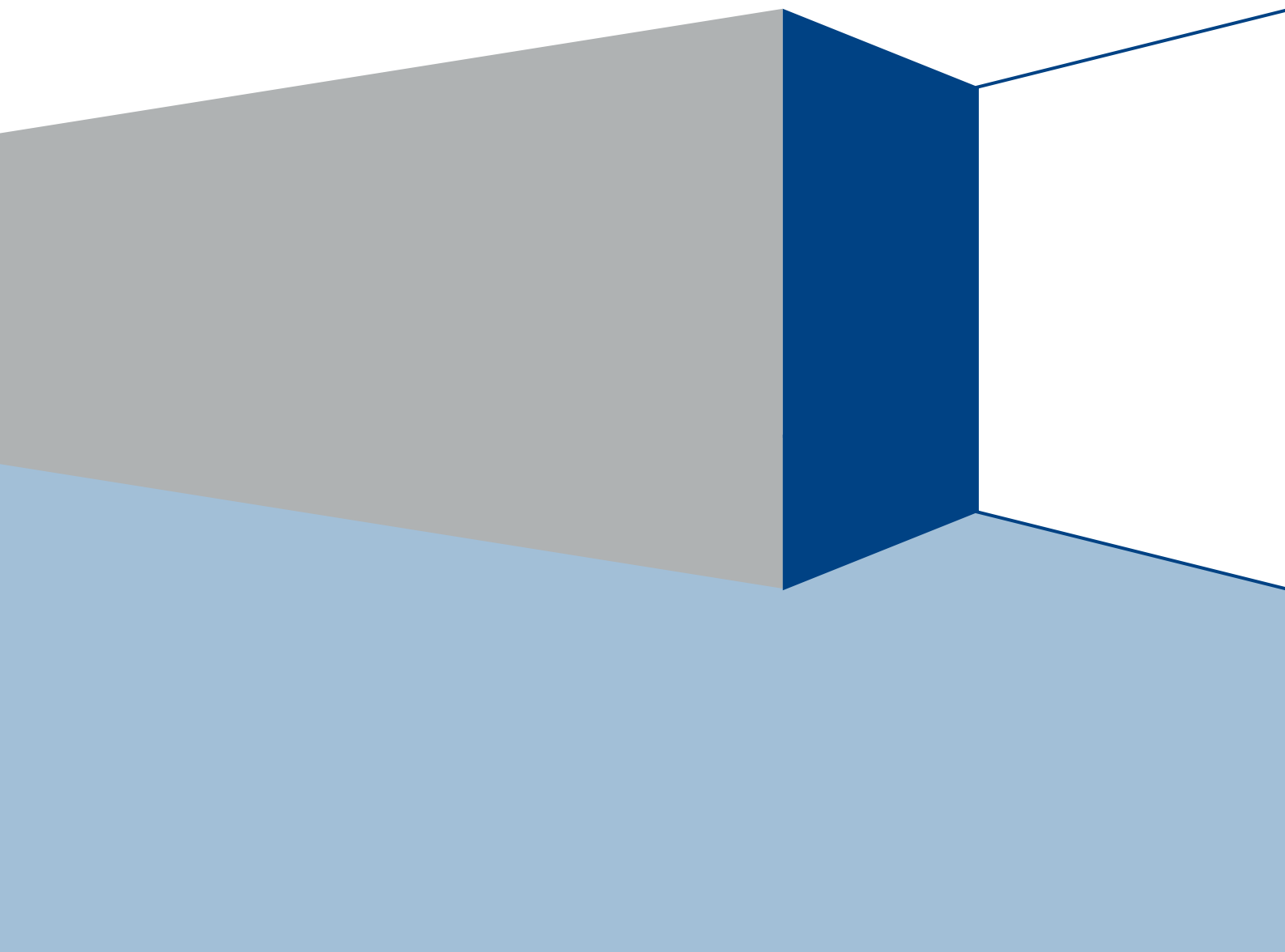




**London**  
Stock Exchange

OUTLINE SERVICE AND TECHNICAL DESCRIPTION

# IOB Clearing Phase 1



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# 1 Introduction

The International Order Book (IOB) enables investors to unlock the potential of some of the world's fastest growing markets. It offers easy and cost efficient access to markets around the world via depositary receipts (DRs).

Trading on the IOB has grown rapidly since its inception in 2001. Introducing a central counterparty (CCP) model is a natural evolution for the service and aims to consolidate this impressive growth by increasing efficiency and mitigating counterparty risk for participants.

