

# International Securities Market Advisory Group (“ISMAG”) Market Framework – Frequently Asked Questions

## I. BACKGROUND

### 1.1. What is the International Securities Market Advisory Group (“ISMAG”)?

The International Securities Market Advisory Group (“ISMAG”), established in 2007, is a major efficiency programme to harmonise issuance and asset servicing processes of international securities primarily deposited in the International Central Securities Depositories (“ICSDs”).

Representatives from the asset servicing value chain, from Issuers, Issuer’s agents, market associations, global custodians and the ICSDs, worked together to define best practices to:

- Provide the highest quality of asset servicing to investors
- Increase operational efficiency and reduce operational risk in issuance and asset servicing processes

The recommendations for operational processes related to new issues, corporate actions and income are described in the International Securities Operational Market Practice Book (“MPB”) which was finalised in February 2011 (ref question 1.3).

Issuers and Agents now have the opportunity to market their adherence to the recommendations by officially joining the market framework (ref. question 1.4), developed by the ICSDs after ISMAG consultation.

### 1.2. Why ISMAG?

Investors and their servicing intermediaries’ expectations for asset servicing are very high, regardless of the instruments’ complexities, i.e. to receive timely, accurate and clear information in a format suitable for immediate electronic onward processing.

Servicing intermediaries have, for many years, been ‘protecting’ issuers and investors from the inefficiencies and risks linked to asset servicing processes. This level of ‘protection’ was not sustainable as issues in the market became more complex, and the processes linked to which involved more intermediaries – few of them communicating efficiently.

These inefficiencies and risks are mainly due to the lack of awareness of each party’s requirements and the gap between Issuers’ legal requirements and intermediaries’ asset servicing operational requirements. A typical illustration is the lack of a golden source of comprehensive, clear information, each party creating their own interpretation and static data. Another is the need to chase information from Issuer’s Agents and Issuers in order to receive it in a timely manner.

On the one hand there is a need to highlight inefficiencies and risks to issuers’ attention to ensure resolution, and, conversely, there is a need to bring *some* instruments’ servicing “limits” to investors’ attention.

For these reasons, there was an appetite in the international market to set up ISMAG to address asset servicing inefficiencies and risks related to the end-to-end information coverage, timeliness and quality.

### 1.3. What is the “MPB”?

The MPB documents the recommendations and current best practices of some best of class parties for each of the relevant asset servicing processes, all reached through a collaborative and consultative effort in dedicated working groups, one for each stream, covering new issues, corporate actions and income processing.

The recommendations and best practices describe each market segment’s roles and responsibilities, “who” needs to do “what” to “whom” and by “when”, to ultimately address custodians’ and investors’ needs, while increasing efficiency and reducing risks for all parties in the servicing chain. The MPB also helps clients improve their understanding of the whole ‘behind the scenes’ process involved in servicing their securities.

Among the recommendations the MPB includes prescriptions for:

- timely provision of draft, final and amended new issues documentation, for both standalone and securities issued under programme,
- syndicated new issues closing requirements for same day settlement,
- corporate action event notification and processing,
- income event notifications and processing, and,
- the **ISMAG taxonomy** – a set of information checklists and specific drafting recommendations for issue documentation and event notifications.

These “bottom-up” recommendations are complementary to top-down recommendations issued on a European level, the Corporate Actions Joint Working Group, operated under the auspices of CESR), and globally, the ISSA Global Corporate Actions Principles.

For an overview of the best practices – please refer to the MPB chapter **1.2 ISMAG Best Practices Summary**.

### 1.4. What is the Market Framework?

At the beginning of March 2011, the ICSDs launched a new market framework to foster market adherence, mainly by upstream parties, i.e. Issuers, their legal counsels, servicing agents, etc., to the recommendations described in the MPB.

The framework was developed to:

- Improve market performance, service quality and reduce risks in the issuance and servicing of international securities,
- Increase market transparency towards both investors and issuers.

The framework combines two axes, ‘adherence’ and ‘compliance’.

- Issuers and their agents have the opportunity to voluntarily acknowledge their adherence to the MPB recommendations by providing the respective Letter of Representation (LoR) to both ICSDs.
- Effective adherence and compliance to the MPB recommendations will be monitored by a set of Key Performance Indicators (“KPIs”), measured against pre-defined benchmarks, as set out in the MPB.

