EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES AND MARKETS ACT 2023 (BENCHMARKS AND CAPITAL REQUIREMENTS) (AMENDMENT) REGULATIONS 2023

2023 No. [XXXX]

1. Introduction

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

2. Purpose of the instrument

2.1 The Financial Services and Markets Act 2023 (FSMA 2023) repeals retained EU law relating to financial services. This enables the government to deliver a Smarter Regulatory Framework for financial services. Retained EU law will be repealed and replaced with rules set by our independent and expert regulators, operating within a framework set by government and Parliament.

2.2 Each piece of REUL related to financial services is now within a "transitional period", lasting until the repeal of each piece is individually commenced by HM Treasury. During this period, the government will ensure retained EU law continues to be updated. This instrument makes targeted modifications to specific provisions of retained EU law to ensure that it continues to function effectively before the repeal of the relevant pieces of retained EU law have been fully commenced.

2.3 Regulation 2 reintroduces a 'discount factor' which was unintentionally removed from the Capital Requirements Regulation (CRR) in both the UK and the EU. The discount factor reduces the amount of capital small- and medium-sized firms hold for their trading and derivative activities. Reintroducing the discount factor will align UK legislation with relevant international standards and ensure that UK firms remain competitive compared to those based in other jurisdictions.

2.4 Regulation 3 amends the Benchmarks Regulation to extend the transitional period for the third country benchmarks regime from 31 December 2025 to 31 December 2030. The regime stipulates that only third country benchmarks approved for use via one of the prescribed routes set out in the Benchmarks Regulation may continue to be used within the UK. This third country regime does not apply for the duration of the transitional period. This extension ensures that firms do not lose access to non-UK benchmarks that are critical to their operations and provides time for the government to consider where reforms are needed to the third country benchmarks regime.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Extent and Territorial Application

4.1 The extent of this instrument (that is, the jurisdictions which the instrument forms part of the law of) is England and Wales, Scotland and Northern Ireland.

4.2 The territorial application of this instrument (that is, where the instrument produces a practical effect) is England and Wales, Scotland and Northern Ireland.

5. European Convention on Human Rights

5.1 The Economic Secretary to the Treasury (Andrew Griffith) has made the following statement regarding Human Rights:

"In my view the provisions of the Financial Services and Markets Act 2023 (Benchmarks and Capital Requirements) (Amendment) Regulations 2023 are compatible with the Convention rights."

6. Legislative Context

6.1 When the UK left the EU, the body of EU legislation that applied directly in the UK at the point of exit was transferred onto the UK statute book by the European Union (Withdrawal) Act 2018. This is known as "retained EU law".

6.2 The relevant EU legislation related to this instrument is Regulation (EU) No 575/2013, the Capital Requirements Regulation; and Regulation (EU) 2016/1011, the Benchmarks Regulation. Both regulations are repealed by FSMA 2023 subject to commencement.

6.3 FSMA 2023 contains a number of new legislative powers, which work together as a set of tools as the government repeals retained EU law in order to deliver a Smarter Regulatory Framework for financial services.

6.4 These include a power to modify legislation, providing HM Treasury with a power to make targeted modifications to retained EU law during the transitional period between the Act becoming law and when retained EU law is repealed.

6.5 This SI uses this modification power, contained in section 3 of FSMA 2023, to make changes to the Capital Requirements Regulation and the Benchmarks Regulation in pursuit of the policy objectives set out in section two of this memorandum.

6.6 This instrument inserts a discounting factor in the definition of total counterparty credit risk exposure value in article 384 of the Capital Requirements Regulation

6.7 This instrument also amends dates contained in Article 51(5) of the Benchmarks Regulation, extending the transitional period for the third country benchmarks regime from 31 December 2025 to 31 December 2030. This deadline was previously amended by Section 20 of the Financial Services Act 2021.

7. Policy background

What is being done and why?

7.1 This instrument forms part of HM Treasury's programme to deliver the Smarter Regulatory Framework for financial services.

