

Response to DESSUG Paper

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Date: November 17, 2003

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Subject: Response: Place of Listing – considerations by the DESSUG (November 13, 2003)

First, I would like to provide some background to the following discussion, to provide context to why I am responding, and where I am coming from.

In 2001, John Bottega and myself asked Mike Atkin of the FISD to organize a meeting to discuss issues around using ISIN in a multi-listed world. An expected group of 10 turned into over 80 representatives globally from Investment Managers, Brokers, Custodians (local and global), CSD's, Clearstream, Euroclear, market data vendors, and exchanges.

From that meeting, participants were tasked to examine their internal processes and report back to the group. Documentation that resulted can be found at <http://www.fisd.net/referencedata/default.asp>, under 'Working Group Documents' towards the bottom of the page, dated May 4, 2001.

It was from this investigation, validation of those results, and many reviews of the final recommendation from a global constituency that led to the push of 'Official Place of Listing' and 'Registrar' to be added to the description of an instrument to provide uniqueness.

I would like to address each section of the DESSUG letter, to help clarify the issue and point out where there may be misunderstandings of the core issues and final recommendations by groups that have become involved in the UIID discussion since the initial discussion that sparked the industry's attention to the problem.

RE: Rationale for Draft Letter

All these issues are valid, and have always been at the forefront of concern. In the increasingly complex market environment we operate in, solutions must look at the global picture and be realistic in its goals. Solutions must attack the core problems, not symptoms less we waste time and effort, such as what occurred with the T+1 focus, as opposed to the core problem of automating systems.

That said, Point 3 may be somewhat unrealistic in some cases. New situations and products many times require new systems and processes that dovetail with current processes. Trying to solve a new problem by forcing it into an old process only invites complications and deficiencies further down the line. We cannot stop change, just as we cannot stop traders and other financial professionals from creating new instruments, new ways to trade, and new ways to invest or avoid risk.

It should be a goal to try to avoid major change, but if change is required, it should be more rapidly embraced to lessen the overall impact.

RE: Issues to be Solved

The “Traded at” and “Safekept at” discussion is a red herring. Currently, it is available information (from the point of trade) to know where a security was traded. It is a procedural/process issue for passing this information along the security life cycle, if it is needed downstream.

Pricing is not a ‘Traded at’ issue, but a ‘Listing’ issue. (see next section)

While the Safekeeping issue is important, it is not the focus of the Unique Identification problem. Safekeeping will come into the discussion at various points, but it should not be the main focus of the issue, or be used in defining what the core problem is.

RE: Comparison of ‘traded at’ and ‘listed at’

This continues to be the topic that causes the most confusion, but it is key for everyone to have the same understanding. Lack of clarity here will prevent any proper discussion and resolution of the UIID issue.

The problem is semantical, and I would like to set out specific definitions to be used throughout the remainder of this paper, and hopefully throughout any further discussions concerning UIID.

Place of Trade: Where a security is actually traded, whether it is an official exchange (Frankfurt, Munich, Boston, NYSE, LSE, etc..), an ‘electronic’ exchange or ECN (Tradepoint, Instinet, Tradeweb, etc) or off-market (‘OTC’, internal crossing systems, etc). The ‘official’ place of trade would normally be the place with the highest liquidity within a marketplace among all available places of trade.

Listing Place: This mirrors the ‘place of trade’ when dealing with ‘official’ exchanges and ECN’s. (this generally matches the definition being used in the DESSUG paper) For ‘off-market’ trades, the security being traded will be a line from an Official Place of Listing.

Official Place of Listing: This refers to the place where the security in question has been marketed and registered as an official offering. Typically, there is only one ‘Official Listing’ per market (country). (i.e. when/where a company made its public offering). In the majority of cases, this will equate to what is the ‘official place of trade’ on a day to day basis, but may differ due to specific market conditions.

A. Within a single market

For example, IBM was officially listed (publicly offered) and registered (shares outstanding, etc) on the NYSE. Regional exchanges make agreements to cross-list IBM (i.e. it can be bought and sold through Boston). However, the line of the security is the NYSE listing. Valuations and pricing are performed using NYSE prices. Regional listings are typically focused around increasing liquidity of a security within a single marketplace.

The ISIN is the same, although the securities typically have different RIC or ticker codes.

In this way, the Boston Exchange acts in much the same way as an ECN in sharing the ‘official’ listing of IBM on the NYSE.

This distinction is important because the security bought on the Boston Exchange or ECN can be immediately resold on the NYSE without re-registration or stock transfer issues (hence the liquidity).

Note a smaller company that lists directly on the Boston Exchange would have an Official Place of Listing as the Boston Exchange. The concept to note here is that the 'Official Place of Listing' is not an aspect of the market, but an aspect of the security, and the legal and regulatory process undertaken to list a security.

