Date: January 2010
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Feedback statement on the Consultation on "Classification and identification of OTC derivative instruments for the purpose of the exchange of transaction reports amongst CESR Members"

Executive Summary

The consultation was well received by respondents and most of them welcomed the opportunity to respond to the questions and to provide CESR Members with their knowledge and view on the subject.

In general, respondents found the analysis of the issues surrounding the classification and identification of OTC derivative instruments to be well constructed in the consultation paper.

Classification

Almost half of the respondents (AFG, FBF, AMAFI, BBA, Xtrakter, FOA, ZKA, EBF and WKO) supported CESR's proposal for the classification of OTC derivative instruments.
Nevertheless, some of them asked for less ambiguous categories and welcomed CESR's plan to deliver harmonized guidelines to detail the instruments covered by each category.

On another side, BVI and the ANNA considered that CESR should wait to adopt ISO standard (CFI scheme) since it is under revision to cover specifically OTC derivative instruments.

ISDA and LMS are in favor of the "product type simple" system used in FpML, a vocabulary already developed and widely used to describe individual OTC derivative contracts in automated communications.

Identification

In general, many participants gave their view on the viability and the consistency of the characteristics listed in the consultation paper.

The AFG, ZKA and WKO are in favor of CESR's proposed set of characteristics.

BVI and the LSE recommended the use of ISO standards (ISIN) in this field.

NYSE Euronext suggested using a slightly modified version of the Alternative Instrument Identifier.

Markit recommended the use of its Reference Entity Database (RED) code which provides market standard identifiers for credit derivatives. The FBF and the AMAFI also evoked Markit identifiers.

1. Introduction

1.1. Transaction reporting in Europe

Competent authorities ("CAs") throughout the European Economic Area are committed to detecting market abuse and maintaining the integrity of their markets. The receipt and examination of transaction reports are essential elements in enabling CAs to detect market abuse and the Market in Financial Instrument Directive (MiFID) gives CAs the power and obligation to collect transaction reports on instruments admitted to trading on regulated markets. However, many CAs have noted that there are a range of OTC (over the counter) financial instruments that mirror instruments admitted to trading on regulated markets that can equally be used for the purposes of market abuse. Many CAs extended the collection of transaction reports to include OTC instruments whose value is derived from instruments admitted to trading on a regulated market to enhance their ability to detect suspicious activity and maintain the integrity of their markets. Some other competent authorities are currently investigating this option as well.

1.2. The Transaction Reporting Exchange Mechanism

CESR has implemented in November 2007 an IT system to facilitate the exchange of transaction reports amongst regulators. The system, called the Transaction Reporting Exchange Mechanism (TREM), was built based on the request from the MiFID level 2 Regulation to organize the exchange of transaction reports amongst European financial regulators.

TREM is currently limited to the scope of the MIFID Level 2 regulation, e.g. exchange of transaction reports on instruments admitted to trading in Europe. After one and a half year of running and study of the different practices within CESR membership, CESR decided to launch a project to amend TREM to facilitate the exchange of transaction reports on OTC derivative instruments amongst CESR members.

The consultation aimed at defining the framework for this exchange. In this respect, the document focused only on the identification and classification of OTC derivatives for the exchange within TREM. Even though maximum harmonization is expected amongst CESR members, local specificities might lead to different requirements than the ones described in the consultation paper.

1.3. Scope of Transaction Reporting on OTC derivative instruments

CESR decided (CESR/09-129) that only transactions on derivatives whose underlying instrument is traded on a regulated market should be exchanged, focusing on single-name derivatives, except when different underlying instruments all refer to the same issuer. As for TREM, this excludes non-securities derivatives that have a specific transaction reporting regime.

In line with the above, CESR decided to exchange transactions on the following OTC derivatives:

- Options
- Warrants
- Futures
- Contract for Difference and Total Return Swap
- Spreadbets
- Swaps (except CfDs, TRS and CDS)
- Credit Default Swaps
- Complex derivatives

CESR decided to go for a more comprehensive approach where derivatives that would not fall within plain-vanilla general categories would still be reported under a common "complex derivatives" label.

The boundaries between "plain-vanilla" and "complex" derivatives will be further defined in harmonised guidelines, as well as other useful common standards for consistent collection of data between participating Member States.

1.4. Identification and classification of OTC derivative instruments

To monitor the market, CESR members should have a common understanding of the transaction reports they exchange. It requires a common business language between regulators. To allow CESR members' IT systems to exchange transaction reports, a common exchange protocol is also required. A protocol would ensure that transaction reports collected in a member state would be accepted and processed by the system of another CA.

