

EXPLANATORY MEMORANDUM TO
THE FINANCIAL SERVICES AND MARKETS ACT 2000 (COMMODITY
DERIVATIVES AND EMISSION ALLOWANCES) (AMENDMENT) ORDER 2024

2024 No. 719

1. Introduction

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

2. Declaration

- 2.1 Bim Afolami, The Economic Secretary to the Treasury at HM Treasury confirms that this Explanatory Memorandum meets the required standard.
- 2.2 Tom Duggan, Deputy Director for Securities and Markets at HM Treasury confirms that this Explanatory Memorandum meets the required standard.

3. Contact

- 3.1 Urvasi de Biasi at HM Treasury (email: urvasi.debiasi@hmtreasury.gov.uk) can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

- 4.1 This instrument omits amendments to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (“RAO”), relating to the repeal of Commission Delegated Regulation (EU) 2017/592 (“RTS 20”) and revocation of Article 72J, in the Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) Order 2023 (“the 2023 Order”).

Where does the legislation extend to, and apply?

- 4.2 The extent of this instrument is England and Wales, Scotland and Northern Ireland.
- 4.3 The territorial application of this instrument is England and Wales, Scotland and Northern Ireland.

5. Policy Context

What is being done and why?

- 5.1 In May 2023, HM Treasury made changes to the legislation concerning the ancillary activities exemption (“AAE”), which gives firms trading commodity derivatives or emission allowances a possible exemption from needing to be authorised as an investment firm. HM Treasury had consulted on this as part of the Wholesale Markets Review (“WMR”). Following from the changes made by the 2023 Order, in December 2023, the FCA published CP23/27 which sets out its proposals concerning the commodity markets regime, including revoking RTS 20, and new guidance on the application of the AAE. The FCA’s consultation closed in February 2024. Many responses to the consultation raised significant concerns with a principles-based

approach to determining whether a firm requires authorisation for trading in commodity derivatives and emission allowances.

- 5.2 In order to provide time to consider and address these concerns, HM Treasury has decided to pause the implementation of legislative changes relating to the new ancillary activities regime. This SI provides that the planned changes will not come into force by omitting the relevant provisions from the 2023 Order, which were to take effect on 1 January 2025. HM Treasury will work with the FCA and engage further with the market to deliver a regime that reflects the conclusions of the WMR whilst also taking into consideration the concerns raised by industry, with the aim of implementing a new regime by 1 January 2027.
- 5.3 In the meantime, firms will be able to continue to rely on the existing Ancillary Activities Test (AAT) to determine whether they are eligible to use the AAE. This instrument does not omit provisions which remove the requirement for firms to notify the FCA annually of their ancillary activity status with regards to the trading of commodity derivatives or emission allowances. This requirement will still be removed from legislation by the 2023 Order on 1 January 2025.

What was the previous policy, how is this different?

- 5.4 EU Directive 2014/65/EU established an exemption from authorisation for firms trading commodity derivatives or emission allowances as an ancillary activity to their main business.
- 5.5 The AAE was transposed into UK legislation by Part 1, Schedule 3 to the RAO, together with Article 72J, and took effect in 2018. The exemption relies on a set of calculations, known as the AAT which is detailed in Commission Delegated Regulation (EU) 2017/592 (otherwise known as ‘RTS 20’).
- 5.6 In 2021, the WMR consultation proposed a number of reforms to the UK commodities regime, including measures to simplify and streamline the AAT. The government proposed moving to a principles-based approach to determine whether a firm can rely on the AAE.
- 5.7 HM Treasury legislated to take account of this change through the 2023 Order, laid in May 2023, which omitted references to the detailed technical standards in RTS 20 which determine when a firm’s activity is considered to be ancillary, and also removed the exclusion for firms from needing to carry out market threshold calculations under article 72J of the RAO. This was done to allow the FCA to establish guidance for determining when a firm that trades commodities derivatives or emission allowances as an ancillary activity does not need to be authorised as an investment firm.
- 5.8 As set out in paragraphs 5.1-5.3, HM Treasury has decided to pause the implementation of the new ancillary activities regime. This instrument therefore maintains the status quo and delays the deletion of references to RTS 20, including the removal of Article 72J. Firms trading in commodity derivatives and emission allowances will be able to continue to rely on the current AAT to determine whether their trading in those instruments is ancillary to their main business.

