Transition to use of the Unique Product Identifier (UPI) as the basis for OTC derivatives identification for different MiFIR purposes

9 April 2024

Executive Summary

The Alternative Investment Management Association (AIMA), the Global Foreign Exchange Division (GFXD) of the Global Financial Markets Association (GFMA) and the International Swaps and Derivatives Association (ISDA) (hereinafter known as 'the co-signatory associations' or 'the associations') believe that the EU reporting regime for identification of OTC derivatives should be simplified and enhanced, through adoption of the Unique Product Identifier (ISO4914) as the basis for OTC derivatives instrument identification in MiFIR. The UPI can be augmented, as appropriate, with additional fields for different MiFIR use cases, depending on the information required in each use case.

As such, the UPI should be included in

- MiFIR core market data (for the purpose of the Consolidated Tape)
- MiFIR non-equity transparency RTS 2 (along with other fields necessary to identify instruments at an appropriately granular level for this purpose)
- FIRDS (the MiFIR Financial Instrument Reference Data System), for transaction reporting purposes.

The mandate provided in revised MiFIR Level 1 for the European Commission to designate a globally agreed identifier for OTC derivatives (in a Delegated Act) represents an opportunity to establish an OTC derivative instrument identification ecosystem which is fit for the purposes of MiFIR transparency *and* transaction reporting, as well as related reference data reporting requirements. The associations see no reason OTC derivatives instruments should not be adequately identified for each of these purposes.

It is clear that our view is aligned with market consensus (based on the outcome of the EC's recent consultation on this issue).

We believe that this approach would promote the competitiveness of EU capital markets, making market data more useful, in practice, for market participants.

In our view, use of the UPI – the globally-endorsed standard for identification of OTC derivatives – would facilitate investment and encourage new entrants in EU capital markets from non-EU firms, who could use a standard that is being used in other major derivatives jurisdictions.

The use of the UPI as the sole basis for OTC derivatives instrument identification will support regulatory cooperation in international forums (such as CPMI-IOSCO) to aggregate data for market integrity and systemic risk purposes. We do not believe that a decision to discard the OTC ISIN will undermine such cooperation in any way.

Adoption of the UPI as the basis for OTC derivatives instrument identification should also cut costs for EU market participants, by comparison with the status quo. Although the ANNA-DSB ISIN and UPI services are run on cost recovery basis, it should be materially cheaper (in the medium and long term) for users to be able to avail of a single identifier for all MIFIR (and indeed, in time, EMIR) data-related purposes. As UPIs identify OTC derivatives instruments at a less granular level than OTC ISINs, they will not proliferate to the significant extent ISINs have, and service provision for a single identifier (rather than two) should create economies for users of these services.

We recognize that such a step will mean changes to the databases ESMA use and which underpin their collection of reference data. As such, to the extent there is a concern to ease the transition to such a new system, the EC could consider retaining the ISIN for a finite period of time (provided the OTC ISIN is modified in timely fashion to remove the expiry date, for all OTC derivatives instruments (and not only those covered by MiFIR transparency requirements)).

A system which retains the rolling ISIN for some products whilst removing it for others will give rise to unnecessary complexity (even representing a cost-related disincentive to new entrants to the European capital market).

In each of the above-mentioned use cases (core market data, RTS 2 and FIRDS), the UPI should be included as a separate field. It should not be necessary to derive the UPI from the OTC ISIN (modified or otherwise).

The outcome of the recent EC consultation

The EC recently consulted on the appropriate approach to OTC derivatives instrument identification in revised MIFIR, further to the mandates for adoption of (a) Delegated Act(s)[1] to determine such for use in relation to MIFIR transparency and transaction reporting requirements.

The responses to this consultation indicated that ISDA, AIMA and the EBF (who co-signed a response to the EC consultation) were just three bodies within the significant majority of market participants favouring a UPI-based approach to OTC derivatives instrument identification in MIFIR transparency requirements (as opposed to an approach based on modified ISIN). We welcome this clear signal (coming from multiple Member States as well as global and European trade bodies, and from industry associations representing all sides of the market) given to the EC.

