Response Form to the FCA's quarterly consultation – CP 22/26 Chapter 3 – on amendments to the derivatives trading obligation (DTO)

Q3.1 Do you agree with our proposal to remove all derivative products referencing USD LIBOR from the DTO? If not, please explain why

We agree with the proposal to remove all derivative products referencing USD LIBOR from the DTO. This appears necessary now that the scope of the derivatives clearing obligation (DCO) has been amended to exclude all USD LIBOR products, given that the precondition under Article 32(1) of UK MiFIR for declaring a class of derivatives as subject to the DTO is no longer met.

We agree that retaining a DTO in absence of a corresponding DCO for the same class of derivatives is against the intention of the UK MiFIR, and therefore support the FCA's proposal and justification on this.

Q3.2 Do you agree that the removal of USD LIBOR products from the DTO should take place on 24 April 2023? If not, please indicate what we should consider when selecting an alternate date.

We agree with the proposal to dis-apply the DTO for USD LIBOR products as of 24 April 2023.

This is a logical and sensible approach, given that the Bank of England announced in its August 2022 policy statement that at this same date, the DCO will cease to apply to these products, as further detailed in the Bank's technical standards instrument on the clearing obligation published alongside the August 2022 policy statement.

Q3.3 Do you have any comments regarding which and when SOFR products should be brought within the scope of the DTO?

We welcome the FCA's approach with regards to SOFR products, i.e. not proposing to include SOFR OIS in the scope of the DTO, continuing to monitor market data for SOFR products, and coordinating with the CFTC if it becomes appropriate to consider introducing a trading mandate.

We consider that current data series are not long enough to form an informed view on which SOFR products should be brought within the scope of the DTO. We see value in waiting before taking any decision on this. We therefore support the FCA's approach in terms of following developments in the market for SOFR products, monitoring relevant data and market trends. This will allow to build a better picture of the market, which will be necessary if considering, in due course, whether these products meet the venue and liquidity test, as required under Article 32(2) of UK MiFIR as a condition to setting a DTO.

We also note that even in the absence of a declaration of a DTO on SOFR products, market participants have already voluntarily started trading some of these products on venues, as 79% of SOFR OIS transactions reported in the US (by quarterly trade count) were traded on venue in Q4 2022[1], suggesting that there is no trend developing towards trading away from organized venues, and therefore no immediate need or urgency to set an obligation to achieve on-venue trading.

In addition, we consider that before incorporating a new class of products under the scope of the DTO, the FCA should at least wait until:

- its new power to suspend or modify the DTO, as set out under Article 28a of the Financial Services and Markets Bill, is fully in force. Subjecting a new product to the DTO while the suspension/modification mechanism is not yet in place could introduce unnecessary risks to market functioning, especially considering that we lack the data to know whether the market would be sufficiently liquid in all market circumstances;
- after a sufficient period of time has passed beyond the final transition date away from USD LIBOR to SOFR (30 June 2023), as the industry will be focused on managing the actual transition at that time, and considering introducing a new DTO too soon after that date would pose a challenge to firms' systems and operations – building in a gap after the transition date would therefore be welcome.

Finally, we would also note that industry needs an implementation period of at least 6 months to implement any DTO instrument scope adjustments in order, for example, to: adjust all relevant internal trading and control systems, external trading venues and third-party dependencies, internal front-office training and external client communication / set-up.

[1] ISDA analysis based on DTCC SDR data.