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22 February 2017

POSITION LIMITS/REPORTING REGIMES – TREATMENT OF CONTRACTS TRADED ON THIRD COUNTRY VENUES

We write further to the meeting between ESMA and ISDA, GFMA, FIA and member firms on 16 November 2016. As you are aware, we have been considering various issues regarding the scope of the MiFID II position limits and reporting regimes. The purpose of this paper is to set out our understanding of the geographical scope of these regimes in light of the Commission Delegated Regulation of 25 April 2016 (**"DR"**) and, in particular, to set out our reasoning for concluding that contracts traded on third country venues are not in scope for Articles 57 or 58 MiFID II.

Executive Summary

Article 57 (*Position limits and position management controls in commodity derivatives*) MiFID II applies to "*commodity derivatives traded on trading venues and economically equivalent OTC contracts*". In order to provide firms with sufficient clarity regarding the scope of the position limits regime we believe it is important for ESMA to clarify how certain defined terms, such as: (i) "*commodity derivative*"; (ii) "*trading venue*"; and (iii) "*economically equivalent OTC contracts*" (or **"EEOTC"**), should be interpreted. As further discussed below, in our view:

- Contracts that are traded on third country venues <u>may</u> (although they will not necessarily always) fall within the definition of "*commodity derivative*". Nevertheless, falling within the "*commodity derivative*" definition is only the first step in identifying whether a contract is within the scope of the obligations under the position limits contained in Article 57 MiFID II.
- Contracts that are traded on third country venues are a separate category from contracts: (i) traded on *"a trading venue"*; and (ii) that are "*EEOTC*".

Article 58 (*Position reporting by categories of position holders*) MiFID II applies to "*commodity derivatives"* or emission allowances or derivatives thereof. As Article 58 requires Member States to ensure that reports are submitted in respect of *"commodity derivatives"* traded on *"trading venues"* and *"EEOTC",* the same interpretation given to those terms in Article 57 should be used for the position reporting regime contained in Article 58 MiFID II.

Therefore, no contract traded on any third country venue (whether or not it is a *"commodity derivative"*) will be in scope under the Articles 57 and 58 MiFID II regimes.

The two diagrams attached to this paper demonstrate our understanding of the scope of the position limits regime under Article 57 MiFID II and the position reporting regime under Article 58 MiFID II. In particular, the two diagrams indicate that, unlike other C(7) and C(10) contracts, C(7) and C(10) contracts that are traded on third country venues will not be in scope for Articles 57 or 58 MiFID II.

Third Country Venue Commodity Derivatives

It is clear that the definition of "*commodity derivative*" can include contracts that are traded on third country venues[1]. However, in our view not all "*derivatives*" are *"commodity derivatives"* and so not all *"derivatives"* that are traded on third country venues will be "*commodity derivatives*"[2]. In light of the scope and purpose of the regimes, we have separately sought clarification that only those C(10) contracts that meet certain conditions[3] can be classified as *"commodity derivatives"* under MiFID II.

We also note that falling within the "*commodity derivative*" definition is only the first step in identifying whether a contract is within the scope of the obligations under the position limits and reporting regimes contained in Articles 57 and 58 MiFID II, since that specific commodity derivative contract must also be traded on a trading venue.

Trading Venues

In our view, the definition of "*trading venue"* (as that term is used in Articles 57 and 58 MiFID II) does not include any third country venue (irrespective of whether the third country venue is recognised in accordance with the third country recognition regime).

Article 4(1)(24) MiFID II provides that "*trading venue means a regulated market, an MTF or an OTF*" (emphasis added). Taking these definitions in turn:

- Article 4(1)(21) MiFID II provides that "*regulated market means a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments – in the system and in accordance with its non-discretionary rules – in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with Title III of [MiFID II]*".

- Article 4(1)(22) MiFID II provides that "*multilateral trading facility or MTF means a multilateral system, operated by an investment firm or a market operator, which brings together multiple third-party buying and selling interests*

[1] In particular:

- Article 7(1)(a)(i) and (ii) (*Other derivative financial instruments*) of the DR makes clear that the definition of C(7) derivative contracts incorporates contacts that are "*traded on a third country trading venue that performs a similar function to a regulated market, an MTF or an OTF*" or "*is equivalent to a contract traded on… such a third country trading venue, with regards to the price, the lot, the delivery date and other contractual terms…*"
- Article 7(3) *(Other derivative financial instruments)* of DR states that that the definition of C(10) derivative contracts incorporates contacts that are "*traded on a regulated market, an MTF, an OTF, or a third country trading venue that performs a similar function to a regulated market, MTF or an OTF*" or are either "*traded on a third country trading venue that performs a similar function to a regulated market, an MTF or an OTF" or "is equivalent to a contract traded on… such a third country trading venue, with regards to the price, the lot, the delivery date and other contractual terms…*"

[2] The Trade Associations have prepared a separate paper on the scope of Section C(10) contracts that are *"commodity derivatives"* for the purposes of MiFID II which is included as an attachment to this paper ("C(10) Paper").

