or predatory pricing practices or unjustified regulatory provisions creating barriers to entry for potential competitors.
- 2.10** As it stood before 1 April 2013, FSMA made particular provision for the possibility that the regulatory provisions or practices of an RIE could have an adverse effect on competition by requiring or encouraging exploitation of the strength of a market position¹⁷. In such cases, the legislation allowed for an OFT investigation and, if appropriate, for the making of a report. Since

¹² For example, entities consuming market data for the purpose of the operation of reference price trading systems.

¹³ For example, the introduction of the MTF category. The proposals under negotiation as part of the revisions to MiFID, including a further category of trading venue, the Organised Trading Facility, will also be relevant to the future competitive landscape.

¹⁴ As demonstrated by the project organised by a group of market participants that led to the creation of the Turquoise MTF.

¹⁵ Section 291 of FSMA.

¹⁶ See, for example, REC 2.15.

¹⁷ Section 302(3) of FSMA prior to amendment by the Financial Services Act 2012, forming part of the special competition regime administered by the OFT.

these risks still exist, but can no longer be addressed through these particular OFT powers, we believe we have an increased interest in supervising RIE activities that could amount to the exploitation of the strength of a market position.

Q1: Do you agree with our assessment of our interest in the activities of RIEs from a competition perspective?

3.

Our regulatory functions and powers relevant to the competition objective

- 3.1** In this chapter, we describe the bespoke nature of our functions and powers in relation to RIEs and ROIEs¹⁸, as we have reflected them in REC, and how these can support the pursuit of our interests, as discussed in Chapter 2.
- 3.2** It should be noted, as a starting point, that the regulatory framework for RIEs is different to that which applies to an authorised firm. In the case of a firm, the FCA can use certain own-initiative powers, or exercise general rule-making functions, where it considers it appropriate for the purpose of advancing its operational objectives. Instead, we have the following regulatory responsibilities under FSMA in relation to RIEs:
- a.** We grant recognition to investment exchanges that satisfy the requirements set out in the Recognition Requirements Regulations (or, in the case of ROIEs, which meet requirements providing an equivalent degree of protection). Guidance on how we apply the Recognition Requirements is set out in Chapter 2 of REC.
 - b.** We supervise UK RIEs through the continuing application of those Recognition Requirements, according to a risk-based 'close and continuous' approach. We are also the EU Competent Authority responsible for ensuring compliance with directly applicable provisions of MiFID. That supervision is supported by several powers, including the ability to give directions and impose certain disciplinary measures.
 - c.** We implement and enforce the excessive requirement provisions, which – in broad terms - enable us to disallow a UK RIE's proposed regulatory provision which we have assessed to be unjustified or disproportionate.¹⁹
 - d.** And in the case of a ROIE, we receive an annual report containing information about events relating to the exchange's ongoing compliance with the conditions for recognition.
- 3.3** We believe that our functions, as set out above, provide a sound basis for our supervision of RIE activities that could affect the ability of market participants to compete with each other fairly, when offering services by means of an RIE's facilities. For example, under the regulatory responsibilities that we supervise, RIEs are required to:
- establish and maintain transparent and non-discriminatory rules, based on objective criteria, governing access to, or membership of, the RIE's facilities
 - establish transparent rules that provide for fair and orderly trading

¹⁸ As set out in Part 18 of FSMA

¹⁹ Under these provisions, the FCA may find a requirement to be excessive where it is not justified as pursuing a reasonable regulatory objective, or is disproportionate to the end to be achieved. The FCA must also refuse recognition to an investment exchange with excessive regulatory provisions.

- ensure that on-exchange business is conducted in an orderly manner and so as to afford proper protection to investors – when supervising this requirement, we expect to consider whether liquidity incentive schemes made available to participants (or classes of participant) are transparent and are consistent with other factors set out in REC²⁰
- make available to the public pre- and post-trade transparency data, in relation to shares admitted to trading on a Regulated Market, on a non-discriminatory commercial basis at a reasonable cost²¹
- be a fit and proper person to perform the functions of an RIE

3.4 We note that we already place considerable emphasis on the above requirements when supervising RIEs. For example, we expect RIEs to seek non-objection from us in relation to proposals for new or amended liquidity incentive schemes, and before providing this we will consider whether such schemes will operate on a transparent and non-discriminatory basis.

