



## **BULLETIN – 080630/06**

# **ICMSA Variable Rate Instruments – Best Practice Processing Principles Information Provision**

**Issued by the International Capital Market Services Association**

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These processing principles set out guidelines only and are not intended to create legal relations.

### **Executive Summary**

Since the launch of the first Eurobond in 1963, the market for international securities has seen the creation of a wide variety of international instruments, whether issued under programme or as stand alone securities.

In the beginning, the servicing of those assets was fairly straight forward as most of the issues were what we now consider to be 'plain vanilla'. With investors' appetite growing for risk, hedge and structure, issuers have created more complex products (asset-backed securities, collateralised debt or mortgage obligations, reverse convertible bonds, equity linked notes, etc) for which the back office work is very labour intensive and manual, therefore more prone to delay, input risk and errors.

Over the last 5 years, the issuance of variable rate instruments on the international securities market has exploded. As a result, the number of variable rate payments now exceeds those classified as fixed rate payments. When exceptions become the rule and special processes become standard, it is necessary to rethink the way the market operates and streamline the actions market players are taking at various levels in order to ensure that maximum efficiency is reached.

The triggering factor for change is investor satisfaction. Investors are entitled to receive and increasingly demand timely, accurate and complete rate fix information as well as reliable processing. Currently, the market is having trouble meeting these expectations. In order to reach these goals and maintain the attractiveness of the international securities market for all players, it is necessary to take remedial action.

The ICMSA's Variable Rate Instrument ('VRI') working group was created in July 2006 and gathers some of the leading Paying Agents and Calculating Agents in the market along with the ICSDs. Its mission is to review and streamline the VRI information process in order to enhance efficiency, reduce risk and ultimately deliver an acceptable service to investors.



The main areas of focus are:

- create awareness in the market regarding investors expectations
- establish, maintain and enhance contacts between market players
- increase transparency and clarify the roles and responsibility of these players
- ensure information flows in a timely fashion towards investors
- move from a payment date driven process to a fixing date process to facilitate timely distribution of rate information
- create a new model where information is disseminated to the interested parties
- document the Best Practice Processing Principles based on the above focus areas.

These VRI objectives have been delivered in 2 phases. The first milestone, awareness creation, has been reached through the VRI working group but will require nevertheless a continuous effort from hereon. The second milestone is the introduction and validation of the Best Practice Processing Principles through this document.



## 1. Definitions and Abbreviations

<b>Best Practice Processing Principles</b>	This Best Practice Processing Principles document describing processing principles for the timely and accurate dissemination of rate information.
<b>Calculation Agent (CA)</b>	The entity appointed by the Issuer to process and disseminate the rate fixing calculations.
<b>CBL</b>	Clearstream Banking S.A.
<b>Common Depository (CD)</b>	The entity appointed by the ICSDs to provide safekeeping and asset servicing for securities issued in CGN (Classic Global Note) form.
<b>Common Safekeeper (CSK)</b>	The entity appointed by the ICSDs to provide safekeeping for securities in NGN (New Global Note) as per ECB Standard 3 requirements.
<b>Common Service Provider (CSP)</b>	The entity appointed by the ICSDs to provide asset servicing for securities in NGN form.
<b>Determination Agent (DA)</b>	The entity who advises the Calculation Agent of some of the external factors used to calculate the payment under the Variable Rate Instrument.
<b>EB</b>	Euroclear Bank S.A./N.V.
<b>Fixing Date</b>	The date determined in the governing issue documentation on which the rate calculation for the next interest payment date will occur.
<b>ICMSA</b>	International Capital Market Services Association.
<b>ICMSA VRI WG</b>	Specific working group created by ICMSA members in July 2006 to focus on service issues around variable rate instruments.
<b>Interested Parties</b>	The minimum interest parties are: the issuer, paying agent and stock exchange (if listed).



<b>International Central Securities Depositories (ICSDs)</b>	CBL and EB.
<b>International Security</b>	Security primarily issued through and deposited with the ICSDs and held through the network of Common Depositories or Common Safekeepers.
<b>Investment Bank (IB)</b>	The entity in charge of arranging, structuring and placing the issue for the issuer. Alternatives depending on the context can be: 'arranger' on programmes, 'dealer' for non-syndicated issues under programme and 'lead manager' for syndicated issues under programme or stand-alone deals.
<b>Issuer</b>	The entity issuing the securities.
<b>Payment Date (PD)</b>	Date at which entitlements (coupon and/or redemption) are due to be paid to holders as identified in the Terms and Conditions.
<b>Principal Paying Agent (PPA)</b>	The principal entity appointed by the Issuer to process the necessary cash payment (collection of coupon, redemption or other monies) related to a security.
<b>Straight Through Processing (STP)</b>	Automated process which allows information to be captured and passed through without manual intervention.
<b>Terms and Conditions</b>	Documentation containing the terms of a security. These will generally be set out in the Base Prospectus and the Final Terms or Pricing Supplement for securities issued under a programme. For stand-alone issues, terms and conditions will be contained in the Prospectus or Offering Circular.
<b>Variable Rate Instrument (VRI)</b>	Any non-equity instrument under which payments [coupon and/or redemption] include a variable feature.

