



European Securities and
Markets Authority

**Reply form for the
Consultation paper
Guidelines on the application of C6 and C7 of Annex I of MiFID**



30 September 2014



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Date: 30 September 2014



Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the Consultation paper - Guidelines on the application of C6 and C7 of Annex I of MiFID, published on the ESMA website ([here](#)).

Instructions

Please note that, in order to facilitate the analysis of the number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, please follow the instructions described below:

- i. use this form and send your responses in Word format;
- ii. do not remove the tags of type < ESMA_ MIFID_ C6_ C7_ QUESTION_1 > - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
- iii. if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Responses are most helpful:

- i. if they respond to the question stated;
- ii. contain a clear rationale, including on any related costs and benefits; and
- iii. describe any alternatives that ESMA should consider

To help you navigate this document more easily, bookmarks are available in “Navigation Pane” for Word 2010 and in “Document Map” for Word 2007.

Responses must reach us by **05 January 2015**.

All contributions should be submitted online at www.esma.europa.eu under the heading ‘Your input/Consultations’.

Publication of responses

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading ‘Disclaimer’.



Q1: Do you agree with ESMA’s approach on specifying that C6 includes commodity derivative contracts that “must” be physically settled and contracts that “can” be physically settled?

<ESMA_MIFID_C6_C7_QUESTION_1>

We do not agree with ESMA's approach in this context.

As ESMA acknowledges at paragraph 12 of the Consultation Paper, 'the guidelines are based solely on the current MiFID requirements' and '[t]he potential impact of MiFID II and future implementing measures fall outside of the scope of the exercise'. However, we note that the use of “must be” in the context of MiFID is limited to “must be cash settled” for the purposes of C(5) whereas the term “must be physically settled” is not used in MiFID and it is therefore unclear why ESMA has sought to address this issue in the Consultation Paper.

Moreover, as the Commission has noted, it would be inappropriate for ESMA to prejudge the work on the delegated acts being developed under MiFID II. Addressing these issues at this stage is likely to cause confusion for market participants. Therefore, in our view, neither the guidelines nor the Consultation Paper should seek to elaborate on the definition of “must be physically settled”. In this regard, we support the omission from paragraph 21(a) of the guidelines of a reference to “must be physically settled”, notwithstanding the inclusion of such a reference at paragraph 41(a) of the Consultation Paper.

In any event, to the extent ESMA proposes to provide any guidance as to the meaning of “must be physically settled”, we believe that it is imperative that such guidance aligns with the position that is to be adopted under MiFID II.

<ESMA_MIFID_C6_C7_QUESTION_1>

Q2: Do you consider there are any alternatives for or additions to the proposed examples of “physically settled” that ESMA should consider within the definition of C6? If you do, what are these?

<ESMA_MIFID_C6_C7_QUESTION_2>

Yes. We believe that the definition of “physically settled” should incorporate a broad range of delivery methods as guidance for market participants and agree with ESMA’s approach of providing a non-exhaustive list of circumstances which would constitute “physical delivery”. However we are of the view that there are various amendments which should be made to the proposed examples of “physically settled” in paragraph 21(b) of the guidelines (which we set out below).

In relation to paragraph 21(b)(i), we would recommend clarifying that the guidelines apply to derivative contracts relating to commodities and replacing the references to “relevant goods” with “relevant commodities” (as “goods” is not a term defined under MiFID and as all these provisions relate to commodity derivatives).

We note that the text relating to delivery methods set out in paragraph 21(b)(ii) and (iii) of the guidelines deviates from the text that appears at paragraph 41(b)(ii) and (iii) of the Consultation Paper (and the existing CESR guidance which is replicated in the ESMA MiFID II consultation paper). Specifically paragraph 21(b)(ii) and (iii) omit the specific examples of delivery methods which we believe should be reinstated:

(ii) delivery of a document giving rights of an ownership nature to the relevant goods or the relevant quantity of the goods concerned (such as a bill of lading or a warehouse warrant); or

(iii) another method of bringing about the transfer of rights of an ownership nature in relation to the relevant quantity of goods without physically delivering them (including notification, scheduling or nomination to the operator of an energy supply network) that entitles the recipient to the relevant quantity of goods.

Given the extent to which physically delivery can involve different methods across commodity markets, such examples provide useful guidance for market participants, are helpful in delineating the scope of physical delivery and, in our view, should be developed rather than deleted.

