

Harmonisation of critical OTC derivatives data elements (other than UTI and UPI) – third batch – consultative report

Respondent name:

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General comments on the report

On behalf of The Canadian Commercial Energy Working Group (the “Canadian Working Group”), Eversheds Sutherland (US) LLP submits this form in response to the request for public comment set forth in the Consultative Report, Harmonisation of Critical OTC Derivatives Data Elements (Other Than UTI and UPI) – Third Batch (“Batch Three Report”), issued by the Committee on Payments and Market Infrastructures and the Board of the International Organization of Securities Commissions.

The Canadian Working Group is a diverse group of commercial firms that are active in the Canadian energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial, and residential consumers. Members of the Canadian Working Group are producers, processors, merchandisers, and owners of energy commodities. The Canadian Working Group considers and responds to requests for comment regarding developments with respect to the trading of energy commodities, including derivatives, in Canada.

The Canadian Commercial Energy Working Group is separate and distinct from The Commercial Energy Working Group. While the two organizations share similar goals, these comments are solely the product of the Canadian Working Group and should be considered independently of any comments filed by The Commercial Energy Working Group.

2.1 Collateral portfolio

Comments on the data element “collateral portfolio”:

2.2 Collateral portfolio code

Q1: With reference to the alternatives proposed to capture information on portfolio code(s) (Section 2.2):

- (a) In your view, how prevalent is the situation in which different transactions concluded under the same Master Agreement are associated with different CSAs (for initial margin posted, initial margin received and variation margin)?

- (b) The definition proposed in Alternative 1 is based on the assumption that, in the event of default, the entirety of the collateral provided under the given Master Agreement would be used to cover the loss of the non-defaulting counterparty, whether or not separate CSAs (for initial margin posted, initial margin received and variation margin) might be linked to that Master Agreement and whether or not all the transactions concluded under that Master Agreement would be associated with each of these CSAs. Is this assumption correct? If not, please clarify how the respective obligations would be resolved in the case of default. Please provide examples.

(c) Are the differences in authorities' use of the two alternatives clearly illustrated in Table 2?

(d) Which of the proposed harmonisation alternatives should be supported and why?

Other comments on the data element "Collateral portfolio code":

2.3 Portfolio containing non-reportable component

Comments on the data element "Portfolio containing non-reportable component":

2.4–2.28 Data elements related to margins

Q2: The purpose of the data element "Initial margin settlement timing" (Section 2.10) is to allow authorities to better understand the difference between "Initial margin required to be posted by the reporting counterparty" (Section 2.17) and the "Initial margin posted by the reporting counterparty" (Section 2.5) as this difference may be due to the timing of when the required margin is determined and when the margin is posted. In the absence of information on the margin settlement timing, the difference in the margin required and margin posted amounts could be interpreted as over- or under-collateralisation. Information on the settlement timing of margin collected would serve the same purpose for global aggregation of initial margin collected (Sections 2.8 and 2.19).

- (a) Are there challenges linked to the data element "Initial margin settlement timing" as defined above? Is there an alternative, more effective, way to represent this information, such as the date on which the initial margin posted (or collected) has been settled?

- (b) How prevalent is the existence of different settlement timings (T+0, T+1, T+2, T+3) within a given jurisdiction? Would the settlement timing for the initial margin posted differ from the one for initial margins collected?

Other comments on the data elements related to margins:

2.29 Indicator of intraday variation margin calls

Comments on the data element "Indicator of intraday variation margin calls":

2.30 Collateralisation category

Comments on the data element "Collateralisation category":

2.31–2.35 Data elements related to counterparty rating trigger

Q3: With reference to the data elements "Counterparty rating trigger indicator", "Counterparty rating threshold", "Incremental collateral required", "Threshold rating for automatic termination provision" and "Closeout payment for automatic termination provisions" (Sections 2.31–2.34):

- (a) For each alternative of the data element "Counterparty rating trigger indicator", do definitions and allowable values accurately reflect provisions contained in collateral agreements or master agreements covering OTC derivative transactions to protect parties from counterparty credit deterioration? How prevalent currently are counterparty collateral rating triggers or comparable automatic-termination provisions in collateral agreements or master agreements? How, if at all, have recent changes to market practices affected the

prevalence or the form of counterparty collateral rating triggers or comparable automatic termination provisions?

- (b) Are the advantages and disadvantages of the proposed harmonisation alternatives of the data element "Counterparty rating trigger indicator" appropriately defined? If not, which aspects should be revised and how? Which of the proposed harmonisation alternatives should be supported and why?

