EXPLANATORY MEMORANDUM TO

THE CRITICAL BENCHMARKS REGULATIONS 2024

2024 No. 1051

1. Introduction

1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of His Majesty.

2. Declaration

2.1 Tulip Siddiq, Economic Secretary to the Treasury at HM Treasury confirms that this Explanatory Memorandum meets the required standard.

2.2 Tom Duggan, Deputy Director for Securities and Markets at HM Treasury confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Ariane Moshiri at HM Treasury (marketconduct@hmtreasury.gov.uk) can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 This instrument specifies two benchmarks, the WMR Closing Spot Rates (also commonly known in the market as the WMR London 4PM Closing Spot Rate or WMR 4PM Fix) and the ICE Swap Rate® (ISR), as 'critical' using powers under Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016, which forms part of assimilated law. This is referred to as the UK Benchmarks Regulation (BMR).

4.2 As a result of this specification, the administrators of these benchmarks will become subject to more stringent regulatory requirements, reflecting the importance of the benchmarks to the operation of financial markets. The Financial Conduct Authority (FCA) will also have greater powers to intervene to address any potential market disruption.

Where does the legislation extend to, and apply?

4.3 The extent of this instrument is England and Wales, Scotland, and Northern Ireland.

4.4 The territorial application of this instrument is England and Wales, Scotland, and Northern Ireland.

5. Policy Context

What is being done and why?

5.1 The BMR regulates the provision and use of financial benchmarks in the UK. Under this regulation, an index is defined as a benchmark where the index is used to determine the amount payable under a financial contract or financial instrument, or

where it is used to measure the performance of an investment fund. Benchmarks play a key role in the financial system's core functions of allocating capital and risk. The purpose of the BMR is to provide accuracy, robustness, and integrity of financial benchmarks, providing market participants with confidence in the benchmarks they use.

5.2 Under Article 20 of the BMR, a benchmark is recognised as a 'critical benchmark' where it meets certain qualitative or quantitative criteria, such as where the value of the contracts referencing the benchmark is at least €500bn, where it has no or very few market-led substitutes if it were to cease being produced, or where it is not reasonably practicable for one or more users to switch to an available market-led substitute. A benchmark is to be specified as a critical benchmark by HM Treasury following a recommendation by the FCA that the relevant criteria are met.

5.3 In line with its role, the FCA recommended that both the ISR and WMR Closing Spot Rates be specified as critical. HM Treasury agrees that both these benchmarks meet the relevant Article 20 criteria.

5.4 The ISR is provided by ICE Benchmark Administration Limited (IBA) in the UK and represents the mid-price for interest-rate swaps (the fixed legs) and swap spreads (the applicable mid-price minus a corresponding specified government bond yield) in various specified currencies and tenors ranging from 1-30 years at particular specified times of the day. The ISR is used in a variety of swap contracts, which could be used, for example, by pension funds and insurers to manage their interest rate risk. Based on its assessment, the FCA is of the view that (i) the ISR has no appropriate market-led substitutes and (ii) in the event it ceases to be provided, or is provided on the basis of input data no longer fully representative of the underlying market or economic reality that it seeks to measure or on the basis of unreliable input data, there would be significant and adverse impacts on market integrity, financial stability, the real economy, or the financing of households and businesses in the UK. On that basis, the ISR meets the condition set out in Article 20(1)(c) of the BMR.

5.5 The second benchmark, the WMR Closing Spot Rates, is administered by Refinitiv Benchmark Services (UK) Limited (RBSL), part of the London Stock Exchange Group. It provides the mid, bid and offer rates of the foreign exchange (FX) market at 4pm London time for a wide range of currency pairs. The benchmark is widely used across the financial industry, including by investment and corporate banks and asset managers, for example for currency conversion and fund valuation. Based on its assessment, the FCA is of the view that (i) it is not reasonably practicable for one or more users of the WMR Closing Spot Rates to switch to an appropriate market-led substitute and (ii) in the event it ceased to be provided, or is provided on the basis of input data no longer fully representative of the underlying market or economic reality that it seeks to measure or on the basis of unreliable input data, users would face considerable difficulty in transitioning to alternative FX benchmarks. This would result in significant and adverse impacts on market integrity, financial stability, the real economy, or the financing of households and businesses in the UK. The WMR Closing Spot Rates therefore meet the condition set out in Article 20(1)(d) of the BMR.

