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ISDA Response to CESR/09-618
on
Classification and identification of OTC derivative instruments for the purpose of the exchange of transaction reports amongst CESR members

This comment paper responds to the Committee of European Securities Regulators Consultation paper CESR/09-618, dated July 22, 2009, and provides additional information and comment from the International Swaps and Derivatives Association (ISDA) related to FpML.

ISDA believes, in principle, that all trade data on OTC contracts should be made available to regulators, on a post-execution, non-real time basis.

One of the key themes in recent regulatory scrutiny of OTC derivatives markets has been the role that trade repositories can play in enhancing regulatory transparency in the OTC derivatives market. ISDA believes that competent authorities should be able to receive relevant information by querying trade repositories. The DTCC Trade Warehouse has proved to be a valuable source of information for international regulators in the case of CDS contracts in particular (as well as providing many other operational benefits for industry and regulators, including facilitation of central clearing and trade compressions), and has made this information available to all international regulators.

As CESR will be aware, the June 2 2009 'OMG' letter to international regulators made commitments concerning the submission and storage of trade data at trade repositories (like the DTCC Trade Warehouse), for non-centrally cleared transactions in the interest rate and equity derivative markets.

One benefit of the use of trade repositories is their potential to limit complexity and inefficiency in the reporting requirements falling on firms.

ISDA notes that the European Commission is currently engaged in a number of reviews which address the issue of regulatory reporting of OTC derivatives, namely

- The review on Derivatives markets (see EC Communication of 3 July 2009 on 'Ensuring Efficient, Safe and Sound Derivatives Markets');
- The EC review of the Market Abuse Directive;
- The EC review of the MIFID Directive.

ISDA cautions that a move by CESR, under this initiative, to expand the scope of transaction reporting requirements, risks imposing requirements implying significant expenditure by firms (on IT infrastructure, training etc), in a way which prejudges the outcome of the above-mentioned reviews. If these reviews determine that the most appropriate method through which market participants should submit regulatory reports to regulators is one that takes a significantly different approach to that adopted by CESR, this investment will have been both costly and unnecessary. ISDA believes that CESR should consider delaying any decision until these reviews have run their course.

ISDA strongly believes that, for the purposes of transaction reporting requirements, competent authorities should make full use of the 'FpML' (Financial Products Mark-up Language) 'vocabulary' already developed and widely used to describe individual OTC derivative contracts in automated communications.

A. Transaction Reporting in Europe

ISDA believes that a clear and effective OTC derivative regulatory reporting mechanism would help both regulators and market participants in their efforts to maintain market integrity.

B. The Transaction Reporting Mechanism

C. Scope of Transaction Reporting on OTC derivative instruments

Many OTC derivatives could potentially have an underlying instrument that is traded on a regulated market. ISDA welcomes more explicit guidance on which OTC instruments would be included under this mechanism, particularly when the underlying instrument may be traded on a regulated market or over the counter.

D. Identification and classification of OTC derivative instruments

ISDA agrees that standardizing transaction classification across the industry is an important area of concern, and welcomes CESR's efforts in this area.

II. Section 1 - Classification of OTC derivatives

E. The Classification of Financial Instruments (CFI) - ISO Standard 10962

F. FpML

ISDA appreciates CESR's inclusion of FpML in consideration for its transaction classification system.

FpML does contain a number of sub-schemas for different asset classes, as mentioned in the CESR paper. The XML sub-schemas are used for detailed product representations to support life cycle processes such as confirmation. The division of the schema into sub-schemas is done to organize the specification, to make it easier to read and understand. For example, this allows someone interested in a single asset class to focus on a single file or chapter of the specification.

However, the FpML sub-scheme mechanism is not intended for reporting of product types. FpML does have a more fine-grained, single-field mechanism for reporting transaction types/classifications.

FpML defines a "productType" element that contains values chosen from a list (also known as a "coding scheme"). This coding scheme may be supplied by an implementation, but in addition FpML supplies a best practice list, called "productTypeSimpleScheme", which currently contains 28 entries, as described in "Appendix A", and available online via the URL http://www.fpml.org/spec/coding-scheme/index.html (section 4.54), and with XML source at http://www.fpml.org/coding-scheme/product-type-simple-1-2.xml. This coding scheme is under review by the FpML Reporting Working Group with a view to adding some additional entries in areas including Commodity Derivatives and some equity derivative products such as Correlation Swaps, where FpML product definitions have been included recently. These updates are expected to be available close to the time of conclusion of CESR's comment period for this paper.

ISDA respectfully requests the CESR to consider the "ProductTypeSimpleScheme" as the FpML OTC derivative product classification mechanism.