B. Going Multi-Listed

As an example, Deutsche Bank, in 2002, made a big splash about being listed on the NYSE. The ISIN number of the shares listed on the NYSE exchange is the same as the ISIN that is traded in Frankfurt.

The NYSE listing is traded in USD. The Frankfurt listing is in Euro.

The NYSE listing, as per (A), above, may also be traded in Boston. The Frankfurt listing, likewise, may be traded in Munich. It is conceivable that both listings (NYSE and Frankfurt) may be traded on an ECN.

However, in the US marketplace, the only 'Official' listing is on the NYSE. Likewise, the only 'Official' listing in the German market is in Frankfurt. These are the primary listings, in each respective market, where the shares are tracked by the local Central Depositories or regulatory agencies and regulatory issues are primarily addressed (shares outstanding, official close, trading suspensions, etc).

However, unlike the situation in (A), above, it is not possible to purchase stock at the NYSE and immediately sell it in Frankfurt without transferring the actual stock to the German market through the registration process. (there is an issue of 'true' liquidity/fungibility between markets for the same ISIN with two 'Official Places of Listing')

B.1. What are the primary differences

1. For a particular marketplace, where IBM is traded does not affect the downstream settlement of the issue, when dealing with a single Official Place of Listing. For trading purposes, the differences between Boston and the NYSE may provide intra-day arbitrage opportunities, or better market access. However, at the end of the day, the official closing price is reflected by the primary listing, the NYSE.

Likewise, for settlement, all comparisons are submitted centrally and attributed to the shares outstanding at the NYSE, the 'Official' listing place.

'Place of safekeeping' is of no consequence. 'Place of trade' only has 'front office' implications, while the 'Official Place of Listing' is important to mid and back office settlement and reconciliation functions.

2. In dealing with multiple marketplaces, the Official Place of Listing carries more importance.

Trading Siemens in Frankfurt or Munich does not have any more complexity than trading IBM in Boston or the NYSE.

However, for multiple markets, knowing which Official Listing – Paris, Frankfurt, Swiss, or NYSE, has great importance.

First, for the front office, knowing which Official Listing can affect;

Currency to trade in.

Traders may compare offerings and Best Bids in multiple currencies, taking into account exchange rates (both for purchasing/selling currency to acquire the stock, and on the actual pricing of the stock)

Desire of Client:

Some clients may specifically state certain currencies they wish to trade in

Market conditions

Relative health of the market

Regulatory issues affecting trading (suspensions/de-listings, etc) or corporate actions

Risk evaluations
Overall Liquidity

Second, for settlement, Official Listings affect Broker to Investor settlements, as well as ‘off market’ broker-to-broker settlements.

“Where do I settle?” Given Seimens is traded in Euro in both Frankfurt and Paris, under the same ISIN, if a Broker purchases the shares in Paris, the natural place to deliver to the Investor is to their local agent in France. However, with no clues to the market the investment was made (such as currency), based purely on the ISIN, an Investor may believe they are to settle in Germany. (the investor’s request to the broker was ‘Buy Seimens’. Investors, on the whole, **do not** specify the market to purchase the shares in, even with multi-listed instrument)

Investor sends instructions to settle in Germany to their Custodian, while at the same time making a decision to sell the shares, instructing another Broker to sell the shares.

Broker’s settlement in France is rejected by counterparty (no instructions to receive in France). Meanwhile, Investor has not received in Germany. After discussions, Investor tells Broker to deliver to Germany.

Shares are not registered in Germany, so they need to be transferred from Paris Exchange to Frankfurt. Or Broker refuses and Investor must receive in France. In either case, Investor cannot satisfy sale in Germany in time.

NOTE: This is **NOT** a “Safekeeping” issue. This is a **settlement** issue based purely on the Official Place of Listing. It is impossible to settle an instrument Officially Listed in one marketplace (France) in a different marketplace (Germany).

Also note: even if this was between the NYSE and Swiss listing, which have discrete currencies (USD, CHF), using currency of trade is an imperfect and inexact ‘workaround’ solution.

Hopefully this begins to provide the proper framework for the definition on ‘Official Place of Listing’.

In general;

Security Issue + Market + Market	=	Place of Trade/Listing (RIC, ticker, some local codes)
Security Issue + Market	=	Official Place of Listing (SEDOL level, some local codes)
Security Issue	=	‘Parent’ Issue (ISIN)

RE: Accounting Considerations

In the example provided, the first assumption was that “the client moves shares bought at NYSE and Tokyo to Frankfurt”. In most cases, I would offer that clients do not actively ‘realign’ their positions in this manner. Moving a security from one market to another, even when it is the same ISIN issue, is not a trivial matter. It involves time and cost, and is not a transparent activity.