In particular, we would propose the following amendments to paragraph 21(b)(ii) so that it reflects a more generally applicable concept of the transfer of ownership rights in a commodity which is consistent with the position we adopted under the MiFID II Consultation:

~~"delivery of a document giving rights~~ **transfer of a right** of an ownership **or possessory** nature to the relevant ~~goods~~ **commodity** or the relevant quantity of the ~~goods~~ **commodity** concerned (such as **by delivery of a document, e.g. a confirmation from the power or gas market operator, a bill of lading or a warehouse warrant**);"

Finally, we welcome ESMA's acknowledgment at paragraph 37(c) of the Consultation Paper that:

"the amendment, assignment or other form of alteration of the records of rights of ownership in a central registry or other dematerialized system recording entitlement to establish a change in beneficial ownership of a physical commodity"

constitutes a form of physical delivery and we fully support guidelines providing clarity on this point. Accordingly, we would recommend including paragraph 37(c) of the Consultation Paper as paragraph 21(b)(iv) of the guidelines, however with the following changes:

"the amendment, assignment or other form of alteration of the records of rights of ownership in a **storage facility, repository,** central registry or other dematerialized system recording entitlement to establish a change in beneficial ownership of a physical commodity"

<ESMA_MIFID_C6_C7_QUESTION_2>

Q3: Do you agree with ESMA's discussion of the relationship between definitions C5, C6 and C7 and that there is no conflict between these definitions? If you do not, please provide reasons to support your response. In particular, ESMA is interested in views regarding whether the proposed boundaries would result in "gaps", into which some instruments would fall and not be covered by any of the definitions of financial instrument. ESMA also seeks views on whether there are any adverse consequences from the fact that some instruments could fall into different definitions depending upon the inherent characteristics of the contract e.g. those with "take or pay" clauses that may be either cash or physically settled.

<ESMA_MIFID_C6_C7_QUESTION_3>

We broadly agree with ESMA's discussion of the relationship between definitions C5, C6 and C7 and do not believe there is a conflict between these definitions. However although not relevant in the context of MiFID, we would like to take this opportunity to highlight that we do not agree with the comment at footnote 8 of the Consultation Paper which states;

"ESMA notes it has not been able to identify any instrument which can be accurately described as "must be physically settled", as all instruments appear to contain force majeure provisions that would prevent physical delivery."

We strongly believe that default, force majeure and netting do **not** change the fundamental nature of the contractual obligations of the respective parties to deliver and accept the relevant commodity by way of physical settlement. Accordingly, in our view, the existence of force majeure provisions or other bona fide clauses (including events of default specified in the relevant contract, the consequences of which is for one party to pay the other damages due to their inability to perform) providing for cash settlement where physical delivery is not possible should not prevent a contract from being characterized as "must be physically settled". In fact, for physical markets, exposure to force majeure events is a fundamental risk for which contracting parties must account, and the consequences of which must be agreed upon, at the time



of entering into the contract to ensure upon the occurrence of such events there is an orderly unwinding of the contract. For the sake of good order, we would like to reiterate that we do not believe that it is appropriate for ESMA to address this issue in the Consultation Paper or the guidelines.

<ESMA_MIFID_C6_C7_QUESTION_3>

Q4: What further comments do you have on ESMA's proposed guidance on the application of C6?

<ESMA_MIFID_C6_C7_QUESTION_4>

Given the guidelines specifically confirm that forwards fall within the scope of C6, for the avoidance of doubt, we believe it would be helpful if ESMA confirmed that (i) the definition of spot contract that is provided in Article 38(2) of Regulation 1287/2006/EC should be read widely to apply to C6 as well as C7 and (ii) spot contracts therefore fall outside the scope of C6.

<ESMA_MIFID_C6_C7_QUESTION_4>

Q5: Do you have any comments on ESMA's proposed guidance on the specification of C7?

<ESMA_MIFID_C6_C7_QUESTION_5>

We welcome ESMA's acknowledgment at paragraph 25 of the guidelines that the conditions in Article 38 of Regulation 1287/2006/EC are to be applied cumulatively and support the current definition of 'spot contracts' as provided under Article 38(2). We note however that the paragraph should refer to 'the conditions defined in Article 38 of Regulation 1287/2006/EC, set out separately above' rather than 'below'.

Furthermore, as we outline in response to question 2 above, we believe the term 'physically settled' should incorporate a broader range of delivery methods. It is imperative that the 'physical settlement' is interpreted consistently under C6 and C7. Therefore, in our view, the changes we propose in respect of paragraph 21(b) of the guidelines should also be made to paragraph 22(b) of the guidelines.

<ESMA_MIFID_C6_C7_QUESTION_5>