Q4: With reference to the alternatives proposed for the data element "Counterparty rating threshold" (Section 2.32):

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

- (b) Which of the proposed harmonisation alternatives should be supported and why?

Q5: The definition of the data element "Incremental collateral required" (Section 2.33) relies on the assumption that the effects of multiple-notch downgrades are roughly linear. Are there instances in which the effects increase more than linearly with the number of notches in a hypothetical downgrade? If so, how could multiple scenarios be encompassed in the definition?

Other comments on the data elements "Counterparty rating trigger indicator", "Counterparty rating threshold", "Incremental collateral required", "Threshold rating for automatic termination provision" and "Closeout payment for automatic termination provisions" (Sections 2.31–2.35):

2.36 Clearing obligation in the jurisdiction of the reporting counterparty

Comments on the data element "Clearing obligation in the jurisdiction of the reporting counterparty":

2.37–2.41 Data elements related to “Price”

Q6: With reference to the data element “Price” (Section 2.37), are there OTC derivative transactions products where the price or a concept of price is not captured under the “Price” data element or any other data element including “Fixed rate”, “Spread”, “Strike price”, “Option premium” and “Other payment type (upfront payment)”? If so, please provide detailed examples of those products. Would the industry benefit from additional guidance for the “price” data element?

The proposed approach to the data element “Price” for fixed-for-float and float-for-float commodity swaps should be amended to reflect the fact that the price of such a transaction is the difference between the two prices. That difference is what should be reflected in the data element “Spread”, and “Spread” should be used as the price of a fixed-for-float transaction and a float-for-float transaction when calculating notional amount.

In addition, the price of commodities such as freight and electricity in markets such as Ontario can become negative. To account for this, the allowable values for data elements that are a function of price should include negative values.

Q7: With reference to the data element “Price notation” (Section 2.40), is it clear and unambiguous which price notation (amount or percentage) should be applicable to each price? If not, which ones? Are there additional price notations that should be allowed? If so, which ones? Would the industry rather benefit from additional guidance for the “price notation” data element?

Q8: With reference to the data element "Price unit of measure" (Section 2.41):

- (a) Can commodity derivatives be negotiated in different unit of measures for the price and quantity? If so, would industry support two separate data elements for the (1) Price unit of measure and (2) Quantity unit of measure?

- (b) The list of allowable values in Table 4 in Annex 1 encompasses all the values included in ISO 20022's Unit Of Measure Code and four additional values.
 - (i) Are the values useful for reporting the Quantity Unit of Measure and the Price Unity of Measure?
 - (ii) If not, which ones are less useful and why?
 - (iii) Are there other values that should be added? Which ones, and why?
 - (iv) Are there duplicates or similar values that should be removed?

Other comments on the data element "Price", "Price schedules", "Price currency", "Price notation" and "Price unit of measure":

2.42–2.50 Data elements related to "Fixed rate", "Strike price" and "Option premium"

Q9: With reference to the data element "Spread notation" (Section 2.45), is it clear and unambiguous which notation (amount or percentage) should be applicable to each spread? If not, which ones? Are there additional spread notations that should be allowed? If so, which ones? Would the industry benefit from additional guidance for the "spread notation" data element?

As noted in our response to Question 6, the data element "Spread" for a fixed-for-float swap or a float-for-float swap should be amended to be the difference between the two price references. For example, the "Spread" for a WCS vs. WTI basis swap where WCS is priced at \$43.00 and WTI is priced at \$52.00 would be \$9.00. Note that "Spread" should be the absolute value of the differences between the two relevant prices as a negative value for a spread is not reflective of a negative commodity price. It is just a matter of convention reflecting the relative difference between the prices.

