

Blueprint for a market initiative

to promote standardisation for
the processing of international
securities

The International Securities Market Advisory Group

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Table of contents

1	Executive summary	3
2	The international securities market.....	4
3	Proposal.....	6
4	Scope.....	8
4.1	Securities issuance	8
4.2	Corporate actions (including tax and income) information provision	9
4.3	Corporate actions (including tax and income) instruction processing	9
4.4	Securities documentation.....	10
4.5	Communication.....	10
4.6	Items not in scope	10
5	Key success factors	11
Annex 1	Proposed ISMAG organisation.....	12

1 Executive summary

Since the introduction of the euro, the market for international debt securities has grown at an annualised rate in excess of 20%. Investor expectations for efficient asset servicing exceed the market's current support capabilities, limiting its competitiveness and inherently creating a need for change.

To support and enhance the attractiveness of the international securities market, this paper proposes the creation of a change programme that aims to promote a high level of standardisation in the issuance and core asset servicing processes for international securities deposited with the ICSDs. The change programme will affect all parties in the chain positively from issuer to investor, by reducing operational costs and risks associated with current inefficiencies.

The change programme will, amongst other points, target:

- automation of the ISIN allocation and the new issue documentation dissemination process to cover a wide variety of instruments;
- improvement in the timeliness, accuracy, and content of corporate action notifications;
- automation of processing related to new issues and corporate actions; and
- identification and review, or definition where applicable, of standard messages and communication channels to facilitate end-to-end automation of the processing chain.

It is proposed that the programme be established for an initial period of three years, with a first interim report that summarises the key deliverables to be published six months after the launch of the programme (expected March 2007), followed by a second report on the first anniversary (March 2008). 2010 is the target date by which a market protocol for the international securities market, detailing the agreed upon standards, should be finalised.

It is also proposed that the implementation of this change programme be monitored by a senior market committee, the International Securities Market Advisory Group (ISMAG). The ISMAG would include senior executives from the issuing, asset servicing and investor communities, and be supported in the definition, specification and implementation of agreed standards by dedicated working groups.

2 The international securities market

The market for international debt securities has proved highly attractive for issuers and investors alike. The market is flexible, supporting a wide range of jurisdictions and structures, and through the ICSDs, provides issuers with access to the widest pool of liquidity available in Europe. The introduction of the euro encouraged corporate issuers to issue debt securities through the ICSDs as a proxy for a harmonised European clearing and settlement infrastructure.

The competitiveness of this model could in the future become hampered by the currently limited availability of processing standards and automation compared to some domestic markets. Together with the high pace of innovation and increasing complexity, this introduces challenges for the issuing and asset servicing community to maintain processing efficiency while managing costs and risks.

The international securities market differs from domestic securities markets in a number of fundamental aspects. The international market encompasses securities from over 70 issuer countries and is characterised by a diversity of structures and forms, which allows for great flexibility and is conducive to the inherent innovation that makes this market successful. The market is also unique in having two entities, the ICSDs, providing a joint depository infrastructure. However, the market does not fall under a single regulatory oversight; nor can it, by its nature, be organised by a national banking association.

The ECB Standard 3 project premiered the establishment of a senior market committee (the ECB Standard 3 Market Advisory Group (MAG)) by bringing together all business players of the international securities issuing and servicing community to oversee the development and implementation of the New Global Note (NGN) structure. It also provided the opportunity to initiate the drafting of the Standard Market Protocol for International Securities, a document co-sponsored by the International Capital Market Services Association (ICMSA), the International Capital Market Association (ICMA) and the ICSDs, aiming to set best market practices for the issuance and asset servicing of international securities¹. At the end of the ECB Standard 3 project, the MAG agreed that it would be important to maintain the momentum built to further improve the servicing of the market.

