October 23, 2014

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CC:
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RE: **ISDA comments to the** *Formulario Relativo a las Operaciones de Intercambio de Flujos y Rendimientos ("Swaps"), para Instituciones de Crédito y Casas de Bolsa*).

Dear Ms. Rodríguez and Mr. Bracho:

On behalf of our members, the International Swaps and Derivatives Association, Inc[1]. ("ISDA"), would like to provide you with a set of comments related to the proposed (i) *Formulario Relativo*

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[1] Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 64 countries. These members include a broad range of OTC 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 including

a las Operaciones de Intercambio de Flujos y Rendimientos ("Swaps"), para las Instituciones de Crédito y Casas de Bolsa (the "<u>Swap Formulary</u>"), (ii) *Formulario Relativo a las Opciones y Títulos Opcionales (Warrants), para las Instituciones de Crédito y Casas de Bolsa* (the "<u>Options and Warrants Formulary</u>"), (iii) *Formulario Relativo a las Operaciones de Futuros y Forwards, para las Instituciones de Crédito y Casas de Bolsa* (the "<u>Futures and Forwards Formulary</u>"), and (iv) *Formulario Relavtivo a los Contratos que Garantizan Operaciones Derivadas ("Garantías"), de las Institutiones de Crédito y Casas de Bolsa,* (the "<u>Collateral Formulary</u>", and jointly with the Swap Formulary, Options and Warrants Formulary and Futures and Forwards Formulary, referred to as the "<u>Formularies</u>") from de Banco de Mexico.

The comments have been assembled through the working groups from the ISDA Data and Reporting Regulatory Implementation Committee[2]. The Data and Reporting groups look at regulatory reporting requirements on a global basis, assisting our members with the implementation of the reporting requirements in the G20 jurisdictions. The committee strives to develop a consistent cost effective global reporting infrastructure that meets the requirements from national and international regulators and oversight bodies.

Our comments to the Formularies generally appear in the same order as they appear in the Formularies. This order does not intend to attribute more or less importance to any particular comment. We provide these comments so that they can be included in the discussions you are conducting with the Banco de Mexico regarding the implementation of derivatives reporting in Mexico. Please also note that this letter only concerns the Sections, Fields and Codes that relate to derivatives in unrecognized markets (*mercados no reconocidos*).

While comments have been provided for specific Sections in the Formularies, we recommend similar clarifications to other Sections of the Formularies, where applicable. Also, please note that some comments relate to Annexes as a result of our review of a specific Section.

1. **Swap Formulary**

   a. **General Help (*Ayudas Generales*)**

   (i) Sections II and III contain questions about interest rate swaps and cross-currency swaps, respectively, while Section IV contains questions about "exchange transactions" on an underlying that is different than an interest rate. Paragraph 5 of the General Help provides that the Formulary covers swaps, swaptions, notes, derivatives embedded in titles or structured contracts.

(continued…)

exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

[2] http://www2.isda.org/functional-areas/technology-infrastructure/

Please clarify what is meant by "exchange transactions" and that only the other products in Paragraph 5 of the General Help are to be included. For example, an option on an equity security would be excluded.

(ii) As per Part V (*contenido del formulario*), swaps are to be reported one by one. Would a swaption (before it is exercised) be reported separately as an option and a swap or just once for the strategy? Also, for a swaption, the reporting party may not know the number of cashflows under the swap as this will depend on when and if the option is exercised. There may be no cashflows under the swap if the option to enter into the swap is not exercised. Does the reporting party wait until the swap is exercised to report the swap terms?

The Options and Warrants Formulary, also makes reference to swaptions, when defining "*Paquetes de Derivados*". Should the reporting party report the swaption using both formularies, the Swap Formulary and the Options and Warrants Formulary?

(iii) The definition of "*Paquetes de Derivados*" includes total return swaps, which have an implicit credit default derivative ("Credit Default Swaps"). Then in Part VII it provides that Credit Default Swaps are to be excluded from the Swap Formulary. These two sections seem to conflict with each other.