Introducing a CCP model, initially to the 50 most liquid securities by value that trade on the IOB, will deliver appreciable benefits to both issuers and investors. Market participants will gain full counterparty risk protection, enjoy post trade anonymity and experience improvements in straight through processing. Firms will also have access to an optional netting facility to reduce transaction management costs and financial exposure at the settlement level.

## 1.1 Main characteristics

- Participants will gain full counterparty risk protection when trading on book in CCP eligible securities on the IOB.
- Routing of trade information to the CCP will be carried out by the Exchange's post-trade router, X-TRM.
- In Phase 1, LCH.Clearnet Ltd (LCH) will act as the CCP on the IOB. In later phases other CCPs may be introduced, in line with the European Code of Conduct for Clearing and Settlement (see section 2.3 for further details). This document will only deal with the changes that will facilitate Phase 1.
- LCH will act as the CCP for the 50 most liquid securities by value that trade on the IOB. A list of these securities can be found on the IOB section of the Exchange's website at [www.londonstockexchange.com/iob](http://www.londonstockexchange.com/iob)
- It will be a requirement for the 50 CCP eligible securities to settle in Euroclear Bank for on book trades. This requires the default place of settlement to change in some cases. Settlement of trades for these 50 securities will be against the CCP. The default place of settlement for all other IOB securities will not change. The settlement of off book trades can continue to be agreed bilaterally between trade participants.

- Straight through processing will be improved by the use of both a post-trade router and a CCP. The ability to net trades for settlement through the CCP will lead to less pressure on back office functions.
- For on book trades in CCP eligible securities, participants will only need to interact with their CCP and the settlement system (in the case of direct membership).

## 1.2 Scope of this document

This document highlights the main changes arising from the introduction of central clearing to the IOB, and its impact on participants in the market. It does not provide a complete description of the IOB or those areas that do not need to change.

It is divided into two main sections; the service description contains an overview of the new CCP service available on the IOB and the technical description details the technical changes that clients need to make to facilitate this mandatory change to the order book.

This document also outlines the next steps that participants need to take and the proposed timetable for implementation.

## 1.3 Readership

This service and technical description is intended to be a guide for member firms and Clearing Members. It is also useful for prospective participants who may wish to commence trading on the IOB.

## 1.4 Contact details

The Exchange recognises the importance of supporting its customers throughout the implementation of the changes detailed in this document.

To contact the Exchange:

- For a commercial and/or business question please contact your **Primary Account Manager**.
- For more information on the technical set up, enablement and testing please contact your **Technical Account Manager** or the **Technical Information Desk** on +44 (0)207 797 4216.

To contact LCH:

- For more information on the CCP service offered by LCH please contact Mike Knowles on +44 (0)207 426 7498.

Further information about the International Order Book can be found at <http://www.londonstockexchange.com/iob>

## 2 Service description

### 2.1 Overview

The Exchange is introducing a CCP service for the 50 most liquid securities by value that trade on the IOB. This development aims to facilitate further market growth and will bring the IOB in line with SETS, the premier trading service for UK equities and EDX London's IOB Russian Derivatives Service, which already offer central clearing.

The Exchange does not intend to change the operation of its markets or trading system as a consequence of introducing central clearing to the IOB. However there will be some changes to TradElect configuration (eg market segments) which are outlined in sections 3.1 and 3.3 of this document.

### 2.2 Scope

The Exchange expects to introduce centralised clearing as described in this document to all automated order book trades in the top 50 most liquid securities by value that trade on the IOB. Less liquid securities will not be included at this stage. The list of securities included can be found on the IOB section of the Exchange's website at [www.londonstockexchange.com/iob](http://www.londonstockexchange.com/iob)

Trading and settlement for securities not included in the new clearing service will be unchanged from today, as will trading and settlement for off book trades in all IOB securities.

### 2.3 CCP services

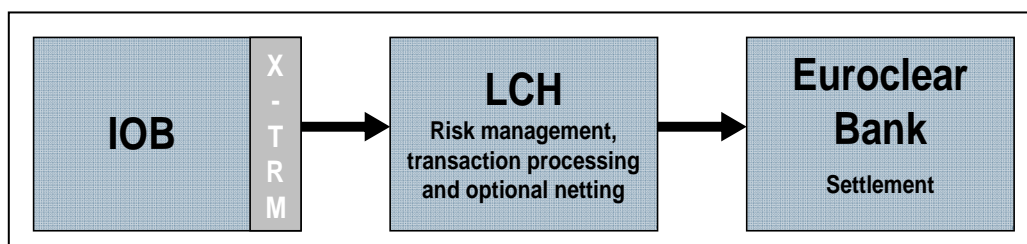
In Phase 1, LCH will provide clearing services for the IOB.