The rapid growth of international securities has introduced challenges for the asset servicing community, in the absence of standardisation, to maintain high levels of processing efficiency. Most issues relate to the timeliness, quality and scope of information passed through from issuers to investors, including the insufficient level of Straight-Through Processing (STP), directly affecting the costs and risks incurred by service providers and, ultimately, investors. To address these issues, various market players (including ICSDs, Common Depositaries, ICMA and ICMSA) have in recent years launched individual initiatives, with limited success though, as service levels in certain areas still fail to meet investor expectations. It is worth noting that in addition to increased innovation and complexity of securities, investors have become more sophisticated, constantly raising their expectations for efficient asset servicing.

Spurred by the 2003 Giovannini Report and other initiatives to remove the barriers to a harmonised European financial market, domestic markets have begun to implement more harmonised communication standards between issuers and investors. Harmonisation is likely to benefit international issuers and investors as the costs and complexities associated with cross-border investments are reduced. The international market therefore has a strong interest in achieving cost and processing efficiencies in order to ensure that its attractiveness is sustained.

The pace of change and the drive towards standardisation across markets now require a more cohesive approach from international securities market players to set and implement standards in order to:

- maintain and strengthen the attractiveness of the international market environment for both issuers and investors alike;

¹ At this stage, the Standard Market Protocol covers only the issuance process for securities in NGN form.

- ensure that the international securities market is developed in accordance with emerging standards in respect of issuance and asset servicing processing;
- achieve a high degree of STP in the interactions between market participants, from the issuing community through to investors; and
- increase operational efficiency and reduce operational risk through clearer definition of roles and responsibilities throughout the servicing chain.

3 Proposal

The ICSDs propose to the market the set-up of a change programme under the guidance of a new senior market committee. The mission of the programme will be to design and implement changes to achieve a high level of standardisation and efficiency in the issuance and core asset servicing processes for international securities deposited with the ICSDs, while maintaining the attractiveness and competitiveness of the market.

To achieve this end-to-end process review, it is necessary to involve all market players throughout the value chain, i.e. from issuers to investors. Therefore, the programme should consider standards applicable to:

- issuers;
- issuer agents;
- investment banks (which act in a variety of capacities);
- legal counsel;
- ICSDs;
- ICSD agents; and
- custodian banks/investors.

Market participation in the change programme should be a reflection of this. To benefit from possible synergies and avoid duplication of work, the relevant market associations, e.g. ICMSA and ICMA, should be involved.

To this aim the ICSDs propose the setup of the ISMAG. The ISMAG will be responsible for monitoring the implementation of the change programme and will:

- provide guidance to the design of standards governing the interaction of market participants involved in the issuance and asset servicing of international securities issued through the ICSDs; this will be achieved through a structured organisation of working groups addressing specific subjects and in which interested market participants will be represented;
- promote and monitor the implementation of such standards across the market;
- ensure adequate communication of its activities and such standards to market participants, in consultation with relevant trade associations, such as ICMSA and ICMA, and the European Central Securities Depositories Association (ECSDA);
- monitor relevant regulatory and market policy developments and integrate, where relevant, such recommendations into the change programme; in particular, to consider the EU harmonised standards as promulgated by those organisations charged with overcoming the private sector barriers identified by Alberto Giovannini in his 2003 report, such as SWIFT and ECSDA; and
- serve as a platform of communication and consultation with interested market participants and related trade associations, such as ICMSA and ICMA.

The ISMAG will decide which working groups will be set up and which working groups will be responsible for the design of the new standards, their approval, promotion, implementation (the programme will agree reasonable target dates) and proposal for adherence through market discipline. The composition of the working groups will depend on the domain under discussion. The working groups will propose their objectives to, and for endorsement by, the ISMAG. The ICSDs will provide administrative support for the organisation and documentation of discussions.

Progress against the objectives of the programme will be reported to and monitored by the ISMAG on a quarterly basis.

The programme will require communication of the new standards to all market players to ensure successful implementation. This will be achieved through different means, such as:

- press release to announce the launch of the market initiative to the market,
- interim reporting summarising the agreed deliverables;
- publication of reference documents (e.g. website); and
- conferences or roadshows.

The new standards will be documented through the Standard Market Protocol for international securities. This document will be the repository of the outcome of the various working groups and will serve as reference for the monitoring of performance of the various market players and market discipline.

