



**EACH response to the CPMI-IOSCO
consultation paper
'Harmonisation of the Unique Product
Identifier (UPI)'**

February 2016

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1. Introduction

The European Association of CCP Clearing Houses (EACH) represents the interests of Central Counterparties Clearing Houses (CCPs) in Europe since 1992. EACH currently has 20 members from 16 different European countries and is registered in the European Union Transparency Register with number 36897011311-96.

EACH welcomes the opportunity to provide input to the CPMI-IOSCO consultative report 'Harmonisation of the Unique Product Identifier'.

Below you will find the responses to the questions of the public consultation paper that we believe are relevant and have an impact on CCPs.

2. EACH responses to specific questions

Q1: Are the above three OTC derivative instrument types (i.e., forward, swap, and option) sufficient to describe (in combination) all OTC derivatives? Which OTC derivatives would fall outside of this approach?

EACH notes that while most OTC derivatives instrument types sit broadly within the three basic instrument types, additional values would be beneficial to help capture the particular features of the following OTC instrument types, which are often traded and are distinct from forwards, swaps and options:

- **Swaption:** it is important to know that the option exercise for an option is different than that of a swaption as the option exercise for a swaption results in a new underlying swap;
- **Contract for Difference ("CFD"):** CFDs do not fit into the standard swap or forward bucket because a CFD is an OTC derivative that can be traded without ownership of any underlying asset. It is a purely financial transaction based on the difference between agreed price points and a CFD is considered a leveraged product which is traded and then leveraged with a broker in order to scale up positions in the market. Although they are similar in nature to basis swaps, EACH believes that the way CFDs are traded and the way they derive their value provides sufficient reasons to be classified differently;
- **Commodity Swaps:** which tend to behave more like forwards than Swaps;
- **Structured Products:** which demonstrate features across the three basic OTC derivative instrument types.

Q2: 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, explain.

EACH is concerned that using information solely on the underlier and the instrument (or even the asset class) will not provide enough detail for TRs and regulators to aggregate data. This is particularly in the case of FX Swaps where different units or currencies on the same underlie need to be aggregated. A number of EACH Members have provided possible solutions to this issue in their own responses to this Consultation Paper.

Q3: Is it valid to assume that a 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.

EACH 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. However, EACH notes that it should be possible to define a general set of data elements independent of asset class, such as contract type and currency.

Q4: Do you agree with this approach to the UPI's treatment of package trades? If not, please explain and suggest alternatives.

EACH believes that package trades should be broken down into their individual legs for reporting purposes and as such would not have an UPI. It may be possible to link individual trade legs with a single identifier (e.g., Package Linkage ID) that traces back to the package transaction. This mechanism of reporting package transactions therefore requires one identifier to identify the package transaction and additional field to link the legs by an UTI. EACH also suggests that swaption straddles are an exception to this rule and should be classified as a discreet instrument.

Q5: Are the principles and high-level specification 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.

EACH broadly welcomes the Harmonisation Group's high-level specification for product classification and notes that the agreed taxonomy:

- should allow for data aggregation and therefore be precise enough to meet the regulatory authorities' purposes.
- must take care to ensure that the agreed taxonomy is be non-proprietary, open source and freely available to the public;
- should apply to both OTC and ETD transactions;
- should made each product unique and jurisdiction neutral;
- should incorporate fields which vary by asset class and may even vary within an asset class depending on the uniqueness of the products contained therein (for example, single-name credit default swaps and index credit default swaps);

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- should be persistent yet adaptable such that any change in underlying reference data only applies to new and open trades while historical data remains associated with the previous trade's product;
- should be able to easily add new products to reflect the ever-changing derivatives markets;
- must take extreme care to ensure confidentiality of the parties involved in a trade. 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;

EACH would also emphasize that prior to implementation these principles and high-level specifications need more thorough definition and explanation.

Q6: 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.