Please clarify whether or not Credit Default Swaps are covered by the Swap Formulary. Please also clarify if other particular derivatives such as options (other than options on another derivative such as a swaption) are to be excluded from the Swap Formulary.

(iv) Part IX refers to the timing for reporting. It includes a provision that certain reporting by a foreign financial subsidiary must be done by 1:00 PM on the following business day. It includes a provision that reporting of early terminations, rights assignments or *baja* must be made by 5:00 PM.

Please consider that for Sections II, III, IV and VI, a foreign financial subsidiary should report on the next business day which is also a business day in the location where it is organized. Also, please remove the word "financial", as currently it is unclear what the obligation is for a non-financial foreign subsidiary.

Please consider that reporting of early terminations, rights assignments or *baja* for a foreign subsidiary should have a reporting deadline of 1:00 PM on the next business day rather than 5:00 PM. Please conform to the deadline for Sections II, III, IV and VI.

Please clarify the meaning of the word "*baja*" in the context of a swap. Does this mean the natural termination of the swap as opposed to an early termination of a transaction?

Please clarify when a derivative embedded in a note or title should be reported (*fecha de concertación*). We recommend that this be upon issuance of the instrument. Please also note that other Fields may not apply when a derivative is embedded in a note or title. For example, there will not be an ISDA Master Agreement or collateral where the swap is embedded in a note. The relevant sections should be clarified that they are not filled out when they do not apply.

b. Content (*Contenido del Formulario*)

(i) Section II

General questions: Although Section II data is reported daily, for a single swap is Section II data to be reported only on the date of its agreement (*fecha de concertación*) or every day over the term of that single swap? Also, if the parties bilaterally agree to amend a swap (e.g., change the Fixed Rate from 2.0% to 2.5%), does the reporting party have to revise and report Section II Complement on that date?

Field (*Campo*) 9- Type of Derivative, Annex C:

- Code (*Clave*) 31 refers to a "real" rate versus a floating rate.

  What is a "real" rate?

- Code (*Clave*) 35 refers to an inflation index versus a fixed or floating rate where there are 2 different base amounts in different currencies.

  Please include a Code for such a swap where there is a single base amount.

- Code (*Clave*) 36 refers to a swap on the performance of a stock versus a fixed or floating rate. However, this is also a strategy on Annex J as Code (*Clave*) 47.

- Are parties expected to report strategies in Field 9 of Section II or only in Field 41 of Section II? It would be preferable if such a swap could be reported only in Field 9 of Section II.

- Code (*Clave*) 36 refers to a swap on the performance of a stock versus a fixed or floating rate. However, such swaps can be on a stock index (e.g., the S&P 500 Index) or a basket of stocks customized by the parties.

  Please include Codes (*Claves*) for equity index swaps and for share basket swaps, index basket swaps and mixed basket swaps (e.g., shares and indices).

- Code (*Clave*) 37 refers to a dividend swap on a stock. However, such swaps can be on the dividends on an index of stock (e.g., the S&P 500 Index).

  Please include a Code (*Clave*) for equity index dividend swaps.

- Code (Clave) 42 of Annex C makes reference to orange juice as the underlying of a swap. Please change this to oranges.

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- The type of products in Annex C is broader than the products listed in Annex D of the current Formulary[3]. Since the range of products on interest rates may expand and some interest rate products may not be covered here, we recommend the addition of another Code (*Clave)* for "other products"

  Please consider this comment as applicable for the other Formularies' Annexes that contain product or other lists. These lists often provide many choices but generally are not exhaustive and having an additional Code (*Clave)* such as "other" that a reporting party can use to report if there is no Code (*Clave)* that matches, would be very helpful. At the same time, It would be good to understand whether these code lists will be updated when required.

Field (*Campo)* 11- Review of the Swap Parameters, Annex H:

- Code (*Clave)* IBREC and IBENT refers to the base amount changing and other main parameters relating to flows changing.

