Consultation Paper CP25/19 Ancillary Activities Test

28 August 2025

Energy Traders Europe welcome the opportunity to respond to the Financial Conduct Authority's (FCA) Consultation Paper (CP) 25/19 (Ancillary Activities Test) and the constructive proposals included in the paper.

We have set out a detailed response to the CP questions in the sections below, however there are four key points that we would like to draw to the FCA's attention:

- **Exclude UK trading venue activity from the annual threshold test.** We are firmly against including on-venue trades, as this would harm UK competitiveness, duplicate existing controls, and diverge from EU and US approaches.

- **Both annual threshold test approaches have drawbacks.** Approach 2, as drafted, is too narrow and arbitrary. Approach 1 is simpler but still needs clarification on cash-settled products and needs removing trading conducted on a UK trading venue from the scope of the annual threshold test.

- **Avoid automatic or inflation-linked threshold adjustments.** Automatic adjustments would add complexity and instability, while the FCA's rule-making powers already allow for proportionate reviews. Any future changes to the threshold should be subject to transparent consultation.

- **Support higher thresholds for the trading and the capital-employed test.** We support the 50% thresholds for the trading test and the capital-employed test.

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.

Energy Traders Europe welcomes the UK FCA's proposal to introduce an alternative annual threshold test and to allow firms to choose among three tests. We fully support this flexible approach, as it enables firms to apply the option that best matches their business model and trading profile.

Our members that benefit from the exemption under EU MiFID II rely on all three available tests: de minimis, Capital Employed, and Trading. This experience confirms that such flexibility is essential as it reflects the diversity of business models.

The FCA's proposal is also consistent with MiFID II's underlying policy objective: ensuring that only firms whose activities are comparable to those of investment firms are subject to authorisation. As such, the FCA's **proposed alternative tests offer a flexible, proportionate, and workable solution for energy market participants, as well as for firms from the real economy** (e.g. the manufacturing sector).

Each of the three tests plays a distinct role:

- Annual Threshold Test: Appropriately exempts energy market participants whose in-scope trading activities are insignificant from a systemic risk perspective.
- Capital Employed Test: Aligns with energy market participants owning substantial real-economy assets, such as wind farms and power plants, by considering the capital invested in physical infrastructure relative to trading activities.
- Trading Test: Addresses energy market participants with limited physical assets, ensuring that their trading activities are evaluated in the context of their overall business operations.

The embedded flexibility of the 3 alternative tests ensures that it:

- Adapts to different company structures and sectoral needs,

- Avoids forcing market participants into rigid compliance mechanisms that do not reflect their real economic activity, and
- Prevents disproportionate regulatory burdens on firms that perform essential market functions but are not, by nature, financial institutions.

In conclusion, the option to apply any one of the three tests offers a **balanced and pragmatic approach** for the different types of energy market participants.

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

Energy Traders Europe firmly believes that **trading conducted on UK trading venues should be excluded from the annual threshold test**.

Reduced competitiveness
Commodity markets are inherently global, with many firms structured to trade across multiple venues. To avoid UK venue trades contributing to the annual threshold calculation, **firms may shift trading to EU or international venues**, making similar products listed outside the UK more attractive and potentially fragmenting liquidity away from UK markets. This could penalise UK trading venues, incentivise regulatory arbitrage, and **place UK firms at a competitive disadvantage**.

If UK trading venues become less attractive due to their inclusion in the threshold test, **market participation may decline**, impairing price transparency and weakening the robustness of key energy benchmarks. This would limit access to competitive, transparent hedging tools for commercial players, given the central role derivatives markets play in managing physical supply and price risk across global supply chains.

Contradicts stated policy commitments
If the UK were to take a different approach by including on-venue trades, it would be contrary to the Financial Services Growth and Competitiveness Strategy (p.8, recently released in July), as it would reduce UK competitiveness by requiring market participants

with cross-border operations to implement dual compliance frameworks, introducing costs and operational complexity without any clear benefit. Secondly, it would contradict the FCA's stated policy intention of keeping the scope of the AAE unchanged, as this approach could result in firms currently exempt being brought into scope for authorisation as investment firms (as the regulatory perimeter alters). Finally, this divergence could **undermine the FCA's statutory objective to enhance the UK's international competitiveness and growth**, and could erode the UK's standing as a global hub for commodity trading.

