EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES AND MARKETS ACT 2000 (COMMODITY DERIVATIVES AND EMISSION ALLOWANCES) ORDER 2023

2023 No. 548

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.

1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 This instrument amends the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO) which specifies types of activities and investments for the purposes of the Financial Services and Markets Act 2000 and the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2017 (MiFI Regulations) which transposed certain European legislation into UK law.

2.2 The purpose of this instrument is to streamline the process for determining when a firm trading commodity derivatives or emission allowances needs to be authorised as an investment firm, which HM Treasury consulted on as part of the Wholesale Markets Review (WMR). The FCA will put in place a simpler and therefore lower cost regime for determining when a firm that trades commodities or emission allowances as an ancillary activity does not need to be authorised as an investment firm.

2.3 Currently firms are required to perform costly calculations to determine whether their trading activity is ancillary to their main commercial business, and therefore whether they are exempt from the commodity position limits regime. This instrument removes the obligation for firms relying on the ancillary activities exemption to notify the FCA of their exemption annually. This instrument also removes article 72J of the RAO which enables firms to carry on their business without obtaining authorisation if there is no data available to enable them to perform the test establishing when an activity is ancillary.

2.4 It also removes references to Commission Delegated Regulation (EU) 2017/592 (RTS 20) which outlines the regulatory technical standards for determining when a firm's activity is considered to be ancillary to its main commercial business.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 This instrument amends subordinate legislation, the MiFI Regulations, made under section 2(2) of the European Communities Act 1972. For these reasons, this instrument is to be subject to the enhanced scrutiny procedure in Schedule 8 of the European Union (Withdrawal) Act 2018 (c. 16) and must be published in draft for recommendations to be made by a Committee of either House of Parliament (including the JCSI), which have been complied with.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is the United Kingdom.

4.2 The territorial application of this instrument is the United Kingdom.

5. European Convention on Human Rights

5.1 The Economic Secretary to the Treasury (Andrew Griffith) 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) Order 2023 are compatible with the Convention rights."

6. Legislative Context

6.1 This instrument is made in exercise of the powers conferred by section 22(1) and (5) of, and paragraph 25 of Schedule 2 to, the Financial Services and Markets Act 2000. This instrument is subject to the draft affirmative procedure.

6.2 This instrument is part of a wider package of reforms to the UK's framework for wholesale capital markets, called the WMR. The WMR was established to improve the UK's regulation of secondary markets, following the withdrawal from the EU. Its aim is to promote openness and competitiveness by allowing domestic and international investors to access the most liquid markets and achieve the best prices for their investments; deliver a fair and proportionate regime, focused on outcomes rather than prescriptive rules and support economic growth, innovation, and wealth creation across society by ensuring the regulatory framework can facilitate investment in both the short and long-term.

6.3 A number of other changes that the government consulted on as part of the WMR between July to September are being taken forward as part of the Financial Services and Markets Bill which introduced in Parliament on 22 July 2022. Where legislative changes are needed but respondents indicated that fast implementation was not paramount, subject to the agreement of Parliament, the government intend to deliver them in due course using the powers in the FSM Bill.

6.4 This instrument removes references to RTS 20 in anticipation of its revocation and the establishment of a new exemption by the FCA.

7. Policy background

What is being done and why?

7.1 EU Directive 2014/65/EU and Regulation (EU) No 600/2014 (collectively referred to as MiFID II) repealed and recast EU Directive 2004/39/EC. MiFID II established the legal framework governing the requirements applicable to investment firms, trading venues, data reporting service providers and third-country firms providing investment services or activities in the EU. EU Directive 2014/65/EU established an exemption from authorisation for firms trading commodity derivatives or emission allowances primarily for investment purposes or in support of the firm's commercial business (this is known as the ancillary activities exemption).

7.2 The ancillary activities exemption was transposed into UK legislation by Part 1, Schedule 3 of the RAO and took effect in 2018. The exemption relies on a set of calculations, known as the Ancillary Activities Test (AAT).

