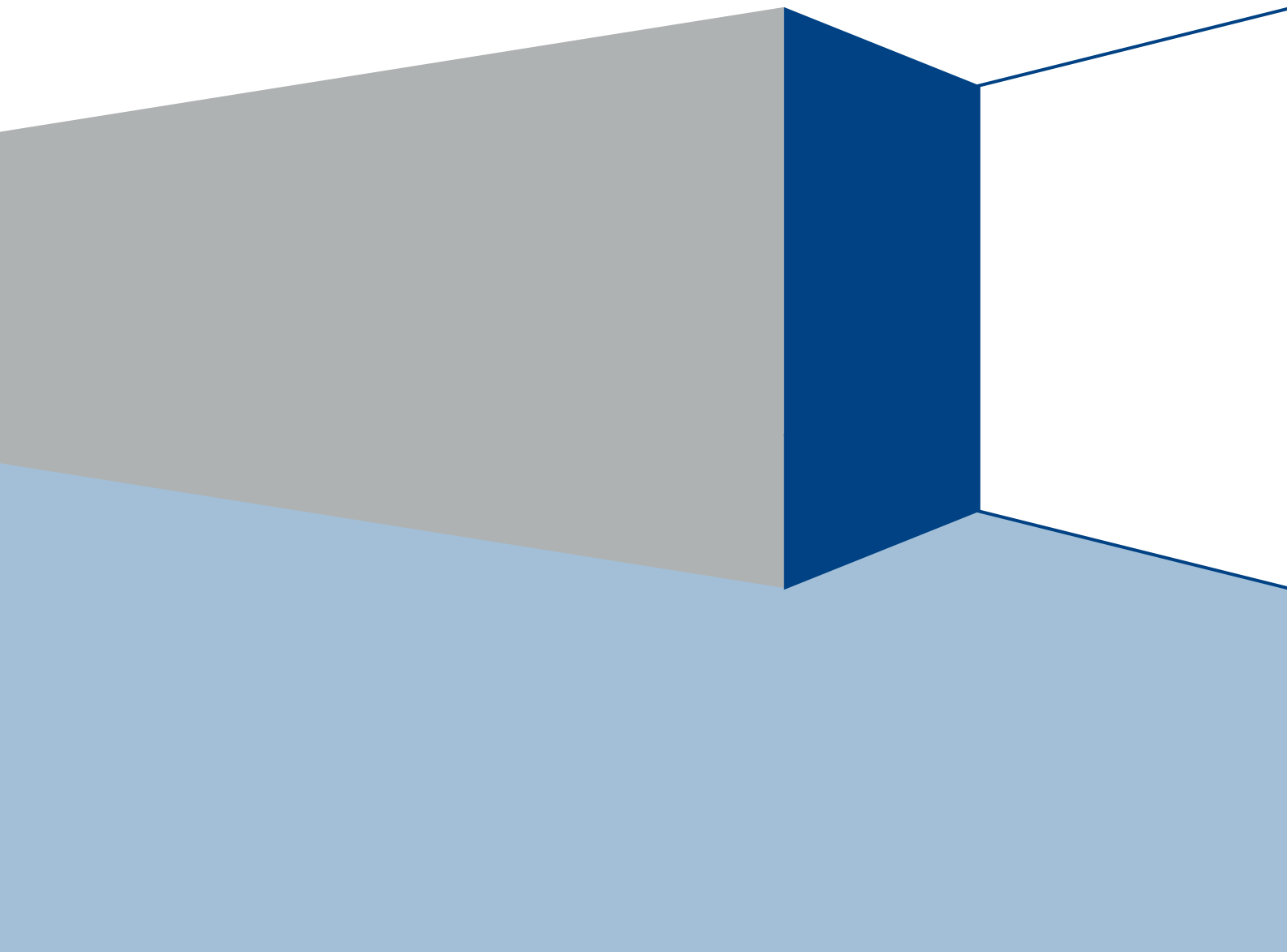




**London**  
Stock Exchange

RESPONSE TO IOB CONSULTATION DATED JUNE/JULY 2009

# International Order Book



# 1 1-8. Questions relating to the corporate action proposal

All respondents rejected the alternative proposal as set out in the consultation for handling corporate actions with options and most requested that the London Stock Exchange (“the Exchange”) and LCH.Clearnet (“LCH”) explore other alternatives as they contend that the current situation leaves them with an unacceptable level of risk. Some respondents asked for clarity regarding why automated buyer protection facilities are not available.

## 1.1 Exchange and LCH response

Automated buyer protection facilities are not available as no equivalent of the ACON functionality provided through Euroclear UK and Ireland exists for IOB securities. Also most corporate actions with options in IOB securities have some form of eligibility criteria attached to them, e.g. the X5 Retail rights offer in 2008 was not open to US holders and applicants had to be Qualified Investment Buyers (QIBs) and could not be affiliated to the underlying company. These restrictions mean that it is very difficult to define a universal set of rules to be able to automate and govern option requests relating to these types of events.

The Exchange and LCH have explored the alternative solutions summarised below:

- **CSD to offer buyer protection functionality** – Euroclear Bank has confirmed that it is currently unable to offer automated buyer protection functionality and that this is not in scope for the Single Settlement Platform release one.
- **LCH to automate the taking in of corporate action elections** – This solution is not under consideration as a significant technology build (or outsourcing deal) would be necessary. The protracted timescale involved with such a project does not fit in with Members’ requirements to have a solution implemented immediately.
- **LCH to process corporate action elections manually** – LCH could take in and manually process election choices from buyers on a ‘reasonable endeavours’ basis. Any elections not received by a cut-off deadline specified by LCH would be presumed to have elected the default. There would likely be a charge for this service and it would be subject to legally binding rules ensuring that LCH has no exposure to any operational risk.