To achieve the two points above, CESR members should standardize the data they exchange. TREM has already settled standards for transaction reports on instruments admitted to trading on regulated markets. However, there are two fields in which the standards used in TREM do not apply to transaction reports on OTC derivative instruments: classification (derivative type) and identification (instrument identifier).

CESR ran a Call for Evidence in February 2009 to get markets participants' inputs on the identification and classification of OTC derivative instruments, and then the Consultation to get their view on CESR's proposals regarding those fields. This document should therefore be considered having in mind the outcomes of the Call for Evidence (CESR/Ref.09-074).

2. Number of responses and range of stakeholders

CESR received 17 responses to the consultation; these were largely split between banks and banking associations, exchanges (and associations) and financial information services providers. The full list of respondents (and the acronyms used to denote them in this summary) is the object of annex 1.

3. Question 1 – Classification of OTC derivatives – Do you agree with CESR's proposal? Any comments on CESR's view on this subject?

<u>CESR's classification scheme</u>

The following respondents are in favor of the classification type proposed by CESR: AFG, FBF, AMAFI, BBA, Xtrakter, FOA, ZKA, EBF and WKO.
A number of respondents suggested that the proposed classification does not seem to be sufficiently unambiguous and therefore claimed for a more detailed specification of each category in the classification. Thus, they are interested in the set of harmonized guidelines CESR plans to produce to define the boundaries of each category.
Among them, the BBA, Xtrakter and the FOA supported the introduction of a "complex derivatives" category that would prevent confusion and improve both accuracy and quality of transaction reports.

<u>Classification of Financial Instruments (CFI) scheme</u>

BVI explained that the classification proposed by CESR would stop at the top level and therefore they suggested that CESR's proposal should be an intermediate measure only until the revision of CFI is finalized and adopted by ISO. They explained that it would be a great benefit to the automation and standardization of transaction reporting in general if CESR continues to mandate the use of CFI standard within TREM.
The ANNA, as well, reminded that the CFI standard is in the final stages of a revision being undertaken to address such matters.

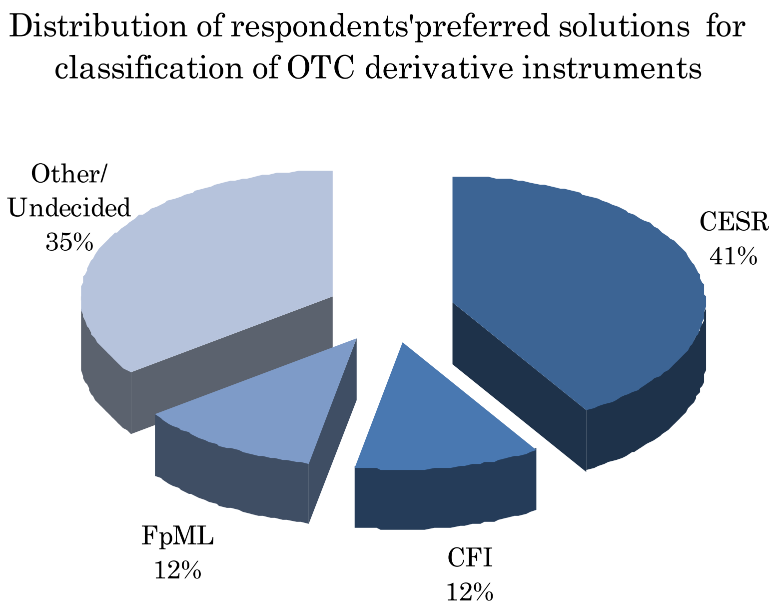
<u>Financial products Markup Language (FpML) scheme</u>

ISDA and LMS strongly believe that Competent Authorities should make full use of the FpML for the purposes of transaction reporting requirements. They are not in favour of a single letter classification scheme for OTC derivative instruments, as the CFI code is. ISDA reminded that CESR's decision to create one new scheme would inevitably require system development by firms.

Other/Undecided:

The IMA, LexiFi, the LSE, Markit, NYSE Euronext did not give information about their preferred solution regarding the classification of OTC derivatives, but focused on their identification.

The pie chart below sums up the distribution of the preferred solutions of the participants regarding the classification of OTC securities.



4. Question 2 – Identification of OTC derivatives – Do you agree with CESR's proposal? Any comments on CESR's view on this subject?

CESR's identification scheme

The AFG, ZKA and WKO agreed with CESR's proposal to use the set of 7 characteristics to describe the main OTC derivative instruments.

The BBA, Xtrakter and the FOA welcomed CESR's proposal that firms are not required to input an identifier in transaction reports for OTC instruments. Those participants and the EBF recommended including a field for the description of the instrument. Otherwise, very dissimilar instruments could be grouped together under the same identifier according to them.

