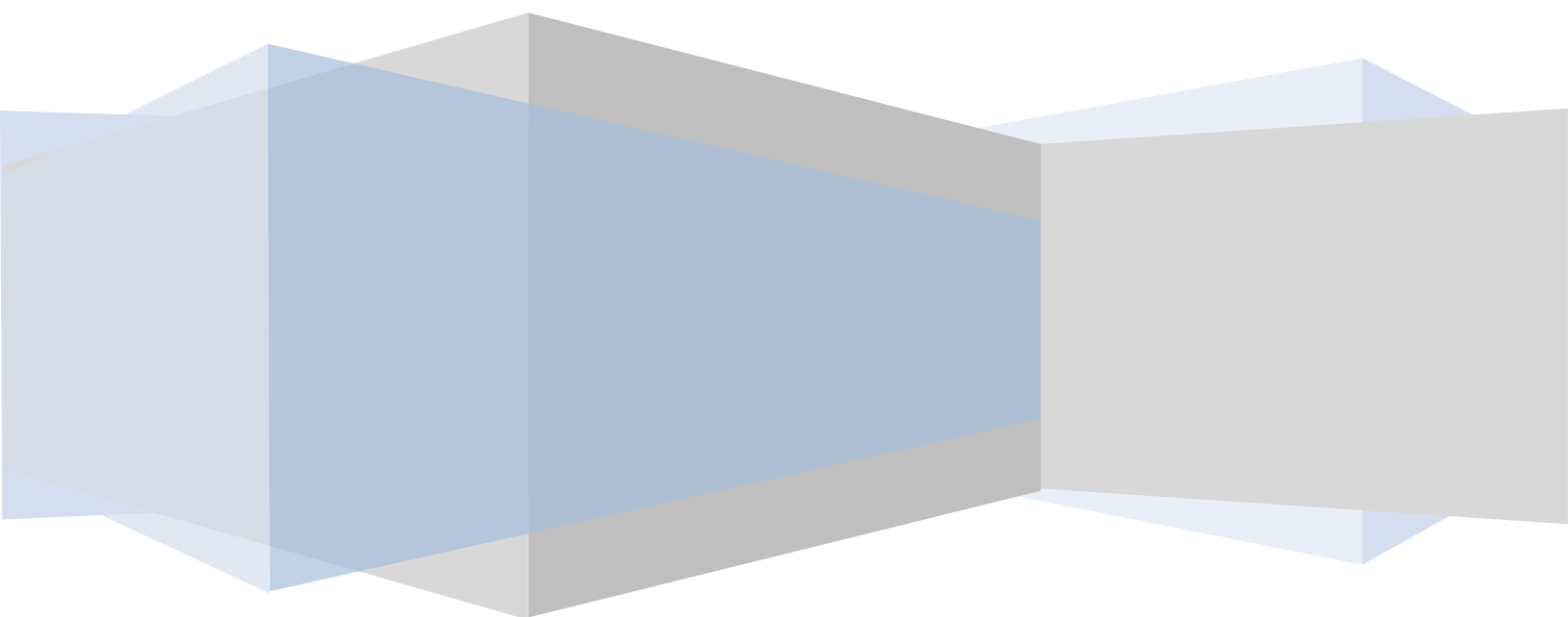




NFA Response to CPMI- IOSCO Consultative Report

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



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Introduction

This document captures the National Futures Association's response to the Consultative Report published by The Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO).

National Futures Association ("NFA") is a self regulatory organization ("SRO") for the US derivatives markets. In its capacity as an SRO, NFA provides regulatory oversight of a variety of OTC derivatives market participants (i.e. swap dealers, swap introducing brokers, pooled investment vehicles and investment managers using swaps). NFA is a non-profit, independent regulatory organization. NFA does not operate any markets and is not a trade association. The development of a harmonized standard for OTC derivatives data will greatly contribute to the effectiveness and efficiency of its regulatory programs.

In addition to its responsibilities as an SRO, NFA provides a variety of regulatory services and programs to electronic trading platforms (swap executions facilities ("SEF") and designated contract markets ("DCM")) to ensure the fair treatment of customers and to maintain orderly markets. In this capacity, NFA provides frontline trade practice and market surveillance to US SEFs and DCMs contracted with NFA pursuant to a regulatory services agreement ("RSA"). These SEFs and DCMs send on a daily basis all pre-trade, trade, product, and market participant information. This data is sent to NFA in a proprietary data format defined and maintained by NFA. In developing and maintaining this data format, NFA leveraged existing and emerging industry standards. However, absent a globally accepted standard for the representation of OTC derivatives data, NFA had to solve several of the challenges that the CPMI-IOSCO Harmonization Group is currently contemplating.