The European landscape for CCP services has been changing in recent years towards increased competition. The European Code of Conduct for Clearing and Settlement is designed to bring new entrants to the UK Market in order to increase market efficiency. In line with this the IOB CCP service has been designed to allow for multiple CCPs should this be required in the future.

The Exchange will advise as required regarding the entry of other CCPs to provide clearing services for the IOB.

## 2.4 Trade processing and routing

In Phase 1, the Exchange's post-trade router, X-TRM, will perform trade routing and LCH will perform risk management and optional netting. LCH will also instruct settlement in Euroclear Bank as shown in the diagram:



X-TRM trade processing and routing will operate as follows:

- The Exchange will send trades to X-TRM immediately after execution.
- X-TRM will perform trade registration and route each trade to LCH.
- X-TRM can also provide information on the trades executed to trading participants and Clearing Members.
- LCH will also provide confirmation of the trades executed. The confirmations will only be of trades LCH has validated and registered for clearing, providing clarity to members.

## 2.5 Clearing arrangements

Member firms that currently trade on the IOB and have either a direct or indirect relationship with LCH will be able to enter orders in those securities being centrally cleared, provided they wish to continue using the same relationship and have completed a static data form (see section 2.8). All other member firms who wish to trade the CCP eligible securities will be required to establish an indirect or direct relationship with LCH and complete a static data form (see section 2.8), however they will still be able to trade off book and in non CCP eligible securities.

Clearing arrangements with LCH can be either by the trading firm being an Individual Clearing Member (ICM) of LCH or by using a General Clearing Member (GCM). Agency trades must be cleared through a separate GCM.



If a firm wishes to become a Clearing Member of LCH, they should contact them directly and advise the Exchange of the change.

It should be possible to use the same clearing arrangements on IOB as on SETS, although this is subject to discussion with member firms' existing SETS GCM or LCH.

## **2.6 Settlement**

Details of the settlement process will be defined by LCH in conjunction with the Exchange and Euroclear Bank.

Firms can use the services of a settlement agent or Model B firm to settle their IOB business. The settlement agent can also act as the firm's GCM, but this is not required.

## **2.7 Corporate Actions**

For a Corporate Action event with options, buyers from LCH will be delivered the default option. They will not be able to elect any other out turn(s).

## **2.8 Informing the Exchange and the CCP**

A necessary action point for all firms wishing to trade CCP eligible securities on the IOB will be to complete a static data form explaining their clearing and settlement details. This will be a new static data form that is separate from the one used for SETS and will encompass all data needed for the Exchange, LCH and Euroclear Bank to set up customers for the service.

This form will be published to the market in early 2009. See section 4.1 for more details.

## **2.9 Settlement with the CCP**

Participants will settle against LCH. LCH will require the use of a Power of Attorney on settlement instructions and will instruct partial settlements where necessary.

LCH will also offer an optional settlement netting service on the IOB.

Market participants should contact LCH directly for all aspects of their service.

## 2.10 Place of settlement

Settlement for the CCP eligible IOB securities will be in Euroclear Bank. Firms should note that this requires a change of place of settlement for certain securities traded on the IOB. Firms should consult the IOB section of the Exchange's website at [www.londonstockexchange.com/iob](http://www.londonstockexchange.com/iob) for the full list of centrally cleared securities.

## 2.11 Settlement fails

Settlement fails are expected to be handled by a combination of two different mechanisms:

- LCH will commence buying in at ISD+30. LCH will commence cash outs on ISD+60.
- The Exchange intends to offer buying in at buyer request, as is currently available for IOB trades. For all IOB securities (CCP eligible and non CCP eligible), the timetable for starting the buying in process will reduce from the current ISD+45 to ISD+30. More information on the Exchange's buying in rules can be found on the Exchange's website at <http://www.londonstockexchange.com/en-b/products/membershiptrading/rulesreg/buyingin>

LCH shall be free to operate other processes that would tend to improve settlement efficiency.