What should the EC's work on this issue achieve?

The co-signatory associations believe that the outcome of the EC's deliberations should align with the following aims:

- It should support a globally convergent approach on OTC derivative identification.
- It should improve data quality (and certainly, it should not further undermine data quality)
- It should seek to limit further unnecessary complexity and cost to market participants.

We believe that only adoption of the UPI as the basis for OTC derivatives identification will achieve each of these aims.

Optimal granularity; limiting complexity

We understand, from the comments made by eTrading Software, ANNA-DSB and ESMA in the EC workshop held on January 16th, that they support a modified ISIN approach to OTC derivatives identification. We welcome this openness to reform of ISIN for OTC derivatives, but it is unclear if this would be applied across all OTC derivatives in scope of MiFIR, or just the more limited range in scope of RTS 2 reporting (or indeed a subset of the OTC derivatives in scope of RTS 2 reporting) under revised MiFIR.

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[1] Text of Article 27.5 under revised MIFIR:

5. By ... [three months from the date of entry into force of this amending Regulation], the Commission shall adopt delegated acts in accordance with Article 50 to supplement this Regulation by specifying the identifying reference data to be used with regard to OTC derivatives for the purposes of the transparency requirements laid down in Article 8a(2) and Articles 10 and 21.

The Commission is empowered to adopt delegated acts in accordance with Article 50 to supplement this Regulation by specifying the identifying reference data to be used with regard to OTC derivatives for the purposes of Article 26.'.

ESMA's [response to the EC consultation]() opined that '*maintaining the OTC ISIN as the instrument identifier while revising some of its attributes (option 2) would lead to greater quality and consistency of transparency data*' by comparison with ISDA's preferred approach ('*UPI combined with additional reference data attributes to be published alongside it (option 1)*)'. We acknowledge and welcome ESMA's willingness to address the rolling ISIN issue (which ISDA and its members have been raising as a concern since as far back as 2016). However, we believe that the issues associated with the OTC ISIN should be remedied beyond the scope of RTS 2 following the revision of MiFIR, before eventually being replaced by the UPI as the basis for OTC derivatives identification in MiFIR.

One of ESMA's key criticisms of Option 1 in the EC consultation is that that Option departs from a 'basic principle of data management' i.e., reliance on 'a common reference data source containing all instrument attributes that form part of a unique instrument ID'. That instrument ID, it says, can be linked with instrument attributes contained in the Reference Data Library (RDL) to establish the unique identification of the instrument. We understand that one of the reasons for ESMA's opposition to Option 1 is that it would necessitate re-design of the ESMA data eco-system because of the inter-dependencies built into that system (e.g. the relationship between the MIFID RDL (which will eventually be leveraged by the CTP for derivatives), MIFID FIRDS/FITRS (Financial Instrument Transparency System) and data reported under MIFIR RTS 2 (though we acknowledge ESMA's qualification in its response to the EC consultation that it is more concerned about *'re-designing the system in a sub-optimal manner, which has a negative impact on the quality and reliability of the information to be published'*). ESMA is of the view that data points such as dates input upfront as part of reference data submission, rather than ad-hoc on individual regulatory reports, will exhibit better data quality.

In our view, the granularity of the existing (ISIN) OTC derivative identifier, combined with the dependencies built into the existing MIFIR data system are actually vulnerabilities which generate data quality issues. These have manifested in multiple asset classes, notably Rates, FX, and OTC equity derivatives (even if OTC derivative transparency requirements will only apply to Rates business, among these asset classes, when revised MIFIR enters into effect).

