HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Baroness Worthington & Baroness Bowles of Berkhamsted
House of Lords
London
SW1A 0PW

22 February 2023

Dear Baroness Worthington and Baroness Bowles of Berkhamsted,

FINANCIAL SERVICES AND MARKETS BILL: INTERVENTION OF THE FCA IN COMMODITIES MARKETS

Thank you for your contributions during the first Grand Committee debate of the Financial Services and Markets Bill on 25 January 2023. I committed to respond in writing to questions you raised regarding the intervention of the Financial Conduct Authority in commodity markets.

You both asked if the Financial Conduct Authority (FCA) will retain the power to intervene to set limits, and if the grounds for intervention will be as broad as they currently are. Baroness Worthington also asked for more information about the number and type of contracts that would continue to be subject to position limits.

First, I would like to reassure you that the government agrees that effective regulation of commodity derivative markets is crucial to ensure behaviour in those markets does not lead to economic harm for consumers and businesses. However, as I set out in the debate, the government considers that there is scope to improve the current regime to make it less burdensome, without reducing important protections against economic harm.

In particular, the current regime gives the FCA no flexibility to apply position limits intelligently to commodity derivatives that are truly subject to risks of volatility. Instead the FCA are required to apply them to over 800 contracts in a uniform manner. This is not appropriate as it can impair liquidity, reduce choice for consumers and is not an approach taken in any other major jurisdiction.

The Bill will therefore require the setting of position limits by trading venues, as and when stipulated by the FCA. To ensure orderly markets and that appropriate regulatory oversight is maintained, the Bill grants the FCA a power to specify the contracts to which limits apply and to put in place a framework in which trading venues will need to operate position limits for commodity derivatives. It also gives the FCA the ability to intervene directly to set position limits on contracts which pose a clear threat to market integrity, if need be.

As I set out in Grand Committee, in practical terms, this means that agricultural and physically delivered commodity contracts (including physically delivered energy contracts) will continue to be in scope. This currently amounts to around 18 contracts in total. This is in effect the position that the FCA has taken since 2021, using their supervisory powers to focus the regime to those contracts that genuinely pose a risk and the government expect the FCA to continue with the approach. This has ensured that risks in agricultural and energy markets are effectively managed whilst increasing investor choice.

As Baroness Bowles of Berkhamsted noted, under this approach, there is no requirement in primary legislation that the FCA must use its power to specify contracts to which position limits should apply. This is consistent with the model of financial services regulation in the Financial Services and Markets Act 2000, which this Bill applies across the full body of financial services regulation, including that currently in retained EU law. Under this model, the regulators are empowered to advance their statutory objectives through rule-making, and are held to account by government and Parliament regarding how they have advanced those objectives. Moving to this new approach does not however, in any way reduce the regulators ability to intervene where necessary as compared to the existing system. If anything it empowers the FCA to make more intelligent, judgement based decisions on commodity markets. Furthermore, the FCA has been working closely with the government on these changes and, as stated in the Wholesale Markets Review consultation response published in March 2022, the FCA will take into account the outcome of that consultation when making rules.

You both also asked whether the FCA, in acting to advance its objectives, would have sufficient grounds to intervene in markets, including on humanitarian grounds. The regulation of commodity derivative markets is intended to ensure that those markets are orderly and are not subject to disruptive distortions. This is particularly important, given that volatility in these markets could in extremis directly impact consumer food prices, for example.

While the FCA does not directly regulate prices in commodities, as a financial services regulator, the FCA has a strategic objective to ensure financial services markets function well. They also have operational objectives to protect consumers, maintain market integrity and promote competition in the interests of consumers. The government is therefore confident that, in the event that excessive commodities trading was leading to market volatility that had the potential to have a humanitarian impact, and that the FCA viewed this as undermining market integrity, then the FCA would have the ability to act.

I look forward to further discussing these issues throughout the passage of the Bill. I am copying this letter to Peers who spoke during the debate, and I am depositing a copy of this letter in the Library of the House.

Yours sincerely,

BARONESS PENN