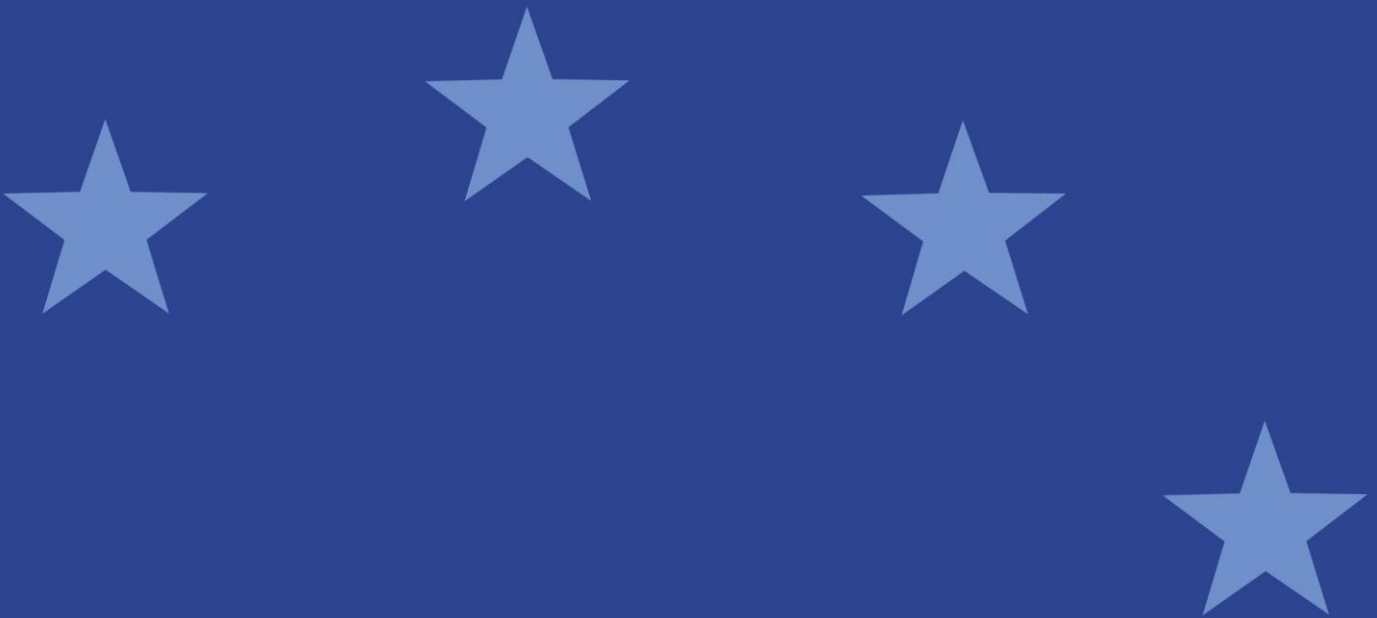
Guidelines

# The application of the definitions in Sections C6 and C7 of Annex I of Directive 2004/39/EC (MiFID)



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# 1 Scope

**Who?**

1. These guidelines apply to competent authorities.

**What?**

2. These guidelines apply to the application of the definition of commodity derivatives and their classification under C6 and C7 listed in Section C of Annex I of MiFID.

**When?**

3. These guidelines apply from 7 August 2015.

# 2 Definitions

4. Unless otherwise specified, terms used in the Markets in Financial Instruments Directive have the same meaning in these guidelines. In addition, the following definitions apply:

| | |
|---|---|
| *competent authority* | an authority designated under Article 48 of the Markets in Financial Instruments Directive |
| *Markets in Financial Instruments Directive* | Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments |

# 3 Purpose

5. The purpose of these guidelines is to ensure a common, uniform and consistent application of the definitions of commodity derivatives under C6 and C7 of Annex I of the Markets in Financial Instruments Directive.

