Title: The Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances)	De minimis assessment
SI (Statutory Instrument) No: 2024/719	**Date: 24/05/2024**
Other departments or agencies: **NA**	**Type of regulation: Domestic**
Contact for enquiries: Urvasi de Biasi (urvasi.debiasi@hmtreasury.gov.uk) and Alison Robinson (alison.robinson@hmtreasury.gov.uk)	**Date measure comes into force:** **31/12/2024**
Cost of Preferred (or more likely) Option: Unquantified but net savings for firms	**Equivalent Annual Net Direct Cost to Business per year** Unquantified, but below £5m

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

Commodity derivatives and emission allowances are financial instruments that derive their value from underlying commodities, such as oil, metals or in the case of emission allowances, carbon credits. They can be traded by commercial firms in those industries to hedge risks or smooth prices or costs of the underlying commodities, or as pure trading instruments by financial markets firms.

The Ancillary Activities Exemption (AAE) allows companies to trade commodity derivatives or emission allowances without FCA authorisation under certain circumstances. Firms that use the exemption include large energy suppliers who use derivatives to hedge against the price of the commodities (for example oil) that they produce or distribute. Such companies use the Ancillary Activities Test (AAT) to determine whether their trading activity is 'ancillary' to their main business, and hence whether they can do it without FCA authorisation.

Feedback to The Wholesale Markets Review (WMR) suggested that, while there was consensus that the AAE should be maintained, the test could be improved.[1] In particular, it is set out in legislation and is complex and difficult for firms to use. For this reason, following the WMR, in May 2023 the Treasury laid secondary legislation which deletes references to the technical standards establishing the AAT from legislation, so that the FCA could replace it with guidance setting out how the test should apply.[2] The intention was that firms would no longer need to conduct complex calculations and could instead conduct an objective assessment in line with the FCA guidance as to whether their trading activities are 'ancillary' to their main business.

The FCA published a consultation on their proposed guidance in December 2023, and the provisions deleting references to the technical standard establishing the AAT will come into force on 1 January 2025.[3] Many responses to the consultation raised significant concerns with the approach of replacing a quantitative test in the technical standard with a qualitative approach based on guidance. They suggested that proceeding as planned would negatively impact UK

[1] UK Wholesale Markets Review: a consultation - https://www.gov.uk/government/consultations/uk-wholesale-markets-review-a-consultation
[2] The Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) Order 2023
[3] CP23/27: Reforming the commodity derivatives regulatory framework - https://www.fca.org.uk/publications/consultation-papers/cp23-27-reforming-commodity-derivatives-regulatory-framework

commodity markets as there would be insufficient certainty for firms about whether they could rely on the exemption.

This instrument therefore omits the provisions which delete references to the current test from legislation so that firms can continue to rely on the current test while the Treasury works alongside the FCA to engage further with the market to deliver a regime that meets the objectives of simplifying the test whilst also taking into consideration the concerns raised by industry, with the aim of delivering a new regime by 1 January 2027.

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

The policy objective is that firms have clarity over when they can trade commodity derivatives or emission allowances under the AAE, providing them with the ability to trade without seeking FCA authorisation. This instrument achieves this by providing that firms can continue to rely on the existing AAT while the Treasury works alongside the FCA to develop an approach that reflects the conclusions of the WMR whist also taking into consideration the concerns raised by industry.

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

<u>Option 1: Do nothing</u>

If legislation is not put in place, the current arrangements for the AAT will cease to have effect from 1 January 2025, and firms will instead have to comply with the new regime. Given concerns raised by firms trading in commodity derivatives and emission allowances, including through the FCA's consultation process, this would have significant negative impacts on the UK's commodity markets.

<u>Option 2: 'Preferred' approach</u>

By omitting the deletion of references to RTS 20, this instrument aims to give industry the necessary certainty by maintaining the current arrangements for the AAE and AAT, preventing potential disruption to UK commodity markets, and any impact this may have on firms.

<u>Detailed policy proposals:</u>

The instrument amends the Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) Order 2023 (laid in March 2023) by omitting articles 2(2), (3) and (4) which delete references to the current Ancillary Activities Test. This will mean that when the Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) Order 2023 comes into force on 1 January 2025, the current quantitative test will remain in force, including article 72J of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO).

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

In 2022, 147 firms notified the FCA that they had undertaken the ancillary activities test and were not in scope, however, not all firms notify the FCA. Therefore, we cannot provide an exact figure for all the firms that will be affected.

The de minimis impact assessment accompanying the Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) Order 2023 (the 2023 Order) sets out that engagement with trade associations and the FCA suggested that replacing the existing AAT would save firms money, as it would remove burdens and would not impose any additional requirements or administrative burdens on businesses.[4] This is because firms are currently required to maintain complex systems to track data, carry out calculations and dispatch annual notifications to the FCA. It estimated that the cost to each of the 147 firms of using the AAT who notified the FCA in 2022 was less than £34k each year, and therefore the overall impact of reforming the AAT was below the £5m per annum de minimis threshold.

The impact of this instrument is that the current regime will remain in force, therefore firms will not benefit from any cost saving associated with reforming the AAT at end-2024. Concerns raised by industry suggest that proceeding with the approach provided for under the 2023 Order would be disruptive to firms and to commodities markets. HM Treasury has therefore concluded that the most cost-effective option for firms is to maintain the arrangements for the current AAT.

It is worth noting that the 2023 Order made other changes to the regime for commodity derivatives and emission allowances that will proceed as planned on 1 January 2025, so firms will still benefit from any cost savings related to these changes. For example, the provisions in the 2023 Order which remove the requirement for firms to notify the FCA annually of their ancillary activity status with regards the trading of commodity derivatives or emission allowances will still be commenced as planned.

Market participants likely to be impacted by these proposals include non-financial entities trading in commodity derivatives (for example, energy, food, metal and airline companies who use commodity markets to hedge risk but are not authorised persons) and firms performing advisory services (such as accountancy firms and law firms). As this legislation will mean the AAT remains as it is currently, we do not expect there to be any familiarisation costs for firms.

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

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

[4] https://www.legislation.gov.uk/uksi/2023/548/pdfs/uksiod_20230548_en_001.pdf

No

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

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

SCS of Securities and Markets

Signed: ***Tom Duggan*** Date: 24/05/2024

SCS of Better Regulation Unit

Signed: ***Jonathan Edwards*** Date: 24/05/2024

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

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

(Name, Ministerial role)

Signed: ***Bim Afolami, Economic Secretary to the Treasury*** Date: 24/05/2024

Further information sheet

Please provide additional evidence in subsequent sheets, as required.