[3] The C(10) Paper sets out a methodology, with illustrative examples, for determining which C(10) derivative contracts can be properly classified as *"commodity derivative"* contracts. In summary, the methodology provides that in order for a C10 derivative contract to be a *"commodity derivative"* contract, it must: (i) directly relate to a *"commodity"* (as defined in Article 2(6) of the DR); or (ii) directly and solely relate to an underlying commodity or commodities; or (iii) directly impact the price of an underlying commodity or commodities. In the case of point (iii), the impact on price should not be transitory or minor, otherwise the scope of the position limits regime will be unknowable and consequently impossible to implement and enforce.

in financial instruments – in the system and in accordance with non-discretionary rules – in a way that results in a contract in accordance with Title II of [MiFID II]".

- Article 4(1)(23) MiFID II provides that "*organised trading facility or OTF means a multilateral system which is not a regulated market or an MTF and in which multiple third-party buying and selling interests in bonds, structured finance products, emission allowances or derivatives are able to interact in the system in a way that results in a contract in accordance with Title II of [MiFID II]*".

As discussed further below, a competent authority of a Member State can only authorise regulated markets, MTFs or OTFs under the legislation that is within that Member State. Therefore, a third country venue cannot be authorised as a regulated market, MTF or OTF.

MiFID II makes clear that third country venues recognised in accordance with the third country recognition regime will not be "*trading venues*" for these purposes. For example, Article 25(4)(a) MiFID II refers to financial instruments "*admitted to trading on a regulated market or on an equivalent third-country venue or on a MTF*" and refers to the "*requirements and the procedure*" that must be fulfilled in order for a third-country market to be considered "*equivalent*" to a regulated market. Therefore, third country venues can be "*equivalent*" to, but not "*the same as*" or "*within the definition of*" regulated markets.[4]

In addition, the position limits and position reporting regimes clearly contemplate that a "*trading venue*" will be in an EU jurisdiction and therefore within the remit of a particular competent authority. For example, Art 57(6) provides that where a "*commodity derivative is traded in significant volumes on trading venues in more than one jurisdiction, the <u>competent authority of the trading venue</u> where the largest volume of trading takes place (the central competent authority) shall set the single position limit to be applied on all trading in that contract. The central competent authority shall consult the competent authorities of other trading venues… ESMA shall settle any dispute arising from a disagreement between competent authorities...*" (emphasis added).

Article 4(1)(26) MiFID II provides that a 'competent authority' must be "*designated by a Member State*". Since a "*trading venue*" must have a competent authority that has been designated by a Member State, we understand that a third country venue cannot fall within the definition of "*trading venue*" (irrespective of whether or not it is recognised in accordance with the third country recognition regime).

Q.1. Does ESMA agree with our above assessment that the definition of "trading venue" cannot include a third country venue (irrespective of whether the third country venue is recognised in accordance with the third country recognition regime)?

"Over-the-Counter" (OTC)

MiFID II distinguishes between *"commodity derivative"* contracts traded on a venue and OTC contracts. It is clear in MiFID II that if a contract is traded on a *"trading venue"*, it cannot be an OTC contract. Equally, for the reasons set out above, if the contract is traded on a third country venue, it cannot be traded on a *"trading venue"*. In our view, and following the treatment of "trading venue" contracts, contracts traded on a third country venue cannot be treated as being "*over-the-counter*" contracts and therefore cannot be "*economically equivalent OTC contract[s]*". A third country venue would include, for the avoidance of doubt, any third country venue that performs a similar function to a regulated market, MTF or an OTF.

We are aware that neither MiFID II nor MiFIR defines "*over the counter*" or *"OTC contract"* explicitly or by reference to any other Regulation or Directive. Therefore, we believe that it is reasonable to apply a meaning to that phrase which reflects the distinction between an OTC contract and one which is traded on a venue;

[4] See also Article 28(1) MiFIR which further supports this reading. Moreover, as an MTF and OTF are concepts in EU regulation only, it is not possible for a third country venue to be an MTF or OTF.

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i.e. an "OTC contract" means a transaction bilaterally negotiated between the parties to that contract. Additionally, we draw your attention to Recital 4 of EMIR which provides that over-the-counter derivatives "*lack transparency as they are privately negotiated contracts and any information concerning them is usually only available to the contracting parties*." This emphasises the plain meaning of an OTC contract and highlights that such contracts are usually private and only disclosed between the contracting parties.