6. According to Article 2(5) of Regulation (EU) No 648/2012 (EMIR) 'derivative' or 'derivative contract' means a financial instrument as set out in points (4) to (10) of Section C of Annex I to MIFID as implemented by Article 38 and 39 of Regulation (EC) No 1287/2006. The obligations resulting from Title II of EMIR and the related Commission Delegated Regulations (EU) No 148/2013 and 149/2013 (RTS on OTC derivatives) apply to derivatives or OTC derivatives. In addition, certain requirements for CCPs, as specified in Commission Delegated Regulation (EU) No 153/2013 (RTS on CCPs) only apply to OTC derivative contracts.

7. As explained in Recital 12 of EMIR, uniform rules are required for derivatives contracts set out in points (4) to (10) of Section C of Annex I to MiFID.

8. The application of MiFID in the different Member States has given rise, for certain types of instruments or contracts, to different interpretations among competent authorities on what should constitute a financial instrument and what should be classified as a derivative contract. These different interpretations may lead to an inconsistent application of MiFID, EMIR and potentially other Directives and Regulations that rely on MiFID definitions of financial instruments.

9. A Regulation that is directly applicable in all the Member States cannot be applied differently as a result of different national interpretations of definitions included in a Directive. This is contrary to the spirit and objectives of the Regulation.

10. Against this background and in line with Article 29 of the ESMA Regulation, ESMA should ensure uniform and consistent application of directly applicable provisions, by ensuring consistent approaches throughout the Union. For this reason, a clarification for certain financial instruments for which different interpretations among Member States have been identified is needed.

11. Under EMIR the reporting obligation to trade repositories applies to all derivatives. This obligation is directly applicable across the Union. Different classifications of what constitutes a derivative contract may lead to the reporting of certain transactions in one Member State and not in others. This would lead to a non-uniform and inconsistent application of EMIR within the Union and eventually it would lead to an un-level playing field, which is contrary to the spirit and objectives of a Regulation.

12. Under EMIR the clearing obligation applies to OTC derivatives. The power to determine the classes of derivatives subject to the clearing obligation has been given to ESMA to ensure, amongst other things, one single uniform and consistent application of this obligation across the Union. If competent authorities adopt different classifications of what constitutes a derivative contract, the clearing obligation would not apply in a uniform manner across the Union, contravening the objectives of EMIR.

13. Under EMIR and the RTS on OTC derivatives, the calculation of the clearing threshold by non-financial counterparties is made on the basis of positions on OTC derivatives. From the calculation of the clearing threshold derives directly applicable obligations for non-financial counterparties. Different classifications of what constitutes a derivative contract would determine the inclusion of certain financial instruments in the calculation of the clearing threshold for financial counterparties established in some Member States and the exclusion of those for non-financial counterparties established in other Member States. This would create a non-uniform application of EMIR across the Union and an un-level playing field amongst non-financial counterparties, which is contrary to the principle of the direct applicability of EMIR across the Union.

14. Under EMIR and the RTS on OTC derivatives, the relevant obligations on risk mitigation techniques for OTC derivatives contracts not cleared by a CCP apply to OTC derivatives contracts. All of these obligations are directly applicable in the Union and should therefore apply in a uniform and consistent manner. Different classifications of

what constitutes a derivative contract by different competent authorities would lead to an inconsistent application of EMIR across the Union, which again is contrary to the Regulation.

15. Under the RTS on CCPs, higher margin requirements apply to OTC derivatives than to other financial instruments. If competent authorities apply different classifications of what constitutes a derivative contract, a CCP established in one Member State may implement higher margin requirements than a CCP established in a different Member State. Therefore, different classifications of what constitutes a derivative contract would lead to an un-level playing field among CCPs operating in the Union.

# 4 Compliance and reporting obligations

**Status of the guidelines**

16. This document contains guidelines issued under Article 16 of the ESMA Regulation[1]. In accordance with Article 16(3) of the ESMA Regulation competent authorities and financial market participants must make every effort to comply with guidelines and recommendations.