The initiative may result in the implementation of various elements by individual, associations of or groups of market players. The programme will agree on reasonable target dates for implementation of the standards. From a market discipline viewpoint, the programme will consider whether it would be appropriate to design and implement a framework whereby compliance of market players with the standards would be monitored.

4 Scope

The high-level objectives of the programme will be to achieve:

- an increase in service levels offered to issuers and investors, for the completeness, accuracy and timeliness of information dissemination and processing;
- a reduction of operational costs; and
- a reduction of operational risk.

The ICSDs propose the following non-exhaustive list of areas to be targeted for the standardisation exercise. The final list, priorities and timing are to be agreed with the market and ISMAG.

4.1 Securities issuance

Three areas of the securities issuance process offer opportunities for standardisation and further automation:

- *ISIN allocation and dissemination*: the process is currently based on requests from lead managers (for stand-alone securities), Issuing and Paying Agents (IPAs) or dealers (for securities under programme). These are submitted via the European Pre-Issuance Messaging (EPIM) platform (for euro commercial paper and certificates of deposit – STP), e-mail, phone or fax. The process is highly manual and therefore volume sensitive.

Objective: to further automate the ISIN allocation and dissemination process;

- *Securities static information provision*: the process is integrated with the above or follows it. Securities information is provided by lead managers, legal counsels and IPAs by e-mail or fax. The process is highly manual and therefore volume sensitive.

Objective: to improve information quality and standardise the documentation in order to allow for the automation of the process;

- *Primary market distribution/settlement*: the process relates to the deposit of the global certificate representing the securities with the ICSD's agent in exchange for payment of the cash proceeds to the issuer, as well as the credit of the securities within the ICSDs and the ensuing settlement. Two types of concerns have been highlighted:
 - Service level: the increasing complexity and shorter time to market creates a need for increased flexibility in terms of processing timing; this is currently undermined by exchanges between the lead manager, the ICSDs and their agent that are mostly still based on non-STP messages, and therefore require longer processing timings; and
 - Risk: some market players have expressed concerns related to the credit exposure taken on counterparties linked to the against payment distribution process.
- **Objectives:**
 - **to automate instruction processing; and**
 - **to review the risk incurred by the different counterparties in the new issue distribution process and, where possible, reduce such risk while maintaining the service level.**

4.2 Corporate actions (including tax and income) information provision

This relates to:

- all income events, i.e. fixed or floating rate coupon payments, fixed or floating early or final redemption payments; and
- all corporate actions, i.e. voluntary and mandatory, predictable and unpredictable events.

Four areas of the information provision process offer opportunities for standardisation and automation:

- *Coverage*: this relates to the level up to which information is provided for all corporate actions; some event types systematically suffer from a poor coverage;

Objective: to improve coverage;

- *Content*: this relates to the content of the information to be provided; for instance, with regards to floating rate coupon information, more and more investors are requiring the details of the interest computation to be disclosed;

Objective: to improve quality, accuracy and transparency of information provided;

- *Timeliness*: this relates to the time at which information is provided throughout the chain; as a rule, it should be provided as soon as available and passed through the chain on a same-day basis, if possible;

Objective: to improve timeliness;

- *Flow*: this relates to the communication formats and channels used. Today, information is too often provided in a non-formatted manner (e.g. free format fax, e-mail, Excel sheets) and is sometimes not made available to all parties in the chain for ultimate publication to investors.

Objective: to automate the information provision and to ensure adequate dissemination throughout the chain, through the usage of a market-wide agreed upon STP communication means.

4.3 Corporate actions (including tax and income) instruction processing

This relates to income events and corporate actions where instructions from note holders are required. Such corporate actions fall into two categories:

- voluntary events (e.g. note holders' EGM, exchange offer, tax certification); and
- mandatory events with options (e.g. reinvestment option, currency option).

Instruction flow: this relates to the communication means used for the instruction input as well as for the provision of status reporting. Additionally the timeliness of both the instruction and the confirmation is to be considered.