We also note that Articles 57 and 58 of MiFID II and RTS 21 do not specifically refer to or incorporate provisions of EMIR[5] and do not incorporate the EMIR definition of "*OTC derivative*". This is in contrast to other sections of MiFID II and MiFIR where express reference is made to provisions of that Regulation.[6]

In conclusion, we consider that, while contracts that are traded on any venue (including a third country venue) may be *"commodity derivative"* contracts, such contracts are outside the ordinary meaning of "*over the counter*" in the context of MiFID II and MiFIR and therefore cannot be "*economically equivalent OTC contracts*".

Q.2. Does ESMA agree with our above assessment that contracts on third country venues cannot be considered OTC and therefore will never be EEOTC?

About GFMA Commodities Working Group
The Commodities Working Group of GFMA focuses on regulatory issues specific to banks operating in the financial and physical commodities markets. The CWG's work centers around the creation of a more level regulatory playing field for the commodity markets, advocating consistency and avoiding duplication among legislative measures.
The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, visit http://www.gfma.org.

About ISDA:
Since 1985, the International Swaps and Derivatives Association has worked to make the global derivatives markets safer and more efficient.
ISDA's pioneering work in developing the ISDA Master Agreement and a wide range of related documentation materials, and in ensuring the enforceability of their netting and collateral provisions, has helped to significantly reduce credit and legal risk. The Association has been a leader in promoting sound

[5] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.
[6] By way of non-exhaustive example see:

- Recitals 37 and 39 MiFIR refer to the definition of "*OTC derivative*" in EMIR in the context of the clearing obligation
- Article 2(1)(32) MiFIR provides that an exchange-traded derivative is a "*derivative that… does not fall within the definition of an OTC derivative as defined in Article 2(7) of [EMIR]*"
- Article 4(1)(51) MIFID II which states that "*CCP means a CCP as defined in Article 2(1) of [EMIR]*"
- Article 1(3) MIFIR which states that "*Title V of [MIFIR] also applies to all financial counterparties as defined in Article 2(8) of [EMIR] and to all non-financial counterparties falling under Article 10(1)(b) of [EMIR]*"
- Article 4(40) MIFIR which states that "*interoperability arrangement means an interoperability arrangement as defined in Article 2(12) of [EMIR]*".

risk management practices and processes, and engages constructively with policymakers and legislators around the world to advance the understanding and treatment of derivatives as a risk management tool.
Today, ISDA has over 850 member institutions from 66 countries. These members comprise of a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers.

About FIA
FIA is the leading global trade organisation for the futures, options and centrally cleared derivatives markets, with offices in London, Singapore and Washington, D.C.
FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry. FIA's mission is to support open, transparent and competitive markets; to protect and enhance the integrity of the financial system; and to promote high standards of professional conduct.