5.6 As a result of these specifications by HM Treasury, both benchmark administrators must meet additional requirements and will become subject to enhanced supervision. This reflects their importance to financial markets and the real economy, rather than any immediate risk of their cessation or their reliability.

5.7 These specifications also mean that the FCA could, where the relevant criteria were met, use the additional powers specified in the legislation to support the orderly wind-down of a critical benchmark. For example, the FCA can mandate the administrator of a critical benchmark to continue publishing the benchmark under certain conditions where the administrator gives notice of its intention to cease providing the benchmark. The users of these benchmarks will also benefit from additional protections, such as the legal assurance that the benchmarks must meet enhanced standards and capital.

What was the previous policy, how is this different?

5.8 Under the BMR, HM Treasury, following recommendation by the FCA, can specify a benchmark as critical where it is assessed, among other conditions, that its failure could potentially significantly and adversely impact market stability, market integrity, confidence in the financial system, the pricing of financial products, and/or consumers.

5.9 Previously, the only benchmark specified as critical under the BMR was LIBOR which was administered by the IBA and has ceased to exist as a benchmark following its successful wind-down at the end of September 2024.

6. Legislative and Legal Context

How has the law changed?

6.1 This instrument specifies the ISR and WMR Closing Spot Rates as 'critical' following the process set out under Article A20(5) of the BMR.

Why was this approach taken to change the law?

6.2 This is the only possible approach to specify critical benchmarks under the process set out in the BMR. The FCA has recommended that both the ISR and WMR Closing Spot Rates be specified as critical which HM Treasury has accepted. Under Article A20(5) BMR, HM Treasury must as a result specify the benchmarks as critical.

7. Consultation

Summary of consultation outcome and methodology

7.1 HM Treasury has engaged with the two benchmark administrators affected by this instrument. As the supervising authority, the FCA has closely engaged with the two firms to assess what changes, if any, they need to implement to meet the regulatory requirements and supervisory expectations of this specification.

8. Applicable Guidance

8.1 No guidance accompanies this instrument.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 An Impact Assessment has not been prepared for the instrument because, in line with Better Regulation guidance, HM Treasury considers that the net impact on businesses will be less than £10 million Equivalent Annual Net Direct Costs to Business. Due to this limited impact, a de minimis impact assessment has been carried out and is published with this instrument on the legislation.gov.uk.

Impact on businesses, charities, and voluntary bodies

9.2 There is no, or no significant, impact on charities or voluntary bodies.

9.3 The provisions in the instrument are expected to have a limited impact on the two benchmark administrators (IBA and RBSL) as the FCA considers that they are already voluntarily complying with many of the additional requirements expected of critical benchmarks. This instrument will not result in any additional requirements on the users of these benchmarks, who as noted above, will benefit from additional protections.

9.4 This instrument places additional requirements on the FCA, such as to formalise its enhanced monitoring of IBA and RBSL to ensure that the administrators are meeting their obligations as administrators of critical benchmarks. There is no other impact on the wider public sector.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The approach to monitoring this legislation is set out in the BMR. Under Article A20(1), the FCA must undertake a proportionate review of critical benchmarks at least every two years and recommend to HM Treasury which benchmarks should be recognised as critical. These reviews will inform HM Treasury as to whether these specifications remain necessary in future.

10.2 This instrument does not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015 Tulip Siddiq, the Economic Secretary to the Treasury, made the following statement:

"It is not proportionate to include a review clause in this instrument because the estimated annual net direct cost to business is less than £10 million.".

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 The Economic Secretary to the Treasury, Tulip Siddiq, has made the following statement regarding Human Rights:

"In our view the provisions of the Critical Benchmarks Regulations 2024 are compatible with the Convention rights."

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts"). It does however relate to the withdrawal of the United Kingdom from the European Union because this instrument is made using powers in the BMR which forms part of assimilated law.