PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

Second Delegated Legislation Committee

DRAFT FINANCIAL SERVICES AND MARKETS ACT 2000 (FINANCIAL PROMOTION) (AMENDMENT) ORDER 2023

DRAFT FINANCIAL SERVICES AND MARKETS ACT 2000 (COMMODITY DERIVATIVES AND EMISSION ALLOWANCES) ORDER 2023

Tuesday 2 May 2023

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not later than

Saturday 6 May 2023

The Committee consisted of the following Members:

Chair: JAMES GRAY

† Aiken, Nickie *(Cities of London and Westminster)* (Con)
Brennan, Kevin *(Cardiff West)* (Lab)
† Cruddas, Jon *(Dagenham and Rainham)* (Lab)
Foster, Kevin *(Torbay)* (Con)
† Gardiner, Barry *(Brent North)* (Lab)
† Grant, Peter *(Glenrothes)* (SNP)
† Griffith, Andrew *(Economic Secretary to the Treasury)*
† Howell, Paul *(Sedgefield)* (Con)
† Lewis, Brandon *(Great Yarmouth)* (Con)
† Lopresti, Jack *(Filton and Bradley Stoke)* (Con)
† Malthouse, Kit *(North West Hampshire)* (Con)
† Offord, Dr Matthew *(Hendon)* (Con)
† Penning, Sir Mike *(Hemel Hempstead)* (Con)
Ribeiro-Addy, Bell *(Streatham)* (Lab)
† Siddiq, Tulip *(Hampstead and Kilburn)* (Lab)
† Stephenson, Andrew *(Lord Commissioner of His Majesty's Treasury)*
† Twist, Liz *(Blaydon)* (Lab)

Sara Elkhawad, Susie Smith, *Committee Clerks*

† attended the Committee

The following also attended, pursuant to Standing Order No. 118(2):

Crosbie, Virginia *(Ynys Môn)* (Con)

Second Delegated Legislation Committee

Tuesday 2 May 2023

[James Gray *in the Chair*]

Draft Financial Services and Markets Act 2000 (Financial Promotion) (Amendment) Order 2023

4.30 pm

The Chair: There are two statutory instruments before the Committee. Is it the wish of the Committee that they be taken together?

Kit Malthouse (North West Hampshire) (Con): On a point of order, Mr Gray. In recent months, I have been a member of several Delegated Legislation Committees for which the Government have put two instruments together to try to rush them through, or get them through. In some cases, the two have been connected in some way, not just because they are from the same Department but because they are thematically connected. Although that is not entirely desirable, we can see the rationale for it.

In this instance, however, we have two statutory instruments that are completely unconnected, besides their departmental interests. The first deals with the consequences of leaving the EU and the regulation of commodity groups; the second deals with consumer exposure to financial instruments. They are not the same thing. Taking them together necessarily means that hon. Members have to digest two quite complicated bits of legislation at the same time. I realise that for a lot of colleagues, holding more than one idea in their head is possible, but for a number of us, particularly given the complexity of cryptocurrency and its implications, that is a huge imposition. Putting the two instruments together will not, in my view, give us a coherent debate on what are two quite important bits of legislation.

The Chair: I am most grateful to the right hon. Gentleman for his point of order. If he wishes to do so, he can simply object to the two instruments being taken together, in which case they will be heard separately. My question to the Committee is therefore whether it is content that both statutory instruments be heard together.

Kit Malthouse: Object.

The Chair: Objection taken. We will therefore consider the two statutory instruments separately—the first one being the draft Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) Order 2023.

4.32 pm

The Economic Secretary to the Treasury (Andrew Griffith): I beg to move that the Committee has considered the draft Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) Order 2023.

It is a pleasure to serve under your chairmanship, Mr Gray. The Government have a clear vision for financial services: an open, sustainable and technologically advanced financial services sector that is globally competitive and acts in the interests of communities and citizens across all four nations of the UK.

The Chair: Order. I introduced the incorrect statutory instrument. We are actually debating the draft Financial Services and Markets Act 2000 (Financial Promotion) (Amendment) Order 2023. I think the Minister was quite correctly addressing it, but I wanted to point out that I got it wrong in my introductory remarks.

Andrew Griffith: Thank you, Mr Gray. Two excellent proposals remain in front of the Committee.

I beg to move,

That the Committee has considered the draft Financial Services and Markets Act 2000 (Financial Promotion) (Amendment) Order 2023.