Moving past this, however – the need to accurately price holdings, based on the market they are “Officially registered” in, is a real one. The pricing of all 30,000 shares in Euro would be inaccurate to portfolio valuations, based purely on currency differences between Yen, USD and Euro.

Assuming that the re-alignment illustrated was undertaken, and shares were properly re-registered, the client would be holding:

5,000 USD shares

5,000 JPY shares
20,000 Euro shares

In a consolidated statement using ISIN, you would only see a single position of 30,000. In order to get an accurate valuation, the closing prices from the NYSE, Tokyo, and Frankfurt exchanges would have to be obtained and applied to the corresponding balances.

Note, again, this is not a “Place of Safekeeping” issue. All these lines could, feasibly, be safekept within Euroclear. If Euroclear did not take it upon itself to re-register all the shares into a single market position, the 3 different Official Listings would still exist as separate balances. (And I would not expect Euroclear to automatically re-align any position unless standing instructions existed to do so, for many obvious reasons)

On a customer accounting statement, that is presented in a single ‘Base’ currency, the 30,000 share position could be shown on a single line. However, it would have to be calculated as follows (assuming a Euro base currency report);

$(5,000 \text{ shs} * \text{NYSE price in USD}) * \text{Euro exchange rate}$
 $(5,000 \text{ shs} * \text{Tokyo price in JPY}) * \text{Euro exchange rate}$
 $(20,000 \text{ shs} * \text{Frankfurt price in Euro})$

Note that if there was an additional position held in Euro, such as 5,000 shares from the Paris listing, you would also need to separately price this as $(5,000 \text{ shs} * \text{Paris price in Euro})$, as the Paris close price may actually be different than the Frankfurt Euro valuation.

RE: Considerations for Corporate Actions

The example offered, that of Ireland and the UK listings, is missing a key element. Even though both listings settle through a single depository, (i.e. CREST), the settlement place is not an aspect of the security. Removing this concept from the discussion makes the problem more clear.

Regardless of where the security is held (safekept) or settled, we are still looking at two distinct, discrete Official Listings – Irish Stock Exchange and London Stock Exchange. To further clarify this, theoretically, there could be a regional exchange in Ireland that also trades the Officially Listed instrument from the Irish Stock Exchange, as well as a regional exchange in the UK that trades the Official LSE listing.

To use the definitions put forth above,

The Official Places of Listings involved are ISE and LSE. The places of trade are IRE, the fictitious Irish regional exchange, the LSE, and the fictitious regional UK exchange.

Positions would be held on the aggregate at the ISE and LSE level, regardless of the places of trade (regional or ‘official’ exchange).

The association of CREST being the place where the securities settle for both ISE and LSE listed instruments is inconsequential to the need to identify **at the security level** where the Official Listing Place is. The fact that they both settle at CREST is not an aspect of the security, but the process or workflow that is based upon the property of the individual security.

RE: General Remarks

It is accepted that multi-listed securities currently account for a low percentage of all securities traded. However, it is offered that this number will continue to increase, as the global market place continues to mature and global

corporations look for new and creative ways to increase their exposure, access to cash, and mitigate their risks associated with being a publicly traded company.

In addition, it should be taken into account the securities that are multi-listed. These are not small, low trade volume issues. They are the large corporations, with the highest volumes of trade activity. In this regard, they represent a much larger percentage of activity than would be inferred by only looking at percentage of securities that exist.

It is important to note that there is no recommendation to abandon ISIN as a numbering scheme. In fact, this activity has indicated the importance of the ISIN number in key processes (namely Risk). However, it should be noted that ISIN, by itself, does not provide a solution for the full life cycle of a security.

This lifecycle should encompass the following, with the possibility of additional steps to be filled in;

- Investment decision making
- Portfolio valuation and rebalancing
- Risk management
- Trading (encompassing best bids, offers, etc)
- Mid office processing (pre-matching, matching, confirmation, alledgement, etc)
- Back office processing and settlement processes (settlement, fail, etc)
- F/X
- Corporate Action
- Accounting
- Regulatory Reporting

There are currently four major classifications that are used in all of these processes, and are key to straight Through Processing in regards to UIID:

- Issuer
- Issue (traditional 'ISIN' level)
- Official Place of Listing of Issue (SEDOL and other local market ID's – such as CUSIP, Quik)
- Traded places of Official Listing (RIC, Tickers, etc)

Conclusion

I believe that the DESSUG paper is well thought out and shows a good perspective of some issues. However, it misses out on some of the basic core themes and therefore draws some inaccurate conclusions. Hopefully the above clarifies where the misunderstandings are. It is important, due to the complexity of the issue, that the semantics surrounding the definition of the problem are agreed upon and clear in order to have a productive discussion and to avoid exploring paths that should not be introduced (such as the 'safekeeping' concern).

I look forward to a review of this response, as well as critical remarks to validate the accuracy of the statements I have made.

Best Regard,

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