

## Consultation Paper

CP25/19\*\*

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# Ancillary Activities Test

July 2025

## How to respond

We are asking for comments on this Consultation Paper (CP) by **28 August 2025**.

You can send them to us using the form on our [website](#).

Or in writing to:

Priya Kotadia/Zaril Razak  
Financial Conduct Authority  
12 Endeavour Square  
London E20 1JN

**Telephone:**

02070661317

**Email:**

cp25-19@fca.org.uk.

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# Chapter 1

## Summary

### Why we are consulting

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- 1.1** The Ancillary Activities Exemption (AAE) exempts commercial users or producers of commodities from the need to seek authorisation as an investment firm, if they trade in commodity derivatives, emission allowances or derivatives of emission allowances (referred to collectively as 'commodity derivatives' going forward) as an ancillary activity.
- 1.2** To benefit from the AAE, a firm is required to carry out a test (the 'Ancillary Activities Test' (AAT)) which aims to determine if its activity in these financial instruments is ancillary to the main activities of the group to which it belongs.
- 1.3** The AAT, which was introduced by MiFID II, is complex and relies on calculations that require market data to be sourced every year at a cost. We are consulting on changes to the AAT that aim to simplify how firms determine whether they can benefit from the exemption while ensuring that it provides them with the necessary legal certainty.
- 1.4** In May 2023 the Treasury made legislative changes (The Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) Order 2023) to the AAE, which replaced calculations with qualitative criteria. Then, in CP23/27 we consulted on guidance that would assist firms to apply those criteria and determine whether they can use the AAE. However, market participants raised concerns in their feedback over the lack of legal certainty from the overall approach.
- 1.5** To address these concerns, in May 2024 the Treasury delayed the commencement date of the new AAE framework until 1 January 2027. In line with this, we confirmed in our policy statement PS25/1 that we would not proceed with our guidance proposed in CP23/27. Instead, we said the existing requirements will remain in place until a permanent solution is agreed and that we would work with Treasury to address the concerns raised.
- 1.6** On 3 July 2025, the Treasury has proposed amending legislation to enable us to write rules to define the conditions under which firms can rely on the AAE. This CP sets out our proposals regarding those rules.

### What we are proposing

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- 1.7** We are proposing to establish 3, separate and independent tests to assess whether a firm can use the AAE. These will include a new annual threshold test (commonly known as a "de minimis" test), which will exempt firms that undertake trading in commodity derivatives on a relatively small scale. They will also include the existing trading and capital employed tests, that are currently part of the AAT's main business test, but we are proposing some modifications to these.

- 1.8** Under our proposal, a firm can use the AAE if it meets the conditions set in any of the 3 tests. This is different from the current regime where a firm needs to pass a market share test and a main business test to use the AAE, and where the threshold applicable to the market share test varies depending on the scale of a firm's activity.
- 1.9** We propose the new annual threshold test will be based on a specific monetary threshold. This test will replace the current market share test which is based on yearly averages of overall market activity in relevant commodity derivatives. Compared to the market share test, we propose that the calculation against the annual threshold is not done for each different type of commodity but across all commodity derivatives.

## Outcome we are seeking

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- 1.10** In line with the broader objective under the Wholesale Markets Review (WMR) and our Secondary International Competitiveness and Growth Objective (SICGO), we are simplifying the AAT and aim to establish a regime that provides greater legal clarity and certainty for firms by building on existing exemptions and adding to the choice of quantitative criteria available when determining whether or not they require authorisation or are exempt, for these purposes. We have also sought to ensure that our approach preserves market integrity, factors in best international practices and maintains open access to UK commodity markets to non-financial firms. We do not intend through these proposals to change the firms within the regulatory perimeter than is the case under current MiFID-based tests.

## Summary of the cost and benefit analysis of our proposals

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- 1.11** We have carefully considered the potential costs and benefits of our proposals. These are set out in the Cost Benefit Analysis (CBA) in Annex 2.
- 1.12** We expect that the main change to the regime (ie the annual threshold test to replace the market share test) will have minimal impact on direct costs as firms are already observing a similar assessment for the UK EMIR clearing threshold.
- 1.13** Similarly, as part of the main business test, firms are already using the capital employed test and trading test. They are therefore familiar with the methodologies to carry out the relevant calculation and have systems in place to do so.

## Measuring success

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- 1.14** Since the main objective of the consultation is to simplify the exemption and reduce costs for firms, we will focus on measuring such outcomes by engaging with firms using the new AAE after the new regime is implemented. We do not intend, through this consultation, to modify the regulatory perimeter to bring more persons into authorisation than is the case under current MiFID-based tests. We are aiming to

monitor the scope of the perimeter following implementation of the proposed changes to the AAE framework.

## Who this applies to

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- 1.15** The proposals in this CP will apply to non-financial firms that trade commodity derivatives seeking to rely on the AAE.

## Next steps

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- 1.16** We are seeking views on our proposals by 28 August 2025.
- 1.17** Please send your comments to us by using the options in the 'How to respond' section above. Unless you indicate that your response is confidential, we will not treat it as such.
- 1.18** We will consider feedback and aim to publish a Policy Statement finalising our changes in Q4 2025/Q1 2026.

## Chapter 2

# The wider context and the relationship to our objectives

## Background

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- 2.1** The AAE regime has been in operation in the UK since the entry into force of MiFID II in 2018. Before a firm assesses whether its activities are ancillary to the main business of its group, the following conditions must be met:
- The firm does not execute orders on behalf of clients by dealing on own account unless the client is a client or supplier of the group's main business.
  - The firm does not use a high-frequency algorithmic trading technique.
  - The main business of a firm's group is not the provision of investment services, services requiring authorisation as a bank, or acting as a market maker in commodity derivatives.
- 2.2** Once a firm determines that it meets the above conditions, it can proceed to perform the AAT. The detailed parameters and methodology of the AAT, set out in the [UK version of Commission Delegated Regulation 2017/592](#) (referred to in the Handbook as RTS 20), were onshored when the UK left the European Union (EU). There are 2 components to the AAT, both of which need to be met for the firm's activities to be deemed ancillary. These are the market share test, and the main business test, which are described in more detail in Chapter 3.
- 2.3** In the case of both above tests, intra-group transactions, hedging transactions and transactions entered into as part of an agreement to provide liquidity on a trading venue are excluded from the calculations. The AAT must be performed annually, in the first quarter of the year, based on data from the previous 3 years. Before changes made by the 2023 Order, firms needed to notify us on an annual basis when they used the AAE.
- 2.4** Article 72J of the Regulated Activities Order (RAO) provided a mechanism enabling the AAT to function in the absence of publicly available data on the overall size of the market.
- 2.5** In 2022 we made [changes](#) to our Perimeter Guidance Manual and RTS 20. These changes clarified that firms did not need to undertake the market share test and if they relied on the derogations from the main business test, as specified in Article 3(2) of RTS 20, firms could use historic data for the overall size of the market. We issued further statements in [January 2023](#) and [December 2023](#) clarifying how firms could determine their use of the AAE for 2023-24 and 2024-25 respectively.
- 2.6** As part of the WMR, the Treasury proposed to simplify the AAE without changing its scope of application. In March 2022, Treasury published its [WMR consultation response](#). The Treasury suggested that revoking the current AAT, re-introducing the 'commodity dealer exemption' (that is the qualitative exemption that was available under the original

MiFID) and removing the annual notification requirements would improve the operation of the regime.

- 2.7** In May 2023 the Treasury legislated to make changes to the AAE. The legislation did not reintroduce the commodity dealer exemption, which was in Article 2(1) (k) of the original MiFID. The commodity dealer exemption was broader than the corresponding parts of the AAE in MiFID II. As well as exempting commercial firms trading commodity derivatives to manage the risks of their underlying business it also allowed a principal trading firm focused on trading commodity derivatives to be exempt from authorisation.
- 2.8** The 2023 Order introduced 3 main changes:
- To remove the requirement for firms using the AAE to make an annual notification to us.
  - To remove the references in the RAO to RTS 20 with the intention that the AAT as formulated in that RTS should no longer apply.
  - To remove the transitional arrangements set out in Article 72J of the RAO.
- 2.9** The 2023 Order left in place the description of the AAE that was included in the RAO as part of the transposition of MiFID II. That includes the conditions set out in paragraph 2.1 above together with the overarching requirement that activity in commodity derivatives be ancillary to the main activities of the group to which a firm belongs.
- 2.10** In CP23/27 we consulted on guidance to assist firms to apply the AAE as described in the RAO.
- 2.11** Most respondents expressed concerns regarding the lack of legal certainty in relying on guidance compared to rules. Respondents were also strongly in favour of the inclusion of a de minimis test, in line with the frameworks in other major jurisdictions, including the EU, the United States (US) and Switzerland.
- 2.12** Following the feedback received in response to our proposals in CP23/27, the Treasury laid a statutory instrument (2024 Order) that delayed the commencement date of certain provisions of the 2023 Order, including the change to remove Article 72J of the RAO, as outlined in Chapter 1. We also confirmed that the current regime would continue to apply, including delaying the repeal of RTS 20 until a permanent solution is considered. Currently only the requirement for firms to notify us annually of their use of the exemption has been removed.
- 2.13** This CP fulfils our commitment to work with the Treasury, and market participants, with the aim to develop an approach that reflects the conclusions of the WMR while also taking into consideration the concerns raised by industry.