Redundant – market abuse covered by other regulations

The risks targeted by the threshold test are **already effectively managed through existing infrastructure** under EMIR and the FCA's proposed reforms to the commodity derivatives regulatory framework (e.g., position reporting, position limits regime, position management controls). UK trading venues operate under robust exchange rules, including margining, daily settlement, and stringent conduct standards. Access, whether direct or via Direct Electronic Access (DEA), is tightly controlled, with multiple layers of oversight ensuring market integrity and stability. Exchanges must verify that participants are appropriately supervised, and risk management controls apply regardless of a user's regulatory jurisdiction. Additional safeguards such as position limits (recently strengthened through the UK FCA's February reforms (PS25/1)) and large position reporting further tighten market surveillance and promote orderly markets, rendering additional perimeter-based controls via the threshold test duplicative and unnecessary.

Added complexity

We strongly support the FCA's intention to simplify the AAE and the related tests. However, the proposed inclusion of exchange traded derivatives adds unnecessary complexity: firms would not only need to identify and calculate exchange traded derivatives, but **would also need to classify these transactions into financially-settled vs. physically settled transactions**, privileged transactions (e.g., hedging transactions and liquidity provision) and non-privileged transactions - which **represents a considerable compliance burden**.

Misalignment with international frameworks
Including such activity would create **a stricter and more complex regime** which does not align to international standard and business trading models. This approach would go against the Financial Services Strategy (p.11), as it would inappropriately put the UK's approach out of line with international competitors. Well-established and trusted frameworks in both the European Union and the United States explicitly exclude exchange-traded derivatives (ETDs) from *de minimis* thresholds.

Conclusions
In conclusion, the FCA should **exclude all trading activity conducted on UK trading venues from the annual threshold test** to avoid penalising UK trading venues, incentivising regulatory arbitrage, and placing UK firms at a competitive disadvantage. Moreover, including such activity would conflict with recent policy commitments set out in the Financial Services Growth and Competitiveness Strategy, the FCA's stated intention to maintain the scope of the AAT, and the FCA's broader statutory objective to promote the UK's international competitiveness and growth. Doing so would preserve the UK's market competitiveness, support regulatory principles of simplification and efficiency, protect legitimate commercial trading activity, and ensure coherence without undermining market integrity or discouraging participation in UK markets.

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.

While member firms have not expressed a clear preference of the options as written, as both of the options come with significant drawbacks and need to be amended in order to work, **approach 1 is preferred, subject to exclusion of trading activity on UK trading venues**.

Approach 1 as generally regarded as being the simpler of the two. However, firms have noted the need for the FCA to provide a definitive list of "*cash settled*" products in order to ensure legal certainty. In the absence of such clarity, it is difficult for firms to assess whether the GBP 5 billion threshold is appropriate.

Additionally, as argued in Q2, we are strongly against introducing trading conducted on a UK trading venue in the annual threshold test. Doing so would preserve the UK's market competitiveness, support regulatory principles of simplification and efficiency, align with current policy commitments, maintain regulatory alignment with the EU and US, and ensure coherence without or discouraging participation in UK markets.

Approach 2 also has a significant drawback and, as currently proposed, does not appear to be workable. It would exclude a significant number of firms because the "*with or through*" exclusion Regulated Activities Order (RAO) exemption is broader in design than the narrowly defined exclusion set out in Approach 2, which is limited to trading "*with or through*" an "*FCA-authorised*" firm. The reference in Approach 2 to an FCA authorised firm does not include as broad a range of persons as can be used to satisfy the exclusions in the RAO that refer to the "*with or through*" concept (which many commodity market participants currently use). The difference between the "*with or through*" wording in the RAO and that used in Approach 2 seems unnecessary and potentially confusing. This could be remedied by aligning the "*with or through*" wording in Approach 2 with the corresponding concept and the scope of persons to which it applies in the RAO, as well as recognizing equivalence for overseas firms.

