28 August 2025

FIA-ISDA response to FCA Consultation 25/19 on the review of the Ancillary Activities Exemption

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.

Response:

Yes, we agree with the approach to allow firms to choose which test they complete. However, we believe MAR10A.2 would benefit from a clarification that the three tests are alternatives and that firms will only need to satisfy one of the tests (at their discretion) to be exempt under the AAE.

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

Response:

We agree with the FCA's reasons in para. 3.27 of CP 25/19 why aligning the new UK test with the EU test should be the starting position. However, we strongly disagree with the inclusion of trading activity conducted on a trading venue counting towards the new threshold test and urge the FCA to revisit their approach. We recommend basing the test on cash-settled commodity derivatives not traded on a trading venue.

International competitiveness of the UK

Incorporating trading venue activity into the scope of the annual threshold test would result in a significantly more stringent and operationally complex regime than those adopted in other major jurisdictions. This approach risks placing UK firms at a material competitive disadvantage, directly conflicting with the objectives of the UK's Financial Services Growth and Competitiveness Strategy, which aims to foster a proportionate and globally competitive regulatory framework.

By limiting the scope of the threshold test to cash-settled OTC commodity derivatives, the UK would achieve greater alignment with international standards—specifically, the de minimis test under the ancillary activities exemption in the EU and the Swap Dealer Test under the U.S. Dodd-Frank Act, both of which exclude exchange-traded activity and focus solely on financially-settled OTC derivatives.

Maintaining consistency with these established international frameworks would help preserve the competitiveness of UK markets. Conversely, expanding the test to include trading venue activity would increase the number of transactions captured, thereby raising the threshold burden and potentially deterring firms from operating within the UK—regardless of whether they ultimately qualify for exemption under the new test.

Moreover, the inclusion of trading venue activity introduces significant operational challenges. There is currently no comprehensive or accessible dataset of cash-settled transactions executed on trading venues, and even if such data were available, it cannot be extracted or processed automatically. Firms would be required to manually identify and compile relevant transactions, substantially increasing compliance costs and resource demands.

In practice, this could incentivize firms—particularly those relying on the threshold test to access the ancillary activities exemption—to relocate trading activity to non-UK venues offering comparable products. Such a shift risks fragmenting liquidity and diminishing the depth of UK commodity derivatives markets.

The FCA recognise that 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, leading to increased liquidity and better price formation, which help maintain orderly markets, see paragraph 2.21 of CP25/19. Therefore, we reiterate our support to align the scope of the new UK test with a similar test under EU MiFID.

Change in outcome

We question the statement in paragraph 3.19 of CP 25/19 that "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".

However, some of our members (specifically companies that are not heavily asset-based, i.e. those that do not own commodity infrastructures, such as pipelines or power networks), will need to apply the new annual threshold test to continue to remain exempt. If such companies fall into the 10% that will likely fail the new test, then they would have to become an investment firm under MiFID II, if they are to continue to remain in the UK.

This outcome would contradict the FCA's intention to retain the current outcome of the ancillary activities exemption tests, as alluded to in paragraphs 3.35 and 3.36 of CP 25/19. We note further HMT's intention under the Wholesale Markets Review to simplify the AAE without changing its scope, see paragraph 2.6 of CP25/19.

The fact that a majority of non-financial commodity firms in the UK currently qualify for the ancillary activities exemption should not be interpreted as evidence that the test is ineffective. On the contrary, it demonstrates that firms have appropriately structured their trading activity to remain ancillary to their main business, in line with the parameters of the existing tests.

We are not aware of any indication from HM Treasury or the FCA that the current scope of the exemption is considered overly broad. In fact, both the Wholesale Markets Review and CP25/19 consistently emphasised the importance of simplifying the tests while maintaining their existing scope and outcomes.

Against this backdrop, it is unclear what specific issue would be addressed by including trading venue activity within the threshold calculation. Introducing such a change would add unnecessary complexity and, based on current data, could result in approximately 10% of firms that are presently exempt losing access to the exemption. This outcome appears to conflict with the stated policy objective of preserving the effectiveness and accessibility of the ancillary activities exemption.

Increasing complexity and burden

The FCA's intention is to simplify the AAE and the related tests, which we strongly support.

The proposed inclusion of exchange traded derivatives adds unnecessary complexity, as noted under the section on competitiveness above.

