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ISDA Response to CESR/09-768
on
Consultation on guidance to report transactions on OTC derivative instruments

Introduction

This comment paper responds to the Committee of European Securities Regulators Consultation paper CESR/09-768, dated January 2010, and provides additional information and comments from the International Swaps and Derivatives Association (ISDA).

ISDA appreciates the opportunity to comment on CESR Consultation paper and thanks CESR for its consideration of its responses to previous CESR consultative papers.

ISDA is disappointed that its previous inputs were not able to be accommodated more fully by CESR, because it feels that a number of the issues raised in this current paper could be handled better if CESR's standards were more closely aligned with post-trade OTC derivative position reporting being developed by ISDA's members and reporting repository vendors. In particular we are concerned from an industry perspective not to be able to leverage the under development or existing OTC derivatives reporting infrastructure.

The following comments and responses are organized according to the specification and questions in the original paper.

ISDA, which represents participants in the privately negotiated derivatives industry, is the largest global financial trade association, by number of member firms. ISDA was chartered in 1985, and today has over 780 member institutions from 56 countries on six continents. These members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the risks inherent in their core economic activities. ISDA develops and maintains Financial products Markup Language (FpML) the industry XML standard for derivatives and structured products. For further information, please visit www.isda.org.

For further information on issues raised in this paper please contact Karel Engelen (kengelen@isda.org)

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Response

Section I.

A. through D.

No comments.

E. Transaction reporting fields

Buy/sell indicator

Comment: please clarify the definition of "buy" vs. "sell" for swaps or other non-options. In general, "buy" for non-options should mean "take a long position in the underlying asset" and "sell" should mean "take a short position". This is covered to some extent by the examples in sections II through IX, but a more general definition would be helpful.

Instrument Identification

See response to question 20 in section VIII: Credit Default Swaps.

Unit price

Comment: Unit price needs to be defined in more detail for more product types; this is covered by the examples to some extent, but a more general definition would be helpful. It appears that for equity security based OTC derivatives, the unit price is the initial price in currency unit per share of the equity. For bond-based OTC derivatives, the unit price is a single rate (expressed as a percent per year) encompassing any fixed rates plus initial fees. What would the unit price be for an OTC bond option? For a TRS on a bond? Also see response to question 21 in section VIII for CDS unit price particulars.

Q1: Do you agree that the Unit Price should be the premium per single underlying of the contract as it is in market practice and not per contract?

A1: ISDA agrees that premium per single underlying unit is acceptable.

Price notation

Comment: When is % of nominal value permitted? Is it ever required?

Quantity

Comment: This needs to be defined in detail for each type of derivative transaction. This is covered in the examples but a more general definition would be helpful. For example, it appears that the "quantity" for derivatives based on equity securities is the number of units of the underlying, where the quantity for derivatives based on fixed income or credit securities is based on face (principal) amount of the underlying, or equivalently notional value in currency units.

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Venue identification

Q2: Do you agree that the Venue Identification should be XXXX in order to differentiate transactions on OTC derivative instruments from off-market transactions of instruments admitted to trading, marked as XOFF? Do you think this should also be the case if the transaction is executed on an MTF?

A2: ISDA agrees that XXXX should be the venue code for OTC derivatives, whether or not they are executed on an MTF. This would be consistent with existing FSA guidance. In addition, ISDA recommends that the definition of the term "Multilateral Trading Facility" (MTF) be clarified with respect to OTC derivatives; some ISDA members feel that the existing definition could be interpreted to include OTC derivative trading platforms operated by single dealers (and offering trading with that dealer only).

Derivative/Instrument Type

Comment: Would an option on a CDS be considered a "complex" derivative?

Ultimate Underlying ISIN

Comment: What symbol/notation should be used if no ISIN is available for the underlying instrument?

Put/call indicator

No comments.

Price multiplier

No comments.

Strike price

No comments.

Expiration date

See response to question 4 in section II: OTC options.

Other

Q3: Any other views on the above?