The current narrow wording of Approach 2 risks creating a two-tier "*with or through*" exclusion, further complicating the UK regulatory regime for commodity market participants. It would create two tests: 1) a broader test applying to consider whether a market participant can apply an RAO exclusion based on trading "*with or through*" a relevant person and 2) a different, narrower test to consider whether its trading activity can be excluded from the annual threshold calculation applied for the purposes of working out whether it can use the (MiFID) ancillary activities exemption.

The availability of the ancillary activity exemption to smaller firms seeking to use the annual threshold test, if this takes the form set out in Approach 2, is highly arbitrary and largely outside the control of the firm seeking the exemption. Its applicability depends heavily on a firm's trading structure, counterparty relationships, and market access models.

It risks steering trading behaviour based on regulatory status rather than commercial logic. The additional complexity introduced by this difference in scope may disadvantage UK commodity market participants and may ultimately discourage international firms (e.g., operating via EU or US entities) from using UK markets, to the detriment of UK market liquidity and competitiveness.

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.

The legal uncertainty on what "*cash settled*" products are intended to be included in this calculation has made it difficult for firms to provide evidence based data, as firms do not currently capture this data. Additionally, as mentioned in the response to Q2, the classification of these transactions into financially settled vs. physically settled transactions (plus privileged or not transactions, such as hedging and liquidity provisions) revealed that the calculations are extremely complex - a sensitive and considerable compliance burden. As Energy Traders Europe, we encouraged firms to provide evidence based data directly to FCA, in their own replies.

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.

a. We support the FCA's proposal to use GBP as the currency for the annual threshold. The main reason is that most energy market participants in the UK (though not all) use GBP, and this would simplify the calculation of their tests. Additionally, many users of the annual threshold are likely to be small UK firms, for whom a test based on GBP would further simplify compliance.

b. We support the FCA's netting approach. We consider appropriate the FCA's proposed netting methodology to the annual threshold test, as it provides a well-understood and workable calculation method already familiar to market participants.

   The alternative 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, as alluded to in paragraphs 3.23 of CP 25/19.

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.

We acknowledge that exceptional market developments may occasionally warrant a review of the annual threshold. However, we do **not believe that such circumstances justify the need for rapid or automatic adjustments embedded in the rules**.

Commodity prices can be volatile due to external factors such as geopolitical tensions (e.g., the Russian invasion of Ukraine), regulatory shocks (e.g., US tariffs), or sudden shifts in supply and demand. Yet, these movements are not always structural or sustained. Given that the annual threshold is based on average notional exposures over 3 years, temporary spikes or corrections are already smoothed out to a large extent by design.

Embedding a mechanism for quick adjustment could introduce regulatory volatility and uncertainty - effectively forcing firms to recalibrate systems and assumptions with little notice. This would go against the broader objective of reducing compliance burden and enhancing legal certainty.

Additionally, the FCA will be already empowered to amend the threshold through its rule-making powers, as provided by the amendments to Schedule 3, Part 1 of the Regulated Activities Order (HMT Ancillary Activities Exemption, Policy Note, July 2025, point 4.3) - making an additional amending mechanism redundant. We much welcome the FCA's stated intention (at point 3.55 of CP25/19) to exercise this power through public consultation, rather than automatic adjustments.

In our view, the current approach, retaining a fixed threshold with the possibility of targeted review via public consultation, remains the most proportionate and effective solution (as FCA also rightfully notes in 3.55 of CP25/19). It ensures stability while preserving regulatory flexibility when truly needed.

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.

We do **not support the introduction of an automatic mechanism to adjust the annual threshold**. While we agree with regular, but not overly frequent, regulatory reviews, we do not consider it necessary to include an adjustment mechanism as a specific provision in the legislation.