7.2 Regulation 2 of this instrument reintroduces a 'discount factor' which was unintentionally removed from the Capital Requirements Regulation in both the UK and the EU. The purpose of reinstating the CVA discount factor is that it would ensure that the UK remains competitive with other jurisdictions by allowing firms to hold proportionate capital for CVA risk, in line with international standards. If this change to legislation was not made, affected firms would have to hold more capital and make costly changes to their systems and process.

7.3 Regulation 3 of this instrument extends the end of the transitional period for the third country regime set out in the Benchmarks Regulation from 31 December 2025 to 31 December 2030.

7.4 The Benchmarks Regulation regulates the provision and use of financial benchmarks in the UK. Under this regulation, an index is defined as a benchmark where it 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.

7.5 Third country benchmarks are benchmarks provided by administrators located outside of the UK, and the third country benchmarks regime governs the use of these benchmarks within the UK. The regime stipulates that only benchmarks that have been approved for use via one of the prescribed access routes set out in regulation may be used in the UK. As noted above, this third country regime does not apply for the duration of the transitional period, meaning that there are no restrictions on the use of third country benchmarks.

7.6 HM Treasury has previously identified potential issues in the third country regime, which mean that some third country administrators may be unable or unwilling to come through the existing access routes. For example, some third country benchmarks are provided on a non-commercial basis and therefore the administrators lack the economic incentives to come through the prescribed routes for continued access to UK markets. Losing access to these benchmarks could have serious repercussions given their widespread use by UK firms for a range of business activities. Extending the transitional period will provide more time for HM Treasury to consider where reforms are needed to the UK's third country benchmarks regime as part of the financial services Smarter Regulatory Framework Programme.

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not trigger the statement requirements under the European Union (Withdrawal) Act.

8.2 This instrument is not being made under the European Union (Withdrawal) Act but relates to the withdrawal of the United Kingdom from the European Union because it related to the modification of retained EU law under HM Treasury's programme to build a smarter regulatory framework for the UK.

9. Consolidation

9.1 There are currently no plans to consolidate the relevant legislation.

10. Consultation outcome

10.1 Given the targeted nature of this instrument, the government has consulted informally with relevant stakeholders. Reintroducing the discount factor will align the CRR with relevant international standards and ensure that UK firms remain competitive compared to those based in other jurisdictions, including the EU. Extending the transitional regime for third country benchmarks will allow industry to plan business activities with confidence and without concern about the third country regime coming into force at the end of 2025.

11. Guidance

11.1 HM Treasury does not propose to provide any guidance in relation to this instrument.

12. Impact

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

12.2 There is no, or no significant, impact on the public sector.

12.3 A full impact assessment has not been prepared for this instrument because, in line with Better Regulation guidance, HM Treasury considers that the net impact of this instrument on businesses will be less than £5 million Equivalent Annual Net Direct Costs to Business. Due to this limited impact, a de minimis impact assessment has been carried out, a copy of which is published alongside this Explanatory Memorandum on the legislation.gov.uk website.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses. The amendments made by this instrument are not expected to have an impact on small businesses, and therefore no action is needed to mitigate the impact on them.

14. Monitoring & review

14.1 These provisions are subject to review as part of HM Treasury's work to repeal financial services REUL in order to deliver a Smarter Regulatory Framework for the UK.

14.2 The instrument does not include a statutory review clause, and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015, the Economic Secretary to HM Treasury (Andrew Griffith) has made the following statement:

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

"It is not proportionate to include a review clause in this instrument because the SI does not have significant impacts on business."

15. Contact

15.1 David Bissell at HM Treasury (email: david.bissell@hmtreasury.gov.uk) can be contacted with any queries regarding the Benchmarks Regulation amendment in this instrument.

15.2 Deeven Seyan at HM Treasury (email: deeven.seyan@hmtreasury.gov.uk) can be contacted with any queries regarding the Capital Requirements Regulation amendment in this instrument.

15.3 Tom Duggan, Deputy Director for Securities and Markets and Fayyaz Muneer, Deputy Director for Green and Prudential at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.

15.4 Andrew Griffith, Economic Secretary to the Treasury at HM Treasury, can confirm that this Explanatory Memorandum meets the required standard.