## 1.5. ISMAG – In summary - What's in it for ...?

- **Issuers?**
  - ✓ Increased Investors' satisfaction
  - ✓ Attractive and competitive issuance model to expand Investor base
  - ✓ Better servicing and increased efficiency, leading to reduced costs and risks
  
- **Issuer agents and servicing intermediaries?**
  - ✓ Improved service level towards Investors and Issuers,
  - ✓ Attractive issuance model to expand Investor base
  - ✓ Better cost control in a volume increasing and complex environment
  - ✓ Better risk controls through increased efficiency and standardisation
  - ✓ Improved and increased communication amongst various market players
  
- **Investors?**
  - ✓ Improved service levels in asset servicing, i.e. timely, complete and accurate information & processing
  - ✓ Increased transparency on their assets performance/structure (e.g. "ISMAG Adherent" labels)

## 1.6 Is ISMAG an ICSD initiative?

The initiative is market-driven, sponsored by the ICSDs, but with representatives from all processing roles around the table. Collaboratively, these parties defined the recommendations contained in the Market Practice Book. The Project Management Office (PMO) role is performed by representatives from both ICSDs, who continue to report to the ISMAG.

## II. MARKET FRAMEWORK – ADHERENCE

### 2.0. Why is a market framework necessary?

Having defined the recommendations, the ISMAG has to ensure the recommendations are, firstly, well known in the international securities market by all Issuers and their Agents, across all locations, and secondly, correctly applied.

Indeed, through the market framework, the ICSDs will be able to increase awareness of the recommendations to a wider audience, and additionally we will be able to monitor the compliance against the recommendations. The market framework is similar to others already existing, e.g. DTCC in the U.S. apply a similar approach applicable to their procedures, which is supported by the U.S. Securities and Exchange Commission.

### 2.1. Why should an issuer adhere to the framework?

The Issuer can market its engagement to implement the MPB recommendations to its newly issued securities in order to improve asset servicing quality provided to its investors. This can be done by sending an Issuer Letter of Representation (LoR) to both ICSDs. The Issuer has the possibility to submit representations for all its future issued securities or for a specific programme and its future drawdowns.

Those securities will be awarded an "ISMAG Adherent" label available online to the investor community on both ICSDs' websites.

Issuers also have the possibility to highlight specific securities' structures that may prevent calculation agents to provide information as per the defined benchmarks (i.e. fixing/determination date) by assigning such securities with an "ISMAG Exempt" label, thereby excluding them from the timeliness of rate fixing notifications benchmark measurement.

Both "ISMAG Adherent" and "ISMAG Exempt" labels for newly issued securities will bring transparency:

- ✓ to Investors on their securities portfolio and related expected service levels, being in line with MPB recommendations, and,
- ✓ to Issuers on their securities' compliance vis-à-vis the best practices, in other words how their various Agents are performing and ultimately servicing the Investor.

## 2.2. How will the ICSDs publish "ISMAG Adherent" Issues?

As soon as an Issuer LoR is received by both ICSDs, the issuer's entity name will be published on the respective websites, either for all securities or for a specific securities programme, from a specified date.

The differentiation of adherence coverage will be done at the level of the security codes in the respective securities' databases with:

- "ISMAG Adherent" label if an Issuer LoR has been received
- "ISMAG Exempt" label in case an exception notification has also been received.

The relevant labels will be published on the respective ICSDs' websites, except if securities are defined as "confidential" by the lead manager.

If no Issuer LoR is received, no 'ISMAG' labels will be assigned.

## 2.3. What do the different ISMAG label values mean?

- A security with an **ISMAG Adherent** label means that its issuer has engaged to implement MPB recommendations by providing an Issuer LoR. Performance of the securities will be monitored against pre-defined benchmarks.
- A security with an **ISMAG Exempt** label means that its issuer has engaged to implement MPB recommendations by providing an Issuer LoR, **except** that for this specific security, where the timeliness of rate fixing notifications from the calculation agent to the paying agent are not possible within the prescribed timeline of fixing/determination date + 1 business day, given the specific structure of the security. Investors shouldn't expect to receive the variable rate information within that benchmark and ISMAG exempt securities will not be included in income rate timeliness KPI monitoring.
- A security without an 'ISMAG' label could mean that:
  - the security is not primarily deposited in the ICSDs, so the LoR is not applicable, or,
  - the securities were issued before May 2011, so the ISMAG label is de-facto 'blank' as the framework is only applicable to newly issued securities, or,
  - for securities issued after May 2011, it will mean that no Issuer LoR has been received yet or that the Issuer has provided LoR for some of its newly issued securities, but not on a 'blanket' basis, i.e. for all newly issued securities.

