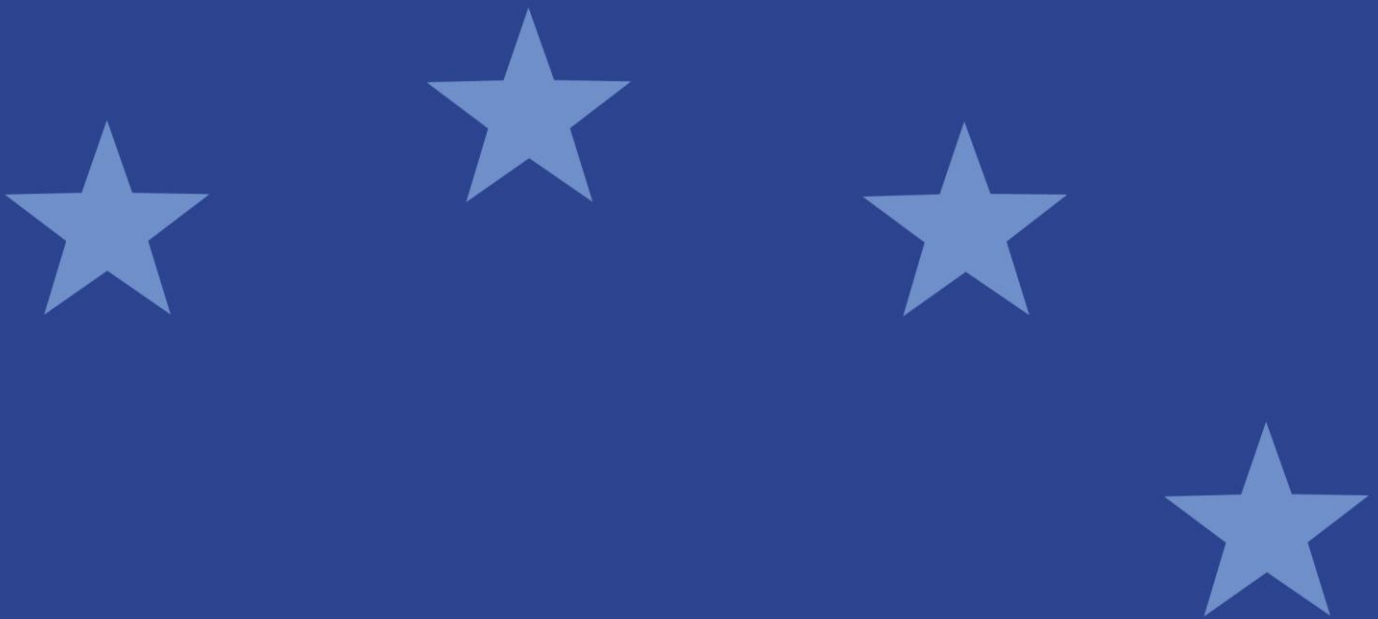




European Securities and  
Markets Authority

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





European Securities and  
Markets Authority

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](http://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](http://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>

Energy Regulators broadly support ESMA’s aim to clarify the application of C6 of MiFID I. In particular, as regards the definition of financial instruments in C6, the boundaries of this definition are correctly identified in ESMA’s draft guidelines, where they refer to the following two requirements in order for a contract to be classified as a commodity derivative under C6: i) the contract “can be physically settled”; ii) the contract is “traded on a regulated market and/or an MTF”.

Energy regulators are of the view that the analysis on the application of C6 should be carried out strictly referring to relevant and defined terms under MiFID I, which do not include the notion of “must be physically settled”. In particular, CEER has considered the proposed approach of ESMA to extend the scope of C6 to contracts that “must” be physically settled, but, without pre-empting the interpretation of MiFID II, would rather be of the opinion that the notion of “can be physically settled” does not encompass contracts that “must be physically settled” because these describe two different groups of contracts. If a contract must be settled physically then – by nature – there is no other ordinary settlement method than physically.

In this respect, CEER considers that discussion on contracts which “must be physically settled”, including the consideration to be given to exceptional circumstances, such as *force majeure*, *bona fide* or *default clauses*, should be carried out more appropriately in the context of the level 2 implementation of MiFID II, where the notion of “must be physically settled” enters the definition of financial instruments under C6.

CEER would like to point out that contracts that must be physically settled represent an important part of wholesale energy products and that the reporting and supervision of those contracts is properly captured by REMIT, the sector specific market abuse regime for electricity and gas markets. In particular, the notion of wholesale energy products under REMIT explicitly encompasses both physical contracts and commodity derivatives irrespective of where and how they are traded (definition of wholesale energy product in Art. 2 (4) REMIT).

<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>

Energy regulators welcome ESMA’s general approach on determining what is meant by “can”, “may” and “must” be physically settled. Moreover, Energy regulators agree that CESR advice issued in 2005 provides clarification on the notion of “physical settlement” and an appropriate reference in terms of delivering methodologies. However, we suggest ESMA considers, as an addition to the proposed examples, the treatment of “operational netting” in energy markets, in line with the current work on the draft implementing rules on MiFID II and MiFIR (see ESMA Consultation paper on MiFID II/MIFIR of 22 May 2014). Operational netting is a form of settlement in electricity and gas markets typically originating from the transmission system operators’ operational rules requiring the parties to the contract to net the flows at the point of delivery for operational efficiency and balancing of network capacity. Adjustments in traded positions in the context of operational netting occur continuously and should be considered within the original obligation to physically deliver.

<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>

Energy regulators are of the view that the analysis of the definitions should be carried out only referring to relevant and defined terms under MiFID, namely the notions of commodity derivatives that “must be settled in cash” or “may be settled in cash at the option of one of the parties” or, finally, that “can be physically settled”. Discussion on contracts which “must be physically settled”, including the consideration to be given to exceptional circumstances, such as *force majeure*, *bona fide* or *default clauses*, should not preempt the current work on level 2 implementation of MiFID II.

For the classification of specific contracts, and having regards to the definitions of financial instruments provided in C5, C6 and C7, we deem it important to highlight the distinction between primary obligations and secondary obligations. This will assist in the classification of some instruments. For example, “take or pay contracts” are typically long term contracts for the physical delivery of relatively large volumes of the underlying commodity that are structured in a way to manage the risks to which a large project capital investment (i.e. gas production fields, pipelines and LNG terminals) is typically exposed. In particular the importer assumes the volume risk via the take-or-pay provision. In this context, the cash settlement can be considered as a compensation for the damage otherwise incurred by the producer-exporter which is caused by a failure to accept delivery of the relevant commodity, often due to changing market conditions. Therefore, considering “take or pay” contracts as not being contracts that “can be physically settled” would not only have adverse consequences on the energy market but contradict the intrinsic nature of those contracts.

<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>

Energy regulators agree with ESMA’s proposed guidance on the application of <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>

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<ESMA\_MIFID\_C6\_C7\_QUESTION\_5>