TP ICAP Group plc – Written evidence (SCG0010)

TP ICAP Group plc ('TP ICAP') is a global leader in financial market infrastructure. We are the world's largest interdealer broker, energy & commodities broker and provider of OTC pricing data. Through our people and award-winning technology, we provide clients with access to global financial and commodities markets, improving price discovery, liquidity and distribution of data. We operate from more than 60 offices across 28 countries. We are a UK-listed firm and a FTSE 250 constituent.

TP ICAP welcomes the opportunity to respond to the House of Lords Financial Services Regulation Committee's inquiry into this crucial and complex topic and we would be delighted to provide any further information as required to support your inquiry.

Many aspects of the UK regulatory framework support international competitiveness, including:

- Regulators are generally focused on outcomes rather than the imposition of administrative requirements for their own sake.
- Staff at regulators are generally open, approachable and willing to consider feedback.
- The FCA has made substantial improvements in the efficiency of its processes for new or expanded authorisations for regulated persons and firms.
- Regulators' rigorous approach to preventing market abuse and financial crime helps foster confidence in the cleanliness of UK markets.
- The openness of UK markets to foreign firms and infrastructure helps make the City of London a truly global financial centre.

However, competition to attract internationally-mobile financial services business is intense. Several Asian countries are working hard to attract firms, with advantageous tax regimes and flexible regulation. Across the EU, efforts continue to attract business displaced from London by the loss of the EU passport. At the same time, there are opportunities. If Brexit Day 1 involved the immediate handling of the transition and Day 2 was embedding those arrangements, we are now at Brexit Day 3, where firms take a more strategic look at those previous tactical decisions. This creates an opportunity for the UK to reassert its status as Europe's pre-eminent financial centre.

While personal and corporate taxation (itself a significant variable in competition between jurisdictions) is beyond the scope of this inquiry, firms make business location decisions by weighing all factors together. Improvements to the regulatory framework can certainly help swing the balance in the UK's favour, leveraging the UK's world-class market

infrastructure and ecosystem of services. The following steps delivered in short order would make a real difference to the UK's competitive position:

1. Establishing a 'Global Access Taskforce', comprising staff at the FCA, Bank of England and Treasury, to secure access to more international financial markets.
2. Revisiting the FCA's unduly restrictive approach to "payment for order flow", which has driven material amounts of business away from the UK to US, EU and other locations.
3. Reforming the prudential rules for broking businesses, which create a substantial capital penalty for locating businesses like ours in the UK versus other jurisdictions such as the US and EU.

What opportunities or changes should be prioritised in order for the regulators to meet their secondary growth and competitiveness objectives effectively?

As an interdealer broker active across many of the world's key financial markets, we directly see how the same activities are regulated across different jurisdictions. This provides us with insights on what the UK does well and areas for improvement. Below, we've outlined some important areas of policy where we believe the government and regulators should focus their efforts:

UK firms' ability to do business in other countries. TP ICAP's business centres on matching buyers and sellers in a range of asset classes. The more seamlessly we can do this across borders, the better the service we can offer our clients and the more likely the centres of liquidity stay and prosper in the UK. The City's strength as a global financial centre is founded on its connectivity with other markets around the world. Where we cannot access international markets, TP ICAP is required to set up offices and relocate staff, taking jobs, investments and capital away from the UK. Regulators and governments elsewhere in the world offer varying levels of access to foreign firms, with many operating "equivalence" or "substituted compliance" regimes, whereby firms from outside their jurisdictions can offer services in, subject to some assessment of the adequacy of the rules in the jurisdiction of the incoming firm. The UK already benefits from a number of such equivalence decisions in other countries, and the FCA, Bank of England and Treasury have done good work in facilitating those decisions. However, to our knowledge, there is no publicly coordinated programme or strategy across UK regulators and the Government to maximise the range of equivalence decisions and other means by which UK firms may offer their services into other countries. The creation of a "Global Access Taskforce", comprising staff from the FCA, Bank of England and Treasury, and tasked with maximising UK financial services firms' access to foreign

markets has the potential to increase the international competitiveness of UK firms.

The Government could lead on political negotiations around bilateral access agreements and Memorandums of Understanding, while regulators would provide technical support to demonstrate how UK regulation creates equivalent outcomes to regimes elsewhere. Where access to foreign markets requires firm-specific application processes, UK authorities could provide support to UK firms making applications, for example prompt provision of good standing letters or making available standardised information on the UK regime.

Regulatory requirements (capital and liquidity) for interdealer brokers. UK headquartered interdealer brokers are subject to the UK Prudential Sourcebook for Investment Firms (MIFIDPRU) under the IFPR Framework. The IFPR includes an Internal Capital Adequacy and Risk Assessment (ICARA) which requires investment firms to assess and capitalise to a level of stressed risks over and above the prudential rules. This results in significantly higher regulatory requirements for our UK business relative to other jurisdictions in which we operate. The regime, inherited from assimilated EU law, is materially aligned to the banking requirements and we would recommend a revised approach which is more appropriate for interdealer brokers.