A3: See comments above, organized by field.

F. Population of fields by type

No comments on mapping table.

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II. OTC Options

Q4: Do you agree that in the case of multiple expiration dates, the field should be filled in with the latest expiration date?

A4: Latest expiration is fine.

Q5: Any other views on the above?

A5: For those OTC bond options that are in scope (because the underlying instrument is traded on a regulated market), an example should be provided.

III. OTC Warrants

No comments.

IV. OTC Futures/Forwards

No comments.

V. Contract for Difference (CfDs)

Q6: Do you agree that an option on a CFD on an equity is not a complex derivative as the terms of the bet can be accommodated in the transaction reporting fields?

A6: ISDA agrees that CfDs should not be classified as complex derivatives for the purpose of regulatory compliance and transparency reporting. However, it is worth noting that the booking process for CfDs is not standardized, so CfDs cannot be thought of as standardized derivatives for other purposes, such as confirmations.

VI. Spread bet

Comment: the textual description is unclear about when the price multiplier should be provided, and the meaning when it is not provided. Q11 seems to imply a specific assumption, where not populated = 1 EUR/0.01EUR movement.

Questions 7 to 14

Q7: Do you agree that the Quantity field should contain the amount of the „bet"?
Q8: Do you agree that the Unit Price field should contain the reference price for the transaction?
Q9: Do you agree that the Unit Price should be in the currency of the underlying instrument?
Q10: Do you agree that the Price Notation field should reflect the currency of the underlying instrument even when the spread bet is made in a different currency?

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Q11(a): Do you agree that the Price Multiplier field should be populated to validate what movement in the price of the underlying instrument the spread bet is based on e.g. 100 for 1 point (cent/penny); 1 for 1 Euro/Pound movement?
Q11(b): Do you agree that the spread bet will normally be based on a movement of one point (cent/penny) movement in the price of the underlying instrument and the Price Multiplier field should only be populated when the spread bet is **not** based on a movement of one point?
Q12: Do you agree that a transaction report is required for opening and closing a spread bet and for the expiration of a spread bet?
Q13: Do you agree that an option on a spread bet on an equity is not a complex derivative as the terms of the bet can be accommodated in the transaction reporting fields?
Q14: In relation to spread bets on other MiFID instruments, do you have any views on how the fields in a transaction report should be populated?

Answer on questions 7 to 14: ISDA has no position on these questions, except for the comment above related to Q11.

VII. Equity swaps

Q15: Do you agree that the buyer of the Equity Swap (Buy/Sell Indicator field, B) should be the Fixed Rate Payer?

A15: The buyer of an equity swap should be the firm that receives the equity performance and pays interest (financing).

Q16: Do you agree that the Quantity field should be the notional value of the Equity Swap or the number of shares subject to the agreement?

A16: The number of shares is acceptable for single name equity swaps. For equity swaps with basket or index underlyers that are in scope, the number of units should be used.

Q17: Do you agree that the Unit Price field should contain reference price of the underlying equity on which the equity returns are calculated?

A17: The Unit Price should contain the INITIAL reference price of the underlying instrument, not the current market price, in cases where reporting occurs some time after the trade was executed.

Q18: Do you consider that when the initial reference price is not known when the Equity Swap is traded, this product should be considered a Complex Derivative?

A18: No. Instead the reference price should be omitted in these cases, or replaced with a code meaning “forward setting”.

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Q19: Do you agree that Equity Swaps with two Equity legs should be reported with two different transaction reports with the same Transaction Reference Number for both reporting firms?

A19: ISDA has concerns with this question. In addition to the CESR proposed format, the reporting system should be able to receive an OTC transaction within the same record so in this case a single record with a unique transaction reference number should be able to cover the full product representation.

