Annual Report
2018/19

FCA
Markets
Practitioner Panel

Chair’s foreword

I am pleased to introduce the FCA Markets Practitioner Panel Annual Report for 2018-19.

The FCA's responsibilities are very wide and there are many areas of regulatory policy and practice that affect financial markets. The Panel therefore has to prioritise what is important for practitioners and where it can make a difference through our interaction with the FCA.

In 2018-19, the implications of Brexit have continued to dominate our work and will do so until the form of exit of the UK from the European Union is clear, and beyond. We also covered many other topics from MiFID II to Cryptoassets to Culture and Governance. These discussions and our advice are summarised in this report.

In January 2019, the Panel held its annual prioritisation exercise and revised its priorities to focus on the following five areas of work in 2019-20:

- The UK's exit from the European Union (Brexit)
- Market preparedness for crisis scenarios
- Effective and proportionate regulation
- Cyber, middleware and technological resilience
- LIBOR transition

The Panel also established the two themes of "market liquidity" and "international best practice framework" through which the Panel will consider new regulations, policy decisions and the FCA's approach.

Our relationship with the FCA Board and Executive Committee continues to be strong and professional. We have welcomed regular engagement with the FCA Chairman, CEO and other Board and ExCo members and look forward to this continuing in 2019-20.

I would like to thank all the FCA staff who have presented openly and thoughtfully to us and particularly to the Panel members for giving their time and sharing their expertise so freely. It is that experience and the open and constructive way in which it is shared that enables the Panel to be efficient and productive and to support the FCA in ensuring that relevant markets work well.

This is my second and final report as Chair of the Panel as I step down in July 2019. I wish the new Chair and other Panel members every success in supporting the effectiveness of the work of the FCA.

John Trundle
Chair, FCA Markets
Practitioner Panel

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Introduction

The Markets Practitioner Panel is a statutory panel of the FCA. It is one of a number of panels that the FCA is required to establish and maintain under the Financial Services and Markets Act 2000 (as amended), and represents the interests of practitioners who are likely to be affected by the exercise of the FCA's functions relating to financial markets. The Panel meets formally six times each year and also holds sub-group meetings and conference calls on specific topics as required, as well as other strategy meetings.

The Panel benefits from some of its members belonging to other panels, which broadens its understanding and encourages a closer working relationship across the panels. It has a constructive working relationship with the FCA Chairman, CEO and other members of the FCA's Executive Committee and FCA Board. A number of ExCo members attend Panel meetings regularly, and senior representatives from the FCA's Markets Policy team engage very closely and constructively with the Panel.

In the Panel's Effectiveness Review in January 2019, it considered how to maximise the positive impact on the FCA and the FCA Board. It seeks to ensure that it continues to reflect different market perspectives, including through its engagement with other panels.

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2. The UK's exit from the European Union (Brexit)

Brexit continued to be a principal focus for the Panel due to the risks and uncertainties it poses for financial markets. These risks and uncertainties are likely to continue until the terms of the UK's exit become clearer and up to and beyond the date of exit from the European Union. The topic remains a standing agenda item for its meetings.

The Panel was concerned throughout the year that the uncertainty surrounding the political environment in the UK made it very difficult for firms to plan effectively despite the FCA having done what it reasonably could to support continuity and minimise disruption. Firms had to plan on a worst case basis and, in many cases, implement their contingency plans for a "hard" exit.

The Panel welcomed the FCA's own contingency planning for a "hard" exit, but stressed that this would not eliminate the risk of the financial system failing to function effectively and of significant damage to its users and practitioners. In such an outcome, the FCA would need to be able to respond quickly to the changing situation and work together with other relevant UK regulators to take a flexible approach towards firms which were taking reasonable steps in difficult circumstances to comply with relevant rules.

One possible outcome of the UK's withdrawal would be that the UK would become a "rule-taker" while the FCA would lose its ability to shape and influence EU rules directly. The Panel advised that, in such an event, the FCA's relationships with its international counterparts in Europe and globally would become even more important, and was pleased to hear that such relationships continue to be strong and remain a priority for the FCA.