3.5 We consider that our functions and powers that would be relevant to addressing the exploitation of the strength of a market position by an RIE are less well developed. This may be explained, in part, by the fact that before April 2013 the OFT had specific responsibilities, under a special competition regime, to oversee the activities of RIEs in parallel with our regulatory functions.²² Under that special competition regime, as noted above, the OFT had specific reporting responsibilities in relation to an RIE's regulatory provisions having a significantly adverse effect on competition, including those amounting to an abuse of market strength. However, that regime has now been repealed²³ and RIEs have been brought within the normal provisions of the Competition Act. In addition, the FCA was given a power to request that the OFT consider the competitive impacts of a feature, or combination of features, of a market in the UK for financial services.²⁴

3.6 In principle, our powers under the excessive requirement provisions²⁵ provide a basis for us to address an attempt by an RIE to exploit the strength of its position by imposing unjustified or disproportionate requirements – directly or indirectly – on potential competitors. The FCA is largely responsible for determining the scope of the excessive requirement provisions through its ability to make rules specifying types of regulatory provision that are excluded from an RIE's notification obligations.²⁶ The FSA originally proposed its rules in this area, through CP07/10, in June 2007 and they have not been amended since their introduction.²⁷ Among other things, those rules currently exclude the regulatory provisions set out in the table below.

²⁰ As provided for by REC 2.6.29

²¹ Article 32 of the MiFID Implementing Regulation (Regulation 1287/2006).

²² Chapter II of Part 18 of FSMA.

²³ As set out in Chapter 4, the special competition regime was seen to have become redundant in light of the powers conferred on the FCA under the excessive requirement provisions.

²⁴ Under section 234H of FSMA, The FCA may ask the OFT to consider whether a feature, or combination of features, of a market in the United Kingdom for financial services may prevent, restrict or distort competition in connection with the supply or acquisition of any financial services in the United Kingdom or a part of the United Kingdom.

²⁵ It should be noted that, in this context, the term 'regulatory provision' means: 'any rule, guidance, arrangements, policy or practice'. It therefore captures a much broader range of activities than the rule-making functions of an RIE.

²⁶ Section 300B of FSMA.

²⁷ They are currently set out in REC 3.26

REC 3.26.4

Disapplication of duty to notify proposal to make regulatory provision

The duty in section 300B(1) of the Act does not apply to any of the following:

...

(5) any other regulatory provision which has not been excluded under (1), (2), (3) or (4) other than any such provision which (taken together with any other regulatory provision not otherwise the subject of a notice under section 300B(1) of the Act):

(a) materially increases disclosure, reporting or corporate governance requirements imposed on any person (whether directly or indirectly); or

(b) imposes a material limitation affecting any person (whether directly or indirectly including, without limitation, through an amendment to fees or charges) on the type or nature of financial instruments which may be listed or the subject of admission to trading on the facilities operated by the UK RIE proposing to make the regulatory provision; or

(c) materially limits access to, or use by, any person (whether directly or indirectly including, without limitation, through an amendment to fees or charges) of the facilities operated by the UK recognised body proposing to make the regulatory provision or

(d) materially adds to the circumstances in which any person (whether directly or indirectly) may be liable to penalties or other sanctions or have liability in damages.

