

2015

FpML Response to CPMI-IOSCO Consultative Report

*On Harmonisation of key OTC derivatives
data elements (other than UTI and UPI) -
first batch*

This document constitutes the FpML response to the CPMI-IOSCO consultation
paper published September 2015



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1. Introduction

Financial products Markup Language (FpML), through the FpML Standards Committee, would like to provide CPMI-IOSCO with comments and recommendations on the “Harmonisation of a first batch of key OTC derivatives data elements (other than UTI and UPI)”¹.

We fully support the response submitted by ISDA. The analysis conducted and provided in this comment letter is an addition to the ISDA response with a focus on technical implementation. The engagement with regulators in the US, Europe and Asia on various reporting requirements through the FpML Regulatory Reporting Working Group² (FpML RPTWG) has been very beneficial. We welcome the ongoing dialogue with CPMI and IOSCO.

About FpML

FpML (Financial products Markup Language) is the freely licensed business information exchange standard for electronic dealing and processing of privately negotiated derivatives and structured products. It establishes the industry protocol for sharing information on, and dealing in, financial derivatives and structured products. It is based on XML (Extensible Markup Language), the standard meta-language for describing data shared between applications. The standard is developed under the auspices of ISDA, using the ISDA derivatives documentation as the basis. As a true open standard, the standards work is available to all at no cost and open to contribution from all. The standard evolution and development is overseen and managed by the FpML Standards Committee, following W3C rules of operations guidelines. The Standards Committee has representatives from dealers, buy side, clearing houses, large infrastructures, vendors, Investment managers and custodians. To find additional information on FpML, visit www.fpml.org.

Within in the broader standards landscape, we collaborate actively with ISO on the further development of the ISO 20022 standard and with organizations that cover other parts of the financial standards landscape.

Regulatory Reporting Coverage in FpML

A variety of changes have been made to the FpML standard in recent years to allow for coverage of the reporting requirements in different jurisdictions. A core design principle has been to implement a robust technical framework that could be leveraged by global regulators as new regulations become available. To that effect we have tracked requirements that are specific to a particular reporting regime in a structure that accommodates the needs of multiple regulators. Over a period of time, FpML has been actively involved with regulatory bodies in Asia, the US and Europe in devising compliant solutions, in order to report the specific data fields for various regulatory regimes.

¹ The Consultation Paper is publicly available at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD503.pdf>

² The meeting materials and minutes of the various FpML working groups, including the Reporting Working Group are publicly available at: www.fpml.org in the working group section at http://www.fpml.org/mg_groups/fpml-rptwg/

2. FpML Feedback

General Feedback

A key problem that CPMI-IOSCO needs to solve, in harmonising data elements, is to ensure that this set of data elements is defined clearly and consistently, in such a way that all stakeholders involved in trade reporting have the same understanding of these data elements. The first step of this process is to agree on a set of definitions for the key concepts and terms involved in the reporting process, and to describe how these terms relate to one another. Regulatory reporting for OTC derivatives is an integral part of the trade lifecycle and values, data and terms are used in other processes such as the confirmation process. Introducing new concepts or terms that do not currently exist in other pre- or post- trade processes requires that these concepts or terms be clearly, precisely and unambiguously defined.

For this reason we strongly recommend that CPMI -IOSCO creates a list of key business terms with their definitions and validates these definitions with the industry. Once the terms and definitions are agreed, the actual data elements and their format can be defined.

For example, multiple entities can be involved in a trade, each of them playing one or multiple roles throughout the lifecycle of the trade:

- Counterparty
- Direct counterparty, indirect counterparty
- Reporting party
- Principal
- Agent
- Prime Broker
- Clearing Broker
- Executing Broker
- Beneficiary
- Guarantor
- Issuer
- Clearer

The following key trade-related elements and structures should be clearly defined if there is a requirement to report them, and examples of their usage should be given:

- Trade
- Contract
- Position
- Transaction
- Business event
- Stream/Leg
- Cashflow
- Underlying Asset
- Alpha trade

- Beta and gamma trade
- Block trade
- Allocation, allocation trade
- Large sized trade
- Post-trade Event e.g.:
 - Termination
 - Increase
 - Amendment
 - Novation
 - Compression
 - Netting
 - Exercise, Expiry

For example, Counterparty might be defined as follows:

- A **Counterparty** is one of two named entities participating directly in an OTC derivative trade. Each counterparty is responsible for fulfilling the economic terms in the agreement, such as making payments based on defined rules, and in turn has the right to receive assets as defined in the contract. If an investor executes a trade through an agent such as a prime broker or clearing broker, and if the trade documentation lists the name of the broker as principal to the contract, the counterparty to that trade is the broker, not the investor. (The investor would be the beneficiary of that trade.)