#### **2.4. Why should an Issuer's Agent adhere to the framework by sending an Issuer Agent Letter of Representation (LoR) to both ICSDs?**

By doing so, the Issuer's Agent will market its engagement to implement 'best of class' practices described in the MPB on securities it does/will service.

The Issuer's Agent relates to any capacity it may play, e.g. Paying Agent, Issuing and Paying Agent, Fiscal Agent, Corporate Action Agent, Calculation/Determination agent, Lead Manager, Arranger, Dealer, Legal Counsel, etc. They have the option to provide a blanket letter for their relevant role that will be applicable for all ISMAG labelled securities it (will) service.

As soon as an Issuer Agent LoR is received, this agent's entity name will be published on both ICSDs' websites, but not directly linked to any specific Issuers' securities.

#### **2.5. If the Issuer sends an Issuer LoR, but one or more of the Agents does not send an Issuer Agent LoR will the Securities still be 'ISMAG' labelled'?**

Yes. The ICSDs will assign the "ISMAG" label based on the Issuer's LoR.

The ICSDs will not reconcile that each or every relevant servicing agent has signed an Issuer Agent LoR. As such, the Issuer will need to monitor this with its' agents and take relevant actions to create the conditions for its' agents to be able to comply with the applicable recommendations as noted in the LoR.

#### **2.6. Does the Issuer or Issuer Agents' LoRs create specific legal obligations on adherent Issuers and Issuer Agents?**

As stated in each LoR, "this is not legally binding nor enforceable nor does it create any contractual relationship" between signing parties. The LoR itself is a commitment, an engagement of the Issuer and/or its' Agents which might be, at each parties' discretion, reflected in underlying contractual arrangements.

#### **2.7. Could agreeing to implement MPB recommendations through Issuer Agent LoR create inconsistency, uncertainty and increase exposure in such instances with Agent's obligations set out in their legal documentation with Issuers?**

Issuers might decide to change their programme documents, term sheets, final terms, etc., and perhaps also amend agency or service level agreements to enable all their agents to implement recommendations detailed in the MPB.

The purpose of the MPB is to document current end-to-end best practices that increase efficiency and reduce risks for all servicing intermediaries, especially for Issuer Agents, so it shouldn't create inconsistency, uncertainty nor increase exposure, but the contrary.

#### **2.8. By signing the LoR, Issuers and their Agents are agreeing not only to comply with the version of the MPB as at that date (currently February 2011) but also automatically to amendments from time to time?**

Updates will not be carried out without prior notification and consultation with the ISMAG. Future changes should be very limited to ensure accuracy and adequacy of the MPB recommendations with future asset servicing requirements or regulatory changes.

## **2.9. Can Issuers and/or Issuer Agents cease their LoR engagements?**

Should Issuers and/or their Agents wish to cease their practice of complying with the MPB, either in whole or in part, a Revocation Request should be provided to both ICSDs. Any labels assigned to securities or agents will then be removed.

## **2.10. Could the voluntary market framework adherence become mandatory?**

Adherence could become mandatory by the end of 2012 should the adherence level of newly issued securities in 2011 be below 50% at the end of 2011. This is the reason why market awareness is so important in 2011 and why ISMAG needs the support of all international market players to promote the recommendations to high volume issuers and their agents.

The exact basis for the mandatory scheme is still to be defined, i.e. explicit with an Issuer LoR (as for DTCC eligibility) or implicit (de-facto) by requiring ICSD's eligibility, an Issuer will be deemed to have signed the issuer LoR for all newly issued securities, also seen in DTCC.

## **2.11. What is the Market's view on the framework?**

Market and ISMAG members are supportive on the principle to improve market performance by fostering implementation of best practices, but there are divergent views on how these principles should be applied. The PMO presented the ICSDs' view to the Members for the 'starting point' in the framework during their February 2011 meeting and is addressing the concerns and points raised in this and subsequent discussions.