- 3.7** As can be seen from the table, our current notification rules exclude, in broad terms, regulatory provisions other than those that represent a material limitation or restriction on access to, or use of, the particular facilities operated by the UK RIE proposing to make the regulatory provision. So it is not sufficiently clear that our current approach would require notification of a proposal whose principal effect was to limit or restrict the ability of an RIE's users to make use of competing third party facilities – an issue which would clearly be of concern to us given our statutory objective to promote competition in the interests of consumers.
- 3.8** So far, we have not sought to use the excessive requirement provisions as a tool to address competition issues. In practice, we receive a limited number of formal notifications under this regime.
- 3.9** Further, we note that the excessive requirement provisions do not apply to a ROIE. The regulatory framework for ROIEs provides that we may recognise such exchanges where they provide investors with protections equivalent to those which they would receive if the applicant were required to meet the Recognition Requirements. Our continuing oversight of ROIEs against these obligations is then based on us receiving an annual report. Before 1 April 2013, this report was required to contain a statement on whether any events have occurred which are likely to have any effect on competition, and was submitted to both the FSA and OFT. However, the requirement for such a competition statement, and for the OFT to receive a copy of the report, have now both been removed from the legislation.

- 3.10** In assessing the case for changes to our current supervisory approach in support of the competition objective, we should also consider the possibility of future changes to the regulatory framework. In October 2013, the Government proposed amendments to the Financial Services (Banking Reform) Bill that would confer certain competition functions on the FCA, to be held concurrently with the Competition and Markets Authority (CMA), insofar as financial sector activities are concerned. Those functions are:
- a.** the ability to conduct market studies under the Enterprise Act 2002, and
 - b.** the power to enforce the provisions of Chapters I and II of the Competition Act 1998 (to which RIEs are now subject)
- 3.11** If granted, concurrent competition powers would apply from April 2015. At that point, the power to make a formal request to the OFT in relation to a competition issue would fall away, to be replaced by the power to refer a market directly to the CMA for in-depth investigation.

4.

Our proposed changes to REC

- 4.1** Our approach to promoting effective competition in the interests of consumers needs to function within the bespoke framework provided by FSMA for the recognition of RIEs and ROIEs. So in the absence of own-initiative powers similar to those that apply to authorised firms, we need to advance the competition objective primarily through our supervision of the Recognition Requirements and through appropriate use of the excessive requirement provisions.
- 4.2** We have taken into account the Government's proposal to confer new competition functions on us from April 2015. We believe that certain limited changes to REC now will, as an interim step, enhance our competition capabilities under our existing functions while in due course complement any concurrent functions we are given.

Competition as a 'relevant circumstance' in our risk based close and continuous supervisory approach.

- 4.3** The Recognition Requirement Regulations give us flexibility to take account of 'all relevant circumstances' when determining if an RIE satisfies its regulatory responsibilities²⁸. We have chosen to set out, within REC, a list of considerations which are illustrative of the circumstances we will generally regard as relevant to our application of the Recognition Requirements.
- 4.4** We think it would be helpful to clarify, within REC, that competition considerations are among the relevant circumstances that we will take into account in our general supervision of the Recognition Requirements. This will underline the emphasis we will place on the Recognition Requirements (and particularly those with direct relevance to our competition interests, as summarised in Chapter 3) as a key component of our competition approach to RIEs. We propose to achieve this by making the amendments to REC 2.2.2 set out at Appendix 1.

Q2: Do you agree with our proposal to clarify that competition in the markets for services provided by RIEs is a relevant circumstance that we will take into account in our general supervision of the Recognition Requirements?

Notification rules under REC 3.26 implementing the excessive requirement provisions

- 4.5** The FSA's approach to the implementation of the excessive requirement provisions reflected the existence of the OFT's special competition regime and the absence of a specific competition objective. It is now expected that greater use will be made of these powers to address competition issues, as an alternative to the special competition regime. The explanatory notes to the Financial Services Act 2012 state:

²⁸ REC 2.2.1

'[The special competition regime] is now considered to be redundant, particularly as a result of the coming into force of... [the excessive requirement provisions]... which permits the appropriate regulator to refuse to make a recognition order if it appears that an existing or proposed regulatory provision of the applicant (in connection with relevant business) imposes or will impose an excessive requirement on a person affected directly or indirectly by it'.