  What might the other main parameters be? For example, one might use 3 month USD LIBOR. As it is a floating rate the actual value will change for each period. We assume it is not intended to capture this type of contract-intrinsic change, but rather changes that the parties agree otherwise. We would extend this as a general comment for all other Codes where applicable.

- Also, please clarify that these Codes refer to changes expected as of the Trade Date since of course the parties may later amend the base amount or other parameters. As stated elsewhere, please clarify where the parties reflect amendments to existing trades that they agree to after the Trade Date (e.g., where the parties decide to amend the Fixed Rate).

Field (*Campo)* 14-Notional Amount Currency, Annex E:

- The currencies in Annex E are broader than the products listed in Annex G of the current Formulary. Since the range of currencies may expand we recommend the addition of another Code (*Clave)* for other products and then the reporting party can use another currency.

Field (*Campo)* 20- Type of Underlying, Annex F:

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[3] See Swap Formulary, Futures and Forwards Formulary and Collateral Formulary - Annexes C (Type of Derivative), D (Purpose of the Transaction), E (Notional Amount Currency), F (Type of Underlying), J (Structured Transaction or Package), N (Master Agreement Type), R (Reason for Early Termination or Rights Assignment), and AD (Type of Collateral).

See Options and Warrants Formulary Annexes C (Type of Derivative), D (Purpose of the Transaction), E (Notional Amount Currency), F (Type of Underlying), J (Structured Transaction or Package), and R (Reason for Early Termination or Rights Assignment).

- Annex F should be expanded to include the addition of another Code (*Clave*) for other underlying assets and then the reporting party can use another currency.

Field (*Campo*) 41- Transaction Makes part of a Structured Transaction or Package, Annex J:

- If you report a strategy in Field 41, do you also report the other information in Section II?

- Code (*Clave*) 50. Please provide an example and clarify what type of strategy this is.

  Annex J should be expanded to include the addition of another Code (*Clave*) for other strategies and then the reporting party can describe this or have the General Help indicate that these are the only possible strategies.

Field (Campo) 47 – Calculation Agent, Annex B:

- Sometimes both parties act as joint Calculation Agent. Please include a field for "Both Parties" that the reporting party can use if it and the other party to the swap being reported are acting as joint calculation agent.

Field (*Campo*) 48- Transaction Confirmation Code:

- It is not clear how this differs from Field (*Campo*) 49 (Transaction Identification Number) and that there is such a Code (*Clave*). Also see Fields in Section V.

(ii) Section V

Field (*Campo*) 9- Reason for Early Termination or Rights Assignment, Annex R:

- These Codes (*Claves*) should be revised. Parties may agree to early terminations or assignments or there may be a contractual right of a party to terminate a trade without another party's consent. Code (*Clave*) 4 is unclear as "*compresion*" "optimization" is unclear. Parties may choose to terminate a swap early or assign it for several reasons that are difficult to define by a Code (*Clave*). We recommend that Field (*Campo*) 9 be removed. If retained, please add the following Codes (*Claves*) in Annex R: (1) a termination agreed by the parties, (2) a termination due to a contractual right, (3) an assignment agreed by the parties, (4) an assignment due to a contractual right, (5) an assignment as per operation of law or (6) "Other Reason".

(iii) Section VI

Field (*Campo*) 12– Notional Exchange or Up-front Fee Serial Identification Number:

- Parties generally don't assign identification codes to such payments. Therefore, we recommend that this Field (*Campo*) 9 be deleted.

(iv) Section VIII

Will there be a facility or process for parties to re-submit prior *Convalidaciones* sections across the Swaps Formulary, Futures and Forwards Formulary and the Options and Warrants Formulary, if one is reported with in error (e.g,. wrongly populated valuation etc.)? If so how will this process work?

Field (*Campo*) 4- Cut-off date:

- We do not know what a "cut-off date" is. Does this mean the date which ends the week for which the reporting occurs? Please clarify

Fields (*Campos*) 5- Transaction Identification Number:

- Same comments as above regarding identification codes.

