

EXPLANATORY MEMORANDUM TO
THE FINANCIAL SERVICES AND MARKETS ACT 2000 (BENCHMARKS)
REGULATIONS 2018

2018 No. 135

1. Introduction

- 1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.
- 1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

- 2.1 This instrument gives effect to Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investments and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (“the EU Benchmarks Regulation 2016”).
- 2.2 This instrument provides that the Financial Conduct Authority (“the FCA”) is designated as the competent authority for the purposes of the EU Benchmarks Regulation 2016. This ensures that the FCA is responsible for regulating benchmarks and their administrators.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 This instrument provides for dual operation of the current and a new benchmarks regulation regime for a transitional period ending on 1 May 2020 and for the continuation of the new regime thereafter. During the transitional period the existing provisions in articles 63O to R of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (S.I. 2001/544) (“the RAO”) will continue to apply. Article 63O provides for specified kinds of activity relating to benchmarks to be regulated activities for the purposes of the Act (providing information in relation to a specified benchmark and administering a specified benchmark) and Schedule 5 to the RAO specifies certain benchmarks. In addition, however, anyone wishing to carry on the new wider benchmarks activity covered by this instrument will have to apply for permission under Part 4A of the Financial Services and Markets Act 2000 (“the Act”) to carry on the new regulated activity of administering a benchmark as defined in Article 3 of the EU Benchmarks Regulation 2016 from the general date of coming into force of this instrument. This instrument accordingly amends section 22(1A) of the Act to add at paragraph (c) a new regulated activity of a specified kind carried on by way of business and relating to administering a benchmark, as defined in new subsection (6A) by reference to the EU Benchmarks Regulation 2016.
- 3.2 This instrument also amends the RAO by inserting a new article 63S stating that administering a benchmark as so defined is a specified kind of activity. As of 1 May 2020, this will be the sole regulated activity in relation to benchmarks. As well as the

consequential revocation of articles 63O to R of the RAO, section 22(1A)(b) and (6) of FSMA will be repealed on that date under this instrument.

- 3.3 HM Treasury chose not to rely on the new section 22(1A)(c) power to amend the RAO to provide that administering a benchmark is a specified kind of activity in the new article 63S of the RAO because as indicated above this instrument itself amends section 22 by inserting the power in subsection (1A)(c) to provide for a new framework for benchmarks regulation. It would not have been feasible to both amend section 22(1A) and exercise the powers to specify an activity in an order made under section 22(6) in the same instrument. And it would not have been possible to make an Order simply amending the RAO under section 22(1A)(b) which relates to “the setting of a specified benchmark” (as described in Part 2B of Schedule 2 to the Act) since under the new approach it is the administration of any benchmark as defined which is the specified kind of activity and which therefore becomes the regulated activity; hence the provisions of the section itself also needed to be amended. Accordingly, this instrument has been made under section 2(2) of the European Communities Act 1972 alone as the only available power.
- 3.4 This instrument is to be made under the negative resolution procedure notwithstanding that had it been possible to make the relevant amendments to the RAO under section 22(1A)(b) of the Act the use of the affirmative resolution procedure would have been required. Paragraph 26 of Part 2B of Schedule 2 to the Act provides that an order under section 22(1A) which adds a new regulated activity is to be made using the affirmative resolution procedure. This instrument amends the RAO and adds the new regulated activity of administering a benchmark in article 63S. The new regulated activity subsumes and replaces the existing regulated activities (providing information in relation to a specified benchmark and administering a specified benchmark) in articles 63O to R in respect of the specified benchmarks in Schedule 5 to the RAO once the transitional period comes to an end in May 2020. It thereby extends regulation to a large number of additional financial benchmarks albeit that the underlying concept and activity is broadly similar.
- 3.5 It is recognised that the preferable approach would have been to use the affirmative resolution procedure here. However, there has been full consultation by the FCA and everyone who will be required to obtain a permission from the FCA in order to carry out the new regulated activity ought to be aware that the existing regulated activity will be replaced. There is also a long transitional period which will ensure that affected persons have ample time in which to obtain permission. In addition, the EU Benchmarks Regulation 2016 is directly applicable and came into effect on 1 January 2018. Given these factors, it was considered that the factors favouring the use of the affirmative resolution procedure to safeguard the interests of those who will become subject to regulation and to enable the fullest Parliamentary consideration were outweighed by the importance of introducing the new regime in the UK without delay.

Other matters of interest to the House of Commons

- 3.6 As this instrument is subject to negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

- 4.1 This instrument gives effect to the EU Benchmarks Regulation 2016 by making the activity of administering a benchmark a regulated activity. This enables the FCA to regulate benchmark administrators. This instrument also provides the FCA with powers in respect of other persons who are involved in the provision of benchmarks.
- 4.2 Part 1 of the instrument (introductory provisions) designates the FCA as the competent authority for the purposes of the EU Benchmarks Regulation 2016.
- 4.3 This instrument also amends the Act and instruments made under the Act so as to enable the FCA to regulate benchmarks in line with the requirements of the EU Benchmarks Regulations 2016. Under section 22(1A) of the Act (regulated activities) administering a benchmark will be a regulated activity and benchmark administrators will be required to be authorised by the FCA. Parts 4 (administering a benchmark) and 5 (amendments to the Act) of this instrument make provision for the FCA to regulate benchmark administrators, including recognition of third country administrators and amends FSMA to allow applications to carry on the regulated activity of administering a benchmark to be made to the FCA.
- 4.4 Other persons (Miscellaneous Benchmark persons) involved in the provision of a benchmark or otherwise contributing to its provision will not be required to be authorised by the FCA and Part 2 of this instrument (FCA powers over Miscellaneous BM persons) sets out the FCA's powers over these persons.
- 4.5 Part 3 of this instrument (FCA powers in relation to persons publishing or contributing to benchmarks) makes provision for the FCA to impose requirements on persons requiring them to administer or to contribute to a benchmark to ensure continuity.
- 4.6 Part 6 of this instrument (amendments to secondary legislation) amends secondary legislation and in particular amends the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (S.I. 2001/544) ("the RAO") to provide that, amongst other things, administering a benchmark is a specified kind of activity for the purposes of section 22 of the Act.
- 4.7 Part 7 of this instrument (transitional provisions) makes transitional provision.
- 4.8 Part 8 of this instrument (miscellaneous provisions) makes a minor amendment to the Act for the purposes of Directive (EU) 2016/1148 of the European Parliament and of the Council of 6 July 2016 concerning measures for a high common level of security of network and information systems across the Union. Part 8 also provides that this instrument must be reviewed by the Treasury within five years of this instrument coming into force.