Over recent years, multiple reports by the cryptoassets taskforce and the Financial Conduct Authority have identified misleading advertising and a lack of suitable information as a key consumer protection issue in cryptoasset markets. The statutory instrument seeks to address those issues by ensuring that cryptoasset promotions are held to the same standards as broader financial services products carrying similar risks. The statutory instrument therefore proposes to expand the scope of the restrictions provided for by the Financial Services and Markets Act 2000 by amending the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 to include financial promotions in respect of in-scope cryptoassets.

Firms that are not authorised by the FCA will be required to have promotions of qualifying cryptoassets approved by an authorised firm unless an exemption applies. To avoid the unintended consequence of an effective ban on such promotions, the intention is to have a temporary exemption for firms registered with the FCA under its anti-money laundering regime. The intention is that promotions made under that exemption would still have to comply with the same rules set by the FCA for equivalent promotions made by authorised firms. When in force, the SI and the FCA rules will apply to all businesses making cryptoasset promotions to UK-based consumers, whether from the UK or abroad, so it is a valuable protection for UK consumers.

In order that firms have suitable time to understand and prepare for the regime, the SI proposes a four-month implementation period, which is intended to commence on publication of the FCA's detailed rules, subsequent to the SI being made. That will reduce a key risk to consumers of suffering unexpected or large losses without regulatory protection as a result of buying cryptoasset products while unaware of the associated risks. That complements, and forms part of, our wider proportionate approach to regulation, harnessing the advantages of distributed ledger and crypto technologies while mitigating the most significant risks for consumers.

4.36 pm

Tulip Siddiq (Hampstead and Kilburn) (Lab): It is a pleasure to see you in the Chair, Mr Gray. The Opposition will support the SI. In recent months, we have seen

major scandals in the crypto sector, including the concerning activities of FTX; the collapse of so-called stablecoins, which saw the savings of millions of British people put at risk; and a surge in crypto-related crime and scams. It is therefore right that consumers are made aware of the significant dangers of purchasing cryptoassets, and that the companies promoting such assets are properly regulated.

I have a few questions that I wish the Minister to address. I am particularly concerned about the temporary exemption to allow cryptoasset businesses that are not authorised by the FCA but that are registered under anti-money laundering rules to communicate their own financial promotions. I know that the Minister will agree that the risks posed by the cryptoasset sector extend far beyond money laundering and include other forms of crime, such as many scams targeting the public, but how will the Government ensure that they have made it absolutely clear to the public that those firms are not authorised by the FCA, and that consumers are fully aware of the associated risks?

The organisation Positive Money, which the Minister will probably know, has made the case that if the Government are serious about an approach of "same risk, same regulatory outcome", stablecoins should be regulated in a similar way to bank deposits. Has the Minister made an assessment of that proposal? If the Government plan to regulate stablecoins as e-money rather than as akin to bank deposits, how will the Treasury ensure that consumers are made fully aware that their funds are not covered by the financial services compensation scheme?

What work is the Minister doing to develop additional protections for consumers in this high-risk and volatile space? For example, has he considered requiring crypto firms to include risk warnings that make clear to investors the percentage of retail investor accounts that have lost money when trading cryptoassets, as is the case for firms offering spread betting and contracts for difference?

Finally, it is noticeable that the Government are making the distinction that non-fungible tokens are collectibles rather than financial investments. Does that mean that NFTs are not considered cryptoassets under the draft order? The Government recently U-turned on their instruction to the Royal Mint to issue an NFT as part of plans

"to make the UK a global hub for crypto asset technology and investment".

Does the distinction made in the SI signal that the Government's NFT offer has finally been abandoned?

The Chair: I call Kevin Brennan. Will Members stand up if they wish to speak? It is hard to see people.

4.39 pm

Peter Grant (Glenrothes) (SNP): Thank you, Mr Gray —it is Peter Grant, by the way, not Kevin Brennan. I am sure that Kevin will be more insulted than I am if you mistake him for me.

The Chair: I do beg your pardon.

Peter Grant: I can assure you I have been called worse, Mr Gray.