## Regulated Activities Order exclusions

- 2.14** To be exempt from authorisation when conducting investment business, a firm needs to be able to use an exemption in MiFID and an exclusion in the UK RAO, which predates MiFID. The 'MiFID override' does not allow firms to be excluded from authorisation where exclusions from the RAO are wider than those in MiFID. Instead, firms can be required to be authorised where RAO exclusions are narrower than those in MiFID.



- 2.15** For a firm dealing as principal in commodity derivatives there are 2 main exclusions in the RAO that are relevant. First, a 'with or through' exclusion where a firm's counterparties are authorised persons ('with') or a firm's trades are arranged or intermediated by authorised or exempt persons ('through'). Second, where the trades a firm carries out are for risk management purposes.
- 2.16** For example, an electric utility firm uses derivatives to hedge the risks involved in buying gas and/or oil. It would therefore be involved in dealing on own account (MiFID) and dealing as principal (RAO) in energy derivatives. If the size of speculative activity (dealing on own account) qualifies as being ancillary to its main business, it can be exempt from authorisation as an investment firm using the AAE. However, the exclusions in the RAO from dealing as principal are narrower than the AAT. The energy company may decide to set up a separate company, which it can pass its trades through to take advantage of the 'with or through' exclusion from dealing as principal. When the electric utility firm wants to buy or sell energy derivatives, whether on a trading venue or over-the-counter (OTC), it passes an order to the entity acting as agent to take advantage of the with or through exclusion.
- 2.17** Market participants have asked if this consultation provides an opportunity to create a simpler perimeter that removes the layering between the AAT and domestic legislation. However, a commitment was made to delivering a new AAT regime by January 2027 – it was not possible to remove the MiFID override and consider the long-term implications without hindering delivery of a simplified AAT.
- 2.18** The changes in our rules relate to when a firm is an investment firm for RAO purposes, as do the Treasury's changes in its legislation. Our reform of the AAT will not change the requirement for a firm trading in commodity derivatives to consider whether it can rely on an RAO exclusion if it concludes that it is not an investment firm.

## How it links to our objectives

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### Market Integrity

- 2.19** Our proposed changes will provide greater legal certainty to firms relying on the AAE by outlining the test in rules rather than guidance. This will help provide relevant non-financial firms with confidence regarding their regulatory status when participating in UK commodity derivatives markets.
- 2.20** The AAE is an important part of the commodity derivatives regime, and it is relied on by many small and medium sized firms, as well as by some of the largest producers of commodities globally. The AAE allows these firms to manage the risk of their commercial activities through their participation in UK commodity derivatives markets without authorisation, where this would impose disproportionate costs. Without an appropriately calibrated exemption, non-financial firms could be forced to become authorised as investment firms, which could have a significant impact on their operations, capital requirements and resources, possibly discouraging participation in UK markets to the detriment of market liquidity.

- 2.21** Further, simplification of the test and changes that align with frameworks in other jurisdictions will help reduce the operational burden on relevant firms and may increase participation in UK commodity derivatives markets. This could lead to increased liquidity and better price formation, which help maintain orderly markets.

## **Secondary international competitiveness and growth objective**

- 2.22** We consider that our proposals support international competitiveness and growth of the UK in various ways:

- By introducing the option to carry out 1 of 3 different quantitative tests, which include clear and proportionate thresholds, that all aim to reduce the operational burden associated with carrying out the test.
- By introducing a framework that is broadly consistent with approaches taken in other jurisdictions.

## **Wider effects of this consultation**

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- 2.23** The UK has some of the largest commodity derivatives markets in the world. UK commodity derivatives markets provide benchmarks for the pricing of commodities internationally as well as serving the risk management needs of a wide range of financial and non-financial market participants from around the world. In doing so, they support the real economy and promote economic growth. The proposals in this consultation help support high levels of participation and liquidity in those markets, enabling them to perform their important role.
- 2.24** Our CBA provides further supportive evidence on the impact of our proposals on firms.

## **Environmental, social & governance considerations**

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- 2.25** In developing this CP, we have considered the environmental, social and governance (ESG) implications of our proposals and our duty under ss. 1B(5) and 3B(c) of the Financial Services and Markets Act (FSMA) to have regard to contributing towards the Secretary of State achieving compliance with the net-zero emissions target under section 1 of the Climate Change Act 2008 and environmental targets under s. 5 of the Environment Act 2021.
- 2.26** Overall, the AAE is designed to be proportionate and targeted. It supports legitimate risk management while keeping within our regulatory obligations and climate responsibilities. Our proposals should also support liquidity levels within the market for emission allowances, helping to maintain sound price formation and providing a broader market signal regarding the pricing of greenhouse gas emissions. Overall, we consider this to be aligned with meeting the duty set out above. We would welcome stakeholders' views on this and will keep this issue under review during the course of the consultation period and when making the final rules.

## Equality and diversity considerations

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- 2.27** We have considered the equality and diversity issues that may arise from the proposals in this CP. Our rules apply to any firm carrying on activity from an establishment in the UK, meeting one or more of the 3 tests under the AAT.
- 2.28** Overall, we do not consider that the proposals materially impact any of the groups with protected characteristics under the Equality Act 2010 (in Northern Ireland, the Equality Act is not enacted but other antidiscrimination legislation applies). We will continue to consider the equality and diversity implications of the proposals during the consultation period and will revisit them when making the final rules.
- 2.29** In the meantime, we welcome your input.

## Chapter 3

# Proposal for modifications to the Ancillary Activity Test

### The existing Ancillary Activity Exemption (AAE)

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- 3.1** Non-financial firms trading commodity derivatives for hedging purposes can benefit from an exemption from authorisation as investment firms through the AAE. The AAE is not available to firms that do not meet the relevant pre-conditions mentioned in Chapter 2, such as where the firm applies a high-frequency algorithmic trading technique.
- 3.2** Firms can benefit from the exemption where their trading activity in commodity derivatives is ancillary to their main business, which must not be the provision of investment services. Whether trading is ancillary is determined based on a firm's trading activity relative to the overall market on an asset class basis (the "market share test") and of a firm's level of speculative trading activities (the "main business test"). We summarise below how each test operates. A firm must meet both the conditions for the market share and the main business tests to benefit from the AAE.

### Market Share Test

- 3.3** The market share test determines the materiality of a firm's activity in commodity derivatives by comparing the size of a firm's trading against the overall market trading in the UK and European Economic Area. It uses different thresholds for different asset classes. The thresholds range from 3% for gas and oil to 20% for emission allowances and their derivatives. If a firm's trading activity is above any of the thresholds, it would fail the AAT.
- 3.4** Since certain transactions, such as hedging and intragroup transactions, are not included in the calculations, the market share test focuses on limiting the ability of unauthorised firms to take speculative positions that have a material footprint in the market in a particular class of commodity derivatives. Exempt non-financial firms could otherwise compete with investment firms operating in the same market on an unlevel playing field and may potentially pose a risk to market integrity.
- 3.5** Delivered through the Capital Markets Recovery Package (CMRP), in February 2022 the EU removed the market share test from its AAT. The main reason was that following the departure of the UK from the EU, the market share test couldn't operate as intended because some classes of commodity derivatives were predominantly traded in the UK. Leaving the market share test in place would have resulted in a material number of EU non-financial firms being excluded from the exemption and requiring authorisation as investment firms.

- 3.6** Those changes also affected the UK. Because of the abolition of the market share test, the European Securities and Markets Authority (ESMA) stopped publishing data on the overall trading in different commodity derivative asset classes that UK firms had been using to perform the market share test. We issued a statement in March 2022 confirming we would not publish data on the size of the market in the asset classes specified in RTS 20. To provide continuity, we also clarified that Article 72J of the RAO would continue to enable firms to rely on the UK AAE in the absence of published data on the overall size of the market, which enabled them to perform the market share test. UK firms have operated under this and other supervisory statements (mentioned in Chapter 2) since then.