17. Competent authorities to whom the guidelines apply should comply by incorporating them into their supervisory practices, including where particular guidelines within the document are directed primarily at financial market participants.

**Reporting requirements**

18. Competent authorities to whom these guidelines apply must notify ESMA whether they comply or intend to comply with the guidelines, with reasons for non-compliance, within two months of the date of publication by ESMA, by emailing secondary-markets-team@esma.europa.eu. In the absence of a response by this deadline, competent authorities will be considered as non-compliant. A template for notifications is available from the ESMA website.

19. Financial market participants are not required to report whether they comply with these guidelines.

# 5 Guidelines on the application of C6 and C7 of Annex 1 of MiFID

**Application of C6 of Annex 1 of MiFID I**

[1] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC.

20. ESMA considers that definition C6 of Annex 1 of MiFID applies in the following way:

a. C6 has a broad application, applying to all commodity derivative contracts, including forwards, providing that:

   i. they can or must be physically settled; and

   ii. they are traded on a regulated market and/or an MTF.

b. *"Physically settled"* incorporates a broad range of delivery methods and includes:

   i. physical delivery of the relevant commodities themselves;

   ii. delivery of a document giving rights of an ownership nature to the relevant commodities or the relevant quantity of the commodities 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 commodities 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 the commodities.

**Application of C7 of Annex 1 of MiFID I**

21. ESMA considers that definition C7 of Annex 1 applies in the following way:

a. C7 forms a category that is distinct from C6 and applies to commodity derivative contracts that can be physically settled which are not traded on a regulated market or an MTF providing that the commodity derivative contract:

   i. is not a spot contract as defined under Article 38(2) of Regulation 1287/2006/EC;

   ii. is not for the commercial purposes described under Article 38(4) of Regulation 1287/2006/EC; and

   iii. meets one of the three criteria under Article 38(1)(a) and also the separate criteria under Article 38(1)(b) and 38(1)(c) of Regulation 1287/2006/EC.

b. "*Physically settled*" incorporates a broad range of delivery methods and includes:

   i. physical delivery of the relevant commodities themselves;

ii. delivery of a document giving rights of an ownership nature to the relevant commodities or the relevant quantity of the commodities 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 commodities 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 the commodities.

22. Physically settled commodity derivatives which do not fall within the definition of C6, i.e. are not traded on a Regulated Market or an MTF, may fall within the definition of C7 and the definitions of C6 and C7 form two distinct categories as C7 applies to commodity derivatives "*that can be physically settled not otherwise mentioned in C6".*

23. The other characteristics of commodity derivatives under C7 - "*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 recognised clearing houses or are subject to regular margin calls*" - are further defined under Article 38 of Regulation 1287/2006/EC.

24. ESMA notes that the conditions defined in Article 38 of Regulation 1287/2006/EC, are to be applied cumulatively.

# Annex 1: Feedback to the Consultation

**General Feedback**

1. A significant number of respondents expressed the view that the "secondary contractual rights" (e.g. default and bona fide provisions) within the terms of a commodity derivative contract do not change the nature of what must be physically settled. It was noted that the distinction between cash settlement and physical settlement should be based upon the legal nature and objective of the contract, where elements such as:

   i) the primary obligation of making and taking delivery;

   ii) transfer of title and risk to the commodity;

   iii) delivery type and termination clauses;

   are relevant to the capability of at least one of the parties to make or take physical delivery of the commodity. It was also highlighted that in order to ensure the correct classification of a transaction for both counterparties, the capability test should be applied on an individual transaction basis at the point of execution.

2. **ESMA's response:** ESMA is in agreement with this position, and notes that this approach is consistent with what it has proposed in its Technical Advice to the European Commission in respect of MiFID II. ESMA's purpose is to ensure, wherever possible, there is continuity between the application of the MiFID I regime and the MiFID II regime in order to prevent disruption to the existing practices of the industry at the time of transition.