The Scottish National party, like the official Opposition, will not be opposing the draft order today, but I want to raise one or two points. I am concerned not about the way in which these transactions will be regulated, but about just how effective the arrangements will be. My concern is that the financial promotion regulation that we have for more traditional forms of financial products is not working. It is not protecting consumers. Too many of my constituents have lost a lot of money. I do not remember whether I have had discussions with the Minister about Blackmore Bond, which I have certainly discussed with a lot of his colleagues.

Andrew Griffith *indicated assent.*

Peter Grant: I see from the Minister's nodding that he knows what I am referring to. The Financial Conduct Authority just never got ahead of the chancers in the way that those bonds were being sold and promoted to innocent members of the public in my constituency and elsewhere. There is still an issue as to whether the Financial Conduct Authority takes seriously enough potential scams that may not break the economy, but will certainly cause untold harm to sometimes quite significant numbers of our constituents.

Will the Minister indicate what the Government are doing to make sure that the Financial Conduct Authority and others who are trying to regulate the crypto market have got the resources and expertise to do the job? If we are giving them more and more responsibilities and they are already saying that they do not have the resources they need to regulate as firmly as we would like, that means that significant additional resources will have to be put in. Will the Minister confirm whether, on the back of this order, there is an intention to increase the resourcing of the Financial Conduct Authority?

What are we going to do to make sure that where there are breaches, those who are in breach are brought to book much more quickly than often happens with more traditional promotions? One of the problems with any kind of e-commerce is that if things start to go wrong, they can go very wrong very quickly indeed. We need to make sure that the regulatory process can be speeded up.

Finally—this may be beyond the remit of the Minister today—what are the Government doing to make sure that when cases come to court, those hearing the cases understand what they are dealing with? A judge and jury trial in relation to these matters might not work, for example: where are we going to find a jury that understands the very fine points of technical detail that may be critical in deciding whether something is permitted or not permitted and therefore in deciding whether somebody is innocent or guilty?

My primary concern is whether those who will be asked to regulate under this new order will have the resources and the expertise necessary to make sure that they can do the job effectively.

4.42 pm

Kit Malthouse: It is a pleasure to appear before you, Mr Gray. There are many reasons for not just consumers, but Governments, to fear cryptocurrency. The growth in cryptocurrency effectively represents a loss of control

[Kit Malthouse]

in nation states of our money supply, and a loss of control by co-ordinating nations across the world of the global money supply.

At the moment, cryptocurrency capitalisation, if you like, or gross valuation is anywhere between $1.2 trillion and $1.5 trillion, against a global liquid money supply of about $50 trillion, so it is not a huge percentage. Nevertheless, it could have an impact at the margin, and it is only going to grow. The Government should be careful about seeking to legitimise the use of cryptocurrency, not just among individual retail investors and users but among businesses. When I see this kind of legislation coming forward, I am not necessarily convinced that the full implication of the journey on which we are heading with cryptocurrency has been appreciated.

You will recall from your history studies, Mr Gray, the Dutch tulip bulb madness of, I think, the 18th century. Tulip bulbs became a form of currency, many a family were bankrupted to purchase one or two bulbs, and thereafter the market crashed. It was based on an imputed value of something that had no connection to reality. I am afraid that the same is true with bitcoin.

While bitcoin, ethereum and others—there are now hundreds, if not thousands, of these cryptocurrencies out there—are supposedly fungible and exchangeable, they effectively rely on trust between individuals as to the value, and an opinion of the value, unlike normal cash and assets such as the pound sterling or the dollar, which rely on the Government or the central bank standing behind the value of the currency. That makes them very different; it also makes them very volatile. There have been massive plunges in the value of bitcoin, for example, over the past few months: I think it is down something like 36% in just the past three to six months. That makes me wonder whether we want our constituents to be exposed to this currency—if it is one—at all.

In seeking to regulate the promotion of cryptocurrencies, the Government are, I am afraid, unwittingly giving them an element of legitimacy and bringing them into the same fold of investment as stocks and shares, bonds or anything that someone might put in their individual savings account. They will be promoted with a big banner headline, but at the bottom, tiny type that nobody reads will say, "The value of investments can go down as well as up. You could lose the farm, your house—everything—on this investment."

Peter Grant: I put it to the right hon. Gentleman that the self-same weaknesses in the current system apply already to investment bonds and property development bonds. The issue is not the kind of scam asset that is being sold, but the fact that they are not being properly regulated, regardless of whether they are traditional investments or crypto investments.