## Main Business Test

- 3.7** The purpose of the main business test is to determine whether a firm's activity in commodity derivatives is ancillary to the firm's main business, assessed at the level of the group within which it operates (where applicable). There are two methods to perform the main business test: the trading test and the capital employed test. Firms can choose to apply either method in performing the test. Each method calibrates the main business test differently depending on a firm's business model.
- 3.8** The trading test measures a firm's speculative trading in commodity derivatives as a percentage of the total trading in commodity derivatives undertaken by the group in which the firm operates (where applicable).
- 3.9** Under the trading test a firm's trading activity in commodity derivatives is expected to be lower than 10% of the activities of its group. However, a firm that is above the 10% threshold may still be judged to have met the test provided it meets stricter thresholds for the market share test than typically apply. This enables a firm with a much smaller overall footprint in commodity derivative trading to remain exempt without having to perform calculations that would impose a disproportionate burden on it.
- 3.10** A second method is available under the main business test which is based on the capital employed by the firm (the capital employed test). This test offers firms flexibility where they might conduct large trading volumes to support their commercial activities, which could potentially result in them failing the trading test. The capital employed test reflects the fact that certain firms have large capital investments, such as in infrastructure (like power grids or pipelines) or production facilities (like factories or refineries). As a result, their trading activities might look large but reflect their core business – which is physical, capital-intensive, and long-term.
- 3.11** The capital-employed method compares the estimated capital employed by the firm when dealing in commodity derivatives against the actual amount of capital employed at group level for carrying out its main business. The capital employed at group level is calculated from the total assets of the group minus its current debt.
- 3.12** The threshold for the capital-employed test is set at the same level as that under the trading test at 10%.

## Analysis

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- 3.13** Since it was introduced by MiFID II in 2018, firms have been able to use the AAT with confidence. It has also delivered outcomes that are consistent with our market integrity objective. We want to maintain those positive features of the AAT. However, we want to modify it to reduce costs that it imposes on firms, especially smaller ones, because of its complexity. There are 2 main issues with the current AAT.
- 3.14** The first is that it broadly requires firms to calculate both tests under the AAT. As described above, a firm operating below the relevant threshold under the market share test, needs also to perform calculations under the main business test. This imposes unnecessary costs on smaller firms who are unlikely to account for a material portion of the activity. It also does not recognise that the potential for harm from unauthorised firms is different depending on the size of those firms, as measured by their footprint in the market.
- 3.15** The second problem arises from how the market share test is calculated. It requires firms to compare their activity against the total amount of activity in the market for the relevant classes of commodity derivatives. That figure is calculated as a rolling average over the course of three years, and it requires the aggregation of data on the trading of commodity derivatives across trading venues and OTC for each commodity type. The inevitable variation in trading activity for each market creates uncertainty as to the continued ability of the firm to benefit from the exemption over time and the calculation is overly complex.

### Annual threshold (de minimis test)

- 3.16** Earlier this year, we held discussions with relevant market participants on the framework for the UK AAT. There was strong support for broad alignment of our AAT framework with the EU, particularly the inclusion of a de minimis test. This test would enable firms that undertake trading in commodity derivatives on a smaller scale (i.e. below a fixed monetary threshold) to use the AAE. Many market participants are active on both UK and EU markets, and we heard that a similar regime would help reduce the operational burden on firms carrying out the test in both jurisdictions.
- 3.17** The Treasury is now making changes to legislation that would enable us to establish an annual threshold test.
- 3.18** Market participants suggested aligning the threshold for a de minimis test with the UK EMIR clearing threshold, but with the currency set in Pound Sterling (GBP) or US Dollar (USD). Some market participants prefer GBP over USD because their firms largely operate and maintain their accounts in GBP, even though USD is the currency in which most commodities trade. Further, one market participant said that the currency should be determined by the location of the trading activity in scope, for example, trading activity in the UK would support using GBP, while global trading activity would support using USD. Finally, it was recommended that where conversion might be necessary, our rules should specify what acceptable currency conversion methods can be used to harmonise the calculation and facilitate compliance.

- 3.19** To assess how the inclusion of an annual threshold test, set at the level of the UK EMIR clearing threshold, might affect the scope of the perimeter, we compared firms currently exempt under the AAE with firms that have notified us that they exceed the UK EMIR clearing threshold of EUR 3 billion (bn). The clearing threshold applies to the gross notional value of the 12-month average aggregate group position in OTC commodity derivatives. Around 90% of the firms currently benefitting from the AAE had not notified us that they were above the UK EMIR clearing threshold. This means that those firms would very likely be able to continue to use the AAE if the annual threshold was set at a similar level to the UK EMIR clearing threshold. The remaining 10% of firms that may fail the annual threshold test would still be capable of using the AAE on the basis of other available alternative tests.
- 3.20** There are significant differences in how a firm determines whether its notional exposure exceeds the EMIR clearing threshold compared to the EU's de minimis threshold for the AAT. The EU's de minimis test requires a firm to calculate its notional exposure on a net basis, while very limited netting is permissible in relation to the EMIR clearing threshold. Also, differently from the EMIR clearing threshold, the EU's de minimis test excludes derivatives that can only be physically settled. This means that only commodity derivatives which must be settled in cash or may be settled in cash at the option of one of the counterparties (except in the case of a default or other termination event) are included in the calculation against the de minimis threshold.
- 3.21** Further, the EU de minimis test excludes any positions originating from transactions executed on a trading venue, that is exchanges, Organised Trading Facilities (OTFs) and Multilateral Trading Facilities (MTFs).
- 3.22** The approach is in some way similar to the swap dealer test in the US with respect to the exclusion of derivatives traded on US exchanges (Designated Contract Markets) as only swap trading activity counts towards the swap dealer de minimis exemption, set at \$8bn (however, activity on Swaps Execution Facilities would still be included).
- 3.23** Some market participants recommended using the same **approach** for a de minimis test as that used in the EU and the US, which broadly only consider cash-settled OTC contracts. In addition to minimising costs, adopting the same approach would be consistent with the MiFID perimeter which already excludes certain physically settled contracts. They also flagged with respect to the **methodology** that in their view the netting method under EMIR is narrower and more complex as it only permits limited netting with the same counterparty, commodity, and maturity. As a result, it would be more difficult for firms to stay below the threshold, potentially expanding the scope of the perimeter.

**3.24** When assessing whether a firm exceeds the EMIR clearing threshold, netting is only allowed at the counterparty level and only for contracts that have identical characteristics, such as the contract type, underlying asset, and maturity. Below, we outline the key differences between the methodology used for the EMIR clearing threshold and that used for the EU de minimis test:

Feature	EU de minimis test	EMIR clearing threshold
Basis of calculation	Net basis at a firm level	Gross basis at group level
Netting allowed?	Yes	Only limited netting is permitted
Exclusion for physically settled trades	Yes	No

**3.25** We recognise that trading in cash-settled contracts is more likely to be associated with speculative trading than that in physically settled contracts (which are more likely linked to a firm's underlying commercial activities). Physically settled contracts are typically used by commodity producers, distributors, and consumers, where trading in commodity derivatives supports – and is ancillary to – their core commercial activities. The inclusion of physically settled contracts may also result in inconsistencies in the way firms apply calculations.

**3.26** On the other hand, the assessment referred to in paragraph 3.19 looked at notifications by relevant non-financial firms above the clearing threshold, for which trading activity is considered on a gross group basis in both cash and physically settled commodity derivatives. This suggests that a substantial proportion of firms using the AAE would continue to rely on it if a threshold test set at a cash level similar to the UK EMIR clearing threshold were to be introduced. However, using the list of firms that have notified us for the purposes of the AAE and that are currently below the EMIR threshold should not be used as a precise prediction of how the introduction of a de minimis test set at that threshold would impact UK firms. Below we provide further detail on the indicative impact using data analysis.

**3.27** Our starting position is to adopt the same methodology as the EU de minimis test. We believe that introducing a de minimis test – using a similar methodology as the EU – offers several advantages. It provides a straightforward approach that is suitable for firms with a limited footprint in commodity derivatives markets, in terms of complexity and resource demands. It also promotes consistency with other international regulatory regimes by using a threshold and calculation method that many firms are already familiar with. This helps reduce the operational burden on firms when carrying out the test and supports advancing our secondary competitiveness and growth objective. Additionally, it would likely achieve the same regulatory outcome as the current market share test but without requiring the annual publication of market data.

**3.28** However, that methodology excludes trading activity conducted on trading venues. The structure of UK markets differs from that of the EU given the relevance of certain commodity derivatives markets on UK trading venues. Applying the same approach in the UK would result in a significant proportion of trading activity being excluded from



the calculation. Our analysis shows that this approach would exclude around 80% of UK commodity derivatives trading as, except in the case of 2022, cash-settled OTC commodity derivatives have accounted for only around 20% of total market volume.