That said, there is an agreement in place and respective Letters of Representation have been signed beginning of May 2011 by:

\* issuers' agents:

BNP Paribas Securities Services, Luxembourg

Citi Agency & Trust (GTS), London

Lucid Issuer Services Limited

Bondholder Communications Group LLC

\* issuers

European Investment Bank (EARNs Programme)

KfW announced their support and will sign their LoR when their yearly programme update is complete.

Other Issuers and Agents are undertaking a review of the respective letters with a view to providing signed versions in the near future.

The PMO welcomes feedback from the wider Issuing and Agent community on the content of the letters to enable them to create a more widely acceptable content whilst still in the voluntary phase.

The PMO continue to discuss with Issuers, Agents and legal counsels globally, to promote the ISMAG recommendations, Market Practice Book and the market framework for wider adoption.

## **III. MARKET FRAMEWORK – COMPLIANCE**

### **3.1. Which KPIs are monitored?**

Currently, there are 3 KPIs for which specific yearly targeted benchmarks have been defined by ISMAG. Those are:

1. The receipt, by the ICSDs, of the securities' final documentation by issue/closing date + 1 Business Day (from the Issuing & Paying Agent in case of issuance under programme or from the Lead Manager for securities issued on a stand alone basis);
2. The receipt, by the Paying Agent, of the rate fixing notification, at the latest on fixing/determination date + 1 Business Day from the Calculation Agents;
3. The number of reversals and their detection timing after the payment date by the reversals originator.

The levels of compliance will not be made public.

### **3.2. How will compliance against the KPIs be monitored?**

There are multiple agents appointed on a security and how each agent is assessed based on its particular agency role, especially where one agent relies on another, or where an agent relies on the Issuers performance is unclear.

It is important to have a significant adherence level in the market as it reflects the engagement of the different parties. More importantly, this engagement must translate into improved behaviour and performance of the relevant securities, leading to a higher level of investor satisfaction.

Each downstream party should monitor its upstream counterpart for ISMAG labelled securities to ensure adequate awareness and implementation of the MPB recommendations. The purpose is to move from a information "pull model" from downstream parties, to a "push model" from upstream parties to increase information coverage, timeliness and accuracy.

Each party will be monitored for its own responsibility. As such, KPIs are built to monitor the "originator" of information, e.g. Calculation Agent performance is monitored by Paying Agents for the timeliness of rate fixing, Lead Managers or Issuing and Paying agents are monitored by the ICSDs for the final documentation availability, etc.

### **3.3. How will KPI results be aggregated to assess 'ISMAG' compliance?**

KPI results will not be aggregated; each KPI will be monitored distinctly vis-à-vis the MPB recommendations and the targeted benchmarks.

### **3.3. What are the potential implications of under performing compliance levels for adherent Issuers and Agents?**

Reporting will be established to adherent Issuers on their ISMAG labelled securities performance vis-à-vis the MPB recommendations and the targeted benchmarks. The same will be done with relevant servicing Agents, and where necessary, follow-up tripartite discussions will take place to develop action plans to further improve performance against the KPI benchmarks.

The level of compliance will only be shared with relevant Issuers and Agents to provide transparency on their respective performance levels in order to improve their servicing performance and quality towards investors. The levels of compliance will not be made public.

In case the KPI results are systematically below the yearly pre-defined benchmarks, i.e. for more than 3 quarterly periods (9 months), and no clear action plan is shared by the Issuer and/or their Agents to improve performance, the following measures might be taken by the ICSDs:

- Issuers/Agents names removed from the published list of ISMAG adherent parties, and/or either,
  - a) removal of ISMAG Adherent label on each security, or,
  - b) replacement of ISMAG Adherent label with a “non-compliant” label. This remains a very last resort as the purpose is not to ‘name and shame’ nor harm issuers’ reputations.

#### **IV. ADDITIONAL INFORMATION**

**For further information, please consult**

- **ICSDs websites on:** [www.euroclear.com/ISMAG](http://www.euroclear.com/ISMAG) and [www.clearstream.com/ISMAG](http://www.clearstream.com/ISMAG)
- The International Securities Operational Market Practice Book (MPB)
- **ISMAG PMO Teams on** [ismag.pmo@euroclear.com](mailto:ismag.pmo@euroclear.com) and [ismag\\_pmo@clearstream.com](mailto:ismag_pmo@clearstream.com)

The ISMAG PMO is at your disposal to further clarify any questions and help you to “spread” the MPB recommendations within your organisation and with your relevant external contacts (e.g. Clients, Issuers, Agents, etc.)