We note that, in this consultation paper, CPMI and IOSCO have introduced new terminology, such as Principal Obligor, which is not used in existing processes and has not been properly defined. This is likely to increase rather than reduce confusion in the marketplace, and reduce the ease of data aggregation. In addition, CPMI and IOSCO define a set of abbreviated code values for a number of data fields that in most cases do not appear to be based on existing published sources. FpML recommends that CPMI and IOSCO use standard English-language definitions of the concepts and refer to existing published code lists where possible. FpML as part of the open source publication publishes lists of codes that include both internal and external codes³.

Effective Date

The existing OTC derivative industry practice is to specify effective date as a date, not a datetime, as accruals begin on a specific business day, and fractions of a business day are not used to compute accruals. Introducing a timestamp would introduce ambiguity regarding which business day was intended, particularly in cases where reporting parties are located far to the east or west of typical

³ FpML coding schemes are publicly available at <http://www.fpml.org/spec/coding-scheme/>

international settlement locations. For this reason we strongly recommend Alternative 1. FpML represents the effective date of trades this way.

End Date

The existing OTC derivative industry practice is to specify end date as a date, not a datetime, as accruals begin on a specific business day, and fractions of a business day are not used to compute accruals. Introducing a timestamp would introduce ambiguity regarding which business day was intended, particularly in cases where reporting parties are located far to the east or west of typical international settlement locations. For this reason we strongly recommend Alternative 1.

For cases where the final payment occurs prior to the end of the final accrual period (i.e. “payment in advance” products such as FRAs), explicit guidance should be given to indicate whether the end date refers to the end of the risk, which occurs on the final payment date, or, the notional end of the accrual period, which is normally recorded as a maturity or termination date of the trade (see previous discussion on definition of concepts and terms).

For cases in which there is an option on an underlying swap or forward contract, the guidance should be clear as to whether the end date refers to the expiration of the option or the termination date of the underlying instrument.

We note that for option expiry dates that represent the maturity of a trade, a date and time combination could be an appropriate alternative. An option expires at a particular time in a particular business center or other location. As such an indication of time is needed. However, most regulators require separate expiration dates for option expiration, so this might be a separate data field. Current market practice, also applied in FpML, is to represent expiration dates and times as separate fields, with the expiration time defined in relation to a business center. For this reason we recommend that expiration times, if required in a future batch of data fields, be represented as a separate field.

Cleared Indicator

The CPMI-IOSCO proposal for this field is problematic, as it combines expressions of clearing status and clearing method into a single field, without clearly distinguishing between the respective meanings.

- There are two reporting cases to consider:
 - A. Reporting of the original (“alpha”) trade, as executed on a trading facility or bilaterally, prior to submission for clearing.
 - In this case, once the original trade is cleared, it is terminated and no longer in effect. Indicating that the trade has been cleared may be unnecessary. Instead it could be recorded as being terminated, with a termination reason of “Cleared”.
 - However, a number of reporting regimes do require an explicit clearing status. When required, this information can be explicitly represented through the

clearing status, although, no additional information is conveyed and once cleared the trade is terminated.

- We believe that for alpha trades, the following values would convey extra information: i) Not intended to be cleared, ii) Intended to be cleared (but not yet submitted for clearing), iii) Failed clearing. FpML represents these concepts with an “intent to clear” indicator and a “clearing status” indicator.
- In addition, Alternative 1 includes information about the method of clearing that may not be available, for example, to reporting parties that are executing a trade; this obviously would complicate the reporting and is an argument against Alternative 1.
- Finally, the “Not Cleared” in Alternative 1 could be interpreted as saying that a clearing operation failed. In case Alternative 1 is chosen, clear guidance should be given which status to report for a failed clearing operation (see our proposed alternative values above).