- 3.29** We recognise that including activity conducted on UK trading venues may have implications for firms using the AAE. We conducted analysis to understand better the potential impact. Our analysis, based on data reported to us and publicly available information, shows that only a small number of firms currently using the AAE have gross notional exposures, across both OTC markets and trading venues, exceeding GBP 3 bn, the UK EMIR clearing threshold in sterling. This analysis covered all activity, including that which would otherwise be excluded from the assessment against the threshold, such as intra-group trades, hedging and trades entered as a liquidity provider. As such, we expect that firms' net notional exposures, after these exclusions, to be lower than what we observed.
- 3.30** We also calculated net notional exposures for these firms and estimated the level of hedging activity done by each firm using commodity derivatives position reporting data. Our analysis confirmed that almost all firms currently using the AAE could continue to do so under a GBP 3 bn threshold.
- 3.31** We discussed with market participants the possible impact of including trading activity conducted on a trading venue in the threshold methodology. Many argued that including such activity could potentially put UK trading venues at a competitive disadvantage relative to other jurisdictions. It could discourage market participants from using UK trading venues to remain below the threshold, which may negatively affect market liquidity. One said that including on-venue trading activities in line with the treatment of OTC contracts, but excluding physically-delivered contracts, could create an unlevel playing field for markets where contracts are predominantly cash-settled.
- 3.32** Many said that such an approach would require a higher threshold to ensure that the same outcomes are achieved under the new test. Firms also highlighted the importance that the threshold is set in a prudent way by factoring in unexpected market shocks, such as from geopolitical factors, which could temporarily push firms' notional exposure above it. Some firms told us that they would usually operate at about 30% below the set threshold to cater for such events.
- 3.33** We want to simplify the test, whilst aiming to achieve the same outcomes as under the previous test and for the test to be robust to potential risks to our markets from unauthorised firms. We want our approach to be sufficiently flexible to allow for periods of market volatility and support the UK's leading position as a global centre for commodities trading.
- 3.34** We recognise that our rulebook provides mitigation tools that apply equally to authorised and unauthorised firms, like the commodity derivatives position limits regime or various reporting requirements. However, they do not replace the need for authorisation where the scale and type of activity is significant. Including trading activity conducted on trading venues in the AAT ensures firms that are materially active – even if primarily on-venue – are subject to appropriate authorisation and oversight where the activity is predominantly speculative.

- 3.35** We are of the view that the **available exclusions**, such as for hedging activity and physically delivered contracts, in line with the treatment of OTC contracts, would help ensure that firms that currently benefit from the AAT can continue to do so in the future. We acknowledge the concern that excluding physically delivered contracts could be seen as creating an unlevel playing field, particularly for markets where contracts are predominantly cash-settled. However, the exclusion is intended to reflect their typical use in commercial hedging rather than speculative trading. This approach is consistent with the overall objective of the AAE and also with the approach taken in the EU.
- 3.36** We see a case for including trading conducted on UK trading venues, but only if the approach adopted effectively supports the functioning of those markets. We believe that there are 2 **approaches** that would achieve the policy objective of ensuring that the AAT factors in activity carried out on trading venues while preserving the same outcomes of the current exemption so that non-financial firms can continue to participate in UK commodity derivatives markets.
- 3.37** Under the **first approach**, we would maintain the same methodology as the EU de minimis test but include all activity on trading venues. To mitigate the risk that firms that are currently carrying out activity legitimately under the current AAT need to seek authorisation, we propose to set a higher threshold to account for the wider range of activity captured in the calculation.
- 3.38** Under the **second approach**, we would maintain the same threshold but permit firms to exclude positions that arise from trades conducted on a trading venue where a) the counterparty to the firm seeking to use the AAE is an authorised firm or b) a trade is executed by an authorised broker acting on behalf of the firm seeking to use the AAE.
- 3.39** The first approach captures more comprehensive trading activity, reflecting firms' full market involvement and is simpler to administer without needing tracking of trades against different counterparty types. However, it does not factor in the different risk from positions for which UK authorised firms retain a degree of oversight and responsibility in the transaction.
- 3.40** The second approach is more sensitive to the risks above as it excludes trading activity of non-financial firms that they conduct with UK authorised counterparties or through authorised brokers where their regulatory status and obligations provides additional protections to market integrity. However, it is also more complex to administer.
- 3.41** We would be interested in hearing more about the potential advantages and disadvantages of each option. Well-informed responses and data will be key to informing our final decision.
- 3.42** Separately, we note that any threshold would need to account for inflation and market volatility and consider it appropriate to include a reasonable risk margin for this purpose.

### Trading test and capital-employed test

- 3.43** We also reviewed how the trading test and the capital employed test operate. Consistent with the reasons outlined above under the main business test, we continue

to believe that they provide appropriate tests for firms to assess whether their trading activities qualify as ancillary.

- 3.44** Firms currently use either test depending on their size and the complexity of their operations. When these tests were introduced, firms allocated resources and set up the necessary systems required to carry out the tests. Based on the market feedback received, firms continue to support retaining both tests and the current calculation methodology. Firms stated that both tests are working well but to remove complexity suggest that we review the thresholds and consider aligning them with the EU.
- 3.45** In our view, setting the thresholds for the trading and the capital employed tests at 50% and using the same calculation methodology currently used would ensure that only firms for which dealing in commodity derivatives constitute a minority of their business will benefit from it. It will also deliver the desired simplification.

## Proposal

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- 3.46** In line with changes the Treasury has legislated for, we propose to establish 3, separate and independent, tests to assess whether a firm can use the AAE.
- 3.47** The 3 tests are as follows:
- a.** A new annual threshold test (de minimis), which will allow firms that undertake commodity derivatives trading on a small scale to be exempted from authorisation. It replaces the current market share test.
  - b.** The existing trading test (currently part of the main business test) with some modifications.
  - c.** The existing capital employed tests (currently part of the main business test) with some modifications.
- 3.48** Firms may benefit from the AAE where they meet 1 of the 3 tests mentioned above.
- 3.49** For all the above tests, intra-group transactions, hedging transactions and transactions entered into as part of an agreement to provide liquidity on a trading venue are excluded from the calculations. The definition of hedging transactions will remain consistent with that set out in RTS 20, and the commodity derivatives regulatory framework outlined in PS25/1.

### Annual threshold (de minimis test)

- 3.50** We propose to introduce an annual threshold test with the assessment based on whether a firm's outstanding notional exposure in commodity derivatives is below a fixed monetary threshold. The assessment would include OTC derivatives. For derivatives traded on a UK trading venue, that is Recognised Investment Exchanges OTFs and MTFs, we see a case for including this activity, as outlined above. However, our decision on whether to include these derivatives will depend on the evidence-based feedback we receive. Our decision will be guided by whether either approach outlined

below effectively supports continued growth in participation on UK trading venues, and whether it could give rise to any unintended consequences. In the context of our draft rules, we have specified that activity conducted on trading venues shall be included in the assessment.

- 3.51** This exposure should be calculated on a net basis, using the average of the aggregated month-end outstanding notional values over the previous 12 months. The calculation shall only include cash-settled commodity derivatives. Cash-settlement refers to contracts that are either required to be cash-settled or may be cash-settled. Contracts traded on Recognised Overseas Investment Exchanges and third country trading venues shall not be included in this calculation. In addition, intra-group transactions, hedging transactions and transactions entered into as part of an agreement to provide liquidity on a trading venue are excluded from the calculations.
- 3.52** As discussed above, we invite views on the inclusion of commodity derivatives traded on UK trading venues. Our decision on this, alongside our intended outcome that the scope of the AAE remains unchanged, will dictate what the appropriate threshold should be. Accordingly, we seek views as to whether a **threshold set at GBP 3 bn** that excludes all transactions where the counterparty is a UK-authorised firm, or where the transaction is executed by a UK authorised broker on behalf of the firm seeking to rely on the AAE is preferable to raising the **threshold to GBP 5 bn** which includes all cash-settled positions in derivatives traded on UK trading venues. **We would welcome evidence-based responses on the thresholds supported by data.**
- 3.53** We propose to retain the netting method prescribed in RTS 20 for the capital employed test and apply it to the annual threshold test. This aligns with the approach in the EU's de minimis test.
- 3.54** We propose that the calculation be determined by reference to the 3 relevant calculation periods preceding the date of calculation where the average of the resulting annual values should be compared with the threshold.
- 3.55** We recognise there may be a potential need to adjust the threshold in the future to cater for changes in market conditions. This would require consultation, which we consider to be the appropriate way of making such adjustments. However, there may be other factors, such as inflation, for which we could embed a mechanism within our rules to adjust the threshold accordingly. The advantages of such an approach are that the threshold remains unchanged in real terms. However, the disadvantage is that it is unclear that inflation is the appropriate proxy of the size of nominal positions taken by firms where changes in prices of the underlying commodities are likely to be more relevant. Moreover, embedding such an adjustment in our rules could increase complexity for firms as they need to comply with an annual threshold that changes periodically. We are interested in views on whether our rules should include a mechanism to make this type of adjustment or whether we should just use the standard consultation process to review the annual threshold.