6. Legislative and Legal Context

How has the law changed?

- 6.1 This instrument is part of a wider package of reforms to the UK’s framework for wholesale capital markets, the WMR. The WMR was established to improve the UK’s regulation of secondary markets, following the withdrawal from the EU.
- 6.2 This instrument omits amendments to the RAO, relating to the repeal of RTS 20, in the 2023 Order in anticipation of a delay in the revocation of RTS 20. The 2023 Order is not yet in force.
- 6.3 Omitting these amendments means that references to RTS 20 and the exclusion in article 72J of the RAO, relating to the market threshold calculation of the AAT, will remain in legislation beyond 1 January 2025.

Why was this approach taken to change the law?

- 6.4 This is the only possible approach to make the necessary changes as the omission of references to RTS 20 and of Article 72J is established in legislation.

7. Consultation

Summary of consultation outcome and methodology

- 7.1 HM Treasury undertook a formal consultation on these issues as part of the WMR and the response was published on 1 March 2022¹¹. HM Treasury received over 20 responses to the part of the consultation about the amendments in the 2023 Order, including from representatives from across the financial services sector. These responses are summarised in HM Treasury’s consultation response, and the Explanatory Memorandum accompanying the 2023 Order.
- 7.2 In CP 23/27 “Reforming the commodity derivatives regulatory framework”, published in December 2023, the FCA consulted on guidance intended to clarify how the AAE should be applied by firms.
- 7.3 Following publication of the FCA’s CP23/27, HMT has engaged with the FCA and industry stakeholders to further understand concerns raised. Supplemented by evidence provided by the regulator, it became clear that the regime, as legislated for in May 2023, presented sufficient risk to require re-assessment.

8. Applicable Guidance

- 8.1 For more detail, see also FCA’s published statement on the matter: <https://www.fca.org.uk/publications/consultation-papers/cp23-27-reforming-commodity-derivatives-regulatory-framework>.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

- 9.1 An Impact Assessment has not been prepared for the instrument because, in line with Better Regulation guidance, HM Treasury considers that the net impact on businesses will be less than £5 million a year. Due to this limited impact, a de minimis impact assessment has been carried out and is published with this instrument on [Legislation.gov.uk](https://legislation.gov.uk).

Impact on businesses, charities and voluntary bodies

- 9.2 There is no, or no significant, impact on charities or voluntary bodies. The provisions in the instrument are expected to benefit businesses as they prevent potential disruption to UK commodity markets, and any impact this may have on firms.
- 9.3 The legislation does impact small or micro businesses. However, as the instrument aims to reduce disruption by maintaining the status quo, it is right that small and micro businesses are not exempted from the legislation.
- 9.4 The impact on the public sector is that the changes made by this instrument affect the FCA. HM Treasury has worked closely with the FCA in developing this instrument.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

- 10.1 HM Treasury will work with the FCA and engage further with the market to deliver a regime that reflects the conclusions of the WMR whilst also taking into consideration the concerns raised by industry, with the aim of implementing a new regime by 1 January 2027.
- 10.2 This instrument does not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015 the Economic Secretary to the Treasury, Bim Afolami, has made the following statement:
“It is not proportionate to include a review clause in this instrument because the estimated annual net direct cost to business is less than £5 million and there are no factors present which make it particularly desirable to include a review clause.”

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

- 11.1 None.

12. European Convention on Human Rights

- 12.1 The Economic Secretary to the Treasury (Bim Afolami) has made the following statement regarding Human Rights:

“In my view the provisions of the Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) (Amendment) Order 2024 are compatible with the Convention rights.”

13. The Relevant European Union Acts

- 13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 (“relevant European Union Acts”). It does however relate to the withdrawal of the United Kingdom from the European Union because the AAT is derived from assimilated law, therefore HM Treasury would not have been able to undertake these reforms were the United Kingdom part of the European Union.