## 2. Overview

As contemplated under the Terms and Conditions, investors in the international capital market are entitled to receive and require:

- rate information, as soon as reasonably practicable after the Fixing Date
- relevant details and reference data used to calculate/determine the rate

The prompt provision of correct information to investors ensures that the negative impact of late payments, payment adjustments and reversals are kept to a minimum.

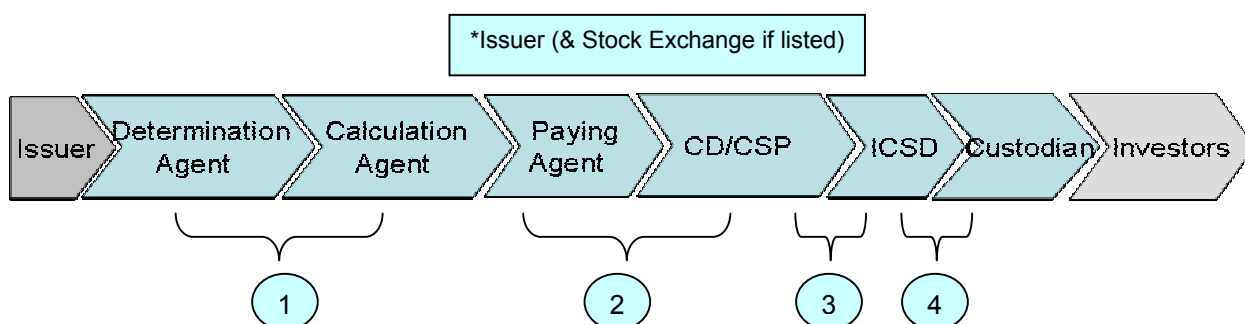
These Processing Principles aim to provide a single set of general guidelines to all involved parties to assist in delivering an acceptable service to investors. The purpose of the Processing Principles is not meant to supersede the Terms and Conditions but to provide guiding operating principles. It is understood that some highly structured issues may not always be able to maintain all of the Best Practices or that different terms may be agreed between the parties involved. Nothing in the Best Practice Processing Principles requires changes to the documentation or contractual agreements relating to existing securities.

The Processing Principles describe the guidelines pertaining to the timely dissemination of rate fixing information and the actual calculation of the payment to be made on international securities issued through the ICSDs.

These Best Practices set out suggested guidelines only and are not intended to create legal relations.

## 3. Current Information Flow

### 3.1. Parties involved

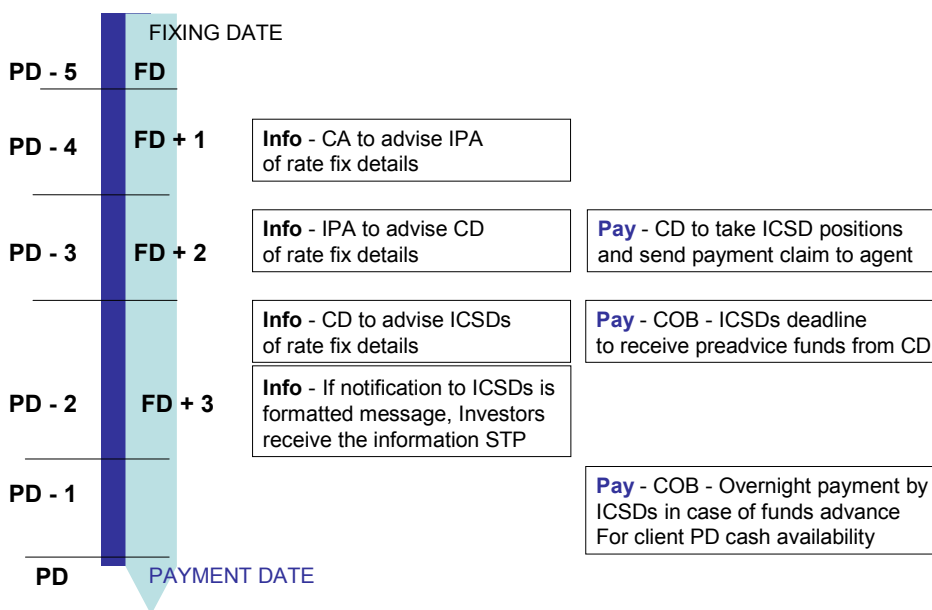


\* The Calculation Agent is responsible for distributing the rate information to the Interested Parties

- Investment Banks , at the Issuer’s request, may take on the role of the Determination Agent or the Calculation Agent for debt issues with the intention of ensuring the accuracy of complicated calculations on bonds and any hedged cash flows.
- The information flow typically involves a minimum of 3 separate entities to pass the variable rate information to the final investors. This chain can possibly extend to 6 or more separate entities.
- In the current manual environment, investors may have to wait to receive information following the Fixing Date.

### 3.2. Timings

The graphic below highlights the typical timing viewed for a rate fixing that occurs towards the end of the interest period.