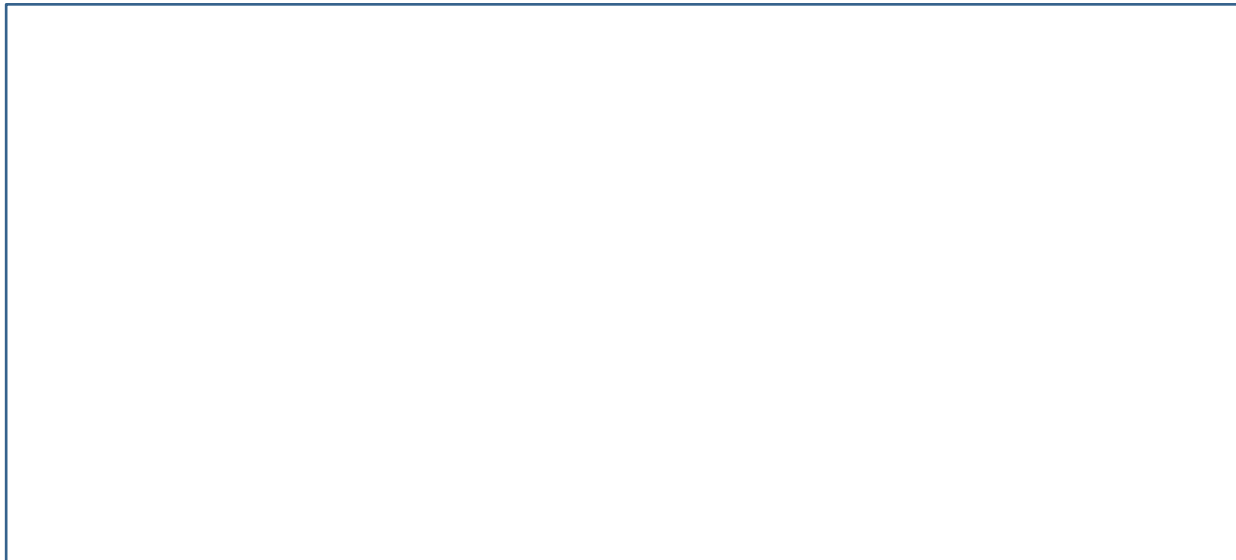
Other comments on the data element "Fixed rate", "Spread", "Spread currency", "Spread notation", "Strike price", "Strike price currency", "Strike price schedules", "Option premium", "Option premium payment date":

2.51–2.52 Data elements related to "Exchange rate"

Comments on the data element "Exchange rate" and "Exchange rate basis":

2.53–2.54 Notional amount and Notional amount schedules

Q10: With reference to the data element "Notional amount" (Section 2.53), are there particular cases where the notional amount may not always be known when a new transaction is reported and may be updated later? If so, which ones?



Other comments on the data element “Notional amount” and “Notional amount schedules”:

Commodity derivative market participants typically do not measure their derivatives activity in terms of notional amounts denominated in an amount of a particular currency. Notional amount, if measured at all, is thought of in terms of the measure of the underlying volume of the relevant commodity (i.e., barrels for crude oil). This ensures a consistent metric to measure activity. Said another way, it can be more relevant to analyze trading activity in terms of volume than in terms of the dollar value of that volume. For example, a crude oil producer that hedges an annual volume of 1 million barrels would not view its level of trading as doubled if the price of crude oil doubled over a year.

Even though notional amount is far from a perfect metric for commodity derivatives markets, the Canadian Working Group understands the desire of regulators to use it as a means to make comparisons across derivatives markets. However, the proposed approach to the calculation of notional amount for commodity derivatives in the Batch Three Report should be revised to allow for a more accurate comparison.

The first revision should be on how notional amount is calculated for fixed-for-float and float-for-float swaps. As noted above, for many commodity derivatives market participants, the price of fixed-for-float and float-for-float swaps is the difference between the two prices – the data element “Spread.”

This approach to price reflects how market participants view commodity price risk exposure. For example, a shipper on a natural gas pipeline that sells its gas at index is exposed to the difference between the price of natural gas at the injection location and the delivery location – not changes in the absolute price of natural gas. Or, a crude oil refiner that purchases crude oil at a floating price and sells gasoline at a floating price is exposed to changes in the difference between the prices of crude oil and gasoline – not changes in the absolute price of either commodity.

To properly reflect this market view, the Canadian Working Group suggests that notional value for fixed-for-float and float-for-float swaps should be calculated as the spread multiplied by the total notional quantity.

The second amendment needed to ensure that the approach to the calculation of notional amount in the Batch Three Report allows for meaningful comparisons is with respect to the notional amount of options. As options, prior to exercise, do not represent firm commitments to “make or take delivery,” they should not be treated as having a notional amount equal to that of transactions without contingent obligations.

The notional value of options should be adjusted in some manner to reflect the likelihood that they will be exercised. That can be accomplished by delta adjusting the options, which can be a complex process. A simpler approach that still reflects an approximate likelihood that an option will be exercised is to calculate the notional amount of an option by multiplying the total notional quantity of the option by the option premium.

Not accounting for the likelihood that an option will be struck can result in incongruous outcomes. Take, for example, the owner of a power plant who hedges the price of electricity by buying a put option with a strike price of \$15 when the day-ahead price of power is \$17.00 and who mitigates the cost of the put option by selling a far out-of-the-money call option at a strike price of \$45. If the total notional quantity of the option is 10 MW, then the notional amount of the option most likely to be exercised, the put option, would be \$150 while the notional amount of the far out-of-the-money call option would be \$450, or three times greater than the put option.