- 4.6** In certain circumstances, the regulatory provisions of an RIE could affect the ability or the incentive for a third party service provider to enter a market for exchange services, or a related market. For example, this could be through the imposition of a direct limitation or restriction on the service provider (such as an exchange's policies for the provision of reference data to third party trading venues); or an indirect restriction on that provider (such as by placing additional burdens on an exchange's member firms when using the facilities of that provider to trade the same or similar instruments). In such cases, where the limitation or restriction was material, we believe it would be a legitimate use of the excessive requirement provisions for us to receive a notification and consider whether the proposal was justified and proportionate, in pursuit of our competition objective. However, as set out above, our rules currently focus on regulatory provisions that have an impact on a market participant's access to, or use of, the particular facilities operated by the RIE making the proposal (and do not necessarily pay sufficient regard to the impact on the supply of services in the broader markets for services provided by RIEs or related markets). So we think it is appropriate to clarify that regulatory provisions of this kind are subject to a notification obligation and the resultant processes allowing us to assess them.
- 4.7** We are therefore proposing to make it clear that regulatory provisions that materially limit or restrict the ability of third-party suppliers to offer services to the users of the UK RIE proposing to make the provision are within the scope of the excessive requirement provisions. Appendix 1 sets out our proposed amendment to REC 3.26. Consistent with our existing approach, we will exclude regulatory provisions that are not assessed to be material and we don't believe this change will lead to significant additional burdens for UK RIEs.

Q3: Do you agree with our proposal to clarify that regulatory provisions imposing a material limitation or restriction on the supply of competing services to users of an RIE's facilities fall within the scope of our notification rules implementing the excessive requirement provisions?

C: The contents of the annual report of a recognised overseas investment exchange

- 4.8** In our view, a requirement for the annual report of a ROIE to contain a competition statement (as described at paragraph 3.9 above) would allow us to advance our competition objective by monitoring any events which are likely to have an impact on competition in the ROIE's home markets. We are therefore proposing to add a provision to REC 6.7 which re-instates the requirement for a competition statement, and in effect therefore to ensure that the annual report provides us with the same information as it did prior to legal cutover. As this proposal would re-establish a long standing position prior to legal cutover, we do not believe it will present material burdens for ROIEs.

Q4: Do you agree with our proposal to make rules requiring the annual report of a ROIE to contain a competition statement?

Annex 1

Cost benefit analysis

1. Section 138I(2)(a) of the Financial Services and Markets Act 2000 (FSMA) requires us to publish a cost benefit analysis (CBA) when proposing draft rules. Section 138L(3) of FSMA states that section 138I(2)(a) does not apply where we consider that there will be no increase in costs or the increase will be of minimal significance.
2. In our view, the proposals put forward in this CP will impose minimal burdens on RIEs and therefore no CBA is required.
3. The amendments to REC 2.2.2 will be in the form of guidance to clarify that we regard competition to be a relevant circumstance in our continuing supervision of RIEs. They will not, therefore, impose any new requirements on RIEs, but provide a clearer basis for us to consider competition issues when applying existing requirements. The amendments to our notification rules under REC 3.26 will require UK RIEs to consider changes to their internal processes for the making of notifications under the excessive requirement provisions, but we do not believe these changes will involve more than minimal cost. The amendment to REC 6.7 will allow the FCA to receive information regarding competition, via an annual report, from ROIEs which is the same as the information that such exchanges were required to provide prior to 1 April 2013. It therefore represents a practice with which ROIEs are already familiar and is not expected to involve more than minimal cost.
4. We believe that our proposals will make a significant difference to our ability to discharge our functions with respect to our competition objective. They aim to ensure that exchange markets remain contestable, by addressing the risk that incumbent providers may seek to establish barriers to entry. They will accordingly promote effective competition among providers of exchange services, which benefits consumers by safeguarding against excessive trading fees or costs, and providing incentives for innovation.

Q5: Do you have any comments on our assessment of costs and benefits of the proposed amendments to REC?

Annex 2

Compatibility statement

Compatibility with the FCA's General Duties

1. This Annex explains the FCA's reasons for concluding that our proposals in this consultation are compatible with certain requirements under the Financial Services and Markets Act 2000 (FSMA) as amended by the Financial Services Act 2012.
2. When consulting on new rules, the FCA is required by section 138I(2)(d) FSMA to include an explanation of why it believes making the proposed rules is compatible with its strategic objective, advances one or more of its operational objectives, and has regard to the regulatory principles in s. 3B FSMA. The FCA is also required by s. 138K(2) FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.