Kit Malthouse: The hon. Gentleman raises an interesting point. Of course, traditional investments very often have some foundation in reality. A stock or share very often has a company behind it that is producing revenue or otherwise. A bond will have the same thing. With bitcoin, all that is being sold is the assumption that somebody else will pay for that asset, even though there is no asset whatever that sits behind it. That is where it is subtly and importantly different.

The other thing to bear in mind is that cryptoassets are being overwhelmingly used in international organised crime. They have become the equivalent of the £50 note, in that they are being used by large international crime syndicates to move money around the world, largely undetected and unmolested by Governments. That is another major problem and a reason to be wary. As the Government regulates—and therefore brings into the fold and adds a veneer of legitimacy to—this form of exchange, they are effectively facilitating transfers between the illegitimate and criminal market and the legitimate market.

An individual will never know from whom or where their bitcoin is coming when they buy it from their investment adviser. It may well have been through the hands of several organised criminals before it gets to them, and unlike many £50 notes it will not bear traces of cocaine or heroin. We have seen the scale of the problem with cash in this country. The Bank of England has about £70 billion-worth of cash in notes and coins in circulation. Only about £20 billion is seen through the tills, so £50 billion is somewhere else. The Bank reckons that about £1.5 billion is in suitcases under the bed, held in cash savings or otherwise. The rest, I am pretty certain, is involved in crime. The same will be true, I am afraid, of so many of these cryptoassets.

I will not necessarily vote against the draft order, but the Government have to ask themselves whether they are legitimising a form of exchange that in the long term is likely to be damaging to the country's economy and the global economy, and to those individuals who invest in it. For all the warnings that we put on things, once this sits alongside all the other investments that an independent financial adviser will offer, it becomes a legitimate option. At the moment, it is an esoteric investment available only to the most sophisticated of those looking to invest. I realise that that is growing every day, but when it gets a stamp of respectability I worry that it will become like the economic equivalent of cigarettes, which were out there for years causing millions of people to die of lung cancer before we stamped a health warning on them all. By then, they were just too legitimised for us to do anything about them. I worry about that in particular.

My second major point is about fraud and money laundering. I understand that one reason the Government want to bring cryptoassets into the fold is to give fraud and money laundering legislation greater purchase. However, we have to reflect on the fact that over the past 30 years we have had ever greater attempts by Governments of all stripes to introduce legislation to deal with fraud and money laundering yet it is worse than it ever was. Strangely, criminals worked out that they too had a passport and a utility bill and therefore found it fairly easy to open a bank account. We are certainly seeing much higher levels of money laundering, particularly around drugs, than there used to be, and that is now very much enabled by cryptocurrencies. Given how much more susceptible such currencies are to being used in money laundering, fraud and crime in general, because they are much less trackable and traceable, I would be interested to know from the Minister why the existing rules will make any difference at all.

My final point is about the exclusion of NFTs. As the hon. Member for Hampstead and Kilburn said, although NFTs are carved out in this legislation and are deemed

to be different because, thus far, they have largely been used as collectibles because they are supposedly digital works of art, there is growing evidence that they are being used as a means of exchange and that, slowly over time, they will become fungible. It will not be long before there will be—in fact, there already are—central exchanges of NFTs that mark a price on them. We will have classes of price for different NFTs that will make them, in effect, the same as bitcoin. If the Government aspire to bring in this regulation, they really ought to include NFTs. Two students in a back room with a bit of sophisticated computer programming knowledge can create a class of NFTs and sell them—and people do buy them, sometimes for thousands of pounds. The idea that they should be excluded from the regulation seems to me to be a bit strange.

To conclude, I am concerned that a Government running helter-skelter towards cryptocurrency are not looking far enough ahead at the consequences. I realise that there is now a global consensus that crypto is a good thing, and we cannot be like King Canute and stick our finger in the dam, but cryptocurrencies present questions about the controllability of economies in the future. No one has yet come up with a solution to the significant and escalating crime problem that cryptocurrencies represent. No one has actually answered the question, before we bring in this regulation, of whether we think retail consumers should have access to this asset class at all.

4.52 pm

Barry Gardiner (Brent North) (Lab): I pay tribute to you in the Chair, Mr Gray, and look forward to contributing to this debate, but only to say this: King Canute would be horrified to find out that he was a Dutchman. King Canute was not a Dutchman and did not stick his finger in the dam. King Canute was the chap who tried to stop the tides from coming in and failed to do so. I just wanted to correct the right hon. Member for North West Hampshire on his metaphor.