3. The views of several respondents were split regarding whether or not physical forward contracts for commodities are derivatives under either C6 or C7.

4. **ESMA's response:** ESMA notes that the existing wording of C5, C6, C7 and C10 includes the general and inclusive term "any other derivative contract". Therefore derivative contracts that are, or are merely termed, "forwards" will be captured within C6 if they are traded on a regulated market or an MTF, and within the scope of C5, C7 or C10 if they have the other characteristics relevant to these respective definitions.

5. A number of other issues of a general nature were raised in the responses to the public consultation, in particular:

   - the need for clarification on those instruments that have a number of legs before being ultimately "physically settled". In particular, those instruments that settle into a future first, before being ultimately "physically settled", which are sometimes referred to as "hybrid settlement" contracts; and

   - the need to align EU and US rules on commodity derivatives.

6. **ESMA's response:** ESMA is of the opinion that it is the ultimate mode of settlement of a derivative contract that should determine whether it is cash-settled or physically-settled, providing that the settlement chain is integral to the contract specification and remains incapable of disruption except in bona fide circumstances. ESMA is also aware that the different definitions of financial instruments that exist between the EU and other jurisdictions can cause market participants operational difficulties. However ESMA notes that these definitions arise from different implementing legislation, and without the harmonisation of the source legislation it is not possible for ESMA to implement steps of its own initiative to achieve this outcome.

**Question 1: 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?**

7. A significant number of respondents agreed with ESMA's distinction in confirming that the existing definition of C6 covers both contracts that "must" be physically settled and contracts that "can" be physically settled. Some respondents considered that to highlight the distinction was unnecessary as contracts that "must be physically settled" is a concept that only stems from MiFID II.

8. **ESMA's response:** ESMA's aim is to clarify that the existing definition is an inclusive term, and that in confirming there are two elements within the existing definition, ESMA hopes this should assist in the understanding of the transition to the modified C6 definition that will take effect under MiFID II.

**Question 2: 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?**

9. Many respondents agreed with the general approach taken by ESMA but voiced their concerns about framing the list too narrowly or exhaustively and asked ESMA to assess the impact on commercial markets. In particular, respondents warned about the consequences of the list of physical settlement options being incorrect and the definitions too narrow and considered that any attempt to impose an exhaustive list would be ill advised.

10. **ESMA's response:** ESMA takes note of these concerns and is aware of the risks associated with framing the list of physical settlement options too narrowly. ESMA believes that the text of the final guidelines is sufficiently wide in scope to recognise current practices in the physical market and to permit new developments and therefore addresses such concerns.

11. Respondents pointed out that there were slight differences in the proposals of delivery methods ESMA made in the Consultation Paper compared to the CESR Advice of 2005 and asked, in particular, for scheduling and nominating to the operator of an energy supply network as a delivery method to be explicitly listed in the final guidelines. In addition, some respondents asked for the delivery mechanisms to extend to book entries (examples being precious metals and uranium).

12. **ESMA's response:** In the Consultation Paper, ESMA noted it largely endorsed the CESR Advice from 2005 which mentioned explicitly "*the amendment, assignment, or other form of alteration of the records of rights of ownership in a central registry or other dematerialised system recording entitlement to establish a change in beneficial ownership of a physical commodity*". The reason ESMA dropped this description from its proposal in the Consultation Paper is that it believes it is redundant and already contained in alternative iii. in the Consultation Paper: "*another method to bring about the transfer of rights of an ownership nature…*". ESMA also considers that book entries are encompassed in this alternative. In addition, ESMA has, in its final guidelines, inserted the term ""*including notification, scheduling or nomination to the operator of an energy supply network*" and has aligned the guideline text with the text used to define methods of physical delivery in the ESMA Technical Advice to the European Commission in respect of MiFID II[2].

13. A number of respondents considered that the practice of operational netting in energy markets and portfolio compression should also be mentioned explicitly as types of physical settlement in the guidelines.