## Trading test and capital-employed test

- 3.56** We propose to maintain the methodology set in RTS 20 for calculating the trading and capital employed tests. However, we propose to change the applicable thresholds by setting both at 50%. This level would be consistent with the aim of limiting the use of the exemption to firms whose business is predominantly commercial.
- 3.57** We propose that for the purposes of determining whether a person should be authorised in the UK calculations should look at activity traded in the UK. For both tests the comparison is to group activity which can include the activity of entities located in the UK and outside of the UK. For the trading venue test, the group's activities will include for UK based entities their OTC trading activity and trading conducted on UK trading venues and for non-UK based entities their trading conducted on UK trading venues. For the capital employed test, the group's activities will be capital employed on a world-wide basis, not just within the UK.
- 3.58** We propose that the calculation for both tests continue to be carried out annually using a 3-year rolling average.

## Frequency

- 3.59** We are proposing that non-financial firms must meet the conditions set out in any of the 3 tests on an annual basis to be able to use the AAE.

## Currency conversion

- 3.60** Currency conversion is necessary, for example, when converting notional exposure in USD to GBP under the annual threshold test. According to our proposed guidance, firms should use the Bank of England rate or another reputable source. Where, for example, the average of the aggregated month-end outstanding notional value is calculated, the relevant month-end rate should be used for each of the previous 12 months.

## Implementation of the new AAT

- 3.61** In the feedback received in response to CP23/27, respondents were concerned that there may be insufficient time for those firms which are unable to rely on the AAE to obtain the necessary authorisation given that HMT intended to remove Article 72J of the RAO and the transitional relief it provided. Treasury has decided to maintain Article 72J for 12 months and will commence its revocation on 1 January 2028.

**Question 1:** Do you agree with the approach outlined above to allow firms to choose one of the following tests: i) annual threshold test ii) trading test iii) capital employed test? If not, please explain why.

**Question 2:** Do you consider that trading conducted on a trading venue should be included in the annual threshold test? Please provide your rationale.

- Question 3:** If the annual threshold test incorporates trading conducted on a trading venue, which option do you prefer from paragraph 3.37 and 3.38, approach 1 or 2? Further, do you agree with the level of the threshold proposed in respect of each option in paragraphs 3.52? If not, please explain why.
- Question 4:** Regarding the annual threshold, do you agree with the following proposals:
- a. currency of the threshold and,
  - b. the methodology (outside of trades conducted on a UK trading venue) for calculating a firm's net notional exposure?
- If not, please explain why.
- Question 5:** Are there circumstances in which the annual threshold might need to be quickly amended, even with the inclusion of a reasonable risk margin (based on internal data analysis)? If yes, please explain.
- Question 6:** Should our rules include a mechanism that adjusts the annual threshold due to certain factors, such as inflation? If so, please suggest on what basis this could be achieved and how frequently reviews and updates might be needed.
- Question 7:** Do you agree with the proposal to retain the calculation methodology of the trading test and to raise the threshold? If not, please explain why.
- Question 8:** Do you agree with the proposal to retain the calculation methodology for the capital-employed test and to raise the threshold? If not, please explain why.

## Annex 1

### Questions in this paper

- Question 1:** Do you agree with the approach outlined above to allow firms to choose one of the following tests: i) annual threshold test ii) trading test iii) capital employed test? If not, please explain why.
- Question 2:** Do you consider that trading conducted on a trading venue should be included in the annual threshold test? Please explain your rationale.
- Question 3:** If the annual threshold test incorporates trading conducted on a trading venue, which option do you prefer from paragraph 3.37 and 3.38, approach 1 or 2? Further, do you agree with the level of the threshold proposed in respect of each option in paragraphs 3.52? If not, please explain why.
- Question 4:** Regarding the annual threshold, do you agree with the following proposals:
- a. currency of the threshold and,
  - b. the methodology (outside of trades conducted on a UK trading venue) for calculating a firms net notional exposure?
- If not, please explain why.
- Question 5:** Are there circumstances in which the annual threshold might need to be quickly amended, even with the inclusion of a reasonable risk margin (based on internal data analysis)? If yes, please explain.
- Question 6:** Should our rules include a mechanism that adjusts the annual threshold due to certain factors, such as inflation? If so, please suggest on what basis this could be achieved and how frequently reviews and updates might be needed.
- Question 7:** Do you agree with the proposal to retain the calculation methodology of the trading test and to raise the threshold? If not, please explain why.
- Question 8:** Do you agree with the proposal to retain the calculation methodology for the capital-employed test and to raise the threshold? If not, please explain why.

## Annex 2

# Cost benefit analysis

1. The Financial Services and Markets Act (2000) requires us to publish a cost benefit analysis (CBA) of our proposed rules. Specifically, section 138I requires us to publish a CBA of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made'.
2. FSMA does not, however, require us to publish a CBA where our consultation paper is proposing new rules that we believe will involve either no cost increase or where the increase will be of 'minimal significance' (compared to a scenario of no FCA intervention).
3. For the proposals presented here, we do not think that there will be costs of more than minimal significance and therefore we have not undertaken a CBA. Our proposed changes to the Ancillary Activities Test (AAT) do not attempt to modify the regulatory perimeter to bring in more persons into authorisation than is the case under current MiFID-based tests. They aim to simplify the regime and address the deficiencies caused by the absence of the data (formerly provided by ESMA) to perform the current 'market share' test by introducing an annual threshold test. The proposals also aim to make the other tests under the AAT simpler for firms to perform.
4. Currently around 110 firms benefit from the exemption. Potentially some costs could arise for these firms from our proposals from two sources: an increase in costs from undertaking the tests, or any increase in costs from regulation if fewer firms can pass the test. However, as we set out below, we believe such costs are minimal.
5. The proposal could change the number of firms that can use the exemption, and potentially create new costs. Firms that can no longer use the exemption will need to be authorised and regulated by us as an investment firm. However, we do not think that there will be a material change in the number of firms that can use the exemption based on analysis of firms' trading levels.
6. The vast majority of firms currently using the exemption are below the proposed annual threshold. Of the remainder, we expect many of these firms will be able to use one of the other tests to qualify for an exemption and therefore not incur new costs. For firms to be eligible for the AAT they need to meet the following criteria:
  - that do not execute orders on behalf of clients by dealing on own account unless the client is a client or supplier of the group's main business.
  - do not use a high-frequency algorithmic trading technique.
  - that the main business of a firm's group is not the provision of investment services, services requiring authorisation as a bank, or acting as a market maker in commodity derivatives.
7. Relevant firms that meet these criteria can meet the trading and/or capital employed test and therefore benefit from the exemption regardless of the proposals on the annual threshold test. Consequently, we do not think there will be a reduction in the number of



firms eligible to use the exemption which would otherwise result in them either incurring costs, or having to change their activity to enable them to pass the test.

8. We have also considered whether there would be wider effects on the UK trading volumes and market participation. Industry participants have indicated that firms will have an incentive to trade outside UK trading venues if the annual threshold test includes activity carried out on those trading venues. This would impose a cost on UK trading venues as they lose market share to foreign trading venues. In our view, the effect of our proposals on commercial firms currently benefitting from the exemption to divert trades to other trading venues will depend on the calibration of the parameters. We considered 2 possible ways to mitigate that risk by either setting the annual threshold to GBP 5 bn or by excluding transactions executed with counterparties authorised by us or executed by them on behalf of commercial firms. Our analysis of firm's outstanding notional exposure in commodity derivatives shows that most firms will be able to rely on the new annual threshold test and therefore they will not have an incentive to divert trades. Conversely, we do not think there are any firms that would avoid being regulated by diverting their trading activities. However, we will assess our analysis in light of quantitative evidence provided by respondents. We remain open to excluding on-venue positions, if we see evidence that their inclusion would affect the attractiveness of UK trading venues.
9. With respect to benefits, the rules changes will make the tests easier for firms to perform and increase regulatory certainty when using the exemption. Consequently, the time and resources used to consider the results of the test and ensure that the exemption is being used appropriately are likely to be lower compared to the status quo. While these are tangible benefits, we do not think these savings will be material for the 110 firms currently using the exemption, or any other firms not using the exemption currently doing the test.

## Annex 3

# Compatibility statement

## Compliance with legal requirements

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1. This Annex records the FCA's compliance with a number of legal requirements applicable to the proposals in this consultation, including an explanation of the FCA's reasons for concluding that our proposals in this consultation are compatible with certain requirements under the Financial Services and Markets Act 2000 (FSMA).
2. When consulting on new rules, the FCA is required by section 138I(2)(d) FSMA to include an explanation of why it believes making the proposed rules (a) is compatible with its general duty, under section 1B(1) FSMA, so far as reasonably possible, to act in a way which is compatible with its strategic objective and advances one or more of its operational objectives, (b) so far as reasonably possible, advances the secondary international competitiveness and growth objective, under section 1B(4A) FSMA, and (c) complies with its general duty under section 1B(5)(a) FSMA to have regard to the regulatory principles in section 3B FSMA. The FCA is also required by s 138K(2) FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.
3. This Annex also sets out the FCA's view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (section 1B(4)). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.
4. In addition, this Annex explains how we have considered the recommendations made by the Treasury under s 1JA FSMA about aspects of the economic policy of His Majesty's Government to which we should have regard in connection with our general duties.
5. This Annex includes our assessment of the equality and diversity implications of these proposals.
6. Under the Legislative and Regulatory Reform Act 2006 (LRRRA) the FCA is subject to requirements to have regard to a number of high-level 'Principles' in the exercise of some of our regulatory functions and to have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). This Annex sets out how we have complied with requirements under the LRRRA.