7.3 Currently the AAT is based on specific quantitative criteria (most of which is set out in RTS 20) which requires firms to perform complex calculations and process substantial volumes of historical trading data. The RAO also requires firms to notify the FCA of the outcome of the assessment on an annual basis by reference to regulation 47 of the MiFI Regulations.

7.4 Regulation 47 of the MiFI Regulations establishes requirements that persons who qualify for the ancillary activities exemption are subject to. That regulation requires firms to notify the FCA of the outcome of the AAT on an annual basis and gives the FCA the power to direct persons to notify it of their status.

7.5 Prior to the implementation of the ancillary activities exemption and the AAT, the UK used a qualitative test to determine whether firms participating in commodity derivatives or emission allowances markets needed to be regulated and did not require firms to notify the FCA on an annual basis. This resulted in the same regulatory outcome as the AAT, exempting firms trading commodity derivatives or emission allowances as an ancillary activity, but was less complex and cheaper for firms to comply with.

7.6 As part of the WMR, the government consulted on removing the annual notification requirement and reverting to a principles-based approach, while maintaining the same outcome.

7.7 The FCA and respondents to the WMR consultation said that such an approach would be preferable as it would be more streamlined, proportionate and cost effective. Some respondents also highlighted the fact that, since the test and annual notification was introduced in 2018, no UK firms have exceeded the threshold of speculative trading activity and therefore the requirement to inform the FCA about the outcome of the ATT every year was particularly burdensome.

7.8 This instrument therefore amends schedule 3 of the RAO to remove the requirement to notify the FCA when a firm is making use of the exemption when the activity of trading commodity derivatives or emission allowances is ancillary to its main business. The FCA will establish a simpler and therefore more cost-effective regime for determining when a firm that trades commodities or emission allowances as an ancillary activity does not need to be authorised as an investment firm.

7.9 This instrument also amends Regulations 30 and 47 of the MiFI Regulations to reflect the removal of the notification requirement from the RAO. This is important because the AAT in the RAO and the MiFI Regulations are designed to mirror each other, and if a firm is participating in algorithmic trading and satisfies the tests in the RAO, it automatically comes within scope of the requirements in the MiFI Regulations. Amending the MiFI Regulations at the same time as amending the RAO is therefore important to prevent confusion for firms.

7.10 In line with the FCA adopting a simpler and more streamlined approach to determining whether firms trading in commodity derivatives or emission allowances need to be authorised, this instrument also removes article 72J of the RAO. Article 72J removed the need for firms to do the market threshold calculation, which formed part of the quantitative test under MiFID II, if there was no data available to perform that test and provided the firm with relief from the need to seek authorisation if it

could meet the other components of the ancillary exemption. The permanent absence of the relevant data at EU level needed to perform the current market threshold test, following EU withdrawal, means that Article 72J no longer serves its original purpose. HMT is committed nevertheless to ensuring that the FCA has the right powers to set any transitional provisions that may be necessary to deal with the situation in which a firm's trading activity can no longer be regarded as ancillary under the terms of the test, to preserve continuity and legal certainty.

8. European Union Withdrawal and Future Relationship

8.1 This instrument is not being made under the European Union (Withdrawal) Act 2018 but relates to the withdrawal of the United Kingdom from the European Union because it amends subordinate legislation made under section 2(2) of the European Communities Act 1972.

8.2 The Minister has made any relevant statements in Part 2 of the Annex to this Explanatory Memorandum.

9. Consolidation

9.1 There are currently no plans to consolidate the relevant legislation.

10. Consultation outcome

10.1 HM Treasury undertook a formal consultation on these issues as part of the WMR and the response was published on 1 March 2022.[1] HM Treasury received over 20 responses to the part of the consultation about the amendments in this instrument, including representatives from across the financial services sector.

10.2 Respondents were in favour of removing the need to notify annually the FCA of their ancillary activity status with regards the trading of commodity derivatives or emission allowances. Most respondents did not want to return to a wholly qualitative definition of 'ancillary trading' because of the risk of legal uncertainty. However, respondents were in favour of the FCA developing a simplified method to determine when an activity is ancillary.

