

24 February 2016

Via Electronic Submission

RE: Comments on Consultation for the Harmonisation of the Unique Product Identifier

Dear Secretariats Christina Picillo, Phippe Troussard and Verinder Sharma:

CME Group applauds the commitment to reform OTC derivatives markets in the spirit of improving transparency, mitigating systematic risk, and protecting market participants from market misconduct. Efficient aggregation of data, of which the Unique Product Identifier is an essential aspect, will help to ensure that authorities and participants have a comprehensive view of the OTC derivatives market to perform systemic risk monitoring.

CME Group has considered the list of questions put forth by the CPMI-IOSCO working group on Harmonization of the Unique Product Identifier and has provided feedback which we hope can be used as a starting point in helping to guide the industry to an effective solution.

List of Questions and Responses

Question 1: Are the above three OTC derivative instrument types sufficient to describe (in combination) all OTC derivatives? Which OTC derivatives would fall outside this approach?

CME generally agrees that three categories of swap, forward and option are sufficiently broad to classify the full spectrum of OTC derivative instruments. In some cases the behavior of these instrument types could be further elaborated for clarity. For example the primary way a forward is different from a future is that variation margin is calculated from trade price on a daily basis and expressed as a discounted value with regard to its maturity date. Also the definition of a swap may be overly constraining for commodity swaps which tends to behave more like a forward in the CME taxonomy. It may also serve to emphasize that options can be categorized as OTC only if the underlying instrument qualifies as such.

Question 2: Is it valid to assume that a combination of data elements of the instrument with data elements of the underlier is sufficient to define a product? If not, please explain.

CME agrees that a product can be defined using the appropriate set of data elements describing an instrument and its underlying.

Question 3: Is it valid to assume that the combination/set of data elements in the UPI classification system may differ across asset classes? If not, please explain and state how a uniform set of data elements could be comprehensively applied across asset classes.

CME agrees that data elements will vary across both asset class and instrument type. For example it is clear that an interest rate swap will be defined using elements different from that of a credit default swap index.

Question 4: Do you agree with this approach to the UPI's treatment of package trades? If not, please explain and suggest alternatives.

Yes, package trades or strategies should be broken down into their base component instruments before attempting to classify. CME recommends that the treatment be explicit in specifying both user defined and predefined strategies as packages. CME believes that swaption straddles are an exception to this rule and should be classified as a discreet instrument. Swaption straddles are cleared and margined as a discreet instrument and should therefore be excluded from treatment as a package

Question 5: Are the principles and high-level specifications listed and described above comprehensive in representing the characteristics of a classification system? If not, are there other principles and high-level specifications that should be considered? Please list and explain.

CME believes that the confidentiality of the parties involved in a trade needs to be preserved by the UPI system. In some cases it may be possible to infer the party-related information based on the details incorporated in the UPI, for example the delivery point. Beyond this the principles are outlined at a broad enough level to serve as a basis for a generally defined classification system. We would like to emphasize that prior to implementation these principles will need to be more thoroughly defined and explained. As part of that deeper discovery, a possible outcome may be that for certain markets it may be more appropriate to use less granularity. That is, to operate at a more aggregate level until enough confidence exists that additional defining characteristics will not divulge the confidentiality of the parties involved.

Question 6: Are the principles and high-level specifications listed and described above accurate and precise in their definitions? If not, are there changes you would suggest? Please list and explain.

CME considers the set of classification system principles to set out the right framework for the UPI. Several of the principles need more elaboration in order to explain how they can be accomplished. Several of the questions which arise are; how do principles such as Extensibility, Ease of Generation and Precision extend to the actual implementation and use of the UPI? What will the support model look like and what are the costs associated?'

Question 7: Could some of these principles and high-level specifications pose implementation challenges? Which ones and why?

CME agrees with all the principles laid out for defining a UPI. In order to have an effective UPI system, all the principles defined specified in section 3 of the paper have to be met. In addition:

12. In order for it to be adaptable, we will need to detail out as to how the UPI system will handle new products or changes to the existing products. These details could determine the challenges associated with implementation and adoption of the new UPI system.