4.53 pm

Andrew Griffith: It is a pleasure to follow the hon. Member for Brent North. I will attempt briefly to address Members' concerns.

The fact that there is an exemption process is something that came out of the consultation, to which we responded. It is the way in which we can encompass regulation around what is currently an unregulated sector. It still requires the relevant firms to act as if and to comply with the FCA requirements in this area. It is not a bug; it is a feature. I hope the hon. Member for Hampstead and Kilburn will accept that.

We did not talk too much about the specific regulations with which we expect the FCA to come forward. It is right that the purpose of this SI is to set out the overall structure, on the bones of which the FCA will put some flesh. Members will be interested to know, though, that the regulations will certainly encompass, for example, a 24-hour cooling-off period.

I will try to address the points of my right hon. Friend the Member for North West Hampshire separately—he gave an interesting tour around this space—but he is wrong to assert that the regulation for cryptoassets would be the same as that for stocks and shares or for bonds. Cryptoassets would form part of a high-risk group that required, for example, a 24-hour cooling-off period, which we do not apply to those other assets. They are therefore being regulated as high-risk assets.

The hon. Member for Hampstead and Kilburn mentioned stablecoins. The detailed regulations for them have yet to be seen. There are stablecoins backed by fiat currency, and the thrust of the regulations will ensure that people can have the highest level of trust that they are properly backed. As ever, I am happy to write to the hon. Lady.

I think that I wrote to the hon. Lady about the decision on NFTs—I certainly wrote to the Chair of the Treasury Committee, my hon. Friend the Member for West Worcestershire (Harriett Baldwin). We have clearly delineated that because NFTs are—as in their name—non-fungible and we do not wish investors and consumers to confuse them with instruments of investment. That is important because the counterfactual that Members should consider is not that consumers are not exposed to promotions of cryptoassets. One does not have to go far—we have only to venture down into London's fine underground—to find currently unregulated promotions, which expose consumers to all the risks without any of the protections. The statutory instrument seeks to rectify that.

My right hon. Friend the Member for North West Hampshire gave quite a tour around the sector. He talked about money supply and cash fraud, on which he is obviously an expert. I would argue that by bringing cryptoasset promotions within the perimeter, we are not making the existing situation worse. Arguably, by imposing the FCA's rigorous anti-money laundering measures and providing a greater incentive for more firms to come within them, we potentially add a clearly difficult task, on which I will not expand.

Kit Malthouse: I just want to take the Minister back to his point about NFTs. He said that they are not a form of investment, but I am afraid that they are. People are investing thousands of dollars in NFTs, and particular groups of NFTs, and effectively holding them as a collection as they would fine wine or art. They are certainly not a consumable. They are designed to hold value and to be disposed of at a future date, which is why NFT exchanges exist.

Secondly, does my hon. Friend accept that bringing NFTs into the investment fold grants them an air of legitimacy? We are saying, "This is a legitimate investment, notwithstanding the risk. We'll give you some protections and the FCA will provide investment advice." It makes such investment more legitimate than it otherwise would be.

The Chair: Order. Interventions must be brief.

Andrew Griffith: My right hon. Friend has not been dabbling in either tulips or NFTs, but just like, for example, the art market, they are not within the scope of financial regulations. We can revisit the subject. The purpose of today is to address the clear challenge before us: the number of unprotected consumers, whom all the evidence suggests are being exposed to the promotions. If my right hon. Friend wants to continue to engage

[Andrew Griffith]

in the debate, we shall do so, and I am sure that the Treasury Committee will keep a close eye on that. However, there are markets or perceived investments, whether they be tulips, art or NFTs, that do not fall within the scope of financial regulations and therefore we are not addressing them today.

The hon. Member for Glenrothes made points, which he has made directly to me in the past, that pertain to the regulations but are a bit more general and relate to the FCA's conduct and effectiveness. He and I served on the Committee that considered the Financial Services and Markets Bill, which seeks to place greater duties and accountability on the FCA. I hope that he will continue to work on that, but will let the matter rest for today.

Question put and agreed to.

Draft Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) Order 2023

5 pm

Andrew Griffith: I beg to move,

That the Committee has considered the draft Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) Order 2023.

