Title: The Financial Services and Markets Act 2023 (Benchmarks and Capital Requirements) (Amendment) Regulations 2023	De minimis assessment
SI (Statutory Instrument) No: 2023/1409	**Date: 14/09/2023**
Other departments or agencies: Financial Conduct Authority (FCA) Prudential Regulation Authority (PRA) **Contact for enquiries**: David Bissell; David.Bissell@HMTreasury.gov.uk Deeven Seyan; Deeven.seyan@HMTreasury.gov.uk	**Type of regulation: Domestic** **Date measure comes into force:** **01/01/2024**
Cost of Preferred (or more likely) Option c. £0 As the third country benchmarks measure legislates for the continuation of the current regime, there will be no additional costs to UK users of third country benchmarks or the UK market generally. As the CVA measure confirms current industry practice on using a discount factor, there will be no additional costs to affected firms.	**Equivalent Annual Net Direct Cost to Business per year** (EANDCB in 2022 prices) **c. £0**

1. **What is the problem under consideration? Why is government intervention necessary?**

Third country benchmarks regime transitional period extension

The third country benchmarks regime is contained within the UK Benchmarks Regulation ('BMR') and places restrictions on UK businesses using benchmarks produced outside the UK, unless the providers of those benchmarks have come through prescribed access routes. It is due to come into force at end-2025. This measure will delay it coming into force until 31 December 2030. The existing transitional period will continue to apply for the full duration of this extension.

The implementation of the regime could reduce the number and variety of benchmarks available in the UK, as some of the third country benchmark administrator are likely to be unable or simply unwilling to come through the existing access routes and to be registered in the UK. Overseas providers that wish to comply will need significant time to prepare an application, and many will choose not to as it is not cost-effective.

Similarly, it would take domestic firms time to reduce their exposures to these providers in an orderly way. The government has judged therefore that it needs to consider whether reforms are needed before the transitional period ends and the regime comes into force. This will be considered as part of the government's wider programme of work to repeal and replaced retained EU law in financial services. The government therefore intends to extend the date on which the regime comes into force by five years, providing more time to address the current known issues in the third country regime, and for firms to prepare for the amended regime to go live.

CVA Discount Factor

The UK Capital Requirements Regulation (CRR) sets requirements for the amount of capital UK regulated banks and large investment firms are required to hold against their exposures. The Credit Valuation Adjustment (CVA) discount factor reduces the amount of capital firms have to hold against certain types of derivative activities. The EU CRR was onshored into UK law in time for the UK's exit from the EU. Before that took place, the EU had inadvertently removed the discount factor from the CRR, which was then mirrored in the UK version of the CRR. HMT has worked with the regulators and has established that there was no policy intent but the removal of the discount factor was an error in the EU amendment of the CRR. We understand from industry trade bodies and the PRA that firms have continued applying the discount factor because they were not aware that it had been removed from the UK CRR.

2. What are the policy objectives and the intended effects?

Third country benchmarks regime transitional period extension

The policy objective of this measure is to maintain the status quo for third country benchmarks under the BMR by extending the third country transitional period from end-2025 to end-2030. If this extension were not enacted, the third country regime would come into force in its current form at end-2025. In this scenario, UK markets would lose access to important third country benchmarks. This is because some of the third country benchmark administrators (whose benchmarks are currently used in the UK) are likely to be unable or simply unwilling to come through the existing access routes contained within the regime.

During the extension period provided by our measure the third country regime will not be force. UK users will be able to continue using these benchmarks in existing and new contracts, rather than losing access to them. The extension will also allow time for the Government to review and reform the third country regime.

CVA Discount Factor

This statutory instrument reintroduces a 'discount factor' which was unintentionally removed from the CRR in the EU and consequently the UK version of CRR. The discount factor reduces the amount of capital small- and medium-sized firms hold for their derivative activities. Firms, not realising that the discount factor was deleted, have continued to use it. Reintroducing the discount factor will align UK legislation with relevant international standards, provide confirmation to firms that they should continue to use the discount factor and ensure that UK firms remain competitive compared to those based in other jurisdictions.

2. **What policy options have been considered, including any alternatives to regulation? Please justify preferred option**

Third country benchmarks regime transitional period extension

[Option 1] Do nothing – do not extend the third country transitional period

Without action, it is likely that a number of widely used third country benchmarks will no longer be available in the UK after 31 December 2025. Losing access to these benchmarks could undermine the UK's position as the centre for global FX and derivatives markets. It could also have serious repercussions given their widespread use by UK firms for risk management, treasury financing and overseas investment.