To date, instructions are still too often required and sent in a non-formatted way (e.g., free format fax, e-mail, Excel sheets, paper forms) which can have a negative effect on the deadlines given to the note holders.

Objective: to automate instruction processing throughout the chain from input to confirmation.

The outcome of the review of the above processes could result in impacts on:

4.4 Securities documentation

Industry associations, such as ICMA, have issued recommendations or standards for securities documentation (e.g. Final Terms); however, the market (i.e. mainly law firms and investment banks) continue to use their own standards. As result of the above reviews, some further standardisation may be recommended. This applies to initial securities issuance documentation as well as to corporate actions documentation.

4.5 Communication

Currently different communication channels are used between different market players, some automated (e.g. SWIFT, proprietary systems such as EPIM), some non-STP (e.g. fax, e-mail, phone). The objective will be the gradual migration to STP through the use of appropriate standard communication formats and interoperable channels, and in case no appropriate pre-existing standard is available the programme will request, develop and promote new standards.

4.6 Items not in scope

International securities deposited with CSDs and competitive servicing features are not considered in the programme scope.

5 Key success factors

To ensure the success of such an initiative, the following will be necessary:

- adequate market participation to the initiative, i.e. all parties across the servicing chain. Members should be able to represent their market segment, and promote strategic market-wide proposals reflecting the views and interest of all market stakeholders;
- clear commitment by all parties involved to:
 - the objectives of the initiative;
 - the availability of senior executives (for ISMAG); and
 - the availability of operational experts for the working groups (as per agreed timetable);
 - their willingness to implement the agreed changes;
- a cooperative working spirit;
- adequate external communication, both in terms of market awareness of current issues and processes, as well as communication of new standards to be implemented; and
- good collaboration with market bodies involved in similar standardisation initiatives (at European and international level).

Annex 1 Proposed ISMAG organisation

Chairmanship	The Chair will be one senior market representative.
Market participation/ membership	<p>The members will include:</p> <ul style="list-style-type: none"> • representative(s) from the issuer agents and/or the ICMSA; • representative(s) from each ICSD; • representative(s) from lead managers and/or ICMA; • representative(s) from issuers and/or appropriate issuer associations; • representative(s) from the legal community advising issuers; and • representative(s) from the custodian or investor community. <p>Members will be invited by the Chair to join the ISMAG. Members should be able to promote strategic market-wide proposals reflecting the views and interest of all market stakeholders. The Chair will review on a regular basis the composition of the group, and propose new appointment(s) to the group or mandate the group to propose and approve new appointment(s). Other parties (e.g. market participants not formally represented at the ISMAG or regulators) may be invited to join any ISMAG meeting or working group meeting on an ad hoc basis.</p>
Secretary	The ICSDs plan to provide a Programme Management Office (PMO) to support the activities of the ISMAG.
Frequency of meetings	Quarterly. The Chair may convene further meetings, as he/she considers necessary or appropriate.
Agenda	Prior to any group meeting, the Chair will set up an agenda based on the proposals from the members of the group. The agenda will be forwarded to all members prior to the meeting.
Minutes of meetings	The minutes of the group meetings will be drafted by the PMO. They will be circulated to all group members after review by the Chair and submitted for approval at the following meeting.
Timeframe	<p>The timeframe is to be agreed by ISMAG.</p> <p>The programme will commence in Q1 2007 and is initially foreseen to span a period of three years.</p> <p>Objectives will be defined by the working groups and endorsed by ISMAG on an annual basis. Progress will be reported to and monitored by the ISMAG on a quarterly basis, with a fundamental review to be performed and results published to the market on a regular basis.</p>
Working group	<p>A structured organisation of working groups will be established to:</p> <ul style="list-style-type: none"> • identify inefficiencies in current process; • identify and agree upon short-term and long-term solutions to increase efficiency and STP of processes; • examine existing standards that are relevant to this process and identify potential gaps; • develop new standards if applicable; • liaise with registration authorities for proposing new standards/updates to existing standards; and • develop an implementation plan. <p>Each working group will have a chair who will report to the ISMAG meeting.</p>

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