UKEMA response to Improving Equity Secondary Markets CP22/12

The UKEMA welcomes the opportunity to respond to the FCA consultation paper on Improving Equity Secondary Markets.

The UKEMA represents those investment banks and equity brokerage firms that focus on raising capital for SMEs and small and mid-cap quoted companies. Its members trade in the shares of over 2,000 quoted companies, accounting for 57% of London Stock Exchange turnover by volume, and produce research on over 1,700 companies, representing 87% of listed issuers. UKEMA member firms facilitated investment of more than raised £6.7bn in funds for companies in 2021, supporting growth in the real economy, employment, innovation, entrepreneurship and wealth creation.

The UKEMA recognizes that these consultations can increase the attractiveness of our public equity markets and are therefore supportive of the consultation process to ensure that this results in a better outcome for investors, companies, investment firms and the regulator.

Broadly, we agree with the proposals for Questions 1 to 31 and on that basis we have chosen not to individually comment on these questions. Instead, we have summarised the view of the majority of our members in our remarks below relating to Questions 32 and 33. Individual UKEMA members have submitted their own responses to expand on their specific experience in greater detail.

Detailed response

The RSP system works well for a wide range of consumers including retail customers. The approach is favourable when compared to other systems and approaches used in markets in other jurisdictions, and recent innovation has led to positive developments that assists best execution, such as performance analysis and dynamic pricing.

It is important to note that the RSP isn't a closed system that precludes access to other execution methods. Cost is a key factor for retail customers as part of achieving Best Execution, and the simplicity of the system reduces cost and does not exclude the use of other execution environments. It provides a low-cost method of execution with appropriate immediacy and flexibility for the end user.

Post-trade transparency is an integral part of market information and helps to improve the quality of execution for all participants in the market. The introduction of new transparency measures through both MIFID I and MIFID II has undoubtedly improved transparency in the markets. However, there are several areas where through either unintended consequences or EU regulation which was not designed with the UK market in mind has led to a number of deficiencies. We therefore support the consultation paper proposals for changes to the post trade transparency regime and believe that the proposed changes will help meet the aims of simplifying the flag, condition and information data associated with trade reporting to make it more understandable for users of this data.

Pre-trade transparency should by its very nature allow users of the data to understand the best price achievable and where this can be achieved supporting price discovery. We believe that the prices should be derived from all reliable venues whether these are based in the UK or overseas. It is important that the

assessment process of suitable venues is dynamic and robust to allow for continuous assessment of whether venues are suitable to be considered as part of the price formation process.

Imposing minimum tick sizes as introduced by MIFID II does not necessarily lead to the best outcome for customers and can lead to a degradation of liquidity in certain instances. This can also negatively impact market makers and does not necessarily result in larger profits for market makers as suggested by the FCA consultation paper, as wider spreads are offset by poorer liquidity outcomes in many circumstances. We would prefer a more flexible tick size regime, where tick sizes are set by trading venues, this would enable a more dynamic regime as venues will have access to more up to date data to allow them to make an informed decision about the appropriate tick sizes for each security.

Building Operational Resilience is a key part of the regulatory framework already for many investment firms as a result of Policy Statement 21/3. Therefore, improving resilience for trading venues is a necessary next step in the journey of improving resilience of the whole market. We therefore agree with this initiative and the broad proposals.

RSP system

We believe that the RSP mechanism works extremely well for retail clients, and for smaller 'retail-sized' orders in particular. In the UK, about 95% of retail orders for shares are executed through the so-called Retail Service Provider (RSP) System" (FCA Investment Platforms Study), and this suggests that the system is working well to support the needs of both customers and retail intermediaries.

Q32: Do you think the RSP system works well for retail clients? If not, please explain your views.

The UKEMA believes that the RSP system works well for retail clients, with low transaction costs and liquidity that well exceeds the lit markets. Since the Investment Platforms Market Study published in December 2019, we believe the quality of liquidity and executions on the RSP has increased significantly therefore new data sources should be sought to evidence this improvement, then this data can be used to form basis of any ongoing review. The UKEMA understands that the increase in the quality of execution for the retail clients has been a due to market makers investing heavily in technology and key personnel. Ensuring retail clients are offered liquidity at a price and size beyond that of the lit exchanges.

It is important to make the distinction between system and mechanism, as we believe it should be viewed as a homogenous communication tool, connecting market participants in a more effective, scalable and homogenised way allowing for higher rates of Straight Through Processing

The RSP mechanism has allowed intermediary brokers to offer significantly reduced pricing to the retail broker and wealth management community, including the recent advent of free trading. In that respect the RSP is less of a system and more of a network of parties, communicating efficiently in order to drive down costs for consumers. Some of the other key benefits of the model include:

- Simplicity, Immediacy and Transparency – The RSP mechanism is simple to use and provides clear visibility on pricing allowing investors a defined period of time to trade in a single fill at a visible price.
- Competitive and Cost Effective – Liquidity Providers compete on each price enquiry and the liquidity provided is particularly beneficial to smaller companies listed and traded on the UK SME Growth Markets, where they are often entirely supported by UK liquidity providers. In addition, the

simplicity of mechanism reduces costs for users but does not exclude the use of other execution methods by investors

- Innovation and Flexibility - Market makers are able to offer significant innovation and flexibility such as flexible timing for settlement and real time price checking logic to ensure the best price for the customer.
- Scalable and Resilient – The RSP mechanism has proven to be very resilient and the distributed nature of the multiple RSP hubs means that even during periods of peak volume and volatility such as 'Vaccine Monday' (09/11/20), the RSP hubs continued functioning whilst it was well publicised that certain retail platforms suffered outages.

Some members of the UKEMA have sourced their own data and believe that on average UK retail clients were offered greater liquidity by the RSP at prices better than the LSE touch in most cases. Importantly, some of these prices improve on the available best bid or offer ("BBO"). The remaining transactions are filled at a price equal to or better than the volume weighted BBO. In most cases the size of transactions were greater than the size of liquidity on the lit exchanges.

Q33: Do you have any suggestions for changing the regulatory regime as it applies to the execution of orders by retail clients?

Market makers on the RSP, provide retail clients liquidity in price and size above and beyond what is available on the lit exchanges, with minimal transaction cost. The quality of execution is possible because the RSP eco-system and market makers are efficient. Any change in regulation that impedes the efficiency of the market maker model would have a detrimental effect on liquidity, particularly on smaller listed entities with negative cause and effect.