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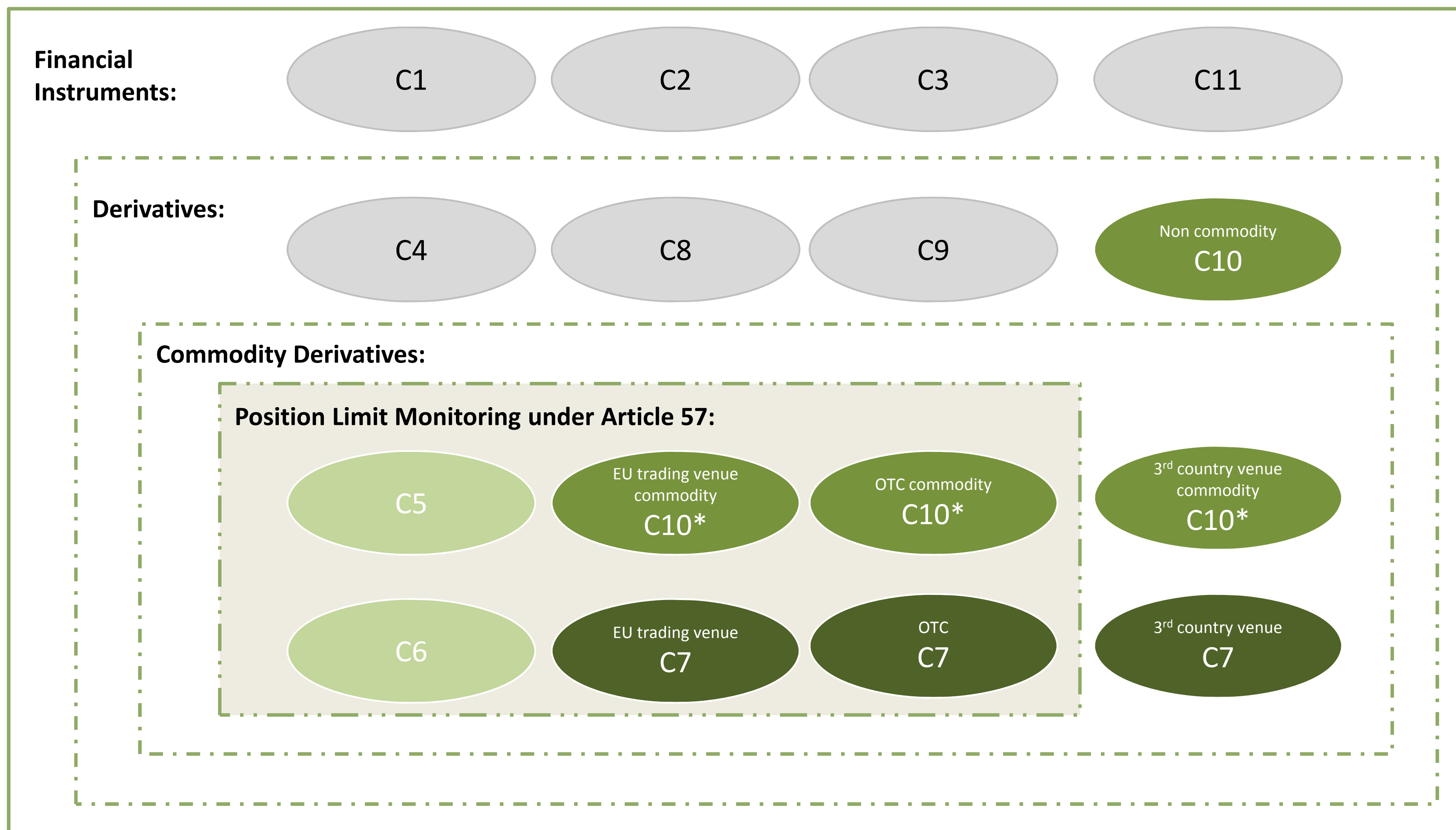
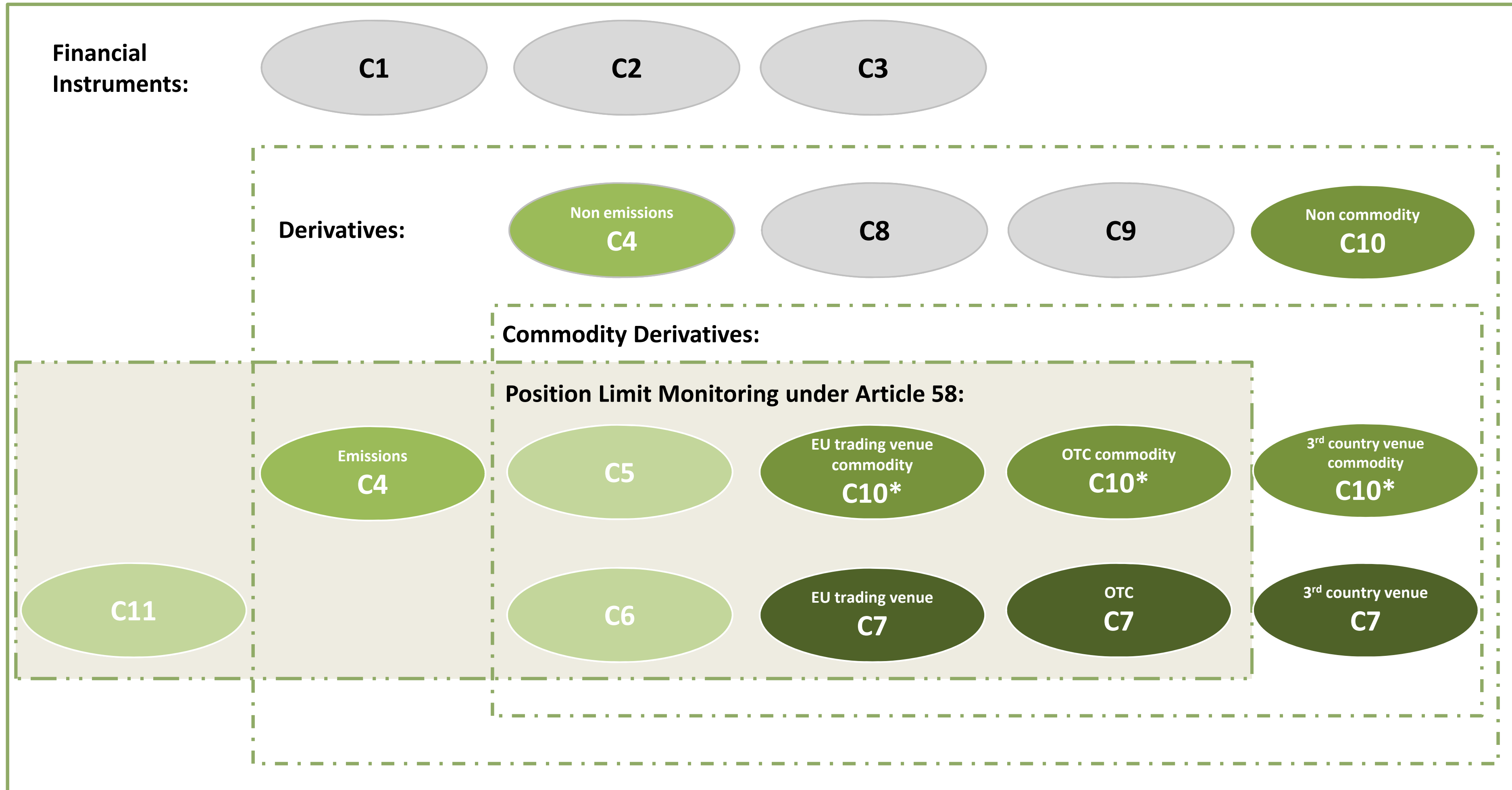
Classification of Section C Instruments under MiFID II – Position Limit Monitoring