14. **ESMA's response:** ESMA does not consider it necessary to include explicitly these two concepts in this context and therefore has not included wording describing them in the final guidelines. Operational netting is mentioned in the Technical Advice to the European Commission in respect of MiFID II[3] to clarify that it does not constitute offsetting in a way which would render a contract as "not must be physically settled" which is an important clarification for the application of the specific "C6 exemption" included in MiFID II. For the purposes of these guidelines, the process of nominating to a transmission system operator (TSO) is explicitly caught by alternative iii. of the guidelines. The term operational netting, in ESMA's view, describes a type of settlement that occurs only on a net basis if the TSO so requires. Therefore ESMA does not consider it is an additional type of physical settlement and has not done so in its Technical Advice to the European Commission in respect of MiFID II either. As far as portfolio compression is concerned, ESMA considers this to be a risk reduction technique applied to a contract but that it does not change the legal nature of a contract and its specifications, and cannot be described as a "delivery method" from the outset. Therefore ESMA has not included portfolio compression as a separate delivery method in the final guidelines either.

[2] http://www.esma.europa.eu/content/Technical-Advice-Commission-MiFID-II-and-MiFIR pp. 407-408.
[3] http://www.esma.europa.eu/content/Technical-Advice-Commission-MiFID-II-and-MiFIR pp. 406-407.

**Question 3: 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.**

15. This question in the consultation paper covered a number of separate areas, combined in a single question. A large majority of respondents agreed with the general proposition that the guidelines as drafted by ESMA did not create a conflict between C5, C6 and C7. Within these responses, a number of more detailed or technical points were made that are explained further below.

16. Comments were made regarding the different possible settlement outcomes of contracts that were entered into for physical settlement, but which for various reasons may be cash-settled or offset and replaced with further contracts.

17. **ESMA's response:** ESMA does not believe that any of these scenarios described affect whether the contracts in themselves fall within MIFID and merely clarifies the reasons by which they may fall into either C5, C6 or C7. Therefore ESMA feels that it is not necessary to set out a more detailed list of specific scenarios within the guidelines or specify the relationship between the definitions.

18. A number of respondents commented that ESMA's proposed guidelines included reference to the condition "must be physically settled" and pointed out that whilst this was relevant to the definitions of financial instruments under MIFID II, this specific language is not included under MIFID I.

19. **ESMA's response:** As noted under the General Feedback, ESMA is aware of this point. However, in order to provide continuity between the existing and future definitions, ESMA considered it important to include this in the discussion.

20. A number of respondents also raised an issue related to "take or pay" contracts, noting these contracts provide flexibility over the actual amount of the commodity that is sold or purchased, and any difference between that amount and the contractual amount is compensated by a cash payment.

21. **ESMA's response:** ESMA acknowledges that these contracts can be useful in certain scenarios, such as providing a hedge for selling forward the output of solar or wind power production which by its very nature is dependent on external climatic factors. ESMA believes that these contracts do not automatically fall outside the definitions of C5, C6 or C7. However by reference to the definitions of those categories, certain "take or pay" contracts may not meet the characteristics of other derivative financial instruments and

therefore would not be included within the scope of MIFID. One respondent stated that the cash settlement element of a “take or pay” contract should not be regarded as falling within C5 because the cash payment is a consequence of the default of the contract. ESMA does not accept this reasoning as an event of default, and the consequences that flow from that are very different in legal and practical terms to the process envisaged at the outset of a “take or pay” contract, which is the ability for the parties to adjust the amount of physical delivery to meet real world requirements.

22. One respondent commented that “forwards are by nature OTC contracts” and that they should therefore not be subject to C6.

23. **ESMA’s response:** ESMA discounts this as a policy position as the term “forward” is not defined in MIFID and therefore MiFID does not prescribe what the characteristics of these contracts are and how they should be treated. Further, there is nothing to preclude a trading venue from calling a product a “forward” regardless of whether it is traded on a regulated market, MTF or OTC. A commodity forward might constitute an “other derivative financial instrument” in circumstances where it meets the criteria for “other derivative” as defined by MIFID and thus may fall within C5, C7 or C10 as appropriate. It is, however, correct to say that OTC contracts do not fall within the scope of C6.

