



21 August 2013

Letter to:

European Commission, European Parliament, Lithuanian Presidency

MiFID II – Annexe I Section C.6 – Definition of Financial Instruments

We are writing to you as a collective group of Trade Associations regarding the definition of financial instruments under MiFID II, in particular the wording in Annexe 1, Section C6 of the Council's compromise text adopted by ECOFIN on June 21 2013.

We and our members fully support transparency in the commodity markets and recognise the need for regulators to have accurate information to enable them to carry out their supervisory and enforcement mandates. We believe that maintaining liquidity in the physical commodity markets is in the interests of all commodity market participants (e.g. utilities, corporates, banks and other financial trading houses and their customers) and it is within this context that meaningful consideration should be given to developing an alternative definition of physical forward contracts in commodities than that which is currently in the Council's text. In addition, the regulatory environment has changed significantly since MiFID I and with EMIR now in force this definition is of key importance to commodity market participants. This current text is very narrowly defined and it inadvertently captures physical commodity transactions that do not have the characteristics of financial instruments and it is our understanding that it is not the Commission's intention to capture this type of trading within the MiFID II legislation.

As commodity markets are global markets, it is of the utmost importance that any new European regulations remain consistent with comparable international regulatory regimes without further exclusions or special treatments. To this point, we draw your attention to the language of Dodd Frank in the US where a physical forward contract, irrespective of the platform on which it is traded remains exempt from financial services regulation. The US legislation also relies on the element of 'intention' behind a trade and objectively defines it in a way that limits scope for discretion and potential 'loopholes'.

We believe that *intentionality* of making/taking delivery when agreeing the terms of the contract should be the governing factor in defining whether a forward commodity contract is a commodity derivative or physical forward contract. Commodity forward contracts concluded with the intention to make/take delivery of a physical commodity at a certain point in the future are used by both non-financial firms and financial firms, in the ordinary course of their business to manage price and commercial risk.

Given the above, we wish to propose a wording that gives certainty to the intention of the parties regarding the physical settlement of contracts. We propose that the Council's text adopted by ECOFIN on June 21 2013 be amended to:

(6) Options, futures, swaps, forwards and any other derivative contracts relating to commodities that can be physically settled provided that they are traded on a regulated market or an MTF or an OTF except for such contracts traded on an OTF that **are intended to** be physically settled.

We also respectfully submit that if this definition is applied within Annexe 1 C.6, it is done so consistently throughout the MiFID text.

Following agreement on Level I wording, the objective criteria to assess the intention of the parties when entering into a commodity forward contract could be further expanded and clarified with a mandate given to ESMA, in cooperation with competent authorities /regulators to draft Level 2 technical standards. These technical standards would be more able to accurately address the divergent nature of the different commodity classes.

As a basis for a determination of the intentionality to deliver physical forward contracts we propose exploring the concepts elaborated in international legislation which include (amongst others) the regularity for counterparties to take or make delivery, the inclusion of clauses that provide the obligation to deliver and do not provide the right to offset, cancel or settle as a payment difference for the contract, the exclusion of contracts which contain an *embedded* option to make delivery 'optional' or to cash settle the contract in lieu of delivery. The legislation should continue to acknowledge payment and settlement netting between market participants for operational or scheduling purposes; as well as ensure the right to cash settle a contract under conditions of extreme market stress, force majeure or counterparty default.

We are aware that that detailed concepts of intentionality will require further attention and the recitals of MiFID II could be used to address this work with ESMA at level 2.

We would welcome further dialogue with the Commission and remain available at any convenient point to discuss.

Yours sincerely



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On behalf of the collective memberships of the:

European Federation of Energy Traders

Futures and Options Association

Global Financial Markets Association

International Swaps and Derivatives Association