Although we support use of the UPI as a globally recognized OTC derivatives identifier, it should be recalled, that it is possible, in practice, to adequately identify OTC derivatives for regulatory purposes without use of an identifier like ISIN or UPI. Indeed, the CFTC had been doing so since the advent of OTC derivatives reporting post-Dodd Frank in the US (it adopted the UPI as the basis for OTC derivatives reporting as of January 2024). This underlines that a very granular identifier (like ISIN) is not necessary, and is certainly not, by definition, superior to a less granular identifier like the UPI. The UPI, we believe, represents the optimal balance between granularity and flexibility (for example, in augmentation of the UPI with different sets of fields for different regulatory purposes, or even for different jurisdictional rulesets).

Smoothing transition to use of the UPI as the globally agreed unique product identifier in MiFIR

To the extent that the EC believes that care needs to be taken to smooth the transition to use of UPI as the unique product identifier under revised MiFIR, and that (like the FCA) the EC believes that use of a modified form of ISIN for a period of time would allow time for this transition to bed in, the associations are open to this idea, subject to a number of considerations:

- We believe it important to ensure that ISIN is modified across all OTC derivatives instruments (not just those (or a subset of those) subject to transparency requirements under revised MiFIR) and for all OTC derivatives use cases (core market data, transparency reporting under RTS 2 and reporting to FIRDS).
- If the UPI and ISIN must co-exist in the EU reporting ecosystem for a certain period, the UPI should exist as its own field. It should not be necessary to derive the UPI from the OTC ISIN (or modified OTC ISIN).

In our view, a rates-only 'modified ISIN' issue could create a further unnecessary layer of complexity and cost. The idea of modified ISIN approach only for major tenors in the Rates asset class would be even more problematic.

Our 'operational' reservations in this context include:

- It is not clear why removing the maturity date and replacing it with the tenor (as we understand to be the eTrading Software, ANNA-DSB, ESMA preference) will be less problematic, in terms of systems adaptations than our preferred approach.
- We are concerned that, in practice, this Option ('Option 2 in the EC Consultation paper of November 2023) would lead to different categories of ISIN for different MIFIR purposes e.g.
    - a "transparency ISIN" for trades subject to the transparency requirements.
    - a "transaction reporting ISIN" for transaction reporting requirements).
    - a "Benchmark tenors ISIN" for all whole-year benchmark tenor trades to be used for both transparency requirements and transaction reporting requirements.
    - a "broken dated ISIN" comprising non-whole-year benchmark tenor trades (to be used for both transparency requirements and transaction reporting requirements)

We remain concerned about costs and complexity, for market participants and regulators alike.

If some form of ISIN is maintained in reporting requirements for a period, co-existing alongside UPI, it should not be necessary to derive the UPI from the ISIN (modified or otherwise). This would preserve a dependency in the reporting ecosystem which would unnecessarily delay transition to use of the UPI as the sole OTC derivatives identifier, and over-engineer the process of obtaining UPIs.

International convergence

We have already expressed the view that international convergence would be best served by adoption of a UPI-based instrument identification system.

The CFTC and SEC adopted a UPI-based OTC derivative instrument identification system as of the UPI go-live on January 29, 2024, for market and regulatory transparency[2].

The only jurisdiction (apart from the EU) that has been using ISIN (having inherited it from its period of EU membership) for OTC derivatives identification is the UK, and the FCA has indicated an intention to introduce the UPI for transparency reporting purposes for OTC derivatives, as a '*more effective method of identifying*' them. However, the FCA proposes to also retain ISINs, for purpose of *'backward compatibility*' regarding OTC derivatives, although it says that it is *'open to the possibility of phasing them out over time*.'

The UPI is being used by other G20 jurisdictions for regulatory (EMIR-style) reporting.

Conclusion

The co-signatory associations propose that the UPI and other relevant trade attributes (as addressed in the ISDA-AIMA-EBF position) should be added to the 'core market data' for OTC derivatives as defined under revised MIFIR Article 2 (which includes the '*identifying reference data as referred to in Article 27(1), second subparagraph*', which for OTC derivatives, the MIFIR text says, *'shall be based on a globally agreed unique product identifier and on any other relevant identifying data'))*.

We further believe that:

- The UPI and other relevant attributes should also be added to MIFIR RTS 2 (further to the position submitted by ISDA to the EC's recent consultation).