[Option 2] Preferred option – extend the transitional period

Our preferred option is to extend the transitional provision for third country benchmarks under the UK Benchmarks Regulation to 31 December 2030. The third country benchmarks regime stipulates that only benchmarks approved for use via one of the prescribed access routes set out in the third country regime may continue to be used in the UK. If the regime were to come into force in its present state it would mean that third country administrators are likely to be unable or unwilling to come through these existing access routes, largely because they may lack the economic incentives to do so.

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 therefore allows for immediate legal certainty for UK benchmark users that they will not lose access to important third country benchmarks. It also provides the Government with the time necessary to consider and operationalise any possible reforms to the BMR third country regime.

<u>CVA Discount Factor</u>

Option 1 – Do nothing – do not reinstate the CVA discount factor

Without action, firms' capital requirements for CVA risk would increase. This could hinder the international competitiveness of UK firms as other jurisdictions apply the discount scalar (in line with international standards). The permanent removal of the discount factor would also increase firms' operational costs as they would have to tailor their systems and processes in accordance with the new requirements. The UK prudential regime for banks and large investment firms would also be left misaligned with international standards.

Option 2 – Preferred option – reinstate the CVA discount factor

Our preferred option is to reinstate the CVA discount factor as 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. It also avoids firms having to make costly systems and process changes.

3. **Please justify why the net impacts (i.e., net costs or benefits) to business will be less than £5 million a year.**

<u>Third country benchmarks regime transitional period extension</u>

As this measure legislates for the continuation of the current regime, there will be no additional equivalent annual net direct costs (EANDCB) to UK users of third country benchmarks. There are no wider impacts associated with this measure.

We do consider there will be some minor familiarisation costs. According to ONS data, 20,000 financial services firms exist within the UK market. Use of benchmarks is widespread across them, although there is no data on the exact size and scope of UK businesses using third country benchmarks. Therefore, it is not possible to calculate exact familiarisation costs to businesses who use third country benchmarks.

However, this measure maintains the status quo, no compliance costs will arise as a result, and it is a short amendment. Further, not all users of benchmarks will engage with this measure directly. Therefore, it is our best estimation that the familiarisation costs for this measure will in no way exceed the £5 million de minimis threshold.

CVA Discount Factor

We expect there to be no impact from the change to the discount factor, as we understand from industry and the Prudential Regulation Authority that firms are operating as if the discount factor is currently in place (as the SI will re-establish a discount factor that was previously in effect). This technical change makes it clear that firms are able to continue to use the discount factor, in line with current industry practice, reducing risk and uncertainty for firms and aligning UK regulation with international standards. If we don't reinstate the discount factor trade bodies have said that firms will need to begin making changes, including holding additional capital and making systems and process changes. The PRA expects that the permanent removal of the discount factor could have a notable impact on firm's capital requirements for derivatives exposures. Therefore, it is our best estimation that reinstating the discount factor will not have a material impact on firms' capital requirements and will not exceed the £5 million de minimis threshold.

5. Please confirm whether your measure could be subject to call-in by BRE (Better Regulation Executive) under the following criteria. If yes, please provide a justification of why a full impact assessment is not appropriate:

a) **Significant distributional impacts (such as significant transfers between different businesses or sectors)**
   No
b) **Disproportionate burdens on micro, small, and medium businesses (below 500 employees).**
   No
c) **Significant gross effects despite small net impacts**
   No
d) **Significant wider social, environmental, financial or economic impacts**
   No
e) **Significant novel or contentious elements**
   No

<u>Sign-off for de minimis assessment: SCS</u>

I have read the de minimis assessment and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

SCS of Securities and Markets

Signed: ***Tom Duggan*** Date: 15/09/2023

SCS of Green and Prudential

Signed: ***Fayyaz Muneer*** Date: 15/09/2023

SCS of Better Regulation Unit

Signed: ***Phil Witcherley*** Date: 21/09/2023

Sign-off for de minimis assessment: Minister

I have read the de minimis assessment and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

(Name, Ministerial role)

Signed: ***Andrew Griffith, Economic Secretary to the Treasury*** Date: 01/11/2023

Further information sheet

Please provide additional evidence in subsequent sheets, as required.