## 2.12 Default

LCH operates protection mechanisms against the default of Clearing Members, including its approach to calculating margin levels and default fund contributions. For more information on LCH default processes please go to [www.lchclearnet.com/cash\\_equities](http://www.lchclearnet.com/cash_equities)

The LCH default rules will apply to those trades where LCH acts as the direct counterparty. All other on Exchange transactions will be subject to the Exchange default rules.

## 3 Technical description

This section provides details of the technical changes being implemented on TradElect to facilitate the new CCP service on the IOB. Customer testing details are also provided.

### 3.1 Market structure

The segment structure used for the IOB will change so that CCP eligible stocks settling in Euroclear Bank and non CCP eligible stocks will be in separate segments.

The Exchange will make the following technical changes to the structure of the international markets:

- Creation of a new market segment: 'IOBE' which will be populated with new sectors as described in the Parameters Document, available at <http://www.londonstockexchange.com/en-gb/products/membershiptrading/tradingservices/>. All CCP eligible securities will be migrated from the 'IOB' and 'IOBU' segments to the 'IOBE' segment.
- The 'IOBU' segment will have its description changed from INT. ORDER BOOK(NON ISD RG.MKT) to INT. ORDER BOOK NON CCP (UNCLEARED). All non CCP eligible securities currently in the 'IOB' segment will be migrated to the 'IOBU' segment. All of the existing sectors in 'IOBU' will be deleted. These will be replaced with new sectors as outlined in Service Announcement 134/08.
- The 'IOB' segment will become redundant and will be deleted in due course. All four sectors in 'IOB' ('ILLA', 'ILLU', 'LIS1' and 'LLIS') will be deleted. A further Service Announcement for the deletion of this segment will follow.

The segment changes are summarised below:

Segment	Segment Description	Action
IOBE	INT. ORDER BOOK CCP (EUROCLEAR BANK)	Addition
IOBU	INT. ORDER BOOK NON CCP (UNCLEARED)	*Change
IOB	International Order Book	Made redundant

### **3.2 Order entry details**

Member firms that currently use the IOB but that do not have a relationship with LCH will not be able to enter orders in those securities being centrally cleared and will receive an advisory code in the acknowledgement. These firms will still be able to trade off book.

The existing 'NSV' settlement venue will no longer be valid for those stocks that are CCP enabled. Any orders populated with this value will be rejected with a Q470I 'Settlement Venue/ Account Invalid' application advisory code. This value will be the only valid value for off book trade reports.

### **3.3 Closing prices**

From the introduction of the CCP service to the IOB, the closing price for the IOB service will be determined by the uncrossing price in the closing auction, or the last automated trade in the event that an uncrossing does not occur.

The current VWAP period and volume check will be removed.

### **3.4 Conformance testing**

No new functionality is being introduced for the changes to the IOB described in this document, and therefore no mandatory testing is required.

Any Independent Software Vendors (ISVs) or in-house software developments that do not currently support the trading functionality in the IOB but wish to subscribe to the service must pass a full trading conformance test.

### **3.5 Customer Development Service (CDS)**

The CDS environment will be updated to reflect the revised IOB structure for start of trading on Monday 19<sup>th</sup> January 2009. Service Announcement 134/08 provides further details.

Customers are recommended to make use of the CDS environment to test their internal systems prior to go-live. More information on the CDS environment can be found on the Exchange's website <http://www.londonstockexchange.com/en-gb/products/membershiptrading/techlib/cust+test/>

## 4 Project implementation

### 4.1 Migration

From Monday 23<sup>rd</sup> March 2009 the Exchange expects that all new trades in the CCP eligible securities will be automatically routed to LCH by the Exchange's post-trade router, X-TRM.

Market participants that wish to sign up to this service must complete a new static data form which will be published to the market early 2009 and will be available on the IOB section of the Exchange's website.

For assistance with this process participants can contact their **Client Implementation Consultant** at the Exchange on +44 (0)207 797 3232 or Mike Knowles at LCH on +44 (0)207 426 7498.

### 4.2 Instrument moves

The specific securities to be migrated, and the segments / sectors to which they will be moved will be communicated prior to go-live via a Service Announcement. Customers should then use the Reference Data Service (Full & Changes) for the full details of the updated IOB securities, segments, sectors, period rules etc.

The implementation date for the introduction of the new clearing service will also be communicated via a Service Announcement prior to the go-live. From that date, expected to be Monday 23<sup>rd</sup> March 2009, all new trades will be automatically routed to the LCH by the Exchange's post-trade router, X-TRM.



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