On the other hand, ZKA welcomed that CESR abandoned the consideration of free text fields and welcomed the fact that ISIN codes can be provided on a voluntary basis in CESR proposal, instead of being mandatory.

International Securities Identification Numbers (ISIN)

BVI strongly recommended using ISIN as the identifier for OTC derivative instruments since its use is quasi mandatory under a number of European directives, easy to get on demand and the ISO 6166 standard is currently under revision. BVI do not agree with CESR's conclusion that ISIN allocation to OTC derivative instruments would be costly and burdensome.
As well, the LSE recommended that CESR consult the ANNA since National Numbering Agencies may deliver a solution in this area.
The ANNA pointed out that proposing an alternative instrument identifier (AII or equivalent) be used is contradictory to the fundamental principles of international financial instrument standardization through the use of approved ISO standards.

Alternative Instrument Identifier (AII)

NYSE Euronext considered that identification of OTC derivative instruments for transaction reporting purposes should be based on the AII or a slightly modified version of the AII code for OTC derivatives which may become exchange contracts if cleared by a central counterparty. The necessary changes to the AII code should be defined together with the CAs. They provided a suggested draft format based on the Alternative Instrument Identifier (AII) for the reporting of OTC derivative transactions.

Other/Undecided

Markit, a financial information services company, are of the view that CESR's goal of using one single set of identifiers is probably unrealistic whereas its RED codes provide critical reference data to enable the confirmation of derivative transactions. Markit has also developed enhanced identifiers for CDS.

Here below are the comments addressed by respondents on each category defined by CESR

- *Ultimate underlying ISIN*: ISDA argued that this may be inapplicable for some instruments such as interest rate swaps. LMS commented that even if an ISIN exists, some markets do not make use of them. WKO added that it would be very difficult to identify the more relevant ISIN where the underlying is a basket.

- *Underlying instrument type*: The BBA, Xtrakter, the FOA and the EBF strongly consider that it is sufficient to collect data on the ultimate underlying instrument without collecting information on the immediate underlying instrument, all the more since the CFI standard planned to be used for does not reflect modern financial markets. They remind that UK FSA's transaction reporting system do not currently require this piece of information.

- *Derivative type*: please refer to question 1 above since CESR's proposal is to use the CFI scheme for that category

- *Put/Call indicator*: ISDA and WKO consider that this should be optional since it may not be applicable or require complex interpretation.

- *Price multiplier*: ISDA consider that this should also be optional since it is not applicable for all OTC derivative instruments.

- *Strike price*: ISDA consider that this should also be optional since it is not applicable for all OTC derivative instruments. WKO add that many trades can have several strike prices (e.g. cap strike and floor strike).

- *Expiration date*: ISDA and WKO warn that the definition of this field needs to be carefully considered since OTC instruments may have multiple termination dates on top of an expiration date or several expiry dates.

5. Other issues raised by respondents

Central Counterparties (CCPs)

ISDA agreed that in many cases it is difficult to get a specific universally agreed identifier for an OTC derivative transaction and therefore it is beneficial to provide a limited set of characteristics of the contract to identify the transaction to report. ISDA highlighted the role that trade repositories can play in enhancing regulatory transparency in the OTC derivatives market, and limiting complexity and inefficiency in the reporting requirements to firms. They believe that Competent Authorities should be able to receive relevant information by querying trade repositories (like the DTCC Trade Warehouse).

The LSE also agreed with the global approach but exhorted CESR to review the issue in order to ensure that the process is as efficient as possible. Since a number of software suppliers are launching a web-based utility style service to help managing these transactions in an automated and audited way, they believe that there would be a number of benefits to the market as a whole if CESR reviewed the OTC trade confirmation/affirmation process.

The FBF and the AMAFI mentioned that some standardized products already have a referential set up by DTCC and/or Markit altogether that could be reused by the banks. They proposed to collect the data from the CCPs.

BVI commented that regulators could get all the information they need from sell side employed information agents. They argued that in such a reporting system, regulators could limit individual transaction reporting by market participants to the delivery of the ISIN code of each trade made.

Transaction reporting on OTC derivatives

Whereas several respondents (AFG, LSE, BBA – Xtrakter, FOA, ISDA and LMS) supported the extension and the standardization of transaction reports on OTC derivative instruments whose underlying instrument is traded on a regulated market, some of them expressed their concerns about this exercise.

The EBF is not convinced that the exchange of transaction reports for OTC derivative instruments would generate any considerable benefits.

As well, ZKA feel that it would appear more appropriate to wait for the implementation of extended reporting obligations in the Member States in order to avoid potential complications due to the practical implementation of those obligations.