24. Some respondents expressed concern over ESMA’s statement that “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.

25. **ESMA’s response:** ESMA confirms that this observation is not intended to call into question the definition of physical settlement under either MIFID I or prospectively under MIFID II but was merely to highlight that the inclusion of this language would not disqualify a contract from being regarded as physically settled. ESMA wished to recognise that there may be extreme and infrequent scenarios where other arrangements must be made in lieu of physical settlement and that this does not render the contract as cash settled from the outset.

26. One respondent called for ESMA to align the definitions of financial instruments with those used by the US and other major regulators.

27. **ESMA’s response:** As noted in the General Feedback, whilst recognising that this may have benefits to certain participants and in certain circumstances, such as the prospective use of “substituted compliance”, it is not possible for ESMA to achieve this as long as the basis of the legislation, and particularly the language contained within it, remains fundamentally different.

**Question 4: What further comments do you have on ESMA’s proposed guidance on the application of C6?**

28. In response to the request for further comments, some participants highlighted issues that have been discussed above already in relation to questions 1 to 3.

**Question 5: Do you have any comments on ESMA's proposed guidance on the specification of C7?**

29. The majority of respondents support the general approach that a financial instrument should be defined as under C7 if it is:

    - physically-settled;
    - not for commercial purposes; and
    - meets the criteria under Article 38(1)(a)(b)(c) Regulation 1287/2006.

30. Several respondents noted that Article 38 has previously worked well. Others welcomed the clarity on the cumulative application of Article 38.

31. **ESMA's response:** ESMA notes the broad agreement of respondents to its proposed guidance on C7.

32. A significant number of respondents, in particular from the agricultural sector, suggest that the definition of 'commercial purposes' should be expanded from its currently narrow application (to contracts for energy transmission grid, energy balancing mechanism, or pipeline network that are necessary to balance the network) to cover other markets and sectors within those markets. Examples were given of bilateral forward contracts for commercial and industrial purposes or contracts entered into to meet regulatory obligations such as Compulsory Stock Obligations and Renewable Transport Fuel Obligation. One respondent suggested that 'take-or-pay' or 'send-or-pay' contracts should be considered as being for commercial purposes. Other respondents suggest that ESMA should consider other more general approaches taken by other regulatory authorities, which take into account the commercial nature of and intentions of the counterparties to the transaction. A small number of respondents, however, requested that the definition of commercial purpose should remain narrow in order to prevent avoidance of financial regulation when contracts were traded for speculative purposes.

33. **ESMA's response:** ESMA did not extend the definition of "commercial purposes" as no parallel scenarios were identified that involved the two key characteristics of the existing term: the obligation derives from a third party, and the necessity of maintaining the stability of a network or other delivery mechanism. As noted in the Technical Advice given on the definition of financial instruments under MiFID II, ESMA remains open to suggestions of similar scenarios that contain these two characteristics. As noted in the General Feedback, ESMA is aware of other regulatory practices but divergences between the source legislations means that harmonisation is not possible.

34. Certain agricultural respondents commented that although some agricultural contracts make reference to trading venues prices as a base price upon which to determine the actual price, they should still be considered as commercial as other factors such as quantity, quality and delivery condition are specified with reference to standard commercial market contractual terms.

35. **ESMA's response:** ESMA notes that these contracts may have varying characteristics and confirms that any analysis of a specific instrument should be made with regard to the criteria of having "the characteristics of other derivative financial instruments". The extent of the standardisation of the contract specification in comparison to those financial instruments that are characteristically traded on a regulated market or an MTF will determine whether it is a MiFID financial instrument or not.