G. CESR classification

Question 1: Comments on CESR classification proposal

ISDA is not in favor of a single letter classification scheme for OTC derivative transactions. The CFI scheme, which has limitations in this regard, is not suitable for OTC instruments. Experience in the OTC markets has been that getting agreement on code lists and meanings of codes is difficult, particularly when a number of different products are grouped under the same code. ISDA has found that more explicit and meaningful codes are easier to understand and implement. Compactness in the code does not appear to be a significant benefit compared to the issues above.

With respect to the specifics of the proposal, the proposed scheme has limitations that make it unlikely to provide the desired meaning. For example, a code such as "O" for options could potentially apply to any type of option product on any type of underlying asset. In OTC derivatives, that may include equity options, OTC bond options, FX options, options on interest rate swaps, options on credit default swaps, and commodity options, just to name a few of the more commonly traded products. These products have very different risk profiles and

complexities from each other, and any reporting system that groups them together reduces the value of reporting the transaction type.

In addition, the proposed mechanism anticipates that products can be classified into a relatively small number of categories, for example options as "puts" or "calls". For OTC options, how to represent more complex products such as swaptions, collars, etc. needs to be explained on a case-by-case basis.

ISDA realizes that not all of these underlying assets may currently be traded on regulated markets, but would prefer a classification system that works for all types of OTC derivatives. ISDA believes that a more explicit system such as the "product type simple" system used in FpML will be easier to understand and to gain industry consensus. As different schemes are currently being used in the industry, we would have to bear in mind that CESR's decision to select one, would inevitably require system developments by firms.

Whatever listing or coding convention is chosen for representing products, to avoid issues in the future, when a new instrument is developed or an instrument becomes of interest to the regulators, we propose the creation of a classification system with accompanying guidance notes to ensure that all instruments with the same characteristics are grouped under the appropriate 'instrument type' heading. For example, this classification scheme might consider the instrument's main risk asset class (e.g., credit, interest rates, equity, commodity, etc), the type of structure (swap/forward vs option), and other key identifying characteristics.

III. Section 2 - Identification of OTC derivative instruments

H. ISIN - ISO 6166

I. I. The Alternative Instrument Identifier (AII)

J. Set of characteristics of the contract

Question 2: Comments on CESR identification proposal

ISDA agrees with CESR that in many cases it is difficult to get a specific, universally agreed identifier for an OTC derivative transaction. However, in cases where the transaction is confirmed through an automated confirmation service and/or maintained in an industry-wide trade inventory system such as the DTCC Trade Information Warehouse, there is an identifier assigned that is known by both parties to the transaction. Similarly, cleared trades will have identifiers assigned by the clearing system. ISDA recommends that CESR consider requiring that such identifiers be provided where they have been assigned by a central service. This will facilitate review and comparison of reported information across parties when this is required.

It would also be valuable to standardize the identification of the parties to a transaction, using an industry-wide legal entity identification system.

In addition, ISDA agrees that it is beneficial to provide a limited set of characteristics of the contract to identify the particular transaction that is being reported. In addition to the fields listed in the paper, fields such as original trade date and notional size and currency are extremely useful for identification purposes. These may be present in the existing TREM reporting.

To address the specific fields included in the CESR paper:

1. **Ultimate Underlying ISIN** - This may be inapplicable for instruments such as interest rate swaps whose price is not based on a regulated or exchange traded underlier. While these are not currently in the CESR scope, it would beneficial to allow corresponding information (such as the index name) to be provided where it is applicable.

2. **Underlying Instrument Type** - using only the first character of the CFI means that only the following can be identified:

   E = Equities
   D = Debt Instruments
   R = Entitlements (Rights)
   O = Options
   F = Futures
   S = Structured Products
   T = Referential Instruments
   M = Others (Miscellaneous)

   Using this scheme, it is not possible to identify non financial instruments (i.e. commodities), swaps or an option on an outcome/event.

3. **Derivative type:** ISDA recommends adopting a classification scheme capable of more completely and consistently representing the derivative's key characteristics, as discussed above in the response to Question 1.

4. **Put/call indicator:** This indicator may not be applicable or may require complex interpretation for more complex OTC options such as swaptions, collars, choosers, etc., nor is it directly applicable for swap type instruments, unless there is an interpretation of the meaning. It should be optional.

5. **Price multiplier:** This is not applicable for all OTC derivatives and so should be optional

6. **Strike price:** This is not applicable for all OTC derivatives (such as basis swaps) and so should be optional.

7. **Expiration date:** The definition of this field needs to be carefully considered. For example, on an option on a credit default swap, is this the expiration of the option or the maturity of the underlying swap? In general OTC instruments may have multiple maturity/termination dates for different legs, possibly in addition to (or instead of) an expiration date.