NFA is committed to finding efficient solutions to regulatory challenges. As such, NFA seeks to incorporate any globally accepted standard for OTC derivatives data representations into its current and future systems. The goal is to continually improve the interoperability of its systems and to ensure efficient solutions for industry's regulatory reporting of transactions. It is with this experience and background that NFA is responding to the Consultative Report.

Responses to Defined First Batch of Key Data Elements

3.1.1. Effective Date

Q1 With reference to alternatives proposed for data elements included in the group “Date” (data elements 1.01, 2.01) and “Timestamp” (data element 8.03 in List 1 and data element 2.02 in List 2)

- (a) Are the advantages and disadvantages of proposed harmonization alternatives included in the report appropriately defined? If not, which aspects should be revised and how?

The alternatives were appropriately defined.

- (b) Is the proposed default value sufficiently unambiguous? Will users of TR data be able to distinguish between the default value for timestamps and reported timestamps? If this would not be possible, what alternative do you suggest?

The default value of 00:00:00 is ambiguous. The value of 00:00:00 could be interpreted as an actual time value for this data field or a required timestamp. NFA recommends the use of an illogical explicit value or the absence of time stamp to be used to represent a default value. This will allow systems to explicitly identify and distinguish between data provided with a default value and data provided with an actual timestamp.

- (c) Which of the proposed harmonization alternatives should be supported and why? Under which circumstances would the alternative(s) be difficult to implement?

Alternative 2 should be supported with a better default value such as "Default", "D00:00:00", 99:99:99 so as to avoid the ambiguity mentioned previously.

3.1.3 Cleared

Q2 With reference to alternatives proposed in the allowable values for the data element “Cleared”:

- (a) Are the advantages and disadvantages of proposed harmonization alternatives included in the report appropriately defined? If not, which aspects should be revised and how?

The advantages and disadvantages of each alternative are appropriately defined.

- (b) Which of the proposed harmonization alternatives should be supported and why? Under which circumstances would the alternative(s) be difficult to implement?

Alternative 1 should be supported due to the level of detail it provides. This level of detail will allow systems to make explicit and important groupings related to the post-trade risk and status of cleared transactions. Without this level of detail, systems will be forced to make inferences based upon other fields to reach these conclusions.

- (c) Are the proposed alternatives sufficient to accommodate the potential need to distinguish between direct and indirect clearing?

Alternative 1 provides a sufficient level of granularity to make the distinction. Alternative 2 does not.

3.1.4 Settlement Method

For this data element, documentation should provide explicit guidance on Credit Default Swaps to avoid any confusion.

3.1.5 ID of the primary obligor

- Q3** With reference to the definition of “ID of the primary obligor 1” (data element 5.01) and “ID of the primary obligor 2” (data element 5.02):
- (a) Would the guidance be sufficiently clear in the case of original and cleared trades, taking different clearing models into consideration?

The written guidance warrants further clarification regarding different scenarios of central clearing. The documentation should provide explicit guidance on how to handle cleared transactions for each step in the lifecycle of a cleared transaction. The documentation should provide explicit guidance regarding the role of clearing member and the clearing house in transactions and whether either of these parties should be reported as a "Primary Obligor" and under what circumstances. While some inferences could be made about who to report as the "primary obligor," explicit guidance would remove any potential for the inconsistency of implementation.

- (b) Would the guidance be sufficiently clear in the case of trusts or collective investment vehicles?
- 3.1.6 Notional amount.

It appears that the guidance is sufficiently clear in these cases.

3.1.6 Notional Amount

- Q4** With reference to the definition for “Notional amount”:
- (a) Should guidance be complemented by a definition of “leg 1” and “leg 2” or are market conventions already clear? In the former case, which definition would you suggest? If relevant, please provide an asset-class specific answer.

Yes, the guidance for Notional Amount should be complemented with definitions for "leg 1" and "leg 2". Explicit guidance for what leg to report as "leg 1" vs. "leg 2" would make the implementation of systems that ingest the data simpler. For example, a clear definition for cross currency basis swaps or an equity swap would allow systems ingesting the data to avoid running instrument specific checks across fields to determine what is intended to be represented and where.