B. Reporting of the two trades created as a result of clearing, i.e. “beta” or “gamma” trades.

- The existence of the beta and gamma trades means that the alpha trade was successfully cleared. This information can be derived because one of the counterparties to the trade will be a CCP. Therefore, when the “beta” and “gamma” trades exist, the cleared indicator (Alternative 2) provides no additional information in this case.

- Alternative 1 combines status with clearing method.
 - A. Value 1: Not Cleared. Does this mean that the trade will not be cleared, or that it is intended to be cleared but clearing has not yet happened?
 - B. Values 2, 3 and 4. These values do not convey a clearing status per se, but rather the clearing method. Perhaps a separate field containing this information could be provided.

Settlement Method

- It is unclear what a Settlement Method of “Other” would entail, beyond “Election”. We propose to remove “Other” from the list of allowed values and add explicitly a value for Election, where the option holder has the right to choose the settlement method. We recommend the value “Election”, or failing that, “CashOrPhysical”.
- Please clarify how Settlement method should be used in different scenarios, with examples. For example, if a swaption exercises into a financially-settled swap, should this be reported as Settlement Method = “Physical”? This is the standard industry convention.
- We note that in the case of FX transactions, there is no indication of a Settlement Method in current market practice, and we suggest that CPMI-IOSCO clarify that the Settlement Method field does not apply to FX derivatives. However, in case CPMI-IOSCO concludes that a Settlement Method should be provided for FX transactions, it should be clarified that only non-deliverable forward and option transactions, and cash-settled options such as digital options, would have

“Cash” as Settlement Method, and all other FX derivative transactions involving exchange of cash flows have “Physical” as the Settlement method. This would be consistent with existing reporting practice as we understand it.

ID of the Primary Obligor 1, 2

- “Primary obligor” is a new term not currently used in the OTC derivatives market, and not used in existing regulations. It appears to be more relevant to fixed income, where bond issuers are obligated to make coupon payments and repay the principal on the bond. In an OTC derivative contract, there are typically two counterparties, both of which may be obliged to pay or entitled to receive payments under the contract. We suggest replacing “Primary obligor” with Counterparty, or another existing term.
- Also, It is unclear how these fields relate to the reporting party and non-reporting party. Are they the same?
- If the terminology is retained, the definitions need to be clarified and any ambiguity should be removed. For instance, in the case of an agency trade, is the primary obligor the agent (which is the legal counterparty to the trade) or the beneficiary (which is not legally a party to the trade)? The agent has the ultimate financial responsibility for the trade, even if the beneficiary is intended to be exposed to the economic risk of the trade. If it is the beneficiary, we suggest renaming this to Beneficiary 1, 2, which is consistent with existing regulations and industry practice. In places where the terms “exposure” or “risk” are used, we suggest clarifying this with either “market” or “default” to distinguish the two types of risk.

Notional Amount 1, 2

- For this field to be useful, we need a more precise definition of “current” or “actual” notional. For example, if the trade is amortizing and the notional changes on the reporting date, is the reported notional that of the period just completed on that date, or the notional going forward? (The first refers to the notional risk just completed, where the second refers to the notional risk still open).
- To be generally applicable for all types of trades, we need clarification on how to handle notionals on trades whose principal amounts/sizes are not expressed in currency units. For example, in the case of equity derivatives whose size/quantity is expressed in shares, or commodities whose size/quantity is expressed in units of the commodity, should these be translated into currency amounts, and if so, how? As far as open questions on how to compute notional are concerned, we would also like to refer to the ESMA consultation paper on trade reporting⁴ and the FpML response⁵ to this paper.

Original Notional Amount

- This appears to represent a new data field, not a harmonization of existing fields.