5. Extent and Territorial Application

- 5.1 The extent of this instrument is the United Kingdom.
- 5.2 The territorial application of this instrument is the United Kingdom.

6. European Convention on Human Rights

- 6.1 The Economic Secretary to the Treasury has made the following statement regarding Human Rights:

"In my view the provisions of the Financial Services and Markets Act 2000 (Benchmarks) Regulations 2018 are compatible with the Convention rights."

7. Policy background

What is being done and why

- 7.1 The EU Benchmarks Regulation is directly applicable EU law which entered force on the 30 June 2016 and applied from 1 January 2018. This SI will amend the Financial Services and Markets Act 2000 to provide the FCA (the designated competent authority) with the necessary rule making powers required to enforce the regulation. Benchmark administration will become a regulated activity, and prospective administrators will have to apply to the FCA for prior authorisation.
- 7.2 On 23 June 2016, the EU referendum took place and the people of the United Kingdom voted to leave the European Union. The government respected the result and triggered Article 50 of the Treaty on European Union on 29 March 2017 to begin the process of exit. Until exit negotiations are concluded, the UK remains a full member of the European Union and all the rights and obligations of EU membership remain in force. During this period the Government will also continue to negotiate, implement and apply EU legislation. The outcome of these negotiations will determine what arrangements apply in relation to EU legislation in future once the UK has left the EU.
- 7.3 Benchmarks play a key role in the financial system's core functions of allocating capital and risk and impact huge volumes of credit products and derivatives. The EU Benchmarks Regulation 2016 defines a benchmark as an index which is used to:
- determine the amount payable under a financial instrument or contract, or the value of a financial instrument, OR
 - measure the performance of an investment fund for the purpose of tracking the return, defining the asset allocation, or computing performance fees.
- 7.4 The purpose of the EU Benchmarks Regulation is to prevent harm that could affect those who use financial instruments or contracts or investment funds that reference benchmarks. The Regulation fits within the context of international benchmark reform led by the Financial Stability Board in the wake of the LIBOR and EURIBOR rate rigging scandals uncovered in 2012. It will introduce a common framework and consistent approach to benchmark regulation across the EU. It aims to ensure benchmarks are robust and reliable, and to minimise conflicts of interest in benchmark-setting processes.
- 7.5 The FCA has played a leading role in domestic and international initiatives to raise regulatory standards for financial benchmarks, and a domestic regulatory regime has been in place for 8 specified benchmarks since April 2015. The new EU regulation is based on the same international principles, but widens the scope to cover all financial benchmarks. The Regulation categorises benchmarks according to their purpose and to their significance in the financial system. Benchmarks which meet certain criteria set out in the regulation will be designated as critical. Critical benchmarks will be subject to stricter rules, including the power for the relevant competent authority to mandate contributions of input data.

Consolidation

- 7.6 HM Treasury does not propose to consolidate any legislation in consequence of this instrument.

8. Consultation outcome

- 8.1 ESMA published a Consultation Paper (CP) on the Benchmarks Regulation on the 29 September 2016. The CP included a first version of the draft technical standards. Their final report can be found [here](#).
- 8.2 The FCA consulted on their Handbook changes to reflect the application of the Regulation and considered responses before publishing their final rules. Their policy statement can be found [here](#).
- 8.3 The Government did not carry out any separate consultation.

9. Guidance

- 9.1 The FCA will publish Rules and guidance for persons affected by this instrument.

10. Impact

- 10.1 There is no direct impact on business, charities or voluntary bodies. Any impact stemming from the enforcement of these powers is as a result of EU regulation, not from these domestic amendments.
- 10.2 There is no impact on the public sector.
- 10.3 An Impact Assessment has not been prepared as there are no direct costs on business associated with this instrument.

11. Regulating small business

- 11.1 The legislation applies to activities that are undertaken by small businesses.
- 11.2 No specific action is proposed to minimise regulatory burdens on small businesses.
- 11.3 The EU Benchmarks Regulation 2016 itself categorises benchmarks by significance and regulates accordingly, and as such small businesses will face lighter requirements than administrators of interest rate benchmarks or others with systemic importance. The FCA has committed to maintain this proportionality when it creates the rules which this statutory instrument enables, and has taken consultation responses into account. More broadly, the FCA takes a risk based approach to supervision in general, which means that businesses are supervised in accordance with the risk they present to the financial sector or consumers.

12. Monitoring & review

- 12.1 This instrument will be reviewed and a report published setting out the conclusions of the review within five years of this instrument coming into force.

13. Contact

- 13.1 Martin Booth at HM Treasury Telephone: 0202701434 or email: martin.booth@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.