The Notional Amount should also be accompanied by a Notional Unit Type that is abstracted enough to handle notional amounts that are not expressed in currencies. Current proposal uses the "NOTCUR" field. However, this field will not handle many Equity Swaps where one leg is expressed in Shares or Index Units as well as Commodity Derivatives where notional amounts can be expressed as metrics of the underlying commodity. For instruments where notional is expressed as a currency the Notional Unit Type is still represented as the currency code.

- (b) As regards FX derivatives, the solution proposes only two notional amounts based on the assumption that for FX swaps the spot and the forward leg are represented as two separate transactions with separate UTIs linked via a linkage data element. Should the Harmonization Group take into consideration an additional alternative? If yes, which one and why? For example, should the Group require a total of four FX notional amount data elements namely two notional amount data elements to represent the two currencies associated with each leg of the swap?

The solution as proposed seems sufficient for FX derivatives.

- (c) Should the Harmonization Group in the future decide to provide harmonization guidance also for the notional amount of commodity derivatives, which aspects should it take into account? How should this potential harmonization proposal be defined for different commodity derivatives?

The current proposal appears to use the NOTAMT attribute in conjunction with the NOTCUR attribute to describe the size of swap transaction. NFA experience with commodity derivatives and equity derivatives has shown the need to abstract the NOTCUR field to accommodate quantities that are not expressed as currencies. To solve this problem, NFA data model uses a "NotionalUnitType" attribute which accommodates both the currency code of notional expressed as currencies and also provides enumerations for notionals expressed as units of an underlying commodity, shares of an underlying security, or index units of underlying index. The enumerations for this representation were largely pulled from existing FpML representations where available. The list of acceptable enumerations for the NotionalUnitType field is therefore a list of Currency Codes (accommodating currency codes for onshore/offshore currency representations) and the list of enumerations from FpML "priceQuoteUnitsScheme" for such values. While not all values included in this list are relevant – many can be used to describe what the quantity amount on a commodity or equity derivative may be representing.

This solution allowed NFA's systems to treat commodity and equity derivatives the same as other derivatives where notional amounts are expressed as currencies and avoid use of an asset class specific quantity type identifier.

See the following link for list of acceptable enumerations from FpML "priceQuoteUnitsScheme":

- <http://www.fpml.org/spec/coding-scheme/index.html>
 - **5.129 priceQuoteUnitsScheme**

Q5 With reference to alternative 1, which harmonizes both the actual “Notional amount” (Data elements 6.01 and 6.02) and the “Original notional amount” (Data element 6.04), versus alternative 2, which harmonizes only the actual “Notional amount” (Data elements 6.01 and 6.02):

- (a) Are the advantages and disadvantages of proposed harmonization alternatives included in the report appropriately defined? If not, which aspects should be revised and how?

Yes, appropriate definitions were captured.

- (b) Which of the proposed harmonization alternative should be supported and why? Under which circumstances would the alternative(s) be difficult to implement?

The first alternative should be supported as it will allow for, if necessary, the appropriate means for explicitly comparing the "Notional Amount" to "Original Notional Amount".

3.1.7 Notional currency

Q6 With reference to alternatives proposed in the allowable values for the data elements “Notional currency” (alternative 1 and 2):

- (a) Are advantages and disadvantages of proposed harmonization alternatives included in the report appropriately defined? If not, which aspects should be revised and how?

The advantage and disadvantages of the proposed harmonization alternatives are appropriately defined.

- (b) Which of the proposed harmonization alternative should be supported and why? Under which circumstances would the alternative(s) be difficult to implement?

The second alternative should be supported so as to avoid any ambiguity. Any currency with a unique set of economic characteristics should have a distinct and universally recognized code.

Also, as previously stated, the NOTCUR data element should be further abstracted to accommodate quantities that are not expressed as currencies (ex equity and commodity swaps). To solve this problem with its own systems, NFA used the field "NotionalUnitType" which accommodates currency codes as well as enumerations from FpML's "priceQuoteUnitsScheme" to describe the quantity. While not all values included in this list are relevant – many can be used to describe what the quantity amount on a commodity or equity derivative may be representing.

This solution allowed NFA's systems to treat commodity and equity derivatives the same as other derivatives where notional amounts are expressed as currencies and avoid use of an asset class specific quantity type identifier.

See the following link for list of acceptable enumerations from FpML " priceQuoteUnitsScheme":

- <http://www.fpml.org/spec/coding-scheme/index.html>
 - **5.129 priceQuoteUnitsScheme**

3.1.8 Valuation

Q7 With reference to the data element “Valuation amount”:

- (a) Are the two proposed alternatives agreeable? Please specify for which types of derivatives which of the alternatives should apply.