#### **4. Current Issues**

From an investor and asset servicing perspective, the current issues faced are:

- Untimely dissemination of rate fixing details to investors
- Lack of transparency of the rate fixing details within the issue documentation
- Lack of transparency of the rate fixing calculation formula data
- Late payment to investors
- Reversals: negatively affecting investors' use of cash proceeds, impacting daily listed fund valuations, etc

The above issues are compounded by:

- Increasing volumes of issuance of structured products
- Increasing trend towards determination of rates and actual payment amounts closer to Payment Dates
- Calculation Agents establishing processes as to release rate fixing details in relation to the Payment Date instead of the Fixing Date

#### **5. Processing Principles**

##### **5.1. Roles and responsibilities**

The VRI Working Group defined the roles and responsibilities of the parties involved in the rate fixing dissemination to be:

- The Investment Bank, the Issuer, Principal Paying Agent and Calculation Agent should, to the best of their ability, ensure that the transaction is documented in accordance with the Processing Principles.
- The Calculation Agent is responsible for the sending of the rate fixing information, as detailed in the suggested template [refer section 5.5.], to the Interested Parties.
- The Principal Paying Agent is responsible for processing the payments in accordance with the rates received from the Calculation Agent and notifying the Common Depository/Common Service Provider, as agents of the ICSDs, refer section 5.5.
- The Common Depository/Common Service Provider are responsible for notifying the ICSDs of the rates received from the Principal Paying Agent, refer section 5.5.

- The ICSDs are responsible for notifying their participant customers of the rate fixing details without undue delay.

## **5.2. Appointment & documentation**

It is recommended that to the extent practicable:

- The Investment Banks will ensure all interested parties involved are named in the contractual agreements, e.g. dealer agreement for a programme, or such other contractual agreement between the calculation agent and the issuer, and that all named parties provide specific contact details for the business unit responsible for the rate calculation [location, email and contact phone numbers].
- A pro forma rate fix template [refer section 5.5.], adjusted as required to the data required for each instrument, be included in the relevant documentation.
- In the current manual notification process, and in order to ensure the timely dissemination of rate fixing and payment information, transactions be structured and documented to allow at least 5 business days between the Fixing Date and the Payment Date. It is understood that certain structures may not adhere to the 5 business day concept. Parties may wish to consider flagging such risk disclosure narrative within the appropriate documentation and/or in the ICSDs data systems warning investors of the possible risk that information may be provided very close to, on or after the scheduled payment date, potentially causing the payment to be deferred. For securities issued under a programme, such a narrative may be included in the Base Prospectus at the time of its next annual update following the publication of the Processing Principles.
- Details of any amendments made to the Terms and Conditions will be made available to the Interested Parties as soon as practicable to ensure timely amendments can be made to any past or future rate fixes or cash flows.

## **5.3. Record keeping**

It is recommended that to the extent practicable:

- Calculation Agents will keep complete records of all past rate fixings and ensure they possess sufficient capabilities to accurately track and determine all future calculation events. This will enable the Calculation Agents to know how the calculation occurred on the previous payment to calculate the next rate correctly.

## **5.4. Rate determination & notification**

It is recommended that to the extent practicable:



- Rates will be determined by the Calculation Agent on the specified Fixing Date detailed in the Terms and Conditions and sent to the Interested Parties, regardless of possible subsequent events impacting the final payment rate.
- Rates will be calculated by Calculation Agents on the Fixing Date and communicated to the Interested Parties within Fixing Date + 1 business day. This is to be adhered to irrespective of the length of time before the Payment Date.
- The Principal Paying Agent will communicate the rate within one business day of receipt to the Common Depository or Common Service Provider as agents of the ICSDs.
- All specific details required by the Interested Parties will be included in the rate fix notice template, refer section 5.5.

#### 5.5. Suggested rate fix notification template

This is the suggested template for the provision of rate fixing information. It is acknowledged that it may need to be adjusted by the Calculation Agent as appropriate to the particular VRI.

<ul style="list-style-type: none"> <li>▪ <b>ISIN code:</b> XS0123456789</li> <li>▪ <b>Issuer /Issue description:</b> XYZ Bank USD 500MM FRN due 2009</li> <li>▪ <b>Rate fix date:</b></li> <li>▪ <b>Interest Period:</b> [Start period] to [End period]</li> <li>▪ <b>Payment date:</b> [DD/MM/YYYY]</li> <li>▪ <b>Number of days in the period:</b>[ ]</li> <li>▪ <b>Interest rate:</b> [ ] %</li> <li>▪ <b>Day count basis:</b> [ ]</li> <li>▪ <b>Pool factor*</b> [ ]</li> <li>▪ <b>Amount payable per denomination:</b>[Currency /amount payable] per [ Currency denomination size]</li> <li>▪ Total amount payable [Currency] and [amount payable] per [total outstanding amount]</li> </ul>
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\* where applicable on amortising notes, detailing Old Pool Factor [OPF] and New Pool Factor [NPF]

\*\* optional information

#### 5.6. Amendments

- Any amendment to the fix rate notification should be clearly highlighted as an amendment and should be sent by the Calculation Agent to the Interested Parties as soon as reasonably practicable.