Fields (*Campos*) 9, 10, 11, 12, 13 & 14

- Please clarify the meaning of "active party" and "passive party" of the transaction. Parties value the flows to be delivered and received. The operational impact of separating these should be considered.

- We would prefer to leave the *convalidaciones* submission requirement for month end submissions as it is in the current formulary, T + 3. The Futures and Forwards Formulary proposes T + 2, but this leaves very little time for GAAP valuations validations and issues with upstream sources (such as PIP). It also implies finalization of P&L on a T+1 basis which often takes more than 1 day.

(v) Section IX

General comment: Section V addresses early terminations. Please confirm that Section IX only addresses scheduled terminations if this is what is intended.

2. **Options and Warrants Formulary**

a. **General Help (*Ayudas Generales*)**

(i) As per Part V (*contenido del formulario*), options are to be reported one by one. Would a swaption (before it is exercised) be reported separately as an option and a swap or just once for the strategy? When defining "*Paquetes de Derivados*", shall the

reporting party report the swaption using both formularies, the Swap Formulary and the Options and Warrants Formulary?

(ii) According to Part VII certain reporting by a foreign financial subsidiary must be done by 1:00 PM on the following business day. It includes a provision that reporting of early terminations, rights assignments or *baja* must be by 5:00 PM.

Please consider that for Sections I, II and III a foreign financial subsidiary should report on the next business day which is also a business day in the location where it is organized. Also, please remove the word "financial" as then it is unclear what the obligation is for a non-financial foreign subsidiary.

Please consider that reporting of early terminations, rights assignments or *baja* for a foreign subsidiary should have a reporting deadline of 1:00 PM on the next business day rather than 5:00 PM. Please conform to the deadline for Sections I, II and III.

Please clarify the meaning of the word "*baja*" in the context of an option or warrant. Does this mean the natural termination of the option or warrant as opposed to an early termination of a transaction?

b. Content (*Contenido del Formulario*)

(i) General Overview

Please clarify if there is a specific Field (*Campo*) to report amendments, as exists in the current formulary, (Field: BS/AS modificas). There should be a field for parties to report amendments to a swap (e.g., changing the Spread over a floating rate or increasing the notional amount). These would not be new trades but revisions to terms of existing trades.

(ii) Section II

Field (*Campo*) 15- Notional Amount Currency, Annex E:

- Since the range of currencies may expand we recommend the addition of another Code (*Clave)* for other currencies and then the reporting party can specify such currency.

Field (*Campo*) 37- Type of Derivative, Annex C:

- Since the range of products may expand and since some products may not be covered here, we recommend the addition of another Code (*Clave)* for other products and then the reporting party can describe this product.

Field (*Campo*) 24- Type of Underlying, Annex F:

- Annex F should be expanded to include the addition of another Code (*Clave)* for other underlying assets and then the reporting party can provide the relevant information.

Field (*Campo*) 21- Transaction Makes part of a Structured Transaction or Package, Annex J:

- Annex J should be expanded to include the addition of another Code (*Clave*) for other strategies and then the reporting party can describe this. Otherwise, the General Help should indicate that these are the only possible strategies.

Field (*Campo*) 43- Transaction Confirmation Code

- It is not clear how this is different from Field (*Campo*) 45 (Transaction Identification Number) and whether such a Code (*Clave) exist*.

(ii) Section IV

Field (*Campo*) 10
Please see comments to Field (*Campo*) 9 in Section V. This should conform to those changes.

(iii) Section VII

Will there be a facility to re-submit prior *Convalidaciones* sections across the Swaps Formulary, Futures and Forwards Formulary and the Options and Warrants Formulary, if one is reported with some sort of error (e.g. wrongly populated valuation etc.)? If so how will this process work?

Field (*Campo*) 5-Cut-off date

- We do not know what a "cut-off date" is. Please clarify what this means. Does this mean the date which ends the week for which the reporting occurs?