Below, we’ve outlined some of the differences in the prudential regimes across the key financial centres in which we operate, and have provided a brief summary of the impact of these diverging prudential regulations, noting that regulatory approaches are based on different underlying measurements and our activities vary across jurisdictions. As a result, direct comparisons are not always easy to navigate and therefore would be happy to provide more information on our approach to measuring the differences in our regulatory requirements globally.

- **UK**: TP ICAP generates a material proportion of its revenues through Name Give Up Transactions. We do not take principal risk on these transactions but we act as an intermediary who receives a commission for matching two clients together to execute a transaction across our regulated operating venues. The MIFIDPRU regulations require a capital charge assigned to each notional leg of these transactions. We would appreciate consideration that a capital charge should only be assigned to one notional leg, based on the fact that we act as an intermediary on a single transaction, albeit arranged and subsequently executed across two clients.
- **EU**: The UK's (under IFPR) and EU's (under IFR) prudential regimes present themselves as similar frameworks. However, the application of the EU’s framework diverges in two material ways. Firstly, the EU

excludes Name Give up Transactions from all regulatory capital charges, and the French Regulator (the ACPR) has confirmed this treatment in writing. This contrasts to the FCA's approach noted above. Secondly, the application of the ICARA framework has not been uniformly imposed locally by individual EU countries. Specifically, the ACPR has not required us to capitalise our locally regulated entities under ICARA framework at this time.

- **APAC**: In Hong Kong and Singapore, the regulatory requirements are primarily linked to the firm's fixed cost base. Conversely, in the UK, the ICARA framework requires a material addition to the capital requirements with a punitive combination of K-Factor requirements, risk modelling and costs of a solvent wind-down. As a result, c.33% of the capital which we hold in APAC is held for regulatory purposes, compared to c.60% in the UK and EMEA.
- **US**: In the US, the regulatory requirement for broking activity is principally a solvency (balance sheet) measurement after certain asset quality adjustments have been applied. To comply, Broker-Dealers are required to calculate their "net capital" (liquid capital) and their minimum net capital requirement which takes into account settlement fails receivables for matched principal broking activity. On average, the minimum net capital requirement which we hold in the US for regulatory purposes is c.10%, compared to c.60% in the UK (after the application of ICARA).

The requirement to hold more financial resources for regulatory purposes reduces our profitability and flexibility in deploying resources across our business, for example, to facilitate investments or new activities and creates a strong incentive for interdealer brokers to move activity out of the UK. We welcomed Nikhil Rathi's speech on 8 October 2024, where he committed to reviewing the UK's prudential framework to foster liquidity. As a world-leading provider of access to liquidity and UK-headquartered group, we welcome this review and recommend it pay special attention to the broking sector, where the UK's comparative disadvantage in the capital rules is particularly acute.

Payment for Order Flow. The term payment for order flow (PFOF) is taken to mean an intermediary firm (e.g. a broker), whose role is to find liquidity for clients, accepting payment from the liquidity providers to which it routes client orders. In some circumstances, particularly where <u>retail</u> stockbrokers take payment from electronic liquidity providers in exchange for access to the retail clients' orders, there is a clear conflict of interest and regulators globally have rightly taken action to restrict the practice. However, uniquely the FCA has gone further by also imposing PFOF restrictions in respect of wholesale business, which come close to an outright ban. The FCA is a significant outlier in imposing such tight

restrictions. For example, the EU’s MiFID/MiFIR Review permits PFOF provided to professional clients, such as investment firms, while the U.S. permits PFOF for retail and wholesale clients.

The arguments which justify a PFOF ban for retail investors are not valid when the clients are expert investors, for example, hedge fund managers with sophisticated tools to monitor execution quality. The FCA’s approach fails to recognise this distinction and because it has been set out mainly through supervisory reviews rather than rules, has never been the subject to a proper cost/benefit analysis or consultation. As a result, firms whose business involves matching expert investors with liquidity providers have tended to move that activity out of the UK to locations such as Paris or Dubai, which have more proportionate regimes. If the FCA were to replace its current approach to PFOF with appropriate controls and a more risk sensitive approach which recognised the ability of different client groups to assess execution quality, it would significantly enhance the UK’s competitiveness as a location for this kind of business.

Matched Principal Trading. We welcomed Treasury’s decision to allow matched principal trading on Multilateral Trading Facilities as part of the Wholesale Markets Review. However, the limitation that OTF operators may not trade as principal other than as matched principal on their own OTFs remains. We do not seek removal of that limitation but would welcome a review of the definition of Matched Principal. The current definition requires the venue operator to interpose itself in transactions in such a way that it is never exposed to market risk throughout the execution of the transaction, with both sides executed simultaneously and concluded at a price where the facilitator makes no profit or loss. This definition, which the FCA adopted while part of the EU, is very narrow and provides little scope for venue operators to facilitate liquidity except where there are simultaneously two willing buyers and sellers.

The revised definition should enable venue operators to take one side of the trade where they are confident that they will be able to find the other side of the trade in the near future. OTF operators would be able to facilitate more liquidity and trading on their venue for clients, and manage any market risk and conflicts of interest through other existing rules. This activity would also remain discrete from traditional market making, as the venue operator would not post simultaneous two-way quotes or fulfil orders in this way on a regular basis. We would welcome engagement with Treasury and the FCA to refine the definition, ensuring it is proportionate and internationally competitive.