## **1.2 Action**

The Exchange and LCH will produce a consultation paper which provides greater detail on the proposal for LCH to process corporate action elections manually. This paper will be published by the end of September for comments from market participants.

## 2 Other questions

### 2.1 Do respondents support this new approach to setting ex dates following late notification of record dates? Do respondents have any concerns around the separation of record dates on the underlying and the DR by the depositary banks?

The majority of responses were positive in regard to the proposed new approach, citing the benefits of reducing manual claims processes and universal clarity on the dividend process for Depositary Receipt instruments (“DRs”).

Some concerns were noted in regard to the separation of record dates on the underlying and the DR, and around the possibility for conversions occurring during the closed books period. One respondent also called for increased focus on DR banks to publish record date information in a timely fashion.

#### 2.1.1 Exchange response

The Exchange is committed to retaining clarity at the point of trade even if it is not available in the home market, and remains against the principal of retrospective record dates. Entitlement to the dividend payment for DRs traded on the Exchange is already separate to that of the underlying market, as entitlement is given to all buyers prior to the Exchange ex date (which may be after the record date on the underlying).

DR instruments are fundamentally separate from the underlying securities which they may represent and whilst the two instruments can be correlated for certain trading strategies, it is possible for them to trade in different ways and be subject to different trading rules, actions and risks.

The Exchange believes that by introducing the possibility of separation of record dates the dividend process for DRs will be formalised and the majority of manual claims processing required by member firms will be removed. The management of the ‘closed books’ period and associated claims procedures will fall to DR banks, providing a clear incentive to work with their issuers to reduce the occurrence of retrospective record dates.

Only one ex date and record date will be published by the Exchange for each DR instrument; however it will be up to the member firm to ensure that they have appropriate controls to ensure that they are using information regarding the DR line rather than the underlying.

Bank of New York Mellon has given its support to the Exchange's proposal and has confirmed that it always attempts to match DR record dates to those of the local record date. Any firm requiring further information on this service or around the 'closed books' period or conversions, should contact Neil Atkinson at [neil.atkinson@bnymellon.com](mailto:neil.atkinson@bnymellon.com).

### **2.1.2 Action**

The new DR proposal will be introduced on 7 September 2009. A Stock Exchange Notice and revised Dividend Procedure Timetable will be issued in due course.

### **2.2 Do respondents continue to support the revised opening hours? Is there a requirement for any further revision to be either the start or end time of automated trading on IOB? If so what should that revision be?**

The vast majority of respondents support the current opening hours on the service. One respondent requested that the hours be returned to the previous opening times (08:50 auction call with 09:00 uncrossing).

#### **2.2.1 Action**

No further changes to IOB opening hours will be introduced at this time.

### **2.3 Are there any additional securities that respondents would like to see included in IOB Clearing, or any comments on those suggested above?**

There was broad support from respondents for the extension of the IOB Clearing service to include more securities. Some member firms requested all securities on the IOB to be included, whilst others requested liquidity to be considered prior to inclusion, or for no additional securities to be included until concerns around corporate actions and ex dates have been resolved.

#### **2.3.1 Exchange response**

It is the view of the Exchange that the service has been successful and should be extended to further securities as appropriate. An important consideration will be the actual or anticipated liquidity levels of the security concerned. LCH must also agree that the security is eligible for clearing based on their required criteria.

### **2.3.2 Action**

A number of securities will be added to the IOB Clearing service in the September quarterly review, including those detailed in the consultation. A final list will be published on the Exchange's website at [www.londonstockexchange.com/iob](http://www.londonstockexchange.com/iob) shortly and be included within the quarterly review Service Announcement issued in mid September.

Whilst the Exchange may continue to add securities to IOB Clearing during future quarterly review processes, new securities being admitted to the IOB service may also be introduced to IOB Clearing on admission. Notification of such securities will be provided in the normal way through our Datasync service.

### **2.4 Do respondents have any feedback on how IOB Clearing is operating since its introduction, specifically in regard to margin levels for IOB business or cost benefits of netting?**

The feedback to this question was very positive. Respondents cited benefits in terms of elimination of counterparty risk, increase in settlement efficiency and complete anonymity. Two participants noted that they are seeing fewer failed trades.

Netting is also providing key benefits including a reduction in the volume of trades to settle, lower cost and reduced risk.

Two respondents noted increased margin rates, however most firms had not seen a discernable increase. Several members noted issues in terms of currency denomination for margining and calculation methods. These concerns will be passed to LCH, however it is suggested that member firms follow up directly with their LCH account manager or General Clearing Member.

### **2.5 Do respondents have any other feedback or suggestions in relation to the IOB trading service?**

One respondent raised concerns about the cost of settlement on IOB for retail firms, due to the choice of place of settlement along with the minimum order sizes that are in place. Due to the nature of the instruments traded on the IOB, the trading service has been designed to meet the needs of professional investors. Euroclear Bank is the standard place of settlement for DR products, and the minimum order size is in place to ensure that very small trades which lead to higher settlement costs for all parties do not occur.



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