The appropriateness of either alternative is contingent upon broader policy objectives regarding the intended use of the field. If the field is intended to evaluate risk in the financial system, expressing the valuation as the exit cost of the contract will provide the most conservative measure. However, it should be known these "exit" valuations will likely contain some liquidity haircutting that is difficult to assess and may fluctuate. Credit derivatives based upon single names or narrow or bespoke indices may prove difficult to value. Also, the valuations may be strained during periods of high volatility and market distress where a lack of liquidity in reference names and correlated markets makes a price difficult to access. This may lead to a misleading

valuation of a position and indicate more distress than actually exists. However, given that many of these products were the source of problems during the financial crisis, using such a conservative valuation may allow regulators using the data to more quickly identify potential problems. Alternative 2 should be reserved for an instrument where assessing the "exit cost" of the contract is impossible. However, consideration should be given for attaching a haircut to such valuations to account for the lack of liquidity in the instrument.

- (b) Should the following factors, upfront payment and daily settlement of the derivatives transaction, be reflected in the valuation amount? If yes, please specify how.

An upfront payment factor should be reflected in the valuation amount. Where daily settlements are provided by a CCP – they should be used as the valuation amount.

Q8 With reference to the data element "Valuation" (data elements 8.04 and 8.05):

- (a) Are the advantages and disadvantages of proposed harmonization alternatives included in the report appropriately defined? If not, which aspects should be revised and how?

The advantages and disadvantages are appropriately defined.

- (b) Which of the proposed harmonization alternatives should be supported and why? Under which circumstances would the alternative(s) be difficult to implement?

Alternative 2 – if a CCP is involved the methodology for the valuation should not impact the data. If a user of the data is curious as to the CCP's methodology, the valuation methodology should be adequately documented and disclosed in the CCP's documentation.

3.2.1 Early termination timestamp

3.2.2 Direction

Q9 With reference to alternatives proposed for the data element "Direction":

- (a) Are the advantages and disadvantages of proposed harmonization alternatives included in the report appropriately defined? If not, which aspects should be revised and how?

The advantages and disadvantages are appropriately defined.

- (b) Which of the proposed harmonization alternatives should be supported and why? Under which circumstances would the alternative(s) be difficult to implement?

Alternative 1 should be the supported approach to this data element. This solution provides for a clearer link (relative to the second alternative) to electronic pre-trade audit trail. As OTC markets become more electronic, the importance of linking pre-trade messaging and post-trade data will grow. As the values (B – Buy / S – Sell) may have different meanings that are asset class and product specific, a clearly defined mapping structure must also accompany the implementation of Alternative 1. However, the development and maintenance of this mapping in conjunction with a commitment to Alternative 1 directs the harmonized standard to be more in-line with the future of electronic trading in OTC markets.

NFA maintains a matrix by asset class, product, and strategy (used to represent multiple leg transactions) that assigns an equivalent value (B / S) to various products and asset class. NFA can make this matrix available upon request to be used as a starting point for the implementation of Alternative 1.

NFA experience has shown that system integrations requiring a mapping to B / S are relatively straightforward so long as explicit guidance is given to market participants for product specific implementations.

- (c) Are the proposals sufficiently robust for transactions with multiple legs? With reference to Alternative 1, can the counterparty side (buyer/seller) clearly identify the parties paying each relevant payment stream? With reference to Alternative 2, is the payer of payment streams an applicable concept for all payment streams? Responses illustrated with worked examples where applicable would be appreciated.

NFA systems process pre-trade and post-trade data for swap transactions. Regarding transactions with multiple legs ("Package Transactions"), NFA systems ingest the data with pre-trade data representing the Package orders and post-trade data representing the individual legs of the transaction. The post-trade legs are joined together using a unique identifier "ExecGroupId." The direction of the pre-trade order is set according to market conventions for the multiple leg transaction. For example, an interest rate swap butterfly attaches direction and size to the middle leg during pre-trade discussions. The post trade data would show the middle leg of the butterfly as having the same direction and size as the pre-trade order. The shorter and longer tenors of the butterfly would have opposite sides and duration weighted equivalent quantities. While market conventions regarding direction vary by asset class, product, and strategy, as long as a clearly defined mapping structure is developed and maintained, market participants should be able to map internal systems with relative ease. The important considerations are that this mapping is explicit enough to remove ambiguity and a sufficient mechanism exists to link the post trade data from the legs of transactions that we executed as a package.