***Convalidaciones* Submission**

- We recommend leaving the *convalidaciones* submission requirement for month end as it is in the current formulary, T + 3. The Futures and Forwards Formulary proposes T + 2, but this leaves very little time for GAAP valuations validations and issues with upstream sources (such as PIP). It also implies finalization of P&L on a T+1 basis (normally this takes more than 1 day).

3. **Futures and Forwards Formulary**

   a. **General Help (*Ayudas Generales*)**

   (i) Part V establishes that futures and forwards have to be reported one by one, even including those derivatives embedded in options over futures or forwards, or other structured agreements. Shall those embedded derivatives be reported separately?

(ii) Regarding the timing for reporting, Part VII establishes that certain reporting by a foreign financial subsidiary must be done by 1:00 PM on the following business day. It includes a provision that reporting of early terminations, rights assignments or *baja* must be done by 5:00 PM.

Please consider that for Sections I, and II a foreign financial subsidiary should report on the next business day which is also a business day in the location where it is organized. Also, please clarify remove the word "financial", as it is unclear what the obligation is for a non-financial foreign subsidiary.

Please consider that reporting of early terminations, rights assignments or *baja* for a foreign subsidiary should have a reporting deadline of 1:00 PM on the next business day rather than 5:00 PM. This conforms to the deadline for Sections I and II.

Please clarify the meaning of the word "*baja*" in the context of a future or forward. Does this mean the natural termination of the future or forward as opposed to an early termination of a transaction?

b. Content (*Contenido del Formulario*)

(i) General Overview

Please clarify if there is a field to report amendments, as exists in the current formulary, (current field: BS/AS modificas). Is there a method of reporting amendments? Are amendments to be modeled as early terminations and rebookings of new trades?

(ii) Section II

> **Field (*Campo*) 8- Type of Derivative, Annex C:**
>
> - Since the range of products may expand and since some products may not be covered here, we recommend the addition of another Code (*Clave)* for other products and then the reporting party can describe this product.
>
> - Code (Clave) 11 of Annex C makes reference to orange juice as the underlying of a future, while it shall make reference to oranges.
>
> **Field (*Campo*) 12-Notional Amount Currency, Annex E:**
>
> - Since the range of currencies may expand we recommend the addition of another Code (*Clave)* for other currencies and then the reporting party can provide such currency.
>
> **Field (*Campo*) 21- Transaction Makes part of a Structured Transaction or Package, Annex J:**
>
> - Annex J should be expanded to include the addition of another Code (*Clave)* for other strategies and then the reporting party can describe this.

Otherwise, the General Help should indicate that these are the only possible strategies.

Field (*Campo*) 24- Type of Underlying, Annex F:

- Annex F should be expanded to include the addition of another Code (*Clave*) for other underlying assets and then the reporting party can provide the relevant information.

Field (Campo) 31 – Calculation Agent, Annex B:

- Sometimes both parties act as joint Calculation Agent. Please include a field for "Both Parties" that the reporting party can use if it and the other party to the swap being reported are acting as joint calculation agent.

Field (*Campo*) 32- Transaction Confirmation Code:

- It is not clear how this is different than Field (*Campo*) 33 (Transaction Identification Number) and that there is such a Code (*Clave*).

(iii) Section III

Field (*Campo*) 8
Please see comments to Field (*Campo*) 9 in Section V. This should conform to those changes.

(iv) Section IV

Field (*Campo*) 5 -Cut-off date:

- We do not know what a "cut-off date" is. Does this mean the date which ends the week for which the reporting occurs? Please clarify.

Fields (*Campos*) 15, 16, 17, & 18

- Please clarify the meaning of "active party" and "passive party" of the transaction. Parties value the flows to be delivered and received. The operational impact of separating these should be considered.

(v) Section V

Will there be a facility to re-submit prior *Convalidaciones* sections across the Swaps Formulary, Futures and Forwards Formulary and the Options and Warrants Formulary, if one is reported with some sort of error (e.g. wrongly populated valuation etc.)? If so how will this process work?