Key: every instrument inside a box is in that category including any instrument in a smaller box in that box

* : Included in these categories would be the in-scope financial instruments defined in point 44(c) of Article 4(1) of MiFID II which relate to a commodity, or underlying referred to in the commodity C (10) list

Classification of Section C Instruments under MiFID II – Position Reporting



Key: every instrument inside a box is in that category including any instrument in a smaller box in that box

* : Included in these categories would be the in-scope financial instruments defined in point 44(c) of Article 4(1) of MiFID II which relate to a commodity, or underlying referred to in the commodity C (10) list

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22 February 2017

SCOPE OF SECTION C(10) CONTRACTS WHICH ARE "COMMODITY DERIVATIVES" FOR THE PURPOSES OF MIFID II

We write further to our letter of 22 September 2016[1] and the meeting between ESMA and our representatives on 16 November 2016. The purpose of this paper is to set out a methodology for determining which C(10) contracts can properly be classified as *"commodity derivative"* contracts and therefore which C(10) contracts could be subject to the MiFID II position limits and reporting regimes. Where possible, we have provided examples to illustrate the proposed methodology.

Executive Summary

Article 57 (*Position limits and position management controls in commodity derivatives*) MiFID II applies to *"commodity derivatives"* traded on trading venues and economically equivalent OTC contracts. In addition, Article 58 (*Position reporting by categories of position holders*) MiFID II applies to *"commodity derivatives"* or emission allowances or derivatives thereof. Determining whether a particular contract is a *"commodity derivative"* is, therefore, the first step in identifying whether a person has a contract that is within the scope of the obligations under the position limits and reporting regimes (subsequent steps would include, for example, identifying whether the *"commodity derivative"* is traded on a trading venue).

In light of the definitions of *"derivatives"* and *"commodity derivatives"* in MiFID II, the Associations believe that it is necessary to clarify the principles for determining which types of contracts listed in Section C(10) of Annex I to MiFID II can properly be classified as *"commodity derivatives"*. Doing so will provide firms, trading venues and competent authorities with the necessary certainty in order to ensure the consistent and effective application of the regimes.[2]

As further discussed below:

- The position limits and reporting regimes in MiFID II are designed to prevent market abuse and to support orderly pricing and settlement conditions in commodity markets, particularly in agricultural commodity markets.
- The definitions of *"derivatives"* and *"commodity derivatives"* in MiFID II both capture those financial instruments in C(5), C(6), C(7) and C(10) of Annex I to MiFID II. While it is clear from the definitions in MiFID II that all *"commodity derivatives"* are *"derivatives"* and that all *"derivatives"* are *"financial instruments"*, it is also clear that not all *"derivatives"* are *"commodity derivatives"*.
- On the basis of the Article 4(1)(50) MIFID II definition of *"commodity derivatives"*, it would appear that the position limits and reporting regimes may apply to all C(10) contracts. However, in our view, Section C(10) of Annex I to MiFID II consists of instruments that are *"commodity"* in nature as well as instruments that are non-*"commodity"* in nature. Therefore, in light of the scope and

[1] Link to letter signed by the Trade Associations dated 22 September 2016 - http://www.gfma.org/Initiatives/Commodities/GFMA,-ISDA,-FIA,-LEBA-and-EFET-MiFID-II-Application-of-Position-Limits-to-Non-Commodity-Contracts-and-to-Securitised-Commodity-Derivatives/

[2] A separate paper prepared by the Trade Associations addresses the scope of the position limits and reporting regimes and is included as an attachment to this paper.

purpose of the regimes, it should be clarified that only those C(10) contracts that meet the conditions set out below can be classified as *"commodity derivatives"* and therefore potentially be within scope of the position limits and reporting regimes.

