

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

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General comments on the report

On behalf of The Commercial Energy Working Group (the “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 Working Group is a diverse group of commercial firms in the 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 Working Group are producers, processors, merchandisers, and owners of energy commodities. Among the members of the Working Group are some of the largest users of energy derivatives in the United States and globally. The Working Group considers and responds to requests for comment regarding regulatory and legislative developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

2.1 Collateral portfolio

Comments on the data element “collateral portfolio”:

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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 Working Group has two comments with respect to the data elements related to “Price.”

First, the Batch Three Report describes certain types of derivatives for which the “Price” data element is not applicable because it is understood that other data elements can be interpreted as the price of the derivative. The “Price” data element should not be applicable to commodity derivatives with two floating prices, such as locational basis swaps. For products with two floating price legs, market participants view the difference between the two floating prices as the price of the transaction and float-for-float swaps are traded and quoted using Spreads. As such, the “Spread” data element should be interpreted as the price of the derivative.

Second, it is possible for the prices of certain commodities, such as electricity, to be negative. Accordingly, 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?

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":

With respect to the data element "Spread," the Working Group understands the spread on a float-for-float swap to be the difference between the two reference prices. To ensure consistency in how data is reported to trade repositories, it would be helpful for IOSCO to provide numerical examples in its final guidance of how "Spread" is to be determined for various instruments, including for commodity swaps.

For example, the "Spread" for a Brent/WTI basis swap where Brent is priced at \$53.00 and WTI is price at \$49.50 would be \$3.50, which is what market participants view as the price of the transaction.

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?

Certain commodity derivatives do not have a knowable notional quantity at the time the transaction is executed. For example, if the total notional quantity of a swap is the output of a wind farm, then that volume would not be known at the outset of the transaction. The total notional quantity would be dependent on the strength and frequency of sustained winds. In that circumstance, it might be appropriate to use the estimated output as an estimated total notional quantity to determine the notional amount of the transaction at execution.

Other comments on the data element "Notional amount" and "Notional amount schedules":

The concept of notional amount is not easily and meaningfully applied to commodity derivatives. The Working Group understands that IOSCO's overarching rationale for applying the concept to commodity derivatives is to allow regulators to measure market size with a metric that can be compared to other asset classes. However, the approach to the calculation of notional amount in the Batch Three Report can be improved so that the desired comparability better reflects the true market characteristics of commodity derivatives.

First, float-for-float swaps, like locational basis swaps, are the prevalent product in commodity derivatives markets when compared to swaps that have a fixed price component. To market participants, the "size" of, or risk associated with, a float-for-float transaction is a function of the spread between the two floating prices, which is viewed as the price of the transaction. Said another way, their commodity price exposure is to the movement of the two prices with respect to one another – not outright price movements. So, they view the price of a float-for-float transaction as the spread between the two prices and use that spread to calculate notional amount.

For example, in a natural gas index swap, one counterparty might pay the First of the Month Index price ("FOM") and receive the Gas Daily price in exchange. So, if the FOM price was \$3.30 and the Gas Daily price was \$3.33, the price of the transaction would be \$0.03. The notional amount of this type of transaction is typically small given the close relationship of the indices in the forward months and the typical limited movement of the two prices with respect to one another.

In addition, the price of a futures contract priced off of two floating prices is the differential between the two floating prices. For example, the price of the NYMEX Rockies Natural Gas (Platts IFERC) Basis Futures Contract is based on the difference between the Platts Inside FERC Gas Market Report Northwest Pipeline Corp., Rocky Mountains Index and the price of the Henry Hub Natural Gas futures contract. The related OTC derivatives markets follow that pricing paradigm and quote the price of similar instruments based on the difference between two floating prices.

As such, the Working Group believes that notional amount for float-for-float swaps should be calculated as the spread multiplied by the total notional quantity. This is also the CFTC's settled and widely adopted approach for the calculation of notional amount for locational basis swaps. (See CFTC Frequently Asked Questions, Division of Swap Dealer and Intermediary Oversight Responds to FAQs About Swap Entities (Oct. 12, 2012)).

Second, if the goal is to use notional amount to measure market size, then options should not be treated in the same manner as transactions without contingent obligations. The notional amount of options should be adjusted in some manner to reflect the probability of options being exercised. This can be accomplished by delta adjusting the options, which can be a complex process, but one has been adopted under the European Union's MiFID II position limits regime. (See ESMA Questions and Answers on MiFID II and MiFIR Commodity Derivatives Topics (July 7, 2017)). 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 underlying volume of the option by the option premium.

Using the strike price of an option to calculate its notional amount grossly overstates the size of the transaction and, therefore, the market. Such methodology also presumes that every option traded will be exercised. The likelihood of an option being exercised is reflected in the size of the premium and the delta of the option. Either of the above alternative approaches accounts for the contingent nature of options and therefore would provide a far more accurate representation of market size and the size of market participants' positions.

Third, the approach to the calculation of notional amount for structured multi-leg transactions, such as collars, should be clarified. Structured multi-leg transactions should be viewed as one transaction as they are assembled to create one net exposure by combining different instruments executed in conjunction with one another. For example, a natural gas producer might buy a put option at \$2.50 and sell a call option at \$3.50. Those two transactions are inextricably linked. The premiums paid for the downside protection of the put option would be offset by the premiums generated by limiting the producer's upside by selling the call option and the producer would have a limited band in which the price of its natural gas could move.

As such, the Working Group recommends treating collars and similar transactions as having a single notional amount – not a notional amount for each leg. This is also consistent with the CFTC's stated approach for the calculation of notional amount. (See CFTC Frequently Asked Questions, Division of Swap Dealer and Intermediary Oversight Responds to FAQs About Swap Entities (Oct. 12, 2012)).

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”:

It is the Working Group's understanding that the data element “Total notional quantity” for a commodity derivative is the sum of the notional volumes “delivered” under the derivative. This is in contrast to the total notional quantity of an interest rate swap, which is just the stated notional amount.

For example, the total notional quantity of a one-year \$100 million interest rate swap is \$100 million, and the total notional quantity for a thirty-year \$100 million interest rate swap is also \$100 million. However, the total notional quantity of a one-year swap based on 1,000 barrels of crude oil is 1,000 barrels, while the total notional quantity of a 30-year crude oil swap based on 1,000 barrels a year is 30,000.

For both derivatives above, periodic payments are based on the stated notional quantity (i.e., \$100 million and 1,000 barrels), but for interest rate swaps the tenor of the transaction does not impact the total notional quantity, while tenor significantly impacts total notional quantity for commodity derivatives.

To make notional amounts more comparable and consistent across asset classes, the 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