Retaining a fixed threshold with the possibility of targeted review via **public consultation** remains the most proportionate and effective solution, as the FCA also rightfully notes in paragraph 3.55 of CP25/19. This approach ensures legal certainty and operational stability for firms, while preserving the FCA's regulatory flexibility to respond to material market developments. We strongly support the principle that **any future**

changes to the threshold should be subject to transparent consultation rather than automatic adjustment mechanisms.

We appreciate the intention to maintain the threshold's real value over time; however, we believe this approach would introduce unnecessary complexity for firms and weaken the clarity the regime seeks to provide.

- **Complexity for firms**: A fixed monetary threshold (such as £3 or 5 billion) is clear, stable, and easy to implement. An annually adjusted threshold would require firms to regularly monitor updates, potentially reconfigure internal systems, and account for currency conversion or differing inflation indices, all of which increase the compliance burden and reduce predictability.
- **Misalignment with market dynamics**: Adjustment indices are typically tied to general economic conditions (such as CPI or GDP deflators), not to commodity market trends. Commodity prices and trading volumes may fluctuate due to entirely different factors (e.g., geopolitical shocks, energy transition, climate policies). Anchoring the threshold to indices could limit the FCA's future flexibility to respond to such developments through targeted and justified revisions.
- **Divergence from the EU**: The EU regime does not include automatic indexation of the threshold for inflation. Introducing such a mechanism in the UK would further increase divergence between the two regimes, reducing operational alignment and increasing compliance burden for firms active across both jurisdictions. This would go against the recent statements made at the 2025 EU–UK Leaders' Summit, where leaders agreed to reduce red tape and bureaucracy, extend energy cooperation on a permanent basis, and continue negotiations on the UK's participation in the EU internal electricity market.

Reflecting on the **specific suggestion of an inflation-adjustment mechanism for the annual threshold**, the idea may seem appealing, but its practical implementation is problematic.

- First, it is unclear which inflation measure should apply. A **general inflation index** (e.g. CPI) reflects a broad basket of goods and may understate changes in commodity markets.

- Alternatively, using **commodity price inflation** might better reflect market realities, but it would risk overreacting to external events (e.g., the Russian invasion of Ukraine). Given that the threshold test captures past trading activity, a sudden drop in prices could disproportionately tighten the exemption (a situation which would be avoided if adjustment only goes up).

In both cases, the choice of index introduces volatility or misalignment that undermines the simplicity and legal certainty the new regime is meant to deliver. These risks outweigh the theoretical benefits of indexation.

Therefore, we recommend **maintaining a fixed nominal threshold**, with the FCA retaining the option to review and consult on changes when market conditions or policy objectives require it. This approach strikes the right balance between legal certainty, simplicity, and adaptability.

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.

We **agree with the thresholds for the trading tests at 50%,** and with **maintaining the current calculation methodology** - this would ensure that only firms for which dealing in commodity derivatives constitutes a minority of their business would benefit.

We observed that **the scope is affected**. The proposal to retain the RTS 20 methodology while raising thresholds for the trading test is framed as a simplification of the Ancillary Activity Test (AAT), but it **actually diverges from the original framework** because of the very fact that it only looks at activity traded in the UK.

Specifically, the revised trading test narrows both the numerator (of the entity) and denominator (of the group), which **significantly lowers the effective threshold** for firms with global operations. There is a risk firms with a small UK footprint will not benefit from this exemption as they will be unable to include the relative nature of their group's activity in global commodity derivatives and emission allowances.

This could drive certain firms to trade outside the UK. While the cost-benefit analysis suggests minimal impact, it may underestimate the effects of this change.

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.

We **agree that setting the threshold for the capital employed test at 50%** and **retaining the current calculation methodology** would ensure that only firms for which dealing in commodity derivatives constitutes a minority of their business would qualify for the exemption.

The Capital Employed Test aligns with energy market participants owning substantial real-economy assets, such as wind farms and power plants, by considering the capital invested in physical infrastructure relative to trading activities.

For other questions please contact

Mike Bostan
Manager, Market Supervision Committee
m.bostan@energytraderseurope.org