- Accordingly, in order for a C(10) derivative contract to be classified as a *"commodity derivative"*, it must: (i) directly relate to a *"commodity"* (as defined in Article 2(6) of the Commission Delegated Regulation of 25 April 2016 ("**DR**")); or (ii) directly and solely relate to an underlying commodity or commodities; or (iii) directly impact the price of an underlying commodity or commodities. In the case of point (iii), the impact on price should not be transitory or minor, otherwise the scope of the position limits regime will be unknowable and consequently impossible to implement and enforce.
- In support of this view, we note the UK Financial Conduct Authority's Perimeter Guidance Manual[3] provides that "the concept of commodity does not include services or other items that are not goods, such as currencies or rights in real estate, or that are entirely intangible" (emphasis added).

Definitions of "Financial Instruments", "Derivatives" and "Commodity Derivatives"

"Financial instruments" are defined as *"those instruments specified in Section C of Annex I"*[4], i.e. any instrument listed in C(1) to C(11);

"Derivatives" are defined as *"those financial instruments defined in point 44(c) of Article 4(1) of [MIFID II]; and referred to in Annex I, Section C(4) to (10) thereto"*[5]*;* and

"Commodity derivatives" are defined as *"those financial instruments defined in point (44)(c) of Article 4(1) of [MiFID II]; which relate to a commodity or an underlying referred to in Section C(10) of Annex I to [MiFID II]; or in points (5), (6), (7) and (10) of Section C of Annex I thereto"*[6].

From these three definitions, for all purposes of MiFID II, it is clear that: (i) *"commodity derivatives"* are a sub-set of *"derivatives"*, i.e. all *"commodity derivatives"* are also *"derivatives"*; and (ii) *"derivatives"* (including *"commodity derivatives"*) are a sub-set of *"financial instruments"*, i.e. all *"derivatives"* are also *"financial instruments"*.

However, based on these definitions, it cannot be said that all *"derivatives"* are *"commodity derivatives"*. In particular, given the range of instruments listed in C(10), there can clearly be C(10) instruments that are *"derivatives",* but which are not *"commodity"* in nature. This is supported by the Commission Delegated Regulation with regard to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of bonds, structured finance products, emission allowances and derivatives of 14 July 2016, which separates *"commodity derivatives"* from *"C(10) derivatives"*[7].

The two diagrams attached to this paper set out how the different contracts under C(1) to C(11) are categorised as *"financial instruments"*, *"derivatives"*, and *"commodity derivatives"*. These two diagrams further show the scope of the position limits regime under Article 57 of MiFID II and the position reporting regime under Article 58 of MiFID II. The scope of these regimes is further discussed in the separate

[3] Question 33 of Section 13.4.
[4] Article 4(1)(15) MiFID II.
[5] Article 4(1)(49) MiFID II and Article 2(1)(29) MiFIR.
[6] Article 4(1)(50) MIFID II and Article 2(1)(30) MiFIR.
[7] See Table 4 (*Measure of volume*) of Annex II.

paper prepared by the Associations.[8]

Q.1 Does ESMA agree with our assessment that determining whether a contract is a *"commodity derivative"* represents just the first step in identifying whether a person has a contract that is within the scope of the obligations under the position limits and reporting regimes?

Q.2 Does ESMA agree that while all *"commodity derivatives"* are also *"derivatives",* not all *"derivatives"* are *"commodity derivatives"*?

Meaning of "Commodity Derivatives"

The position limits regime, established under Article 57 MiFID II and further specified in the Commission Delegated Regulation of 1 December 2016, is specifically designed to prevent market abuse and to support orderly pricing and settlement conditions in commodity markets. As Recital (127) MiFID II makes clear:

> *"explicit powers should be granted to competent authorities to establish limits, on the basis of a methodology determined by ESMA, on the positions any person can hold, at an aggregate group level, in a derivative contract in relation to a commodity at all times in order to prevent market abuse, including cornering the market, and to support orderly pricing and settlement conditions including the prevention of market distorting positions. Such limits should promote integrity of the market for the derivative and the underlying commodity without prejudice to price discovery on the market for the underlying commodity and should not apply to positions which objectively reduce risks directly relating to commercial activities in relation to the commodity"* (emphasis added).