Fields (*Campo*) 10 and 11- *Convalidaciones* Submission
- We recommend leaving the *convalidaciones* submission requirement for month end as it is in the current formulary, T + 3. The Futures and

Forwards Formulary proposes T + 2, but this leaves very little time for GAAP valuations validations and issues with upstream sources (such as PIP). It also implies finalization of P&L on a T+1 basis (normally this takes more than 1 day).

4. **Collateral Formulary**

a. **General Help (*Ayudas Generales*)**

(i) Section IV requires a Collateral Formulary to be filed for each "contract" that is executed. Since the defined term "Contract" means a guaranty contract and the use of the word "contract" in such Section IV is not defined, could you please clarify if this refers to a guaranty contract or a derivatives contract?

b. **Content (*Contenido del Formulario*)**

(i) <u>Section II</u>

It is not clear whether the collateral reporting requirement is intended to be at the portfolio level or at the transaction level. Please note that collateral is generally managed at the portfolio level so that the net exposure of all trades is calculated. As collateral is transferred in respect of more than one trade (e.g., all trades under an ISDA Master Agreement), we recommend that you clarify that the collateral reporting requirement is to be reported at the portfolio level.

Field (*Campo*) 4-Cut-off date:

We do not know what a "cut-off date" is. Does this mean the date which ends the week for which the reporting occurs? Please clarify.

Field (*Campo*) 9-Collateral Type:

- Since the range of assets that may be posted as collateral may include items not on this list, we recommend the addition of another Code (*Clave*) for "Other Collateral"

Field (*Campo*) 15-Collateral Market Value:

- Please clarify whether "reasonable value" is the same as "market value" for purposes of determining the value of the assets posted as collateral. We recommend that this be the market value as determined in accordance with the collateral arrangement between the parties. Please also clarify whether this value should or should not include any Valuation Percentage in the collateral arrangement between the parties. For example, parties may agree that the value of a security is the mid price for that security as of a certain time with haircut of 1%. Therefore, the value would be the mid price multiplied by the Valuation Percentage or 99% (100% minus the 1% haircut).

- Please clarify if the proposed version of the Collateral Formulary allows posting of the market value across asset classes and currencies while reporting in the base currency that was agreed by the parties in the collateral arrangement between them, (e.g., a Credit Support Annex to an ISDA Master Agreement). We recommend allowing such practice. Collateral is generally exchanged by the parties on a portfolio basis across all trades under an ISDA Master Agreement. It is not calculated separately, swap by swap. Please clarify and change the relevant sections in the Formulary and General Help (*Ayudas Generales*) to specify that collateral reporting is at the Credit Support Annex level and not on a trade by trade basis.

(ii) <u>Section IV</u>

Field (*Campo*) 6- Master Agreement Type, Annex N

This description should be modified, as there are various versions of the ISDA Master Agreement published by ISDA. We recommend including a separate Code *(Clave)* for the 1992 ISDA Master Agreement and the 2002 ISDA Master Agreement respectively. Alternatively include a Code *(Clave)* for any Master Agreement published by ISDA We note that there are other Master Agreements in existence such as the Mexican Master Agreement (*Contrato Marco de Operaciones Financieras Derivadas*). The addition of a Code *(Clave)* for "Other Agreements" would facilitate the reporting when a particular agreement is not available as a listed Code. As noted previously, it would be good clarify the process by which the codes generally can be updated if new ones are required.

Field (*Campo*) 7- Potential Future Exposure

- The "*Formulario relative a la Liquidez de la Banca Múltiple y de la Banca de Desarrollo"* (ML) which is to be used t*o calcul*ate the Potential Future Exposure, defines peak exposure using a capital based approach, instead *of a ris*k based approach. The capital based approach is often *used b*y banks and the risk based approach is generally used by broker dealers. Please clar*ify tha*t either a capital-based approach or a risk-based app*roach c*an be used to calculate the Potential Future Exposure.

We appreciate your consideration of these comments and questions on the Formularies. We would be available to discuss this with you at your convenience.

Most sincerely,

Karel Engelen
Senior Director, Head of Data, Reporting and FpML
ISDA