



Response to ESMA/2012/95 Discussion Paper

London Market Systems welcomes the opportunity to respond to the call for evidence by the European Securities and Market Authority (ESMA) on the Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories Discussion Paper, Ref: ESMA/2012/95.

As an active participant of the FpML and ISO working groups, we have undertaken extensive research into analysing the features of OTC derivative products. In addition, we recently instigated the creation of both the ISITC Europe LEI and Instrument Classifications & Identification Working Groups and are chairing both.

Given our area of expertise we have only focused on questions where we believe we can add value, namely Q70, Q72, Q73 and Q77.

Q70: Are the possible fields included in the attached table, under Parties to the Contract, sufficient to accurately identify counterparties for the purposes listed above? What other fields or formats could be considered?

The G20/FSB backed LEI investigation will be complete in early April; therefore assuming the LEI initiative meets ESMA requirements, it would be appropriate to align the thinking with this.

Q72: What are the main challenges and possible solutions associated to counterparty codes? Do you consider that a better identifier than a client code could be used for the purpose of identifying individuals?

A single global scheme for identification of underlying client would require an administration capable of covering potentially every person on the planet - very difficult/cumbersome, if not impossible. It might be better to adopt each jurisdiction's social security number or its closest unique equivalent.

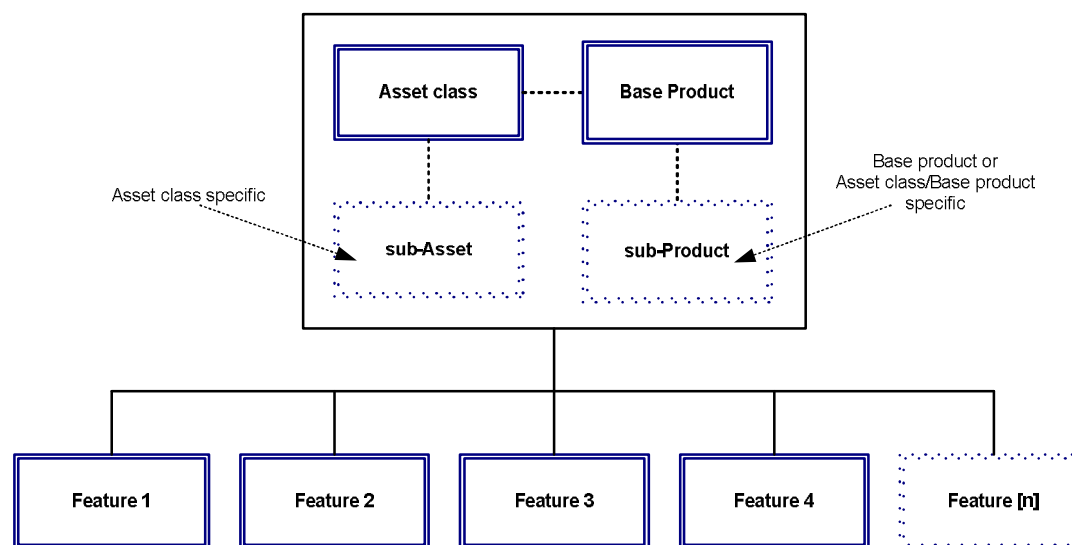
Hopefully the issue of the identification of individuals, partnerships and the ultimate owner of partnerships will be addressed by the FSB backed LEI investigation.

Q73: What taxonomy and codes should be used for identifying derivatives products when reporting to TRs, particularly as regards commodities or other assets for which ISIN cannot be used? In which circumstances should baskets be flagged as such, or should their composition be identified as well and how? Is there any particular aspect to be considered as regards a possible UPI?

It is recognised that a unique product identifier (UPI) is required and that the ISIN is not appropriate given that there is a requirement to link the UPI with its underlying transactions, such information is not easily available to ANNA, the Registration Authority of the ISIN. The UPI will also require the use of a suitable classification scheme to categorise the products into their required groupings for evaluation purposes by the regulators.