Senior Managers and Certification Regime (SM&CR). Following the financial crisis of 2008, ensuring personal accountability in financial services has been an important objective, which the SM&CR has helped to

achieve. While we welcome the regime, the SM&CR imposes a significant administrative burden which deters activity from the UK. The layers of Senior Managers and Certified Persons creates complexity given the sheer number of roles, administrative obligations for each appointment, and requirement to maintain detailed documentation which must be updated alongside personnel and organisational changes. We welcomed the FCA and PRA's discussion paper to streamline the regime.

We are also concerned that determined bad actors are able to move their misconduct from one firm to another. While the FCA is responsible for authorising senior managers, firms are responsible for the certification process for all other employees in regulated client facing roles. Firms are able to certify individuals as 'fit and proper' even where they have been dismissed for misconduct. This allows financial and non-financial misconduct to persist at poorly managed firms, creates an uneven playing field and risks undermining market integrity. We encourage the FCA to use its supervisory and enforcement powers to ensure firms are held to equal and high conduct standards.

Do the regulators have the right capability and capacity to fulfil their regulatory objectives on growth and competitiveness? To what extent might the culture of the FCA and PRA influence their ability to fulfil their growth and competitiveness objectives?

From the point of view of international competitiveness, wholesale financial regulation has a much greater impact than retail. While retail financial regulation is crucial in protecting consumers from harm and maintaining confidence in the system, retail financial services markets are much less internationally contested. The challenges raised by retail regulation are also very different to those in wholesale.

In recent years, the FCA has tended towards greater integration of wholesale and retail regulation, with senior leaders having remits covering both parts of the market. The challenges for a regulator of mastering the vast technical complexity and diversity of wholesale markets are big enough without having to combine it with retail issues, which involve similar levels of complexity and nuance but which are very different in nature. FCA staff are generally of high quality and capability but, in our view, restructuring to allow greater internal specialisation in either retail or wholesale issues would make it easier for the FCA to gain the level of insight needed to remain a world-class regulator.

In delivering their secondary objective on growth and competitiveness, what opportunities are there for the regulators to help to promote and support innovation in the financial services

sector? How effective has the FCA's regulatory sandbox been for supporting greater innovation in the financial services industry?

Cryptoassets and distributed ledger technology offer significant innovation potential. The failure of cryptoasset exchanges like FTX has demonstrated the importance of regulation, and other jurisdictions such as the EU have already introduced regulation for the nascent sector. While we welcomed the Government's statement in October 2023 on the 'Future financial services regulatory regime for market cryptoassets', we would welcome an update from the Government on its intentions.

The Government and FCA should learn from the implementation of the EU's regime and engage with credible market participants to ensure the framework is effective. In contrast to the EU's approach, we recommend the UK better distinguish the regulatory requirements for retail and wholesale markets, reflecting the different issues present in these markets and ensure the FCA's resources are well allocated.

We are highly supportive of the FCA's Sandbox initiatives. To further incubate innovation, we suggest pathways for commercial scalability are better taken into account as this is a significant barrier to participating in the Sandbox, particularly for larger market participants in areas such as tokenisation.

Are there any additional metrics over and above those already agreed by the regulators that would better enable stakeholders to track progress and support scrutiny of their work against the secondary growth and competitiveness objective? How should a measure of growth be included in these metrics?

Given the importance of access to international financial markets in terms of the growth and competitiveness of the UK financial sector, the FCA should track and measure the number of equivalence decisions and determinations of substituted compliance. This would incentivise the FCA to work with regulators and Government to promote international access as far as possible.

Does the requirement within the secondary growth and competitiveness objectives to align with international standards create any constraints to fulfilling those objectives?

Aligning with international standards promotes financial stability and minimum international standards, which lead to better outcomes for market participants and consumers. It is also critical in providing access to international financial markets. We would not advocate for a move away from international standards, even if it would make the UK more 'competitive' in the short-term. In the longer-term, the UK's

attractiveness is not driven by undercutting internationally-accepted standards. The FCA, Bank of England and Treasury should take a more proactive role in standard-setting bodies such as the Financial Stability Board and International Organization of Securities Commissions. This will help to ensure that international standards take into account the specificities of the UK's financial sector.

Are the existing accountability measures around the secondary growth and competitiveness objective adequate?

In retail financial services, the right for designated consumer bodies to make a 'super-complaint' where there is a feature or combination of features of a market in the UK that is or appears to be significantly damaging the interests of consumers, creates a useful means of constructive challenge and accountability to the FCA. There is no equivalent in wholesale financial services and we would welcome legislative change from Treasury to create a comparable regime. This would entail designating a limited number of industry bodies as entitled to make requests for review to the FCA in respect of aspects of UK wholesale financial regulation which they believe significantly hamper either the functioning of the relevant markets or the UK's international competitiveness. The legislation should of course recognise that the FCA will, from time to time, need to impose unpopular rules in order to discharge its objectives.

25 November 2024