⁴ ESMA’s Consultation on Review of the technical standards on reporting under Article 9 of EMIR <http://www.esma.europa.eu/consultation/Consultation-Review-technical-standards-reporting-under-Article-9-EMIR>

⁵ FpML’s response http://www.esma.europa.eu/system/files/isda-fpml-response-to-esma-cp-2015-02-13_0.pdf

- Only a single original notional amount is defined. There should be two, in line with notional amount 1 and 2.
- In the existing reporting practice, we understand “Notional amount” to mean the initial contractual notional amount(s), while the current notional amount is distinguished explicitly by the term “current”. We suggest that ambiguity and potential for misinterpretation should be avoided by renaming Notional amount to “Current notional amount”, and reserving the term “Notional amount” for the value(s) defined as “Original notional amount” in the Consultative report.

Notional Currency 1, 2

- No comments

Valuation Amount

- We support alternative 1

Valuation Currency

- No comments

Valuation Timestamp

- No comments

Valuation Method / Valuation Source

- For the valuation method, and specifically the values Mark to Market and Mark to Model, we recommend more clarification on terms. For example, many industry participants refer to computing the “mark to market” of a swap by pricing it against one or more pricing curves (e.g. yield curve) which forecast future payment streams and discount them back to the present. However, the pricing curve is arguably a form of pricing model, often much more complicated than an option pricing model, and different firms could obtain slightly different prices for the same swap. Should this be considered “Mark to Market” or “Mark to Model”? We believe that “Mark to Market” should be reserved for computing the value of trades by referring to the price of an identical trade obtained from an external source, such as a market data provider, without computation other than scaling for trade size. All other prices, whether derived from an intrinsic curve model (such as most swap and forward pricing models use), an analytic or closed form pricing model such as a Black-Scholes option pricing model, or a complex model such as a backward induction tree or lattice model or a Monte Carlo simulation model, should be considered Mark to Model. If CPMI -IOSCO disagrees with this definition, it should provide an equivalently precise definition of its own.
- Because Mark to Market is in effect the same as a valuation source of “External”, we recommend that Valuation Source not be used (i.e. Alternative 2 in Data element 8.05).
- As far as the values for Valuation Method are concerned, we do not have a position on whether the values for Valuation Method should include “CCP” in addition to “Mark to Market” and “Mark to Model”.

Early Termination Timestamp

- There are a number of events that can end or change the terms of a trade prior to the scheduled termination date of the trade. These include:
 - Negotiated early termination
 - Early termination under an optional early termination provision (“mutual put”)
 - Novation
 - Offsetting (netting) trade
 - Option exercise
 - Partial termination, partial novation
 - Increase
 - Compression
- The definition should either be broadened to cover the events listed above or, should be clarified with regards to the above events.
- There needs to be a distinction between the execution time of the decision to terminate early, which is a datetime, and the effective date of the termination, which is a business day. Both data fields should be included in the specification, or it should be unambiguous which one is required.

Direction

- Specifying “direction” in terms of a buyer and seller for an OTC derivative contract is not always appropriate. There may be several different components included in a contract, so it is not generally possible to think in terms of a buyer and seller, without introducing some essentially arbitrary convention.
- Specifying derivation based on rules is challenging and doesn’t work for all trade types. For example, how should the buyer on a fixed/fixed swap be determined? If this method is to be used, there should be guidance on how to fill in the value for trade types that do not fit into the rules-based methodology.
- If the Payer of payment streams (Alternative 2) is used, there would need to be a payer for each stream, or a rule about which stream should be reported. For example, the fixed rate payer and the floating rate payer might be applicable for a vanilla IRS. Alternatively, it may be preferable to think of the payer of each underlying asset in the trade.
- A simpler alternative might be to specify for each of the parties to the trade (the reporting party and the counterparty) what type of risk that party incurs, i.e. Fixed or Float for swaps and forwards, and Seller/Writer and Buyer/Owner/Holder for options.

3. Conclusion

The FpML standard is widely used for reporting in multiple jurisdictions. The regulatory framework built into the standard over the past several years can be leveraged by CPMI-IOSCO. FpML version 5.8 in particular is well equipped to represent reportable data fields required under CPMI-IOSCO consultation paper with little or no change. The FpML standard continues to be developed to meet requirements from global regulators.

We hope that you will find our comments and suggestions useful, and we are available if you would like to discuss these in further detail.

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