However, on its face, the definition of *"commodity derivatives"* when read together with Section C(10) appears to include all Section C(10) contracts, including those that are non-*"commodity"* in nature. Section C(10) of Annex I to MiFID II covers:

> *"Options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event, as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in [Section C(10)], which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market, OTF, or an MTF".*

It is important to note that the above list makes no further reference to *"commodities"*. In addition, Article 7(3) of the DR further specifies when a *"derivative contract"* relating to an underlying referred to in Section C(10) of Annex I to MiFID II or Article 8 of the DR shall be considered to have the characteristics of *"other derivative financial instruments"* (a term which is not itself defined and which appears to be a combination of two distinct and separate defined terms) for the purposes of Section C(10) of Annex I to MiFID II. Consequently, where Articles 7(3) and 8 of the DR are satisfied, the *"other derivative contract"* will fall within C(10) of Annex I to MiFID II and would appear to be a *"commodity derivative"*, and therefore in scope of the position limits and reporting regimes. However, it is also worth noting that neither Article 7 nor Article 8 of the DR make any specific reference to *"commodity derivatives"*.

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[8] Refer to Footnote 2.

In our view, in light of the scope and purpose of the position limits and reporting regimes, Section C(10) contracts that are not generally considered to be commodity contracts should not be *"commodity derivatives"* and therefore should not be subject to the position limits and reporting regimes. Therefore, in order to determine whether a C(10) contract should be classified as a *"commodity derivative"* under MiFID II, it must: (i) directly relate to a *"commodity"* as defined in Article 2(6) of the DR; or (ii) directly and solely relate to an underlying commodity or commodities; or (iii) directly impact the price of an underlying commodity or commodities. For these purposes, Article 2(6) of the DR provides that *"commodity"* means *"any goods of a fungible nature that are capable of being delivered, including metals and their ores and alloys, agricultural products, and energy such as electricity"*. This definition mirrors the definition set out in Implementing Regulation of MiFID I[9].

None of MiFID II, MiFIR or the DR contains a definition of *"goods"*[10]. In the UK, the Financial Conduct Authority (the **"FCA"**) has published guidance on the scope of MiFID I and *"financial instruments"*. Although the guidance currently applies in respect of MiFID I, Question 33 in Section 13.4 of the FCA's Perimeter Guidance Manual, provides that *"the concept of commodity does not include services or other items that are not goods, such as currencies or rights in real estate, or that are entirely intangible"* (emphasis added). In addition, in its consultations on MiFID II, the FCA has not proposed to amend this guidance. Absent any other guidance, this explanation of the concept of *"commodity"* is a helpful starting point in interpreting *"commodities"* under MiFID II. Consequently, an item that is entirely intangible will not be a *"commodity derivative"* unless it is a commodity by nature or unless it directly relates to a commodity or commodities as specified in the paragraph above. In the case of a component product, to be classified as a *"commodity derivative"*, each component of the product should satisfy the definition of *"commodity"* in Article 2(6) of the DR; therefore, in the case of an index, each component of the index should be capable of satisfying that definition of *"commodity"*.

Q.3 Does ESMA agree that an item that is entirely intangible would not be a *"commodity derivative"* unless it is a commodity by nature or unless it directly relates to a commodity or commodities?

Q.4 Does ESMA agree that in the case of an index, each component of the index should be capable of satisfying the Article 2(6) DR definition of *"commodity" (i.e. "any goods of a fungible nature that are capable of being delivered, including metals and their ores and alloys, agricultural products, and energy such as electricity"*)?

Accordingly, any C(10) contracts which cannot be classified as *"commodity derivatives"* will not be within the scope of the position limits and reporting regimes in MiFID II. This, however, does not remove these contracts from being subject to other parts of MiFID II, as they are still classified as *"derivatives"* and *"financial instruments"* for all other purposes. The classification of C(10) contracts may be done on the basis of the class of contracts (e.g. where they are inherently unrelated to an underlying commodity as in the case of inflation rates) or on a case-by-case basis.

Application of Principles to Classifying C(10) Products

We have applied the principles above to determine which C(10) contracts are *"commodity derivatives"* and

[9] Article 2(1) of Commission Regulation (EC) No 1287/2006 implementing Directive 2004/39/EC.

