CAPITAL MARKETS
EQUITY

A global reshuffling in regulating market structure

Global regulators are grappling with the challenges of transitioning to T+1 and slowly making progress on redefining what constitutes a trading venue

The global regulatory landscape is experiencing a considerable amount of activity amid evolving debates in the industry on market structure change, and regulators are busy. The US Securities and Exchange Commission (SEC) has issued 47 proposals that affect market participants in the first 850 days of SEC Chair Gary Gensler's leadership, compared to 59 proposals put forward by ex-SEC Chair Mary Schapiro in response to the financial crisis in 2009. The UK, as a result of Brexit, has the big task of reviewing and implementing 40 pieces of financial regulatory legislation in two years, and the EU is in the process of undertaking ambitious reviews of MiFID II/R, EMIR, CSDR, CRR/D, as well as many others.

Change is constant and, while markets face different challenges and operate at varying paces, most appear committed to driving healthy market structure change that promotes greater transparency, increases resilience and maintains competition. This article takes a deep dive into how regulators in some of the world's largest markets are looking at two important topics: the transition to T+1, and the progress that has been made around the definition of a trading venue.

The move to T+1

The US has laid out an ambitious financial regulatory agenda and its impact is being felt across the pond. As home to the world's largest and most liquid capital markets, the US has adopted a rule that will see the settlement cycle for most routine securities trades transition from two business days after the trade date to one business day, so from T+2 to T+1, by May 28 2024. This move will have significant global ramifications, and while the transition has been a long time coming in the US, the same can't be said for continental Europe, where discussions have only just begun.

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The Association for Financial Markets in Europe (AFME) has begun setting up a task force to tackle the big questions surrounding a move to T+1, including whether Europe should follow the US's lead in moving to shorter settlement cycles, and if so, when. On October 5 this year, the European Securities and Markets Authority (ESMA) published that it was seeking to collect views on the impact of shortening the current T+2 settlement cycle on the market. The decision to review the question of shortening settlement cycles by ESMA is as a result of the U.S. regulator's plans to move to a T+1 settlement cycle by May next year. In the UK, the government has gotten involved, with the Chancellor of the Exchequer launching a similar task force in December last year to examine the case for moving to a T+1 settlement period.

Europe has been under pressure for some time to align with other developed capital markets, but as a fragmented market with differing legal frameworks and post-trade infrastructure, it is not a simple task. There is a concern that having an investor base that's split into T+1 and T+2 would cause significant misalignment between settlements, and in turn, could impact pricing and increase the number of settlement fails. In an ideal world, everyone would operate in an ecosystem with regulatory harmonisation and convergence. While the progress is slower in continental Europe and the UK, industry working groups and taskforces are making progress in moving towards reduced settlement times, and investors should be getting prepared.

Despite there being differences in markets' progress towards T+1, all investors are grappling with the same challenge. In this increasingly real-time global market, they need to consider where they can remove manual processes and workflows to meet shortened settlement times. At the same time, there has been increased adoption of electronic trading, and within that a proliferation in the use of automation. With investors under pressure to adhere to T+1, automation has been thrust into the spotlight as a tool that can help free up manual processes, so that the operational focus can be on the transition to T+1. AiEX, the parameters-based Automated Intelligent Execution tool on Tradeweb, allows for greater speed of execution, and more immediate and streamlined workflows. Last quarter, average daily trades through the AiEX automation tool grew by 90% in Treasuries and 70% in Credit compared with the prior year period, showing a greater adoption from traders globally.

Defining a trading venue

Conversations are intensifying globally on what constitutes a trading venue, and policy-makers are working to better define technology firms that are bringing buyers and sellers together. ESMA published its final report on the trading venue perimeter in February, and the UK's Financial Conduct Authority (FCA) has also made considerable progress, and most recently confirmed that its guidance regarding the post-Brexit definition of trading venues came into force on October 9. Following a consultation period closing in November last year, the regulator made the decision for the definition to continue to focus on the substance of a firm's activity, rather than how it is labelled. Both of these sought to build on the MiFID II definition and review of multilateral systems. Last year, the SEC proposed significant expansion of Regulation Alternative Trading System (Reg ATS), seeking to update the definition of "exchange" in Rule 3b-16 to include systems that offer protocols and the use of non-firm trading interest to bring together buyers and sellers of securities.

While there may be idiosyncrasies in terms of how different markets are tackling defining trading venues, with varying levels of capital market reforms and concepts of each jurisdiction, there is an overarching policy goal that resonates globally. The definition of a trading venue should not be so narrow as to exclude persons offering protocols or systems that provide substantially similar services to platforms and systems that are covered by the definition. Tradeweb has long believed in the regulation of technology vendors to address concerns about firms operating multilateral systems without being authorised as a trading venue.

A unified objective

The global fixed income market has faced no shortage of headwinds these past two decades, and with the proliferation of electronic trading and technological advancement, regulators have been attempting to keep pace with an industry that is continually on the cusp of change. Since the financial crisis, there has been a shift in the way that policy-makers view market infrastructure regulation. The last few years have been proof that ensuring resiliency and cost-effectiveness, particularly in times of stress, is of the utmost importance, and governments, regulators and policy-makers alike have a role to play.

The transition to T+1 and redefining what constitutes a trading venue are both part of a bigger picture of regulatory reform that aims to drive healthy market structure change. However, while there are differences in the way that regulators have tackled these topics with different challenges ahead, the overarching goal of building greater transparency and efficiency in markets globally rings true for all. Simply put, it is a balancing act between innovation and regulation, and policy-makers should lean on organisations that can provide valuable perspectives on the impact for fixed income markets.

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