10.3 Since the consultation closed, HMT has also conducted follow-up engagement to further explore the impact that these changes could have on industry stakeholders and investors. HMT has also engaged extensively with the FCA on the changes included in this instrument.

11. Guidance

11.1 No further guidance is being published alongside the instrument.

12. Impact

12.1 There is no, or no significant, additional cost on business, charities, or voluntary bodies. The provisions in the instrument are expected to reduce costs on certain businesses.

[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1057897/Wholesale_Markets_Review_Consultation_Response.pdf

12.2 The impact on the public sector is that the instruments being amended impact the FCA rules. Where required, impact assessments for the individual instruments being amended by the instrument are published on legislation.gov.uk.

12.3 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

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses. No specific action is proposed to minimise regulatory burdens on small businesses as this instrument does not introduce new regulatory requirements for small businesses, but instead removes or reduces existing regulatory burdens.

14. Monitoring & review

14.1 The approach to monitoring this legislation is for the FCA to continue to assess that the exemption of firms trading commodity derivatives or emission allowances as an ancillary activity from authorisation is working so that firms that should not be exempt are suitably authorised.

14.2 The 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, Andrew Griffith, 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."

15. Contact

15.1 Cassie McGoldrick at HM Treasury or email: cassie.mcgoldrick@hmtreasury.gov.uk can be contacted with any queries regarding the instrument.

15.2 Tom Duggan, Deputy Director for Securities and Markets, at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.

15.3 The Economic Secretary to the Treasury (Andrew Griffith) can confirm that this Explanatory Memorandum meets the required standard.

Annex

Statements under the European Union (Withdrawal) Act 2018

Part 1A

Table of Statements under the 2018 Act

This table sets out the statements that may be required under the 2018 Act.

Statement	Where the requirement sits	To whom it applies	What it requires
Sifting	Paragraphs 3(3), 3(7) and 17(3) and 17(7) of Schedule 7	Ministers of the Crown exercising sections 8(1) or 23(1) to make a Negative SI	Explain why the instrument should be subject to the negative procedure and, if applicable, why they disagree with the recommendation(s) of the SLSC/Sifting Committees
Appropriate-ness	Sub-paragraph (2) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1) or 23(1) or jointly exercising powers in Schedule 2	A statement that the SI does no more than is appropriate.
Good Reasons	Sub-paragraph (3) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1) or 23(1) or jointly exercising powers in Schedule 2	Explain the good reasons for making the instrument and that what is being done is a reasonable course of action.
Equalities	Sub-paragraphs (4) and (5) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1) or 23(1) or jointly exercising powers in Schedule 2	Explain what, if any, amendment, repeals or revocations are being made to the Equalities Acts 2006 and 2010 and legislation made under them. State that the Minister has had due regard to the need to eliminate discrimination and other conduct prohibited under the Equality Act 2010.
Explanations	Sub-paragraph (6) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1) or 23(1) or jointly exercising powers in Schedule 2 In addition to the statutory obligation the Government has made a political commitment to include these statements alongside all EUWA SIs	Explain the instrument, identify the relevant law before IP completion day, explain the instrument's effect on retained EU law and give information about the purpose of the instrument, e.g., whether minor or technical changes only are intended to the EU retained law.
Criminal offences	Sub-paragraphs (3) and (7) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1) or 23(1) or jointly exercising powers in Schedule 2 to create a criminal offence	Set out the 'good reasons' for creating a criminal offence, and the penalty attached.