VIII. Credit default swaps

Unit price

See response to Q21 below

Underlying instrument identifier

See response to Q20 below

Scope of transactions (activity)

Q20: Which instrument should be reported as the ultimate underlying instrument for a CDS? the market clip, the reference bond if any, or the ISIN of the stock of the issuer? (warning: these are mutually exclusive options, i.e. participants would not have the choice between different reporting options. Once one of them has been selected, it would become the only standard for reporting)

A20: RED codes have been developed to uniquely identify the correct reference entity for CDS trades and should be used for reporting on the underlying instrument for a CDS. RED data is available from Markit Group on a commercial basis, requiring market participants to license the RED data. Availability of the RED data for purposes of this reporting in a cost effective way needs to be ensured for all market participants. As an interim solution only, firms could leverage the existing FSA reporting requirements, using the ISIN for the reference obligation. ISIN's do not enable accurate identification of the reference entity. For example: the reference entity can be either the issuer or guarantor of the reference obligation and CDS contracts on senior debt can be traded without a reference obligation. ISINs of the stock are not used as reference data in the credit market and should therefore not be considered for the transaction reporting requirements.

Q21: Do you agree that the price should be an equivalent all-running payment price expressed in basis points?

A21: While ISDA agrees that is it standard market practice to compute an "equivalent annual payment" or an "equivalent all running payment," this calculation is dependent on assumptions about market data, such as recovery rate and yield curves, and on the details of the credit model that is used.

ISDA recommends that the following approach be used:

CDS transactions always have a coupon and may have an initial payment. ISDA recommends that the coupon be recorded in the "Strike" field. The initial payment (if any) expressed in basis points of notional, not annualized, should be reported in the "unit price" field. For example, in the CESR example on page 26, the fixed rate is 500 bp, and would be reported in the "Strike Price" field. If we assume the upfront payment is €485,000 (rather than $485,000) to simplify the calculations, the unit price would be 485,000 / 20,000,000 = 242.5 bp, and this would be reported in the Unit Price field.

This approach has the advantage that it is based entirely on confirmable fields without requiring complex models and variable market inputs. There is no calculation required other than scaling the upfront amount by the notional. The results are predictable and easy to interpret and compare.

If CESR does not take ISDA's advice and instead requires that an "equivalent all-running payment price" be reported, the exact definition of this calculation needs to be specified to provide comparable values. In this case ISDA recommends using the standard input parameters and the CDS open source standard model widely used in the industry. The model can be found at www.cdsmodel.com. There will be a technology and cost impact in integrating these calculations into a transaction reporting process.

In addition, ISDA comments that the example 8.1 on page26 could be clarified by

1) including in the "Context" section (section i) the description of the price parameters (i.e. the fixed rate and the upfront payment) and other parameters (like trade date) that are covered in the "Data" section (section ii). This will make this example more consistent with other examples, and more understandable.

2) expressing the upfront payment in EUR rather than USD, to make it consistent with the notional currency. If an example is desired where the initial payment is in a different currency than the notional, this should be a separate example.

Q22: Do you agree the price notation should be the currency of the debt protected by the CDS?

A22: The Price Notation currency should be the currency of the notional trade amount agreed between the parties. In the Confirmation this is referred to as the currency linked to the Floating Rate Payer Calculation Amount.

Q23: Do you agree that early terminations should be reported, while assignments and compression should not be reportable?

A23: ISDA disagrees and strongly recommends that early terminations not be included in the scope of the reporting, because they do not represent new positions. If, however, early terminations must be reported, ISDA comments that other post trade events such as novations are of similar economic importance.

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ISDA believes that any participant that is required to report unwinds/early terminations should also be required to report novations/assignments that represent trading activity, in order to present a complete picture of the trading activity. ISDA agrees that early terminations or other post-trade events resulting from portfolio compression have no economic impact and should not be reportable.

IX. Complex derivatives

Q24: Do you have any other relevant examples that should be added into CESR guidelines? Please give detailed explanations of the example.

A24: No examples at this time.

Q25: Do you agree that the Instrument Description field should be required to be populated at local level, in order to explain the derivative being reported?

A25: ISDA believes that terminology is likely to vary widely between firms in the absence of standardized naming, and consequently the value of this field is likely to be limited.