The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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ESMA Issues Consultation Paper on Certain Aspects of Definition of Derivatives

[28419]

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TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 65-14
ICI GLOBAL MEMBERS No. 38-14
INTERNATIONAL COMMITTEE No. 32-14 RE: ESMA ISSUES CONSULTATION PAPER ON CERTAIN ASPECTS OF DEFINITION OF DERIVATIVES

On September 29, the European Securities and Markets Authority ("ESMA") issued a consultation paper on draft guidelines to ensure the consistent classification of certain financial instrument as derivatives. [1] As previously reported to you, there are different approaches to the interpretation of Markets in Financial Instruments Directive ("MiFID I") across the EU Member States, which means that there is no commonly-adopted application of the definition of derivative or derivative contract in the EU for some asset classes. ESMA had raised with the EU Commission the importance of this issue given the implementation of European Market Infrastructure Regulation ("EMIR"). [2] The EU Commission invited ESMA to consider issuing guidance under MiFID I.

The Consultation Paper focuses on commodity forwards rather than foreign exchange forwards and on the application of the definitions of C6 and C7 of Annex 1 of MiFID I. [3] ESMA's proposed guidelines are as follows.

ESMA considers the definition of C6 of MiFID I to include all commodity derivative contracts, including forwards, if they must or can be physically settled and are traded on a regulated market or a multilateral trading facility ("MTF"). "Physically settled" would include: (1) physical delivery of the relevant goods; (2) delivery of a document giving rights of an ownership nature to the relevant goods or the relevant quantity of goods; or (3) 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 that entitles the recipient to the relevant quantity of the goods.

ESMA considers the definition of C7 of MiFID I to apply to commodity derivative contracts that can be physically settled that are not traded on a regulated market or an MTF provided that the commodity derivative contract is not a spot contract, is not for commercial purposes, and meets certain additional criteria. [4] “Physically settled” in this context would have the same meaning as for C6 described above.

Comments on the Consultation Paper are due by January 5, 2015. If you have any concerns about the proposed guidelines, please contact me at jennifer.choi@ici.org by Friday, October 31.

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endnotes

[1] Consultation Paper, Guidelines on the application of C6 and C7 of Annex I of MiFID (Sept. 29, 2014), available at http://www.esma.europa.eu/system/files/guidelines_on_mifid_1_c6_and_c7.pdf (“Consultation Paper”).

[2] For a summary of the ESMA letter and the Commission’s response, see ICI Memoranda Nos. 28297 (Aug. 4, 2014), available at http://www.ici.org/my_ici/memorandum/memo28297; 27980 (Mar. 25, 2014), available at http://www.ici.org/my_ici/memorandum/memo27980; 27895 (Feb. 18, 2014), available at http://www.ici.org/my_ici/memorandum/memo27895.

[3] C6 refers to “[o]ptions, futures, swaps and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market and/or an MTF.” C7 refers to “[o]ptions, futures, swaps, forwards and any other derivative contract relating to commodities that can be physically settled not otherwise mentioned in [C6] and not being for commercial purposes, which have the characteristics of other derivative financial instruments, having regard to whether inter alia, they are cleared and settled through recognized clearing houses or are subject to regular margin calls.”

[4] The three criteria under Article 38(1)(a) and criteria under Articles 38(1)(b) and 38(1)(c) would have to be satisfied.