## **The FCA's objectives and regulatory principles: Compatibility statement**

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- 7.** The proposals set out in this consultation are primarily intended to advance the FCA's operational objective of market integrity as described in Chapter 2. We also consider these proposals are compatible with the FCA's strategic objective of ensuring that relevant markets function well. For the purposes of the FCA's strategic objective, 'relevant markets' are defined by section 1F FSMA.
- 8.** As outlined in Chapter 2 of this consultation paper, our proposed changes are aimed at simplifying the regime while providing greater legal certainty to relevant non-financial firms relying on the AAE when carrying out activities in UK commodity markets. Non-financial firms will be able to determine their regulatory status with confidence through our changes, which aim to also reduce the operational burden on relevant firms. The exemption is important as it allows the relevant firms to manage the risk of their commercial activities by accessing the UK commodity derivatives markets.
- 9.** Without an appropriately calibrated exemption, non-financial firms could be forced to become authorised as investment firms, which could have a significant impact on their operations, capital requirements and resources, possibly discouraging participation in UK markets to the detriment of market liquidity.
- 10.** We consider these proposals comply with the FCA's secondary objective in advancing competitiveness and growth as outlined in Chapter 2 because simplifying the test and changes that align with frameworks in other jurisdictions help reduce the operational burden on firms and may increase participation in the UK commodity derivatives markets, which in turn, supports the UK's international competitiveness and growth.
- 11.** In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in s 3B FSMA.

## **The need to use our resources in the most efficient and economic way**

- 12.** The proposals set out in this consultation are consistent with an efficient and economic use of our resource. The proposals will, if adopted, deliver a regime that allows firms to rely on the exemption with legal certainty through a simplified rule-based test.

## **The principle that a burden or restriction should be proportionate to the benefits**

- 13.** As set out in the cost benefit analysis we have estimated the costs and benefits of our proposals. We are satisfied that the net benefits of these proposals outweigh and justify the costs.

**The need to contribute towards achieving compliance by the Secretary of State with section 1 of the Climate Change Act 2008 (UK net zero emissions target) and section 5 of the Environment Act 2021 (environmental targets)**

14. In developing our proposals, we had regard to our duty towards achieving compliance with the net-zero emissions target. Overall, the AAE is designed to be proportionate and targeted. It supports legitimate risk management while keeping within our regulatory obligations and climate responsibilities. We will keep this issue under review during the course of the consultation period and when making the final rules.

**The general principle that consumers should take responsibility for their decisions**

15. The proposals do not depart from the general principle that consumers take responsibility for their decisions.

**The responsibilities of senior management**

16. Our proposals do not specifically relate to the responsibilities of senior management. Nevertheless, we have had regard to this principle and do not consider that our 76 proposals undermine it.

**The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons including mutual societies and other kinds of business organisation**

17. In preparing these proposals, we have spoken to a wide range of market participants to which the AAE regime is applicable or may impact. This has been done to seek to ensure that our proposals recognise differences, and objectives of, businesses carried on by different persons and their interest in how the new regime will operate.

**The desirability of publishing information relating to persons subject to requirements imposed under FSMA, or requiring them to publish information**

18. Firms are no longer required to notify us on an annual basis if they are exempt under the AAE regime. In our proposal, firms are exempt if they are within the thresholds for any of the three tests under the AAT. Firms should be able to demonstrate to us how they meet the test, if required.

**The principle that we should exercise of our functions as transparently as possible**

19. Our consultation processes are intended to ensure that we are transparent about the thinking behind our proposals and clearly explain what we expect to achieve. We believe that this consultation meets these objectives. We have also spoken to a wide range of market participants in developing these proposals for rules changes.

- 20.** In formulating these proposals, we had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by s 1B(5)(b) FSMA).

## Expected effect on mutual societies

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- 21.** The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies.

## Compatibility with the duty to promote effective competition in the interests of consumers

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- 22.** In preparing the proposals as set out in this consultation, we have had regard to the FCA's duty to promote effective competition in the interests of consumers.

## Equality and diversity

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- 23.** We are required under the Equality Act 2010 in exercising our functions to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, to and foster good relations between people who share a protected characteristic and those who do not.
- 24.** As part of this, we ensure the equality and diversity implications of any new policy proposals are considered. The outcome of our consideration in relation to these matters in this case is stated in Chapter 2 of this consultation.

## Legislative and Regulatory Reform Act 2006 (LRRRA)

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- 25.** We have had regard to the principles in the LRRRA for the parts of the proposals that consist of general policies, principles or guidance and consider that they are proportionate and consistent with the need for increased transparency.
- 26.** We have had regard to the Regulators' Code for the parts of the proposals that consist of general policies, principles or guidance and consider that the proposals are proportionate to the potential market failures identified.

## HM Treasury's remit letter

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- 27.** We have considered the content of HM Treasury's November 2024 remit letter. Our view is that our consultation proposals seek to address the concerns in the remit letter by delivering a simplified regime that provides legal clarity and certainty and reduces the operational burdens on relevant firms.
- 28.** We are seeking to set a regime that provides legal certainty to firms by proposing rules that provide quantitative criteria for firms to assess whether they can use the AAE. This approach provides legal certainty to firms regarding their regulatory status when participating in UK commodity derivatives markets. Our proposals also seek to simplify the AAT which is currently overly complex which will help reduce the operational burden on relevant firms and may increase participation in UK commodity derivatives markets. This will assist government in achieving its mission to grow the economy as set out in the letter.

## Annex 4

# Abbreviations used in this paper

Abbreviation	Description
<b>2023 Order</b>	The Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) Order 2023
<b>2024 Order</b>	The Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) (Amendment) Order 2024
<b>AAE</b>	Ancillary Activities Exemption
<b>AAE</b>	Ancillary Activities Test
<b>Bn</b>	Billion
<b>CBA</b>	Cost benefit analysis
<b>CMRP</b>	Capital Markets Recovery Package
<b>CP</b>	Consultation Paper
<b>CP23/27</b>	Consultation Paper on Reforming the commodity derivatives regulatory framework
<b>ESG</b>	Environmental, Social and Governance
<b>ESMA</b>	European Securities and Markets Authority
<b>EU</b>	European Union
<b>EUR</b>	Euro
<b>FSMA</b>	Financial Services and Markets Act
<b>GBP</b>	Pound Sterling
<b>LRRA</b>	Legislative and Regulatory Reform Act 2006
<b>MiFID</b>	Markets in Financial Instruments Directive
<b>MiFID II</b>	The second Markets in Financial Instruments Directive
<b>MTF</b>	Multilateral Trading Facility
<b>OTC</b>	Over-the-counter

Abbreviation	Description
<b>OTF</b>	Organised Trading Facility
<b>PS25/1</b>	Policy statement on Reforming the commodity derivatives regulatory framework
<b>RAO</b>	Regulated Activities Order
<b>RTS 20</b>	UK version of Commission Delegated Regulation 2017/592
<b>SICGO</b>	Secondary International Competitiveness and Growth
<b>UK</b>	United Kingdom
<b>UK EMIR</b>	UK version of European Market Infrastructure Regulation
<b>US</b>	United States
<b>USD</b>	United States Dollar
<b>WMR</b>	Wholesale Markets Review



## Annex 5

# Derivation and Changes Table

Source of provision –MiFID RTS 20	Handbook Reference	Subject matter	Policy change/HSD <sup>1</sup> / other comment
Article -2	MAR 10A.1.3	Application	Transferred to FCA Handbook with changes having regard to statutory tests in Schedule 3 RAO.
Article -1	Amendments to <i>Glossary</i>	Interpretation of definitions	Transferred to FCA Handbook with HSD changes having regard to statutory tests in Schedule 3 RAO.
Article 1	Not transferred	Application of thresholds	Transferred to FCA Handbook with policy changes having regard to statutory tests in Schedule 3 RAO including new annual threshold test and ancillary activity tests [see commentary relating to article 3 below].
Article 2	Not transferred	Overall market threshold	Assimilated law revoked without restatement.
Article 3	MAR 10A.2 & 10A.3	Main business threshold	Transferred to FCA Handbook with policy changes including (1) increasing thresholds relating to what constitutes a minority of activities at group level in relation to trading test and capital employment test; and (2) removing derogations with link to revoked market share test.

<sup>1</sup> 'HSD' means handbook style drafting. The term is used to denote instances where assimilated law has been transferred to the handbook with minor drafting changes that do not amount to a change in policy.