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LIBOR transition

This has been one of the Panel's strategic priorities given the potentially significant impact that the transition to new reference rates could have on markets and their users, and it had a number of lively discussions during the year.

The Panel expressed its concern that the process by which legacy contracts could be converted from LIBOR to new reference rates remained unclear and raised the risk of significant transfers of wealth between market participants in different scenarios. There were different views amongst members about whether the more effective approach would be the conversion price and timeframe to be fixed in legislation or to be driven by the market. Members agreed, however, that the legislative approach would give the market certainty, time to address any potential issues that arise, and reduce the risk of market manipulation and litigation. Nevertheless, it would need to be coordinated internationally.

The Panel encouraged the FCA not to signal a complete cessation of LIBOR, at least not at this stage, as such an approach would present substantial legal risks that outweighed the potential benefits of providing clarity to the market and incentivising the transition. The Panel advised the FCA to engage closely with its US and other counterparts to ensure that a consistent international approach is taken in at least the main jurisdictions.

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Operational and cyber resilience

The Panel continued to discuss with the FCA various aspects of operational and cyber resilience, a key priority for the Panel and the industry as a whole.

The Panel expressed concern about public expectations about complete reliability. There are strong market incentives on firms to have high levels of operational performance but occasional outages are likely. It was pleased that regulators had explicitly recognised that service disruptions will occur from time to time, and encouraged the FCA to consider the regulatory relevance of outages in terms of material detriment, asset integrity and the reasonableness of a firm's approach to operational resilience.

The Panel felt that impact tolerance levels and metrics for different business services were better set by firms themselves, but, encouraged the FCA to publish guidance on the types of scenarios that firms should be testing against. The Panel also encouraged the FCA to broaden its supervisory dialogue with board and senior management teams, in particular with smaller firms, to increase their focus on resilience. The Panel felt the risks of specific regulation in this area could too easily create a focus on the form rather than the substance of compliance and be a "tick-box exercise". It also discussed the resilience of unregulated firms that provide critical infrastructure and services to regulated firms, and expressed its concern about the lack of oversight of these providers while recognising the difficulties in expanding the FCA's regulatory perimeter.

Cyber threats present an ever-greater risk than ever before to firm's resilience and to market integrity. The Panel discussed ways to reduce risks and respond to incidents and welcomed the move to establish the Financial Sector Cyber Collaboration Centre to support more effective and timely coordination and information sharing about cyber threats and responses.

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Cryptoassets

The Panel supports the FCA in being open to new and innovative methods and technologies of conducting business. These include the application of distributed ledger technology (DLT), and the Panel welcomes the use of a "regulatory sandbox" to try to balance openness to new products and ideas with protecting consumers from high-risk products.

One particular application of DLT that has grown rapidly is the use of cryptoassets (sometimes called crypto-currencies) and the raising of capital through Initial Coin Offerings (ICOs). The Panel believes these present a very real risk of significant harm to retail investors and the wider market due to their highly speculative and volatile nature. The Panel cautioned the FCA on a number of occasions that the public would expect the FCA to have acted to protect them if consumers were to lose significant amounts of money through holding cryptoassets. The Panel was pleased to hear that the topic of cryptoassets was high on the FCA's agenda even though in most cases they did not fall within its statutory remit, and that it was engaging with other regulatory authorities to address the potential risks of this evolving market.

It is an anomaly that ICOs and similar offerings are not classified as investments and subject to direct regulation by the FCA. Although the Panel is generally cautious about the FCA extending its regulatory perimeter, it encouraged the FCA to consider whether it is possible to regulate cryptoassets directly whilst recognising the risk that this could be seen to legitimise them. The Panel welcomed the FCA's announcements to help clarify regulatory coverage and to educate consumers about the risks involved and to ban the sale, marketing and distribution to retail clients of derivative products referencing cryptoassets.

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MiFID II

The implementation of MiFID II continued to present challenges to the industry and the Panel appreciated the FCA's periodic updates on the effects of the changes brought in by the regulation following its implementation on 3 January 2018. These technical discussions included the impact on research, liquidity and price formation, trade data and reporting, and on equity market infrastructure, especially in the context of Brexit.