3. While we see the need for a governance structure consisting of a broad representation of different market participants that enforces a singular classification system, we believe that in order for the system to be effective, markets should be allowed to define their own UPIs based on the guiding principles laid out by the group. We strongly believe the assignment of the UPI should be decentralized and open-source with regard to usage.

Question 8: Providers of product classification systems are encouraged to provide a detailed response to Section 3 to set out how their prospective UPI solutions meet, or could be revised to meet, each of these principles and high-level business specifications. If the UPI solution does not meet a particular principle or high-level business specification, please describe planned or potential amendments that could satisfy it.

CME believes that the first 4 principles (Neutrality, Uniqueness, Consistency, and Persistence) are bare minimum requirements for any system of classification to be effective in creating useful identifiers. The remaining set of principles will allow the system to be adopted as a standard and applied globally. Note that Long-term Viability is not so much a principle as it is the effect of a well-designed system.

The proposal in its current state is consistent with how CME currently uses data elements to construct unique product identifiers although not necessarily as a singular identifier and not necessarily for all asset classes.

Question 9: As discussed in Section 3.5, should a classification system allow one or more of its data elements to take the value "Other" in order to incorporate new and/or highly bespoke products that do not yet have a more precise definition within the classification system? Why or why not? If not, how would the bespoke/non-standard products be treated within the classification system? What should be the criteria and processes for moving one or more data elements from "Other" to a more specific bucket? Should the volume of transactions that can be reported using these "Other" values be capped in order to maintain the precision of the classification system? If so, what would an appropriate cap be?

CME believes that the use of the value "Other" for any of the classification data elements will quickly render the system less effective and should be minimized. Obviously the effectiveness of the classification system will be inversely proportional to the frequency of its use. Essentially it will result in a UPI that cannot differentiate between variations of products at different levels and greatly detract from the usefulness of the system. However CME recognizes that practical considerations may require the use of "Other" in certain cases. CME recommends that the principle of Extensibility allow for interim

values to be assigned after some period of formal consideration that can be introduced to the existing version and later incorporated in a subsequent version if found to be broadly substantiated.

Question 10: The results from the study presented in Annex 4 suggest that data elements which describe the instrument, together with data elements that describe and identify the underlier, may provide an optimal level of granularity for product classification. For informational purposes, beyond the use of a derivative product classification system for the global aggregation of data reported to trade repositories, are you aware of product classifications for other purposes where this level of granularity is applicable? For example, what level of granularity is used for aggregating transactions to calculate a position, or to determine various risk exposures to a particular product? What level of granularity is used to aggregate transactions for the purposes of compression or netting operations?

CME currently uses a product classification system for risk assessment of both OTC and ETD products similar to that proposed in the consultation although somewhat more granular. The more similar the classifications are for a set of products the greater is the correlation of risk exposure and the potential for risk offsets when on opposite sides of the market. The more the classifications diverge, the more correlation is reduced thus reducing risk offsets.

CME's IRS netting service uses a classification that is more granular than what is proposed here. For example netting criteria includes business calendars, business day conventions, day count conventions, stubs and settlement currencies.

Regarding the data elements used to classify an interest rate swap CME advises that the Settlement Currency be added as an underlying data element. This is an important level of granularity in aggregating data for the purpose of gauging risk exposure. Additionally it improves consistency with the FX asset class which includes settlement currency.

Question 11: Do the options presented above appear operationally feasible? If not, please explain why.

CME believes the options presented in the paper are operationally feasible but the process of formulating, constructing and validating the resulting UPI requires further elaboration

Question 12: What are the pros and cons that you see in each considered level of granularity (one with an identifier for the underlier, one without an identifier for the underlier)?

CME believes that it is necessary to include the underlying data elements as well as an explicit underlying ID and source in order to create a classification at a useful level of granularity. The advantages of this approach are a more robust and meaningful UPI that serves to better differentiate products for the purposes of data aggregation and risk exposure assessment. It also removes a level of ambiguity that would otherwise be associated with the UPI and avoids a system that would base the UPI on little more than a high-level asset class hierarchy.