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[2] Under SBSR there are two SEC rules relating to UPI:

- Rule 901(c)(1) – covering the reporting of primary trade information regarding Security Based Swaps including a product ID where one is available.
- Rule 901(h) which requires those with a duty to report information under SBSR transmit information to a Swap Data Repository (SDR) in the format required by the SEC.
- Rule 902(a) which requires an SDR to publicly disseminate SBS information including primary trade information, including UPI.

Since the UPI will be available via the DSB from 29th Jan 2024, firms are required to include UPI under the above rules.
From the CFTC perspective, the following CFTC regulations apply:

- 17 CFR 43 ("part 43"), which covers real-time public reporting of swap transactions and the public dissemination of swap transaction and pricing data in real time by SDRs for public transparency purposes; and
- 17 CFR 45 ("part 45"), which is specific to swap data recordkeeping and reporting requirements.

Prior to the designation of UPIs, the CFTC regulations provisionally mandate use of the internal product identifier or product description used by the SDR to which a swap is reported in all recordkeeping and swap data reporting pursuant to part 45. On February 16, 2023, the Commission issued an order designating the UPIs issued by the DSB for swaps in the credit, equity, foreign exchange, and interest rate asset classes as the UPI and product classification system to be used in recordkeeping and swap data reporting pursuant to the CFTC's regulations.

- The UPI should also be added to FIRDS.

If the EC feels that it is necessary to smooth the transition to a new OTC derivative instrument identification ecosystem by retaining the modified OTC ISIN (alongside the UPI) for a period of time the ISIN should be modified for all OTC derivatives instruments, and not just those subject to revised MiFIR transparency requirements (or a subset of instruments subject to MiFIR transparency requirements).

If the EC does believe it necessary to maintain ISIN (or modified ISIN) in the OTC derivative reporting ecosystem, it should *not* be necessary to derive the UPI from the ISIN. The UPI should exist as its own field.

Adoption of the UPI as the globally agreed OTC derivative product identifier under MiFIR would:

- support international convergence in OTC derivatives identification for market and regulatory transparency. It would promote closer alignment with CFTC reporting (given the CFTC's preference for adoption of the UPI as the basis for CFTC reporting) and with the UK FCA's approach.
- Cut costs for market participants.
- Improve data quality for market participants and regulators, by addressing the rolling ISIN issue.
- Encourage new entrants to the single market, by adoption of an OTC derivative identifier that is used in all major non-EU OTC derivatives jurisdictions (unlike ISIN).

We hope that you find this paper useful as a contribution to your work and remain at your disposal if you would like to discuss the ideas addressed herein.

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About AIMA

The **Alternative Investment Management Association (AIMA)** is the global representative of the alternative investment industry, with around 2,100 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than US$3 trillion in hedge fund and private credit assets.
AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides**.** AIMA works to raise media and public awareness of the value of the industry.

AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 250 members that manage over US$1 trillion of private credit assets globally.

AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors).

About the GFXD

The Global Foreign Exchange Division (GFXD) of the Global Financial Markets Association (GFMA) was formed in co-operation with the Association for Financial Markets in Europe (AFME), the Securities Industry and Financial Markets Association (SIFMA) and the Asia Securities Industry and Financial Markets Association (ASIFMA). Its members comprise 24[1] global foreign exchange (FX) market participants, collectively representing the majority of the FX inter-dealer market[2]. Both the GFXD and its members are committed to ensuring a robust, open and fair marketplace and welcome the opportunity for continued dialogue with global regulators.

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 77 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers.

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[1] Bank of America, Bank of New York Mellon, Barclays, BNP Paribas, Citi, Credit Agricole, Deutsche Bank, Goldman Sachs, HSBC, ING, JP Morgan, Lloyds, Mizuho, Morgan Stanley, MUFG, NatWest Markets, Nomura, Northern Trust, RBC, Standard Chartered Bank, State Street, UBS, US Bank and Wells Fargo
[2] According to Euromoney survey

Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.