EACH believes additional clarity is required on a number of the principles and high-level specifications including, *inter alia*:

- when and how will the versioning approach would work;
- 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;
- what are the associated costs;

Q7: Could some of these principles and high-level specifications pose implementation challenges? Which ones and why?

In general terms, EACH agrees with all of the principles laid out for defining a UPI but also notes that all of the principles set out will need to be properly defined in order to ensure effective UPI construction. However, we would also urge the Harmonisation Group to liaise with other regulatory bodies and trade associations in order to devise a UPI taxonomy that covers OTC and ETD transactions in order to allow full aggregation and reconciliation of data sets. Additionally, it is essential that the Harmonisation Group details how the UPI system will handle new product or changes to the existing products. Further, in the context of the need for a governance structure 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 according to the principles and high-level specifications. Additionally, EACH believes that the role of the governance structure is to ensure compliance with the principles rather than creation of UPIs themselves.

Q8: Providers and 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 advised 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.

EACH notes that a number of its Members and the Trade Repositories used have already created product categorisation taxonomy. Such taxonomies allow the EACH Member or its Trade Repository to create positions, to determine when a trade is mandatorily clearable in multiple jurisdictions and allows for the efficient aggregation of data. We would therefore encourage the Harmonisation Group to review the taxonomies already created prior to embedding a new or revised approach.

Q9: 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?

EACH believes that although practical, widespread and prolonged use of a designation of "Other" is unhelpful as the effectiveness of the classification system will be inversely proportional to the frequency of its use. Among the options which could be used to mitigate the use of the designation as "Other" would be:

- use of a catch-all designation such as "Exotic" to highlight that this product taxonomy should only be used when creating exotic or bespoke products which do not fit into the product taxonomy; or
- the principle of Extensibility allows 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.

Q10: 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 derivatives product classification system for the global aggregation of data reported to trade repositories, are you aware of product classification 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 purpose of compression or netting operations?

EACH Members currently use product classification systems that are more granular than proposed in the consultation in order to provide regulators and counterparties with a sufficiently granular UPI. EACH encourages the Harmonisation Group to review the existing product classification systems already in use in order to assess the appropriate levels of granularity needed.

Q11: Do the options presented above appear operationally feasible? If not, please explain why.

EACH believes the options above are operationally feasible but the process of formulating, constructing and validating the resulting UPI requires further elaboration, for example in relation to option style and type should not be in the 'Instrument type' level but rather position level aggregation.

Q12: What are the pros and cons that you see in each considered level of granularity (one with an identifier for the underlier, or without an identifier for the underlier)?

EACH believes that inclusion of the underlying data elements including underlying id and sources are important in order to create a classification at a useful level of granularity. However, creation of a full universe of underlying ids requires an extensive and detailed data management exercise (particularly in relation to commodity swaps). EACH also notes that ISINs may not be the most effective underlie id source as they are not open source since and issuance is controlled by a National Numbering Agency.

Q13: 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.

EACH is aware that a number of providers have stepped forward to provide underlying identifiers but these are not open source, tend to be proprietary in nature, are not freely available and are not often kept up to date. Essentially all underlying identifiers must be available via open-source or to be used free of charge. This may require that new sources of underlying identifiers be created if the existing sources cannot be used free of charge.

Q14: For identifiers in each asset class, are there corresponding reference data that are open-source and freely available to all users with open redistribution rights?

Please refer to our response to Question 13.

Q15: 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?

EACH is not aware of any open source classification system that would meet the needs of a global UPI. However, as noted above, EACH believes that any source used for identifiers that are part of the classification system must be open-source and freely available.

Q16: 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?

EACH believes that any classification system should incorporate existing standards as much as possible without favouring one individual standard. This will allow a Trade Repository to create a product for that underlier while waiting on a new standard to be created which can then be updated as needed when the standard is available. The lack of a publically available standard should not delay reporting indefinitely.

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