In paragraph 3.28 of CP25/19, the FCA notes that excluding trading venue activity from the threshold calculation would omit approximately 80% of UK commodities trading. However, it is important to recognise that exchange-traded activity plays a critical role in promoting transparent and orderly markets. A lower proportion of exchange-traded derivatives (ETDs) relative to over-the-counter (OTC) transactions should not be viewed as a desirable outcome.

Moreover, the FCA has proposed excluding risk-reducing transactions and those that must or may be physically settled from the scope of the new test. When these exclusions are taken into account, the actual volume of UK commodity derivatives trading omitted from the threshold calculation would be significantly lower than the headline figure suggests.

Nonetheless, firms would still be required to assess the full 80% of exchange-traded activity to identify which transactions fall within scope—specifically, those that are speculative in nature and must or may be cash-settled. This process introduces a disproportionate compliance burden, particularly given the limited impact such transactions would have on the final threshold calculation.

The FCA asked us two additional questions around why the inclusion of trading venue activity would be a new or disproportionate burden, which can be collectively answered as follows:

The issue here is that if a bilateral OTC transaction is not cash-settled – or cannot be cash-settled at the option of one of the parties - it is not a derivative financial instrument (unless it is an OTC forward emissions allowance transaction) and so is not reportable under EMIR. Market participants already have systems that differentiate between those OTC derivative transactions which need to be reported under EMIR and those that do not – and for those that do need to be reported under EMIR, they also flag whether they regard those trades as hedging or not as that is a reportable data field.

By contrast, all (non-spot) exchange traded derivatives (ETDs), whether they are cash or physically settled, are financial instruments and so reportable under EMIR (as are forwards on MTFs and OTFs, unless the REMIT carve-out applies in the case of the latter). There is currently no need to differentiate and consider the exact dividing line between physically-settled and cash-settled ETDs in the way that would be required under this proposed test. So, while many market participants' existing systems will already enable them to classify some ETDs as hedge and some as non-hedge (because if they want to treat any as hedge - and they do a mixture of hedge versus non-hedge - they need to be able to flag trades as one or the other for transaction and position reporting purposes), what they will not have is the ability to identify and separate out physically-settled ETDs versus cash-settled ones. That would require a new build/ process.

If market participants face a choice between a new system build to use a UK exchange and trading a similar product on a non-UK venue that would not require one, then the UK exchanges will be placed at a competitive disadvantage by this.

Further, we feel including trading venue activity is inconsistent with the Overseas Person Exclusion. For example, for a self-clearing unregulated firm, the only way to exclude trading venue transactions from the calculation would be to demonstrate which exchange trades would be considered as hedging transactions, adding considerable complexity. The inconsistency arises in the fact that for exchange trades, such firms can rely on the Overseas Persons Exclusion to be exempt from authorization, but potentially would not be able to rely on the AAE due to the inclusion of exchange trades in this test.

As such, we would ask that self-clearing firms who are not authorised should not be put at a disadvantage due to the inclusion of exchange trades in the de-minimis test. Such firms took on the self-clearing responsibility due to many banks not being able to provide a reliable, reasonably priced and consistent clearing service. If trading venue activity is not exempt, then the threshold should be raised to at least £5 billion under Option 1.

Low risk-profile of trading venue activity

Besides the competition aspects and the intention to retain the outcome of the current AAE tests, we also note that cleared futures/exchange traded derivatives (ETDs) are not systemically important and thus pose less risk than OTC. Credit risk of ETDs is mitigated, for example, by way of posting margins. This lower risk profile was one of the reasons why exchange traded derivatives were not included in the scope of the EU de-minimis test.

Exchange-traded derivatives (ETDs) pose a low risk to financial stability primarily due to their standardised nature, central clearing, and enhanced transparency. In the UK, under the regulatory framework overseen by the FCA and the Bank of England (particularly in their role overseeing financial market infrastructure), ETDs benefit from robust risk mitigation mechanisms. These include mandatory margining, daily mark-to-market valuation, and central counterparty (CCP) clearing, which significantly reduces bilateral counterparty risk. The CCP acts as the buyer to every seller and the seller to every buyer, absorbing default risk and limiting

contagion across the financial system. Thus, we believe basing the scope of the new annual threshold test on cash-settled non-trading venue commodity derivatives is appropriate.

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?

Response:

As set out in our response to Question 2, we strongly recommend to only count cash-settled commodity derivatives not traded on a trading venue towards the de-minimis threshold.

However, if the FCA decides to include activity on UK trading venues, we would prefer Option 1, i.e. a higher threshold of at least GBP 5 Billion and the inclusion of trading venue activity without a distinction by counterparty. This option would support the aim to simplify the test, whereas Option 2 would complicate it.