The ISDA and the LMS believe that CESR should consider delaying any decision until the reviews that address the issue of regulatory reporting of OTC derivatives, in which the European Commission is involved, have run their course:

- review on derivatives market
- review of the Market Abuse Directive
- review of the MiFID directive

Transaction reporting impacts on costs and planning

In general, respondents expressed their willing to avoid inefficient, costly and inflexible regulatory reporting, and felt that a cost benefit analysis should be conducted if transaction reporting on OTC derivatives in Europe is being considered for implementation across the EU.

The AFG pinpointed that several studies have underlined that data exchange on OTC derivative transactions is still poorly automatized between market participants, and that therefore, CESR should consider that this new mandatory transaction reporting would ensure minimal developing and implementing costs for the asset management industry actors.

ZKA emphasized that the costs resulting from a modification of TREM should only be borne by the Competent Authorities participating in the data exchange.
The EBF expect no changes to firms' current reporting requirements and no additional costs – direct or indirect – for industry participants.

The FBF and the AMAFI called attention to the fact that a transitional period of 9 months will be necessary to implement the new classification and identification codes, since IT upgrading and developments are inevitable.

Scope of transaction reporting on OTC derivative instruments

The BBA, Xtrakter and the FOA supported CESR's decision that only transactions on derivatives whose underlying instrument is traded on a regulated market should be exchanged focusing on single-name derivatives.
On the contrary, the FBF, AMAFI and WKO are of the view that it does not make sense to exclude the derivative instruments for which the different underlying instruments all refer the same issuer.

The FBF, AMAFI and the EBF suggested that only purely OTC traded warrants and futures should be included in the categories.

The IMA do not consider that Credit Default Swaps should be reported since their price is not derived from or otherwise dependent on the value of a debt or equity security but based on a number of variables including the risk of default of a number of instruments.

NYSE Euronext is of the view that only the OTC derivative instruments which are proved to be the object of abuse like insider dealing should be included in the transaction reporting.

SWIFT reiterated a previous position that TREM should be developed to accept the input of ISO standard message formats from CESR Members, specifically ISO 20022 messages that have been developed to support MiFID reporting requirements.

LexiFi, a French company that provides software for the analysis, valuation, and management of financial products and portfolios, consider that the set of characteristics proposed by CESR is not sufficient to estimate the positions and the exposure in the underlying instruments, the values and risks, and pushes for a precise and exhaustive definition of the terms and conditions of each contract through a set of about twenty core constructors they have identified.

Instruments Reference Data

The LSE suggested CESR make the reference database used for transaction reporting available to financial institutions and data vendors to reduce the risk of participants using different sets of reference data to describe the same instruments.

Current transaction reporting

Several participants (BBA, Xtrakter, IMA) requested CESR to work on a consistent approach on transaction reporting in Europe by advocating a pan-European approach consistent with existing super-equivalent regimes. They also encouraged CESR to refer to the FSA Transaction Reporting Users Pack (TRUP) in any attempts to produce pan-European guidance for the reporting of OTC derivatives, and to include firms in the associated working group.

The FBF and the AMAFI also suggested that the reporting already done to the FSA could be generalized through all CAs without asking the banks for any further reporting.

The EBF drew attention to the fact that care must be taken to thoroughly coordinate a possible OTC derivative instruments transaction report mechanism with other initiatives concerning the reporting of and information requirements around OTC derivatives.

ZKA gave its view that transactions in certain OTC derivative must only be reported in UK and Ireland, contrary to CESR's statement in the consultation paper.
WKO confirmed that they already report OTC futures and options whose underlying is admitted to trading on regulated markets

Annex A – List of respondents

#	Respondent	Country	Acronym (where applicable)
1.	Association Française de la Gestion financière	France	AFG
2.	Bundesverband Investment und Asset Management e.V.	Germany	BVI
3.	Fédération Bancaire Française – Association française des MArches FInanciers	France	FBF – AMAFI
4.	International Swaps and Derivatives Association	>1	ISDA
5.	Markit	UK	
6.	Zentraler KreditAusschuss	Germany	ZKA
7.	Association of National Numbering Agencies	>1	ANNA
8.	European Banking Federation	>1	EBF
9.	London Market Systems	UK	LMS
10.	LexiFi	France	
11.	Society for Worldwide Interbank Financial Telecommunication	>1	SWIFT
12.	British Bankers Association and Xtrakter	UK	BBA – Xtrakter
13.	NYSE Euronext	>1	
14.	Investment Management Association	UK	IMA
15.	London Stock Exchange	UK	LSEG
16.	The Bank and Insurance Division of the Austrian Federal Economic Chamber	Austria	WKO
17.	The Futures and Options Association	>1	FOA