FpML 5.0, which is currently in Working Draft form, has a view (a schema version) that will allow a limited number of fields to be reported for a transaction for reporting purposes. ISDA will ensure that the CESR requirements are addressed in the definition of the reporting view. In addition, ISDA respectfully requests the CESR to collaborate in the definition of the FpML reporting view, through the FpML Reporting working group, which coordinates the technical reporting requirements and ensures full reporting coverage in the standard.

Appendix A - FpML Product Type Coding Scheme

productTypeSimpleScheme

Scheme Definition:

A simple product typology, focused on identifying the type of financial instrument, without characterizing its features.

Scheme Identification:

- **Canonical URI:** http://www.fpml.org/coding-scheme/product-type-simple
- **Latest Version:** 1-2
- **URI:** http://www.fpml.org/coding-scheme/product-type-simple-1-2
- **Location URL:** http://www.fpml.org/coding-scheme/product-type-simple-1-2.xml
- **All Versions:** http://www.fpml.org/coding-scheme

Coding Scheme

CODE	SOURCE	DESCRIPTION
AssetSwap	FpML	A swap agreement where one leg mimics the return of the underlying asset. No transfer of asset takes place (sometimes the sale of the bond is included in the "asset swap construct").
BondOption	FpML	A contract that gives the buyer of the option the right to exercise it into the bond underlyer (or its cash equivalent) under specified conditions.
BulletPayment	FpML	

		A single known payment between two parties.
CapFloor	FpML	A contract that guarantees either a maximum (cap) or a minimum (floor) level of a variable interest rate reference.
ConvertibleBondOption	FpML	An option contract in which the underlying asset is a convertible bond.
CreditDefaultBasket	FpML	A swap agreement in which one party pays a periodic fee in return for a contingent payment by the other party following a credit event on a basket of credit entities.
CreditDefaultBasketTranche	FpML	A swap agreement in which one party pays a periodic fee in return for a contingent payment by the other party following a credit event on a Tranche of an Index of a basket of credit entities.
CreditDefaultIndex	FpML	A swap agreement in which one party pays a periodic fee in return for a contingent payment by the other party following a credit event on an Index of credit entities.

CreditDefaultIndexTranche	FpML	A swap agreement in which one party pays a periodic fee in return for a contingent payment by the other party following a credit event on a Tranche of an Index of credit entities.
CreditDefaultOption	FpML	An option to buy protection (payer option) or sell protection (receiver option) as a credit default swap on a specific reference credit with a specific maturity.
CreditDefaultSwap	FpML	A swap agreement in which one party pays a periodic fee in return for a contingent payment by the other other party following a credit event on a reference entity, a specific reference obligation or a basket of such reference names.
CrossCurrencySwap	FpML	An interest rate swap agreement which interest streams are denominated in different currencies.
DividendSwap	FpML	TBD
EquityForward	FpML	

		A contract between two parties regarding the future value of the equity underlyer (or its cash equivalent).
EquityOption	FpML	A contract that gives the buyer of the option the right to exercise it into the equity underlyer (or its cash equivalent) under specified conditions.
FRA	FpML	Forward Rate Agreement, corresponding to an agreement between parties regarding the level of a variable interest rate at a future date.
FxForward	FpML	An agreement between two parties regarding the future value of a currency exchange rate.
FxOption	FpML	A contract that gives the buyer of the option the right to exercise it into the FX underlyer (or its cash equivalent) under specified conditions.
FxOptionStrategy	FpML	A transaction consisting of several component transactions, at least one of which is a foreign exchange option transaction.

FxSpot	FpML	A foreign exchange deal that consists of a bilateral contract between a party delivering a certain amount of a currency against receiving a certain amount of another currency from a second counterparty, based on an agreed exchange rate.
FxSwap	FpML	A financial instrument that corresponds to the combination of an FX spot and an FX forward transactions.
InflationSwap	FpML	A swap agreement where one leg references an inflation index while the other one will typically reference a variable interest rate.
InterestRateSwap	FpML	A swap agreement which consists in swapping interest rate streams, whatever the type of interest rate references that are being used (i.e. float vs. float swaps, also known as basis swaps, are included in this category).
InterestRateSwaption	FpML	An option to enter into an interest rate swap.

TermDeposit	FpML	The simple commoditized term deposit that is typically a trade with a tenor of 1-year or less with no interim interest payments.
TotalReturnSwap	FpML	A swap agreement in which one party transfers the economic performance of a reference asset to the other party, typically in the exchange of the financing cost of this asset.
VarianceSwap	FpML	A financial derivative instrument whose price is a function of the variance of the price of the underlyer.