However it should also be noted that use of an underlying ID also has associated challenges. The process of capturing and codifying the full universe of underlying IDs to serve as "master values" will require an extensive exercise in data management. The eligible underlying sources will need to be verified as will the identifiers published by each source. For example, the UPI system should allow only those sources to be references which are captured in the classification model. To draw a parallel with LEI implementation; allowance of alternative entity ID systems spoils the ability for robust validation and data aggregation. Additionally there may not be formal sources for several of the asset types. This is especially true for energy commodities where the delivery points, i.e. power grids and gas storage fields, have not been assigned an official mnemonic value.

CME also recommends further structure in the taxonomy of commodity swaps. The commodity data element values need to be further segregated so that only the appropriate sub-asset values can be used in combination with a given Underlying Asset. For example an Underlying Asset value of Energy should not be able to be paired with a Sub-Asset value of Lumber.

Question 13: A classification system that includes identifiers for underliers in all asset classes would require identifiers that are open-source and freely available to all users with open redistribution rights. Looking at the example of classification systems provided in this section and in Annex 5, do such identifiers exist for all asset classes? If not, please specify where you foresee implementation challenges in this regard and any suggested solutions.

CME is aware that services available to be used as underlying identifiers are often not open-source and tend to be proprietary in nature. This is especially true for identifiers used in the areas of securities and credit. In order to achieve the desired openness and affordability it would be necessary to either use these formalized systems on a non-commercial basis or develop a new system of identification, which would not be a small task in each case. In our view, essentially all underlying identifiers must be available via open-source or to be used free of charge; minimally for the purposes of regulatory reporting. This may require that new sources of underlying identifiers be created if the existing sources cannot be used free of charge, i.e., credit is an example where this may apply. Additionally, limitations exist with respect to the underlying identifiers that are available to the commodity asset class. The large majority of energy and agricultural products do not have underlying identifiers that are sufficiently precise and succinct. In order to alleviate this gap the governance structure to be established may be required to collect all possible variations, locations, and service providers into a set of enumerations which could be used as the basis of the underlying ID.

Question 14: For the identifiers in each asset class, are there corresponding reference data that are open-source and freely available to all users with open redistribution rights?

CME believes that the availability of open-source reference data is critical to the viability of the UPI system. CME encourages the use of existing sources of reference data where it can be freely used. This not the case, however, where new sources of reference data may need to be created.

CME believes that the committee should solicit its membership base to determine if adequate open sources of identifiers exist for each asset class. When all areas are exhaustively reviewed it may be that it is determined that there are existing sources for this data. As previously mentioned, finding coverage in certain areas of the commodity asset class may be a challenge

Question 15: For a classification system that does not include an identifier for underliers in all asset classes, what classification systems are available that are open-source and freely available to all users with open redistribution rights? What are the data elements included in these systems?

CME believes any source used for identifiers that are part of the classification system must be open-source or freely available whether they currently exist or are created for the purpose of the UPI. Please see the answers to Questions 13 and 14 above.

Question 16: Based on the examples provided in this section and in Annex 5, do you have comments on how the allowable values would be technically managed or/and how they are technically managed in the case of existing classification system solutions?

CME believes that any classification system solution implemented should incorporate existing standards as much as possible without favoring any individual standard. This would allow for currently implemented industry standards to be maintained, whilst providing a defined structural framework. Such a framework should be governed by a consortium in order to prevent any individual entity from shouldering the maintenance burden.

CME Group looks forward to working with CPMI and IOSCO on this initiative and appreciates the opportunity to comment on the issued consultation. Please do not hesitate to contact Matt Simpson at matt.simpson@cmegroup.com or +1 312-634-8354 if you have any questions regarding our comments.

Sincerely,

A handwritten signature in black ink, appearing to read "Jonathan Thursby".

Jonathan Thursby
Executive Director
CME Group