At first glance, Option 2 may appear to offer a viable alternative. However, in practice, it introduces considerable complexity into the threshold test, and the scope of its proposed exclusions is overly narrow and misaligned with current market practices.

For instance, the exclusion of transactions conducted with or through FCA-authorised firms, as defined in the proposed MAR 10, would not capture a wide range of legitimate trading activity. This includes commodity derivatives traded on UK trading venues via non-UK banks or brokers, or instances where a firm self-clears through a trading venue or clearing house that is a recognised body and therefore not an authorised person. A substantial proportion of UK trading venue and cleared OTC commodity derivatives activity is currently executed through non-UK clearing firms that are regulated in their respective jurisdictions.

Similarly, where there is an FCA authorised firm within the group (for example, an energy market participant, with 4A permission but that itself relied on an exemption), transactions traded with that entity as agent (the non-authorised entity as principal) would not be excluded - by virtue of 424A making reference to an 'investment firm', and stating that such reference does not extend to a firm that may have part 4A permission, but is an exempt firm itself. Again, this is a typical corporate structure for commodity firms in the UK.

To benefit from the threshold test under the parameters set out in Option 2, firms would need to fundamentally restructure their trading arrangements and counterparties. Such a requirement would be highly disruptive and impractical. For these reasons, we do not support the adoption of Option 2.

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.

Response:

a. We agree with the suggestion to use either GBP or USD as currency of the threshold.

While there are no strong preferences for GBP or USD, i.e. either one would work, it seems the majority recognise that using GBP would send a signal that the UK is a jurisdiction in its own right rather than following the EU or the US when it comes to regulation. Using GBP would also emphasise the Government's competition mandate. Although the majority of commodity contracts are traded in USD, there are also GBP and EUR contracts, so GBP would not be an unreasonable choice. Another supporting fact for GBP is that a UK business (who would be the user of the AAE) would mainly be run in GBP, meaning trading activity would be converted anyway for the calculation of their profit, and so having to do a FX conversion for the USD trades is not an obstacle. If GBP is chosen, it may be helpful to specify what acceptable currency conversion methods can be used to harmonise the calculation. USD, however, would also work well for the test since that is the currency of most transactions. One member expressed the view that it should be considered against what firms would be measuring, i.e. trading activity in the UK (then perhaps this would support using GBP) or global trading activity (in which case USD may be the easier choice).

b. We agree with using the methodology (outside of trades conducted on a UK trading venue) for calculating a firm's net notional exposure.

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.

Response:

We believe this issue is pertinent not only to the new annual threshold test, but to all three existing AAE threshold tests. Currently, these tests are static in nature—calculated annually based on a three-year average—and lack mechanisms for revision or amendment. As a result, they do not accommodate shifts in market conditions, such as those caused by energy or financial crises.

To address this, we support the FCA possessing powers to revise all three threshold tests; however, we are not supportive of purely discretionary ad-hoc changes as temporary emergency measures. We believe that the mechanism for revision should be transparent and rules-based, ensuring that the thresholds remain both reliable and responsive.

We note that in fact the FCA will already be able to amend the threshold through its new rule-making powers in Schedule 3, Part 1, Article 2.2A (as in the process of being amended by HMT) of the Regulated Activities Order - making an additional amending mechanism in MAR10 superfluous.

Finally, any revisions must be explicitly limited to upward recalibrations to preserve legal certainty and avoid destabilising firms' regulatory status. Threshold reductions could prompt firms to unexpectedly reclassify as investment firms, potentially with little notice—something we believe should be avoided.

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.

Response:

As outlined in our response to Question 5, we support the FCA being able to revise the AAE thresholds, noting that none of the three current tests are dynamic in nature.

However, we recommend that any review mechanism avoid automatic triggers based solely on quantitative metrics, as this risks a rigid response to market movements that may not suit the circumstances, as well as adding complexity and uncertainty to the threshold calculations. We believe that the FCA will already be able to amend the threshold through its new rule-making powers in Schedule 3, Part 1, Article 2.2A (as in the process of being amended by HMT) of the Regulated Activities Order.

It may be useful to formalise an intention to review the thresholds periodically following a public consultation process, provided this does not preclude the FCA initiating consultation and change in the interim if market events require that.

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.

Response:

We support the retention of the existing calculation methodology, which our members are familiar with and find effective in practice. In addition, we support the proposal to raise the threshold.