Source of provision –MiFID RTS 20	Handbook Reference	Subject matter	Policy change/HSD <sup>1</sup> / other comment
Article 4	MAR 10A.4	Procedure for calculations	Transferred to FCA Handbook with policy changes. Maintaining use of three-year accounting period for purpose of annual calculations and applying the same to new threshold test; omitting derogations relating to use of most recent calculation period and remaining link to market share test; introducing protection of regulatory status during the period in which firms perform annual calculation in accordance with MAR 10A.
Article 5	Amendments to <i>Glossary</i>	Transactions qualifying as reducing risks	Transferred to FCA Handbook with changes as contained in the new Glossary definition of <i>excluded positions</i> .

# Appendix 1

## Draft Handbook text

**COMMODITY DERIVATIVES (ANCILLARY ACTIVITY EXEMPTION)  
INSTRUMENT 2025**

**Powers exercised**

- A. The Financial Conduct Authority (“the FCA”) makes this instrument in the exercise of the following powers and related provisions in or under:
- (1) paragraph 2A of Part 1 of Schedule 3 to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544); and
  - (2) section 139A (Power of the FCA to give guidance) of the Financial Services and Markets Act 2000 (“the Act”).
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

**Commencement**

- C. This instrument comes into force on *[date]*.

**Interpretation**

- D. In this instrument, any reference to any provision of assimilated direct legislation is a reference to it as it forms part of assimilated law.

**Amendments to the Handbook**

- E. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- F. The Market Conduct sourcebook (MAR) is amended in accordance with Annex B to this instrument.

**Amendments to material outside the Handbook**

- G. The Perimeter Guidance manual (PERG) is amended in accordance with Annex C to this instrument.

**Citation**

- H. This instrument may be cited as the Commodity Derivatives (Ancillary Activity Exemption) Instrument 2025.

By order of the Board  
*[date]*

## Annex A

### Amendments to the Glossary of Definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless stated otherwise.

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

[*Editor's note:* This Annex takes into account the proposals and legislative changes suggested in the consultation paper 'The MiFID Organisational Regulation' (CP24/24) as if they were made final.]

<i>ancillary activity exclusion</i>	the exclusion from the definition of investment firm in paragraph 1(k), when read with paragraph 1A(a) of Schedule 3 to the <i>Regulated Activities Order</i> .
<i>excluded positions</i>	positions from contracts resulting from: <ul style="list-style-type: none"> <li>(a) intra-group transactions as referred in Article 3 of <i>EMIR</i> that serve group-wide liquidity or risk management purposes;</li> <li>(b) transactions in <i>commodity derivatives</i> or <i>emission allowances</i> which are objectively measurable as reducing risks directly relating to commercial activity or treasury financing activity:               <ul style="list-style-type: none"> <li>(i) in accordance with the criteria in <i>MAR</i> 10.2.7R(1) to (2) and (10); or</li> <li>(ii) which cover the risks arising from the potential indirect impact on the value of assets, services, inputs, products, <i>commodities</i> or liabilities referred to in (i), resulting from fluctuation of interest rates, inflation rates, foreign exchange rates or credit risk;</li> </ul> </li> <li>(c) transactions in <i>commodity derivatives</i> and <i>emission allowances</i> entered into to fulfil obligations to provide liquidity on a <i>UK trading venue</i>, where such obligations are required by:               <ul style="list-style-type: none"> <li>(i) regulatory authorities in accordance with <i>UK law on markets in financial instruments</i>; or</li> <li>(ii) <i>UK trading venues</i>; and</li> </ul> </li> <li>(d) contracts where the <i>person</i> within the <i>group</i> that is a party to any of them is an <i>FCA-authorised firm</i>.</li> </ul>
<i>FCA-authorised firm</i>	a <i>firm</i> , to which section 424A of the <i>Act</i> applies, <i>authorised</i> to provide <i>investment services or activities</i> .

<i>non-UK trading venue</i>	a <i>trading venue</i> other than a <i>UK trading venue</i> .
<i>relevant calculation period</i>	a calculation period which starts on 1 January of a given year and ends on 31 December of that year.
<i>short-term debt</i>	debt with a maturity of less than 12 <i>months</i> as recorded in the consolidated financial statements of the <i>group</i> at the end of the <i>relevant calculation period</i> .

Amend the following as shown.

<i>commodity</i>	...
	(3) (in relation to the <i>UK</i> provisions which implemented <u>or correspond to MiFID or MiFIR, and MAR 10 and MAR 10A</u> ) any goods of a fungible nature that are capable of being delivered, including metals and their ores and alloys, agricultural products, and energy such as electricity.
	...
<i>emission allowance</i>	...
	(3) (in <i>MAR 10</i> <del>(Commodity derivative position limits and controls and position reporting)</del> <u>and MAR 10A</u> ) in addition to (1) any derivative of such an allowance, <del>whether falling under paragraph (4) or (10) of Section C of Annex I of MiFID</del> Part 1 of Schedule 2 to the <i>Regulated Activities Order</i> .
<i>market maker</i>	...
	(2) (in <i>COBS</i> and <u>MAR 10A</u> ) a <i>person</i> who holds himself or herself out on in the financial markets on a continuous basis as being willing to deal on own account by buying and selling <i>financial instruments</i> against that <i>person's</i> proprietary capital at prices defined by that <i>person</i> .
	[Note: article 4(1)(7) of <i>MiFID</i> ]
	...
<i>trading venue</i>	(1) (except in <i>FINMAR</i> and <u>MAR 10A</u> ) a <i>regulated market</i> , an <i>EU regulated market</i> , an <i>MTF</i> or an <i>OTF</i> .
	...

- (3) (in MAR 10A) a UK RIE, an EU regulated market, a third country trading venue that performs a similar function to a UK RIE, an MTF or an OTF.

*UK trading  
venue*

for the purposes of MAR 9 and MAR 12A (and in accordance with article 2(1)(16A) MiFIR), a UK RIE, a UK MTF or UK OTF.

## Annex B

### Amendments to the Market Conduct sourcebook (MAR)

Insert the following new chapter, MAR 10A, after MAR 10 (Commodity derivative position limits and controls, and position reporting). The text is not underlined.

#### **10A Ancillary activity exemption relating to trading of commodity derivatives**

##### **10A.1 Purpose and application**

###### Purpose

- 10A.1.1 G The purpose of this chapter is to set out the criteria for determining:
- (1) when an activity is considered to be ancillary to the main business of a firm at *group* level for the purposes of paragraph 1(k) of Schedule 3 to the *Regulated Activities Order*; and
  - (2) an annual threshold for establishing when a *person* is excluded from being an *investment firm*.

- 10A.1.2 G This chapter should be read in conjunction with *PERG* 13.5 Q44 to Q44C.

###### Application

- 10A.1.3 R This chapter applies to a *person* (P):
- (1) *dealing on own account*, including as a *market maker*, in *commodity derivatives* or *emission allowances*, excluding a *person* who *deals on own account* when executing client orders; or
  - (2) providing *investment services*, other than *dealing on own account*, in *commodity derivatives* or *emission allowances* to the customers or suppliers of P's main business,

provided that in each case:

- (a) the activity meets the criteria in *MAR* 10A.1.4R and *MAR* 10A.1.5R; and
  - (b) is carried on from an establishment in the *United Kingdom*.
- 10A.1.4 R The activity in *MAR* 10A.1.3R:
- (1) when considered both individually and on an aggregate basis, is an ancillary activity to P's main business when considered on a *group* basis; or
  - (2) is below an annual threshold, when considered on an individual basis.



- 10A.1.5 R (1) P's main business is not:
- (a) the provision of *investment services* (other than when the activity is one to which MAR 10A.1.4(2) applies);
  - (b) banking activities requiring *permission* under Part 4A of the *Act* (or banking activities which would require such *permission* if they were carried on in the *United Kingdom*); or
  - (c) acting as a *market maker* in relation to *commodity derivatives*.
- (2) P does not apply a *high-frequency algorithmic trading technique*.
- (3) P reports to the *FCA* under regulation 47 of the *MiFI Regulations*, upon request, the basis on which P considers that its activity under MAR 10A.1.4R is ancillary to its main business or below the annual threshold.

