Explanatory statement under Article 28a(6) *Markets in Financial Instruments Regulation (600/2014*) (UK MiFIR) relating to the Financial Conduct Authority (FCA) Direction on the Derivatives Trading Obligation (DTO)

28 November 2024

Introduction

Article 28 UK MiFIR requires certain financial and non-financial counterparties to conclude transactions in derivatives specified by the FCA in their register on UK trading venues or on equivalent third-country venues ("UK DTO").

Schedule 2 to the Financial Services and Markets Act 2023 gives the FCA power to suspend or modify the UK DTO if they consider that the suspension or modification is necessary for the purpose of preventing or mitigating disruption to financial markets, and if it advances one of more of their operational objectives referred to in section 1B(3) FSMA.

This document contains the statement required under article 28a(6).

Statutory context

Article 28a UK MiFIR sets out our [FCA] powers to make a direction modifying or suspending the DTO. Where we are making such a direction, article 28A(6)(a) UK MiFIR requires us to prepare and publish alongside publication of the direction a statement setting out an explanation of the purpose of the direction and how the direction will prevent or mitigate disruption and how it will advance our operational objectives. We may publish guidance in connection with the direction. In giving a direction, we must have regard to our competitiveness and growth objective in section 1EB of FSMA.

Purpose of the direction

Until 31 December 2024, Article 28 UK MiFIR is subject to a power of direction under Part 7 of the Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019 modifying its effect ("the Temporary Transitional Power (TTP)"). Our direction modifying the UK DTO using the TTP expires on 31 December 2024 together with the power itself. Until then, the direction allows firms subject to the UK DTO, trading with, or on behalf of, EU clients subject to the corresponding obligation under EU MiFIR, namely the EU derivatives trading obligation ("EU DTO"), to be able to transact or execute conclude those trades on EU trading venues, providing that certain conditions are met.

The purpose of this new direction under article 28a UK MiFIR is to provide continuity in the outcomes achieved through the TTP. In the continuing absence of mutual equivalence between the UK and the EU for the purposes of the UK DTO and EU DTO, certain market participants would be caught by a conflict of law between the UK DTO and EU DTO – in particular branches of EU firms in UK - unless a new direction is issued.

The direction takes effect from the expiry of the one made under the TTP (commencement occurring on 31 December 2024 at 11.01pm, GMT). Subject to consent from the Treasury, the direction may be varied or revoked at any time if deemed necessary for the purpose of mitigating disruption to financial markets and advancing one or more of our operational objectives. The direction includes guidance to help firms understand its effect.

Necessary for the prevention or mitigation of disruption

We are satisfied that the direction is necessary to prevent or mitigate disruption that could reasonably be expected or otherwise arise for firms and other regulated persons, viewed collectively, from the expiry of the TTP direction. In absence of our direction modifying the UK DTO, certain counterparties would be caught by a conflict of law between the EU and UK trading obligations.

Advancement of our operational objectives

We are satisfied that the direction advances our operational objectives.

By preventing market disruptions, we would advance our market integrity objective as disruption in derivatives markets would affect the orderly operation of those markets and their resiliency.

We have exercised our power by only modifying the UK DTO for those transactions that cannot be executed on UK or equivalent third-country trading venues. This aims to preserve as much as possible the scope of the UK DTO which also aims to strengthen the integrity of UK markets.

The direction also allows firms based in the UK to continue doing a range of international business and serve their global clients, while upholding our G20 commitment in respect of the trading of OTC derivatives. This would also advance our secondary competitiveness and growth objective and have regard to the Government's aim of maintaining and enhancing the UK's position as a global hub for financial services.

Consultation with other regulators and the Treasury on the use of the TTP

We are obliged, under article 28a(5), to seek the approval of the Treasury on the proposed direction. The Bank, the PRA and the FCA are also subject to an obligation to consult each other before giving a direction under this Article.

The direction has received consent from the Treasury and benefited from close coordination and consultation with the Bank and the PRA. This has been done both pre-publication of CP24/14, as well as during the post-consultation process.