Sub-delegation	Paragraph 30, Schedule 7	Ministers of the Crown exercising section 8 or part 1 of Schedule 4 to create a legislative power exercisable not by a Minister of the Crown or a Devolved Authority by Statutory Instrument.	State why it is appropriate to create such a sub-delegated power.
Urgency	Paragraph 34, Schedule 7	Ministers of the Crown using the urgent procedure in paragraphs 5 or 19, Schedule 7.	Statement of the reasons for the Minister's opinion that the SI is urgent.
Scrutiny statement where amending regulations under 2(2) ECA 1972	Paragraph 14, Schedule 8	Anybody making an SI after IP completion day under powers conferred before the start of the 2017-19 session of Parliament which modifies subordinate legislation made under s. 2(2) ECA	Statement setting out: a) the steps which the relevant authority has taken to make the draft instrument published in accordance with paragraph 16(2), Schedule 8 available to each House of Parliament, b) containing information about the relevant authority's response to— (i) any recommendations made by a committee of either House of Parliament about the published draft instrument, and (ii) any other representations made to the relevant authority about the published draft instrument, and, c) containing any other information that the relevant authority considers appropriate in relation to the scrutiny of the instrument or draft instrument which is to be laid.
Explanations where amending regulations under 2(2) ECA 1972	Paragraph 15, Schedule 8	Anybody making an SI after IP completion day under powers outside the European Union (Withdrawal) Act 2018 which modifies subordinate legislation made under s. 2(2) ECA	Statement explaining the good reasons for modifying the instrument made under s. 2(2) ECA, identifying the relevant law before IP completion day, and explaining the instrument's effect on retained EU law.

Part 1B

Table of Statements under the 2020 Act

This table sets out the statements that may be required under the 2020 Act.

Statement	Where the requirement sits	To whom it applies	What it requires
Sifting	Paragraph 8 Schedule 5	Ministers of the Crown exercising section 31 to make a Negative SI	Explain why the instrument should be subject to the negative procedure and, if applicable, why they disagree with the recommendation(s) of the SLSC/Sifting Committees

Part 2

Statements required under the European Union (Withdrawal) 2018 Act or the European Union (Future Relationship) Act 2020

1. Scrutiny statement where amending or revoking regulations etc. made under section 2(2) of the European Communities Act 1972

1.1 The Economic Secretary to the Treasury (Andrew Griffith) has made the following statement regarding this instrument:

"I have taken the following steps to make the draft instrument published in accordance with paragraph 14(2) of Schedule 8 to the European Union (Withdrawal) Act 2018 available to each House of Parliament.

1. On 1 March a draft of the Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) Order 2023 was published on GOV.UK.
2. On the same day, the Written Ministerial Statement "Draft Legislation: The Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) Order 2023" was tabled in the House of Commons.
3. The clerks to the House of Lords Secondary Legislation Scrutiny Committee and Joint Committee for Statutory Instruments were also notified of the publication of the draft of this Order.

No recommendations were made by any committee of either House of Parliament and no other representations were made about the published draft Statutory Instrument."

2. Explanations where amending or revoking regulations etc. made under section 2(2) of the European Communities Act 1972

2.1 The Economic Secretary to the Treasury (Andrew Griffith) has made the following statement regarding regulations made under the European Communities Act 1972:

"In my opinion there are good reasons for the Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) Order 2023 to amend the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2017. As part of its response to the Wholesale Markets Review consultation, HM Treasury committed to removing the requirement on firms to report annually to the FCA their reliance on the ancillary activities exemption, which created an unnecessary burden on firms. These amendments also mirror amendments being made to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 to ensure there is no disparity in requirements on firms relying on the ancillary activities exemption. They also ensure that the applicability of reporting requirements established under the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2017 to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 is clear ."

2.2 Requirements relating to the regulation of commodity derivatives and emission allowances, and the associated ancillary activities exemption, are established in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO) and the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2017 (MiFI Regulations). The MiFI Regulations were made in exercise of

the powers conferred by section 2(2) of the European Communities Act 1972 and section 8(1) of, and paragraph 21 of Schedule 7 to, the European Union (Withdrawal) Act 2018.

2.3 The effect of this Order is to bring the MiFI Regulations in line with the RAO. Specifically, this Order removes the requirement on firms to report annually to the FCA their reliance on the ancillary activities exemption and clarifies the application of reporting requirements established in the MiFI regulations to reporting requirements under Schedule 3 to the RAO.