ISO 10962, the Classification of Financial Instruments does not support OTC Derivative products and in its current structural form (a two level hierarchy plus four optional features) it will not be able to support derivative products effectively in the future. Therefore there are two main approaches available:

- To adopt a taxonomy approach, where the focus is on identifying specific product types, as proposed in the ISDA Unique Product Identifier (UPI) proposal, or
- Adopt a classification scheme based on a two dimensional approach based on Asset class/sub-asset and product (or contract) /sub-product type. This aligns with CFTC regulatory reporting proposal and the BIS transaction reporting for OTC statistical analysis. This method is also regularly adopted by applications used internally by financial institutions and lends itself to being supplemented with additional features (terms) to identify explicit products and thus is future proofed. This scheme is outlined in the following paragraphs.



Asset class / Base product

Asset class/Base product	Cap/Floor	Exotic	FRA	Forward	Future	Loan	Option	Security	Spot	Swap	Swaption	Warrant
Cash						X						
Credit				X ¹			X			X		
Commodity				X	X		X			X		
Equity		X		X	X	X	X			X		X
Foreign Exchange		X		X	X		X		X	X		X
Rate ² (Interest, Inflation, ...)	X		X	X		X	X	X		X	X	X
Hybrid (multiple Asset class)		X	X	X	X	X	X		X	X	X	X

It's worth highlighting that at present the ISDA UPI proposal does not currently encompass Hybrid products, even so it is understood that further work will be undertaken to expand the current asset class list to include Hybrid products, though no timeline has been defined.

¹ I.e. Credit Spread Forward, where the sub-Asset is set to Spread.

² ISDA proposes the use of "Interest Rate".

sub-Asset

The sub-Asset entries are Asset class specific and are principally based on the FpML Reporting Working Group classification proposal. This deviates from the ISDA proposal as the focus is on classifying products, whilst the ISDA proposal aims to identify specific products. Developing a classification on the latter is more likely to break when new financial products are developed. In addition, the ISDA UPI proposal contains product features in its hierarchical structure.

Asset class	sub-Asset
Cash	Bullet Payment, Deposit , Lending, Repo, Reverse Repo, Security, ...
Credit	Debt, Loan, Mortgage, Portfolio ³ , Spread, ...
Commodity	Agricultural, Economic, Energy, Environmental, Freight, Index, Industrial (e.g. Plastics), Insurance, Multi-Commodity Product, Precious Metals, Pulp & Paper, Real-estate, Weather
Equity	Mutual fund, Convertible bond, ..
ForeignExchange	Emerging Market Currencies, G10 Currencies , Non-deliverable Currencies
Rate (Single Currency)	Cross Currency, Debt, Inflation, Single Currency

sub-Product

The sub-Product entries are Base product or Asset class/Base product specific and populated by selecting the appropriate information from both the ISDA and FpML proposals.

Asset class/Base product	sub-Product
Credit/Swap	ABS, ABX, CDX, CDX Structured Tranche, Corporate, IOS, iTraxx, Loans, Sovereign, ...
Equity/Swap	CFD, Correlation, Dividend, Portfolio ⁴ , Price Return, Spreadbet, TRS, Variance, Volatility, ...
Rate (Single Currency)/Swap	Fixed - Float, Fixed-Fixed, Basis, OIS, Variance
-/Option	Barrier, Binary/Digital ⁵ , [Barrier & Binary/Digital]

³ Portfolio of single name credit default swaps.

⁴ Return swap on a portfolio of CDS trades.

⁵ ISDA proposal supports Barrier or Digital, not both.

Q77: Are the elements in the attached table appropriate in number and scope for each of these classes? Would there be any additional class-specific elements that should be considered, particularly as regards credit, equity and commodity derivatives? As regards format, comments are welcome on the possible codes listed in the table.

We have concerns about the level of granularity of terms in Table 2 - common data. For example, it seems to imply that each product is either in a single currency or two currencies in the case of a Forex product. From experience this is rarely the case apart from vanilla instruments. To future proof the system, one needs to ensure that the currency is specified at the transaction (or leg) level.

It may be appropriate to align the model with the latest version of FpML version 5.3, which has been designed to meet the requirements of the new regulatory regimes. It also encompasses a more comprehensive set of financial products (i.e. commodities) and flavours of contracts (including terms required for physical delivery).