However, we are concerned that the proposed amendments to MAR 10A.1.3R through MAR 10A.1.5R may not, in substance, preserve the current methodology and outcome. In particular, they appear to risk materially narrowing the scope of the ancillary activities exemption for firms relying on the trading activity or capital employed tests.

Under the current legal framework—both in the UK (paragraph 1(k) of Schedule 3 to the RAO) and the EU (MiFID Article 2(1)(j))—the exemption applies to persons who:

"can deal on own account when not executing client orders or provide investment services to customers or suppliers of their main business: provided that: — for each of those cases individually and on an aggregate basis, the activity is ancillary to their main business, when considered on a group basis,"

We interpret the reference to "individually" as applying to the two types of activity described in (i) and (ii), rather than to the individual entity's business. In other words, the test assesses whether each activity is ancillary to the group's main business, not whether it is ancillary to the individual entity's business. However, the proposed drafting in MAR 10A.1.3R to MAR 10A.1.5R may suggest otherwise, implying that the test applies at both the entity and group level.

This interpretation would be inconsistent with the policy position expressed throughout the consultation paper, which clearly states that the intention is not to narrow the scope of the ancillary activities exemption or expand the regulatory perimeter.

The following provision further supports our interpretation:

"— those persons are not part of a group the main business of which is the provision of investment services within the meaning of this Directive, the performance of any activity listed in Annex I to Directive 2013/36/EU, or acting as a market maker for commodity derivatives,"

We understand this to mean that the main business test applies solely at the group level. Accordingly, a person may act as a market maker in commodity derivatives at the entity level, provided this is not the group's main business. However, the proposed wording in MAR 10A under CP25/19 appears to preclude such a firm from relying on the exemption, which would contradict the stated policy intention to maintain the current scope and methodology.

We therefore recommend that the proposed rulebook amendments be revised to ensure legal certainty and alignment with the existing framework. While the drafting may not reflect the intended outcome, our members require clarity in the rulebook to avoid interpretive uncertainty. This is particularly important in scenarios such as insolvency, where ambiguity could be exploited—for example, by an insolvency practitioner seeking to disclaim an unprofitable contract.

We strongly urge that the rules be amended to clearly preserve the current scope of the capital employed and trading activity tests.

Further, the following provision introduces additional complexity:

"— those persons do not apply a high-frequency algorithmic trading technique, and — those persons report upon request to the competent authority the basis on which they have assessed that their activity under points (i) and (ii) is ancillary to their main business"

The cross-reference to MAR 10A.1.4R and MAR 10A.1.5R within MAR 10A.1.3(a) and the current drafting of MAR 10A.1.4R and MAR10A.1.5R blurs the distinction between conditions that apply to the individual person (e.g. prohibition on HFT) and those that apply to the activities assessed against the group's main business. This conflation risks creating operational and interpretive challenges for firms relying on the capital employed or trading activity tests.

To resolve this issue, the most straightforward solution—short of removing the proviso at the end of MAR 10A.1.3R, amending MAR 10A.1.4R as set out below and deleting MAR 10A.1.5R

entirely (given that these provisions are already covered in paragraph 1(k) of Schedule 3 to the RAO)—would be to amend MAR 10A.1.5R(1) as follows:

"P's main business when considered on a group basis 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 services (other than when such activity is one to which MAR 10A.1.4(2) applies)".

These amendments would clearly distinguish between the group level main business test and the entity level conditions that apply to a person that wants to use the ancillary activities exemption, which are set out in MAR 10A.1.5(2) and (3).

Additionally, the wording of MAR 10A.1.4(2), which refers to the annual threshold being applied on an "individual basis," introduces further ambiguity. It is unclear whether this refers to the individual activity (as in MAR 10A.1.4(1)), the individual entity, or both. This ambiguity could be avoided by deleting the words "when considered on an individual basis" from MAR 10A.1.4(2) and replacing them with a reference to MAR 10A.3.1, so that it reads as follows:

"(2) is below an annual threshold in accordance with the methodology in MAR 10A.3.1 ~~when considered on an individual basis~~."

These amendments would help ensure that the rulebook accurately reflects the policy intention and provides firms with the legal certainty necessary to operate with confidence under the exemption.

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.

Response:

Yes, we agree with the proposal to retain the calculation methodology and to raise the threshold. However, please see our response to Question 7 regarding our concerns as to whether the intent to apply the test to the main activity of the group is correctly reflected in the proposed changes to MAR10.

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