To avoid this type of outcome, the Canadian Working Group suggests that the Batch Three Report’s approach to calculating notional amount for options be amended to be either of the following approaches:

Suggested Calculation 1: Premium multiplied by the total notional quantity.

Suggested Calculation 2: Option delta multiplied by the price of the underlying commodity multiplied by the total notional quantity.

With respect to the option delta in the Suggested Calculation 2 above, market participants should be able to use: (i) deltas published by exchanges, when available; or (ii) their own deltas calculated using reasonable assumptions, when no exchange delta is available. This approach is consistent with the approach to the treatment of options under MiFID II’s position limits regime.

2.55–2.57 Data elements related to “Total notional quantity”

Comments on the data element “Notional quantity schedules”, “Total notional quantity” and “Quantity unit of measure”:

The Canadian Working Group understands that the “Total notional quantity” of a commodity derivative is the sum of the notional volumes “delivered” under the derivative. This is different than the total notional quantity of an interest rate swap, which is just the stated notional amount.

This difference is best illustrated by example. The total notional quantity of a ten-year \$50 million interest rate swap is \$50 million, and the total notional quantity for a thirty-year \$50 million interest rate swap is also \$50 million. However, the total notional quantity of a one-year swap based on 10,000 barrels of crude oil is 10,000 barrels, while the total notional quantity of a 30-year crude oil swap based on 10,000 barrels a year is 300,000.

The periodic settlement payments for the interest rate swap and the crude oil swap are based on the stated notional quantity (i.e., \$50 million and 10,000 barrels), but for interest rate swaps, the term of the swap does not impact the total notional quantity, while the term of the swap significantly impacts total notional quantity for the crude oil swap.

To make notional amounts more comparable across asset classes, the Canadian Working Group suggests that the total notional quantity of a commodity derivative should be the total notional quantity of the relevant commodity delivered over a one month period, regardless of the settlement frequency. So a natural gas swap with an annual settlement period and notional volume of 120,000 MMBTU would have a total notional quantity of 10,000 MMBTU, while a natural gas swap with a daily settlement period and a notional volume of 1,000 MMBTU would have a total notional quantity of 30,000 MMBTU.

2.58–2.63 Data elements related to “Other payments”

Comments on the data elements “Other payment amount”, “Other payment type”, “Other payment currency”, “Other payment date”, “Other payment payer”, “Other payment receiver”:

2.64–2.71 Data elements related to “Packages”

Q11: With reference to the data element “Package trade price” (Section 2.66), could it be agreed that two possible situations may arise: (i) a package price does exist because all the transactions that represent individual components of the package are priced jointly, or (ii) a package price is not available because all the transactions that represent individual components of the package are priced individually? Is more clarity needed regarding the reporting of “Package trade price” and prices of individual components?

Other comments on the data elements “Package ID”, “Package trade price”, “Package containing non-reportable components”, “Package trade price currency”, “Package trade price notation”, “Package trade spread”, “Package trade spread currency” and “Package trade spread notation”:

2.72 Prior UTI

Q12: With reference to the data element “Prior UTI” (Section 2.74), how is “Prior UTI” represented when clearing and allocation happen at the same point in time? And how is “Prior UTI” represented when clearing

and compression happen at the same point in time, as a single event? Do such cases of clearing and compression and clearing and allocation as a single event happen frequently?

Other comments on the data element "Prior UTI":

2.73–2.77 Data elements related to "Custom baskets"

Q13: With reference to the data element "Basket constituents unit of measure" (Section 2.74) the list of allowable values in Table 4 in Annex 1 encompasses all the values included in ISO 20022's Unit Of Measure Code and four additional values.

- (a) Are the values useful for reporting the "Basket constituents unit of measure"? If not, which ones are less useful and why?

(b) Are there other values that should be added? Which ones, and why?

Q14: With reference to the data element “Custom basket code” (section 2.75)

(a) would it be preferable to separate the information on the LEI of the basket issuer and the unique alphanumeric code assigned by such issuer to the custom basket? If so, please explain why this would be preferable for global aggregation.

- (b) are there types of custom basket for which the "issuer of the custom basket" is not clear? If so, please provide detailed examples of those custom baskets. Would the industry benefit from additional guidance for the term "issuer" in the "Custom basket code" data element?

- (c) are 52 alphanumeric characters after the LEI of the basket issuer enough?

Other comments on the data elements related to custom baskets:

Other comments