Although there is as yet little clear evidence of any significant negative impact of MiFID II on measured behaviour, the consequences of the changes are likely to become clearer over time or when tested in more extreme market conditions.

The Panel will continue to monitor the impact of MiFID, and looks forward to engaging further with the FCA as and when appropriate.

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Culture and governance

Despite the significant amount of work that has been and is being done by both firms and the regulators to ensure consistently good standards of culture and governance in the financial services industry, the public continues to have a poor perception of the sector as a whole. Restoring public trust is essential for the sector's and the UK's economic success in the longer term, and the Panel therefore welcomed the FCA's initiatives in collaboration with industry (e.g. "Transforming Culture" conference, "CultureSprint", webinars, and a series of cross-discipline discussions that a number of members attended) to help move this narrative forward throughout the year.

Culture is hard to categorise. It is complex, dynamic and unique to each firm, and is influenced by the "purpose" of the firm as a whole and of each individual within it. The Panel welcomed the FCA's approach to assessing and understanding culture, and encouraged it to consider culture in parallel with conduct and the drivers of individual behaviour to form a more holistic view of each firm.

The Panel discussed the challenge of changing culture consistently throughout an organisation. Whilst metrics can help to obtain a high-level picture and identify areas of potential concern, the Panel is wary of firms or regulators reducing culture to simplistic metrics, rules and checklists which may drive behaviour to meet measured targets rather than the outcomes intended. It also highlighted the risk for both firms and regulators that a sensible and principles-based approach could get translated into rigid rules at an operational level.

The Panel encouraged the FCA to support its supervisory teams when engaging with firms to make judgements on outcomes and purpose rather than a narrow interpretation of imperfect rules which are at best a proxy for good governance or culture, and also to coordinate with the Prudential Regulation Authority to ensure that a consistent approach is taken by both regulators.

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FCA Strategic Initiatives

The Panel has also advised the FCA on its strategic initiatives such as the Business Plan, the "Approach to" documents, and work on its communication and its climate change strategies.

The Panel welcomed the FCA's collaborative approach with industry to help develop its thinking. The Panel also encouraged the FCA to ensure that its business planning was sufficiently flexible to accommodate Brexit-related pressures. It stressed that the FCA should always consider whether UK regulation is targeted and proportionate encouraging a judgement-based and outcome-focused approach. It believes that the UK and the firms operating in its financial markets benefit enormously from being seen to be well-regulated and being overseen by a world-leading regulatory authority, and this will be a key component of supporting the success of our leading and international financial centre in the years ahead.

Members of FCA Markets Practitioner Panel
(1 April 2018 – 31 March 2019)

John Trundle – Chair
CEO, Euroclear UK & Ireland

Marisa Drew
CEO, Impact Advisory and Finance Department, Credit Suisse

Suvro Dutta
Partner, Financial Services, KPMG LLP

Duncan Ford
Chief Operating Officer, Marshall Wace LLP

Dermot McDonogh
EMEA COO and CFO
Goldman Sachs International

Bernard Mensah
President for EMEA and Co-Head of Global FICC Trading, Bank of America Merrill Lynch

Abdallah Nauphal
CEO, Insight Investment Management

James Palmer
Senior Partner, Herbert Smith Freehills

Nikhil Rathi
CEO, London Stock Exchange plc

Tim Throsby
Former President of Barclays International and CEO of its Corporate and Investment Banking

Alan Trotter
CFO, Invesco Perpetual

Tim Waddell
Chair of the FCA's Listing Authority Advisory Panel; Vice Chairman, Global Corporate and Investment Banking EMEA, Bank of America Merrill Lynch.

Stuart Williams
President, ICE Futures Europe, Intercontinental Exchange Inc.

FCA Markets Practitioner Panel
Financial Conduct Authority
12 Endeavour Square
London E20 1JN
Tel: +44(0)20 7066 1000
Email: MPP@fca.org.uk
Website: www.fca-mpp.org.uk

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