This is like the main feature after the short film, for those of us who are old enough to remember that. The second instrument reduces the burdens that firms face when determining whether their trading in commodity derivatives or emission allowances require them to be authorised as an investment firm. Effective commodities markets regulation is key to ensuring that market speculation does not lead to economic harm. The regulator should be able to effectively regulate and supervise firms that trade commodity derivatives for investment purposes as their main role. However, as well as financial services firms, a number of businesses trade on commodity markets to protect their business from market fluctuations. In regulation that is referred to as trading that is ancillary to their main business.

We have inherited a regime from the EU that uses something called the ancillary activities test, which determines whether activities are primarily for investment purposes or support only the firm's commercial business. That ancillary activities test requires firms to undertake complex calculations. They are also required to notify the FCA about the outcome of the calculations on an annual basis. Taken together, the regime is overly burdensome for firms. Prior to the implementation of the EU ancillary activities test, the UK had a simpler test for determining whether firms were trading in commodity derivatives or emission allowances as an ancillary activity. It was cheaper for firms to comply with and resulted in the same outcomes as the current regime.

In 2021, as part of the wholesale markets review, the Government consulted on reverting to that simpler regime, which maintains the same regulatory outcome. The proposal was to remove the annual notification requirement and revert to a principles-based approach. Respondents to that consultation agreed with the proposed changes, stating that the current regime was onerous and complicated. Consequently, the Government committed to bringing forward those changes when we responded to the consultation in 2022. Today's SI delivers that. It will pave the way for the FCA to adopt a simpler and more streamlined approach to determining whether firms need to be authorised, alongside this SI.

To reflect the FCA's adoption of that simpler approach, the instrument also amends part of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, which exempts firms from having to perform the current calculation. As the FCA's new approach will be based on different information, that exemption is no longer relevant. The SI will not come into force until 1 January 2025, to ensure that industry has sufficient time to reflect on the changes that the FCA will make, and to make the necessary system changes. I understand that the FCA plans to consult on its changes later this year.

The measure will reduce costs for firms and make the UK a more attractive place to do business, with no detriment to our high regulatory standards. I therefore commend it to the Committee.

5.3 pm

Tulip Siddiq: The Opposition support the SI, and recognise that the current ancillary activities test, onshored into UK legislation from the EU rulebook, is too complicated. My only question for the Minister is how the Government will work with the FCA to ensure that relevant stakeholders are consulted on a new test.

5.4 pm

Kit Malthouse: I am grateful for your indulgence a second time, Mr Gray. Again, in delving into the details of the legislation, I wish to urge a little caution about this regulatory approach. The trading of commodities and, in particular, commodities futures can have a huge impact on the price our constituents pay for ordinary goods in their everyday lives. In history, attempts have been made to manipulate those prices. In the 1950s, two traders attempted to corner the onion futures market in the United States. That resulted in the Onion Futures Act, which is still extant in the US and forbids the trading of onion futures. Similarly, we saw—in the 1980s, I believe—a 10-year project by a trader at Sumitomo bank to corner the copper market, which eventually collapsed and failed. The trading of commodities and commodities futures, particularly at a time when there is more and more algorithmic trading and artificial intelligence being used in trading, means that we should take care in this complicated area of regulation and legislation.

One thing I could not find in the information given to us on this SI was why the current rules were introduced. What problem were they trying to solve? I acknowledge the supposed cost of these calculations, while being a little sceptical about them, given the amount of automation that so many of these traders use. Nevertheless, that rationale has not been offered to us, so I would be grateful if the Minister explained why the original rules were devised as they were and what problem they were deemed to be solving. In the past few months, we have learned that we need to take care because our regulatory

organisations are not always watertight on looking at systemic and structural risk in financial markets, commodities or otherwise.

Barry Gardiner: I was listening to the right hon. Gentleman's argument on onion futures trading. How does he reconcile that? Does it not give the lie to his argument about NFTs? It shows precisely that anything can be traded as a derivative in that way and therefore there would be no specific reason—he previously outlined this—to put NFTs into the other regulation. I find that his arguments conflict.

The Chair: I call Kit Malthouse, to respond specifically on the SI that we are considering.

Kit Malthouse: To respond to the hon. Gentleman's point—

The Chair: No, no. You do not need to respond to it all, just specifically to points that relate to the instrument.