The FCA's objectives and regulatory principles

3. The proposals set out in this consultation are primarily intended to advance the FCA's operational objective of promoting effective competition in the interests of consumers. As noted in Annex 1, an appropriate level of competition between suppliers of services in the range of product markets in which RIEs operate benefits market participants by fostering consumer choice, encouraging innovation and safeguarding against excessive fees or costs.
4. We consider these proposals are compatible with the FCA's strategic objective of ensuring that the relevant markets function well because they will provide a clearer basis for us to address competition issues affecting RIEs, their members or their competitors, including attempts by RIEs to establish unjustified barriers to entry through their regulatory provisions. For the purposes of the FCA's strategic objective, "relevant markets" are defined by s. 1F FSMA.

In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in s. 3B FSMA.

The need to use our resources in the most efficient and economic way

5. We do not believe that our proposals will have a material effect on the use of our resources. The proposals reflect our competition objective by embedding competition considerations in our existing supervisory approach and offer an efficient and economic way of advancing that objective in relation to RIEs and ROIEs.

The principle that a burden or restriction should be proportionate to the benefits

6. We do not believe that our proposals will lead to additional burdens or restrictions for RIEs or ROIEs which are more than minimal, but will make a significant difference to our ability to advance the competition objective in relation to exchange markets.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

7. Our proposals align with this principle, by promoting the ability of market participants to access competitive exchange markets to meet their trading needs.

The general principle that consumers should take responsibility for their decisions

8. Our proposals do not affect this principle.

The responsibilities of senior management of persons subject to requirements imposed by or under FSMA, including those affecting consumers, in relation to compliance with those requirements

9. Our proposals do not affect this principle.

The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons subject to requirements imposed by or under FSMA

10. Our proposals recognise the differing approaches we take to the supervision of RIEs and ROIEs.

The desirability of publishing information relating to persons

11. Our proposals do not affect this principle.

The principle that we should exercise of our functions as transparently as possible

12. Our proposals aim to make the role of competition considerations in our ongoing supervision more explicit within REC and are therefore consistent with this principle.

13. In formulating these proposals, the FCA has had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by s.1B(5) (b) FSMA). Under the Recognition Requirements, the RIEs to which this consultation paper relates are required to adopt appropriate measures to reduce the extent to which their facilities can be used for a purpose connected with market abuse or financial crime, and to facilitate their detection and monitor their incidence. Our proposals do not involve any changes to our supervision of those requirements.

Expected effect on mutual societies

14. The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies, as they relate to our supervision of RIEs and ROIEs.

Compatibility with the duty to promote effective competition in the interests of consumers

15. In preparing the proposals as set out in this consultation, we have had regard to the FCA's duty to promote effective competition in the interests of consumers. The purpose of the proposals is to strengthen our ability to take action to promote effective competition in the markets for services provided by RIEs.

Legislative and Regulatory Reform Act 2006 (LRR)

16. We are required under the LRR to have regard to the principles in the LRR and to the Regulators' Compliance Code when determining general policies and principles and giving general guidance (but not when exercising other legislative functions).

17. We have had regard to the principles in the LRR for the parts of the proposals that consist of general policies, principles or guidance. As set out at paragraphs 6 and 12 above, respectively, our proposals are consistent with a proportionate and transparent supervisory approach in relation to RIEs and ROIEs. They are targeted at RIEs and ROIEs, which we believe will benefit from greater clarity on our competition approach given the bespoke regulatory framework within which they operate. Further, our proposals facilitate consistent treatment of entities within the RIE and ROIE communities, and will form part of our approach to advancing our competition objective and fulfilling our competition duty in relation to market infrastructures, according to our statutory responsibilities.