## 10A.2 Annual threshold and ancillary activity exclusions

- 10A.2.1 R
- (1) Option 1: P is not an *investment firm* where the net outstanding notional exposure in *commodity derivatives* or *emission allowances*, for cash settlement, traded in the *United Kingdom*:
- (a) calculated in accordance with MAR 10A.3.1R; and
  - (b) excluding *commodity derivatives* or *emission allowances* traded on a [*non-UK*] *trading venue*,
- is below an annual threshold of [£5] billion.
- (2) Option 2: P is not an *investment firm* where the net outstanding notional exposure in *commodity derivatives* or *emission allowances* for cash settlement, traded in the *United Kingdom*, excluding *commodity derivatives* or *emission allowances* traded:
- (a) on its behalf by an *FCA-authorised firm*; or
  - (b) with a counterparty that is an *FCA-authorised firm*,
- is below an annual threshold of [£3] billion, when calculated in accordance with MAR 10A.3.1R.
- 10A.2.2 R P's activities in the *United Kingdom* are ancillary to the main business at *group* level for the purposes of the *ancillary activity exclusion* where they comply with any of the following conditions:

- (1) in accordance with *MAR 10A.3.2R*, the size of those activities accounts for 50% or less of the total size of the other trading activities of the *group*;
- (2) the estimated capital employed for carrying out those activities, calculated in accordance with *MAR 10A.3.3R(1) to (5)*, accounts for not more than 50% of the capital employed at *group* level for carrying out the main business calculated in accordance with *MAR 10A.3.3R(6)*.

### 10A.3 Annual threshold and ancillary activity tests

#### Annual threshold test

- 10A.3.1 R
- (1) The net outstanding notional exposure must be calculated by averaging the aggregated month-end net outstanding notional values for the previous 12 *months* resulting from all contracts in *commodity derivatives* or *emission allowances* by a *person* within a *group*.
  - (2) The aggregation referred to in (1) must not include positions from contracts resulting from *excluded positions*.
  - (3) The net outstanding notional values in (1) must be calculated:
    - (a) on the basis of all contracts in *commodity derivatives* or *emission allowances* for cash settlement to which any *person* is a party during the *relevant calculation period*; and
    - (b) using the netting methodology of *MAR 10A.3.3R(4)*.
  - (4) The contracts in *commodity derivatives* or *emission allowances* for cash settlement must include all such derivative contracts relating to *commodities* or *emission allowances* which must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event.

#### Trading test

- 10A.3.2 R
- (1) The size of the activities referred to in *MAR 10.2.2R(1)* undertaken by:
    - (a) P; and
    - (b) other *persons* in the *group*,
 must be calculated by aggregating the gross notional value of all contracts in *commodity derivatives* and *emission allowances* to which that *person* is a party.
  - (2) The aggregation referred to in (1) must not include *excluded positions* in the case of P.

- (3) The aggregation referred to in (1) must include *excluded positions* in the case of other *persons* in the *group*.
- (4) The overall market trading activities referred to in (1) and (2) must be calculated by aggregating the gross notional value of all contracts traded in the *United Kingdom* that are:
  - (a) traded on a *UK trading venue*; or
  - (b) in the case of any other contract are:
    - (i) not traded on a *trading venue*; and
    - (ii) entered into by a *person* in the *group* from an establishment in the *United Kingdom*.

#### Capital employed test

- 10A.3.3 R (1) The estimated capital employed for carrying out the activities referred to in *MAR 10A.2.2R(2)*, is the sum of:
- (a) 15% of each net position, long or short, multiplied by the price for the *commodity derivative* or *emission allowance*; and
  - (b) 3% of the gross position, long plus short, multiplied by the price for the *commodity derivative* or *emission allowance*.
- (2) The positions in (1) must be calculated on the basis of all contracts traded in the *United Kingdom* in *commodity derivatives* or *emission allowances* to which any *person* in the *group* is a party during the *relevant calculation period* and which:
- (a) are traded on a *UK trading venue*; or
  - (b) in the case of any other contract are not traded on a *trading venue*.
- (3) The calculation in (1) must not include *excluded positions*.
- (4) For the purposes of (1)(a):
- (a) the net position in a *commodity derivative* or an *emission allowance* must be determined by netting long and short positions:
    - (i) in each type of *commodity derivative* contract with a particular *commodity* as underlying in order to calculate the net position per type of contract with that *commodity* as underlying; or

- (ii) in each type of *emission allowance* contract in order to calculate the net position in that *emission allowances* contract; and
- (b) net positions in different types of contracts with the same *commodity* as underlying or different types of derivative contracts with the same *emission allowance* as underlying can be netted against each other.
- (5) For the purposes of (1)(b):
  - (a) the gross position in a *commodity derivative* or an *emission allowance* must be determined by computing the sum of the absolute values of the net positions per type of contract with a particular *commodity* as the underlying, per *emission allowance* contract or per type of derivative contract with a particular *emission allowance* as the underlying; and
  - (b) net positions in different types of contracts with the same *commodity* as underlying or different types of derivative contracts with the same *emission allowance* as underlying cannot be netted against each other.
- (6) The capital employed for carrying out the main business of a *group* is the sum of the total assets of the *group* minus its *short-term debt* as recorded in its consolidated financial statements of the *group* at the end of the *relevant calculation period*.
- 10A.3.4 G The capital employed for carrying out the main business of a *group*, to which MAR 10A.3.3R(6) applies, relates to the worldwide activities of *group* members, wherever located.

#### **10A.4 Procedures for calculation**

- 10A.4.1 R (1) The calculation for the purposes of the annual threshold test in MAR 10A.3.1R must:
  - (a) be determined by reference to the 3 *relevant calculation periods* preceding the date of calculation;
  - (b) compare the simple average of the resulting annual values with the threshold in MAR 10A.2.1R; and
  - (c) be carried out annually in the first quarter of the calendar year that follows an annual calculation period.
- (2) The calculation for the purposes of the trading test in MAR 10A.3.2R must:

- |         |     |  |
|---------|-----|--|
|         |     | <ul style="list-style-type: none"> <li>(a) be based on a simple average of the daily trading activities during the 3 <i>relevant calculation periods</i> preceding the date of calculation;</li> <li>(b) compare the simple average of the resulting annual values with the threshold in <i>MAR 10A.2.2R(1)</i>; and</li> <li>(c) be carried out annually in the first quarter of the calendar year that follows an annual calculation period.</li> </ul>  |
|         | (3) | <p>The calculation for the purposes of the capital employed test in <i>MAR 10A.3.3R</i> must:</p> <ul style="list-style-type: none"> <li>(a) be based on a simple average of the estimated capital allocated to daily trading activities during the 3 <i>relevant calculation periods</i> preceding the date of calculation;</li> <li>(b) compare the simple average of the resulting annual values with the threshold in <i>MAR 10A.2.2R(2)</i>; and</li> <li>(c) be carried out annually in the first quarter of the calendar year that follows an annual calculation period.</li> </ul> |
| 10A.4.2 | G   | <ul style="list-style-type: none"> <li>(1) Where currency conversion is necessary, for example, when converting notional exposure to GBP for the purposes of the annual threshold test, firms should use the Bank of England rate or other similar widely used rates.</li> <li>(2) Where the average of the aggregated <i>month</i>-end outstanding notional value is required to be calculated, the relevant month-end rate should be used for each of the previous 12 <i>months</i>.</li> </ul>  |
| 10A.4.3 | R   | <p>A <i>person</i> does not breach <i>MAR 10A.2.1R</i> or <i>MAR 10A.2.2R</i> during the period in which it performs a calculation in accordance with <i>MAR 10A.4.1R</i>.</p>   |

## Annex C

### Amendments to the Perimeter Guidance manual (PERG)

In this Annex, underlining indicates new text and striking through indicates deleted text.

#### 13 Guidance on the scope of the UK provisions which implemented MiFID

...

##### 13.5 Exemptions from MiFID

...

##### Exemption for commodity derivatives business

#### Q44. Who can rely on the exemption in ~~article 2.1(j)~~ paragraph 1(k) of Schedule 3 to the Regulated Activities Order?

You may be able to rely on the exemption if:

- you deal on own account in commodity derivatives or emission allowances or derivatives thereof; or
- provide other investment services in commodity derivatives or emission allowances or derivatives thereof to clients or suppliers of your main business (or if you are part of a group, the group's main business); or
- both.

...

The exemption will only apply if what you do is ancillary to your main business or if it falls below an annual threshold (see Q45 for more about this).

...

#### Q45. What is an ancillary activity for the purposes of the commodities exemption?

You can find the meaning of 'ancillary' for the purposes of the commodities exemption described in ~~the answer to Q44 in MiFID RTS 20 (regulatory technical standards for the criteria to establish when an activity is considered to be ancillary to the main business). You will need to consider whether your commodity derivatives business exceeds the main business threshold as stipulated in article 3 of MiFID RTS 20.~~ MAR 10A.

~~This answer does not give a full summary as the definition is too detailed for PERG.~~

~~The test as stipulated by article 3 of MiFID RTS 20 has two calculation methods. If the result of either calculation is that you fall below the specified threshold, you meet the test.~~

- ~~One method is based on the size of group trading activities in commodity derivatives and emission allowances.~~
- ~~The second measure compares the estimated capital employed for carrying out commodity derivative and emission allowance activities with group capital.~~

~~Both methods are based on commodities trading activities in the EEA, as if the UK were still part of the EU.~~

MAR 10A also contains the criteria relating to if your commodity derivatives or emission allowances business falls below an annual threshold, you are not to be treated as an investment firm.

...

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12 Endeavour Square London E20 1JN  
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