[10] In our response to the Consultation Paper regarding 'Guidelines on the application of C6 and C7 of Annex I of MiFID', we recommended that the term 'relevant goods' be replaced with the term 'relevant commodities', since 'goods' is not a term that is defined under MiFID II: http://www.gfma.org/Initiatives/Commodities/GFMA-Submits-Comments-to-the-ESMA-Consultation-on-MiFID1-C6-C7/

which C(10) contracts are not *"commodity derivatives"*.

1. Classes of C(10) contracts that *are* "commodity derivatives" and therefore potentially within scope of position limits and reporting regimes:

Options, futures, swaps, forward rate agreements and other derivative contracts relating to the following:

(i) climatic variables (C(10) and as per RTS 21), e.g. contracts used to hedge or speculate against agricultural commodities, including weather derivatives;
(ii) freight rates (C(10));
(iii) commodity storage capacity (DR Article 8(b)), e.g. contracts to acquire or use storage facilities;
(iv) transmission or transportation capacity relating to commodities (DR Article 8(c));
(v) telecommunications bandwidth (DR Article 8(a); and
(vi) allowances, credits, permits, rights or similar assets directly linked to the supply, distribution or consumption of energy derived from renewable resources (that are not classified as a C(4) *"derivative"*) (DR Article 8(d).

2. Classes of C(10) contracts that are *not* "commodity derivatives" and therefore are not within the scope of position limits and reporting regimes

Options, futures, swaps, forward rate agreements and other derivative contracts relating to the following:

(i) inflation rates (C(10));
(ii) an index or measure based on actuarial statistics (DR Article 8(h)); and
(iii) other derivative contracts that do not exhibit the profile of or a direct relationship to a commodity as described in 1 (above) or 3 below in specific instances.

3. C(10) contracts, the classification of which will be need to be decided on case by case basis to ascertain whether they are "commodity derivatives" and therefore whether they are potentially within the position limits and reporting regimes or clearly outside the regimes

Options, futures, swaps, forward rate agreements and other derivative contracts relating to the following are not *"commodity derivatives"*:

(i) official economic statistics unless the statistics, including each component part, directly relate to an underlying *"commodity"* (C(10)), e.g. publications of oil or mineral reserves or strategic oil stock;

(ii) geological, environmental or other physical variables unless the variable, including each component part, directly relates to an underlying *"commodity"* (DR Article 8(e)), e.g. catastrophe swaps that are not deemed insurance contracts[11] and relate specifically to a commodity asset such as a mine or an oil refinery;

(iii) an asset or right of a fungible nature (excluding services) that is capable of being transferred unless the asset, including each component part, is within the definition of *"commodity"* or the

[11] The definition of *"financial instruments"* (and so by extension the definitions of *"derivatives"* and *"commodity derivatives"*) does not include contracts of insurance.

right, including each component part, directly relates to an underlying *"commodity"* (DR Article 8(f)), e.g. the right to receive royalties from a mine;

(iv) an index or measure related to the price or value of, or volume of transactions in, any asset, right, service or obligation unless the index or measure, including each component part, directly relates to an underlying *"commodity"*; and

(v) *"other derivative contracts"* referred to in DR Article 7(3) unless the contract directly relates to an underlying *"commodity"*.

Q.5 Does ESMA agree with our proposal as to when a C(10) contract will be classified as a "commodity derivative"?

About GFMA Commodities Working Group
The Commodities Working Group of GFMA focuses on regulatory issues specific to banks operating in the financial and physical commodities markets. The CWG's work centers around the creation of a more level regulatory playing field for the commodity markets, advocating consistency and avoiding duplication among legislative measures.
The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, visit http://www.gfma.org.

About ISDA:
Since 1985, the International Swaps and Derivatives Association has worked to make the global derivatives markets safer and more efficient.
ISDA's pioneering work in developing the ISDA Master Agreement and a wide range of related documentation materials, and in ensuring the enforceability of their netting and collateral provisions, has helped to significantly reduce credit and legal risk. The Association has been a leader in promoting sound risk management practices and processes, and engages constructively with policymakers and legislators around the world to advance the understanding and treatment of derivatives as a risk management tool.
Today, ISDA has over 850 member institutions from 66 countries. These members comprise of a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers.

About FIA
FIA is the leading global trade organisation for the futures, options and centrally cleared derivatives markets, with offices in London, Singapore and Washington, D.C.

FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry. FIA's mission is to support open, transparent and competitive markets; to protect and enhance the integrity of the financial system; and to promote high standards of professional conduct.

About EFET

EFET promotes and facilitates European energy trading in open, transparent, sustainable and liquid wholesale markets, unhindered by national borders or other undue obstacles. We currently represent more than 100 energy trading companies, active in over 28 European countries. For more information, visit our website at www.efet.org.