Annex 3

List of questions

- Q1:** Do you agree with our assessment of our interest in the activities of RIEs from a competition perspective?
- Q2:** Do you agree with our proposal to clarify that competition in the markets for services provided by RIEs is a relevant circumstance that we will take into account in our general supervision of the Recognition Requirements?
- Q3:** Do you agree with our proposal to clarify that regulatory provisions imposing a material limitation or restriction on the supply of competing services to users of an RIE's facilities fall within the scope of our notification rules implementing the excessive requirement provisions?
- Q4:** Do you agree with our proposal to make rules requiring the annual report of a ROIE to contain a competition statement?
- Q5:** Do you have any comments on our assessment of costs and benefits of the proposed amendments to REC?

Appendix 1

Draft Handbook text

Recognised Investment Exchanges sourcebook (Competition) Instrument 2013

Powers exercised by the Financial Conduct Authority

- A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) the following sections of the Act:
- (a) section 1E (The Competition objective)
 - (b) section 139A (FCA’s power to give guidance)
 - (c) section 290 (Recognition orders)
 - (d) section 292 (Overseas investment exchanges)
 - (e) section 293 (Notification requirements)
 - (f) section 295 (Notification: overseas investment exchanges)
 - (g) section 300B (Duty to notify proposal to make regulatory provision)
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument shall come into force on [*date*]].

Amendments to the Handbook

- D. The Recognised Investment Exchanges sourcebook (REC) is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Recognised Investment Exchanges sourcebook (Competition) Instrument 2013.

By order of the Board of the Financial Conduct Authority
[*date*]

Annex A

Amendments to the Recognised Investment Exchanges sourcebook (REC)

In this Annex, underlining indicates new text and striking through indicates deleted text.

2.2 Method of satisfying the recognition requirements

...

Relevant circumstances

2.2.2 G The *FCA* will usually expect:

...

(4) the nature and status of the types of investor who use the *UK recognised body's* or applicant's *facilities* or have an interest in the market supported by the *UK recognised body's* or applicant's *facilities*; ~~and~~

(4A) competition in the markets for services provided, or proposed to be provided, by the *UK recognised body* or applicant in its capacity as such; and

(5) the nature and scale of the risks to the *statutory objectives* associated with the matters described in (1) to (4A);

to be among the relevant circumstances which it will take into account in considering whether a *UK recognised body* or applicant satisfied the *recognition requirements*.

...

3.26 Proposals to make regulatory provision

...

Disapplication of duty to notify proposal to make regulatory provision

3.26.4 R The duty in section 300B(1) of the *Act* does not apply to any of the following:

...

(5) any other *regulatory provision* which has not been excluded under (1), (2), (3) or (4) other than any such provision which (taken together with any other *regulatory provision* not otherwise the

subject of a notice under section 300B(1) of the *Act*):

...

- (c) materially limits access to, or use by, any *person* (whether directly or indirectly including, without limitation, through an amendment to fees or charges) of the *facilities* operated by the *UK recognised body* proposing to make the *regulatory provision*; ~~or~~
- (d) ~~materially adds to the circumstances in which any *person* (whether directly or indirectly) may be liable to penalties or other sanctions or have liability in damages~~ materially limits or restricts the ability of any *person* to supply services (including, without limitation, trading, clearing, settlement or information services) to *persons* who are users of the *facilities* operated by the *UK RIE* proposing to make the *regulatory provision* (whether directly or indirectly, including by the imposition of an obligation or burden on the supplier or on a user of the *UK RIE*);
- (e) materially adds to the circumstances in which any *person* (whether directly or indirectly) may be liable to penalties or other sanctions or have liability in damages.

...

6.7 Notification rules for overseas recognised bodies

...

Reports under section 295

...

6.7.4 R An *ROIE* must include in its report submitted in compliance with section 295(1) of the *Act*:

...

- (2) particulars of any disciplinary action (or any similar or analogous action) taken against it by any supervisory authority in its *home territory*, whether or not that action has been made public in that territory; ~~and~~
- (3) a copy of its *annual report and accounts*; and
- (4) a statement as to whether any events have occurred which are likely to have any effect on competition;

where those events occurred, or the period covered by that *annual report and accounts* ended, in the period covered by that report.

Financial Conduct Authority



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