36. Other comments made by respondents are more technical in nature. Several respondents highlight that Article 38(1)(a)(ii) cannot be properly implemented because neither the European Commission or ESMA has published a list of equivalent third country markets.

37. **ESMA's response:** ESMA does not agree with this conclusion. The language of Article 38(1)(a)(ii), and also that of Article 38(1)(a)(i), does not include, and therefore does not require, the term "equivalent". It merely refers to a third country trading facility that performs a similar function to that of a regulated market or an MTF. It does not require there to be an express opinion on and statement of equivalence of a third country market as may be required by the specific language within other EU directives and regulations, such as EMIR.

38. A small number of respondents highlighted uncertainties about the application regarding contractual options with physical delivery with a non-commodities underlying (such as corporate transactions with options providing the right to buy further shares in the future).

39. **ESMA's response:** ESMA will not comment in these guidelines on the appropriate treatment of these transactions given that they involve a non-commodities underlying and so fall outside the scope of C5, C6, C7 or C10.

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# Annex II: Cost-benefit analysis

## I. Introduction

1. Article 16 of the ESMA Regulation[4] requires ESMA, where appropriate, to analyse the potential costs and benefits relating to proposed guidelines. It also states that cost-benefit analyses must be proportionate in relation to the scope, nature and impact of the proposed guidelines.

2. The objective of performing a cost-benefit analysis is to assess the costs and benefits of the various policy or technical options which were analysed during the process of drafting the guidelines.

3. The guidelines included in this report are of an optional nature, i.e. they are not envisaged in any Regulation, but are issued in line with Article 16 of ESMA Regulation in order to ensure uniform, consistent and coherent application of Union Law.

4. The choices or options envisaged by ESMA while drafting these guidelines were therefore limited to whether to issue these guidelines and ensure a consistent application of EMIR within the Union (which is one of ESMA's tasks) or not issuing them.

5. With reference to the classification of the financial instruments covered by these guidelines, different options were considered in view of the different applications and local specificities. ESMA considered that the lowest impacts in terms of costs for market participants were provided by the option supported and implemented by the majority of the CAs.

## II. Should these guidelines be issued?

6. The consistent application of MiFID aside, there are a number of directly applicable provisions in EMIR that would not apply in a uniform, consistent and coherent way within the Union in the absence of a clarification from ESMA on the classification of financial instruments as derivatives.

7. These directly applicable obligations relate to: the clearing obligation, the reporting obligation to TRs, the calculation of the clearing thresholds, risk mitigation techniques for OTC derivatives not cleared by a CCP and margin requirements for CCPs.

8. The costs implied by these guidelines can be summarised as the cost of changing current market practices, where necessary, and potentially enlarging the scope of MiFID and EMIR to financial instruments that were not initially considered to be covered by the regulation. These costs could be associated and would be to an extent similar to the costs

[4] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC.

of implementation of EMIR, which have already been analysed when the Commission proposal on EMIR was published[5].

9. As proved by the impact assessment of the Commission on EMIR, the benefits brought by the proposal significantly outweigh the costs. These guidelines aim at ensuring the uniform, consistent and common application of MiFID and EMIR across the Union, which is an essential component of an EU Regulation that by its nature is directly applicable in all Member States.

10. The absence of guidelines to clarify the classification of certain financial instruments as derivatives would have the following consequences:

    a. An un-level playing field between entities subject to MiFID and EMIR established in different Member States;

    b. A lack of clarity among stakeholders on the classification of financial instruments and on the applicable rules;

    c. Difficulties in implementing consistent approaches for groups or entities operating on a cross-border basis; and

    d. Legal risks for stakeholders in view of the uncertainty resulting from the absence of a clear and consistent classification of financial instruments.

11. On the basis of the analysis above, ESMA concludes that the benefits of issuing guidelines on the classification of certain financial instruments as derivatives outweigh the costs.

[5] http://ec.europa.eu/internal_market/financial-markets/derivatives/index_en.htm#maincontentSec1