Kit Malthouse: Okay. Well, in all circumstances my view is that we need to take care about the extent of regulation, and whether and how we include things within a regulatory envelope. I just ask that people take care. My first question to the Minister was: why were the previous rules adopted as they were? What problem were they deemed to be solving? Why will that problem not reoccur with these rules? Paragraph 7.7 of the explanatory notes to this SI states that

"since the test and annual notification was introduced in 2018, no UK firms have exceeded the threshold of speculative trading activity and therefore the requirement to inform the FCA about the outcome of the ATT every year was particularly burdensome."

That is a cause-and-effect argument. The fact that no firm has exceeded the limits for speculative trading may be because the limits were in place and there was a notification requirement. Obviously those limits for speculative trading were there for a reason: some kind of systemic threat was deemed to be posed, either to the individual organisation or to the market as a whole. I guess I am asking: what problem are we solving here, other than cost to these firms, and are we exposing ourselves to future problems?

The Minister will know that part of the calculation is the market share test, which does what it says on the tin: it works out who is trading the largest part of any particular market and therefore whether their trading is likely to present any kind of risk, either to other participants in the market or to the market as a whole. With the abandonment of this test for a number of organisations that, in effect, do not have to record that their trading is only ancillary, the calculation that they are doing, which they now do not have to do, is not revealing how much of the market they either individually or collectively make up. Given the example of the Bank of England and the structural problem that liability-driven investment phenomenon in pension funds caused us, I am concerned that we may be exposing ourselves to a structural problem here, without knowing.

My final point is about the dynamics of the market. As the Minister will know, when trading in commodity futures, whether on one's own account or speculatively as a hedge fund, one is relying on one's counterparty in that trade being good for the money or the commodity—whichever comes to fruition. When we remove regulation from a section of the market, we are not necessarily providing the kind of reassurance that others might need when they look to their counterparty risk in futures trading in particular.

When I contemplate trading in whatever it might be, whether it be in copper futures or something else, and I am trading with counterparties in that market, some will be FCA regulated and others will not be. How will that be reflected in the market, as I necessarily trade in the commodities that I have, and therefore what greater risk is being presented to me as a trader within the market? While I understand the Minister's admirable desire to deregulate where he can and save money for firms—although as I said, I would be interested, given the level of automation, in understanding exactly what cost is required—I am concerned that we are unwittingly creating further problems for ourselves. What risk assessment has the Minister done of those problems occurring?

5.11 pm

Andrew Griffith: I shall be brief. I am happy to be guided by the hon. Member for Hampstead and Kilburn; she should let me know if there is anyone she would particularly like to be consulted as the FCA brings forward rules. This is the third consultation in the process, so it will be fairly well sighted on the interested parties, but, as ever, one would encourage the widest range of participants. That is certainly the way that we seek to make and inform policy, and I know that the FCA will also seek to do so.

My right hon. Friend the Member for North West Hampshire will forgive me; he used the word "trading" repeatedly, so let me be very clear that this is not the regulation of those who are trading in commodities. By their very definition, they would not be able to take advantage of this measure. This is for the manufacturer of an engine who seeks to place their order for copper some months in advance—those who are using a commodities market, but not for the purpose of trading. With this measure, we are reverting to the situation prior to 2018, when a piece of European legislation came into a regulatory environment that was working perfectly well, in which no one had diagnosed any problem. There was a pragmatic way for businesses to operate and then the bar was raised. We now have the opportunity simply to revert to the situation prior to the introduction of that legislation.

Kit Malthouse: I understand the Minister's point. I am aware of the fact that it is perfectly possible for a company that is trading in a commodity to have futures trading, which is what we are talking about here—commodity derivatives trading—as an ancillary function of its overall business. For example, the Man Group, of which I am sure the Minister is aware, started as a cocoa and sugar ordinary trader. It had a small derivatives department, which was actually algorithmic black box trading—commodity trading adviser trading—which grew and grew. In the early days of the Man Group, under the test, that would have been ancillary to their trading. Nevertheless, it would have been a reasonably big part of the market.

Andrew Griffith: I suspect that neither my right hon. Friend nor I would know the exact application of that test. Clearly, the Man Group would look very much like a very large trading outfit, with all its revenue derived from a source of trading, rather than the purchase of being an end user. However, we are reverting to the original position. Let us be clear: whether it is onions or the Man Group, it would have fallen within the scope of this test in 2018 and we seek to simply revert to that.

Question put and agreed to.

5.15 pm

Committee rose.