

ISITC Europe



Can an industry-wide instrument classification ever hit the spot?

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Martin Christopher Sexton

Aim

- ❑ An overview of the classifications landscape
- ❑ An assessment of the industry's requirements
- ❑ An examination of classification deployments
- ❑ How do we move forward?

Current Status Quo

- ❑ Multiple instrument classifications
 - Loosely based on Contractual Terms (CTs)

- ❑ To meet specific business contexts (or classification facets):
 - Regulatory reporting
 - Statistical analysis
 - Settlement and reconciliation messaging
 - Corporate reporting: Fair value of assets & liabilities

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 - Investment decision making (portfolio governance)
 - “Sector Classification of an instrument”

Commonly used industry classifications

- ❑ Trading & reporting:
 - ISO 10962 - Classification of Financial Instruments (CFI)

- ❑ Statistical Analysis:
 - ESA (European System of Accounts) 95

- ❑ Corporate Accounting view:
 - IAS (International Accounting Standards) 39
 - IFRS (International Financial Reporting Standards) 7 & 9

ESA 95 Snippet

2 Equity-related Instruments	2.1 Stocks	2.1.1 Quoted stocks
		2.1.2 Unquoted stocks
		2.1.3 Other equity
	2.2 Equity-linked derivatives	2.2.1 Forward-type derivatives
		2.2.2 Option-type derivatives
3 Investment and money market funds' shares/units and related Instruments	3.1 Investment and money market funds shares/units	3.1.1 Money market funds
		3.1.2 Bond funds ³⁾
		3.1.3 Equity funds ³⁾
		3.1.4 Mixed funds ³⁾
		3.1.5 Real estate funds ³⁾
		3.1.6 Hedge funds ³⁾
		3.1.7 Other funds ³⁾
	3.2 Derivatives on investment and money market funds' shares/units	3.2.1 Forward-type derivatives
		3.2.2 Option-type derivatives

Financial Instrument Classification Facets

Others

- Proprietary - Vendor specific to "lock in" customers into their service offerings.
- Investment decision making (i.e. Instrument selection for investment proposes).
- Portfolio risk: A classification to identify the appropriate risk calculation that should be applied to an instrument.
- Position valuations: A classification to identify the appropriate fair price calculation that should be applied to a specific instrument.

Distribution of global investment research material. RIXML.org, Inc. - Asset Class, Asset Type & Security Type code lists

Corporate reporting & ledger entries. Fair value measurement of financial assets and liabilities. A classification of principal and income cash flows associated with investments. International Financial Reporting Standards - IFRS 7 & 9 (possible replacement for IAS 39).

Corporate reporting & ledger entries. Fair value measurement of financial assets and liabilities. A classification of principal and income cash flows associated with investments. International Accounting Standards Board - IAS 39 - Classification and Measurement

Bank of International Settlements guidelines on the statistical analysis of OTC derivative deals undertaken within G10 countries. BIS OTC Transaction Reporting Guidelines

ISO 10962 CFI

- EU (CESR) Regulatory transaction reporting of securities (exchanged traded instruments, primarily Equities and Debt).
- National Depository Center (NDC), regulators of the Russian Federation: Use the ISO CFI to identify the foreign instruments that can be held/traded by residents of the Russia Federation.

ISITC (North America) Classification

Instrument classification for use within settlements and reconciliation messaging (primarily used by the SWIFT user base).

European System of Accounts 1995 (ESA 95)

European Central Bank ("ECB"): Used for statistical analysis of securities issued or held by euro area residents.

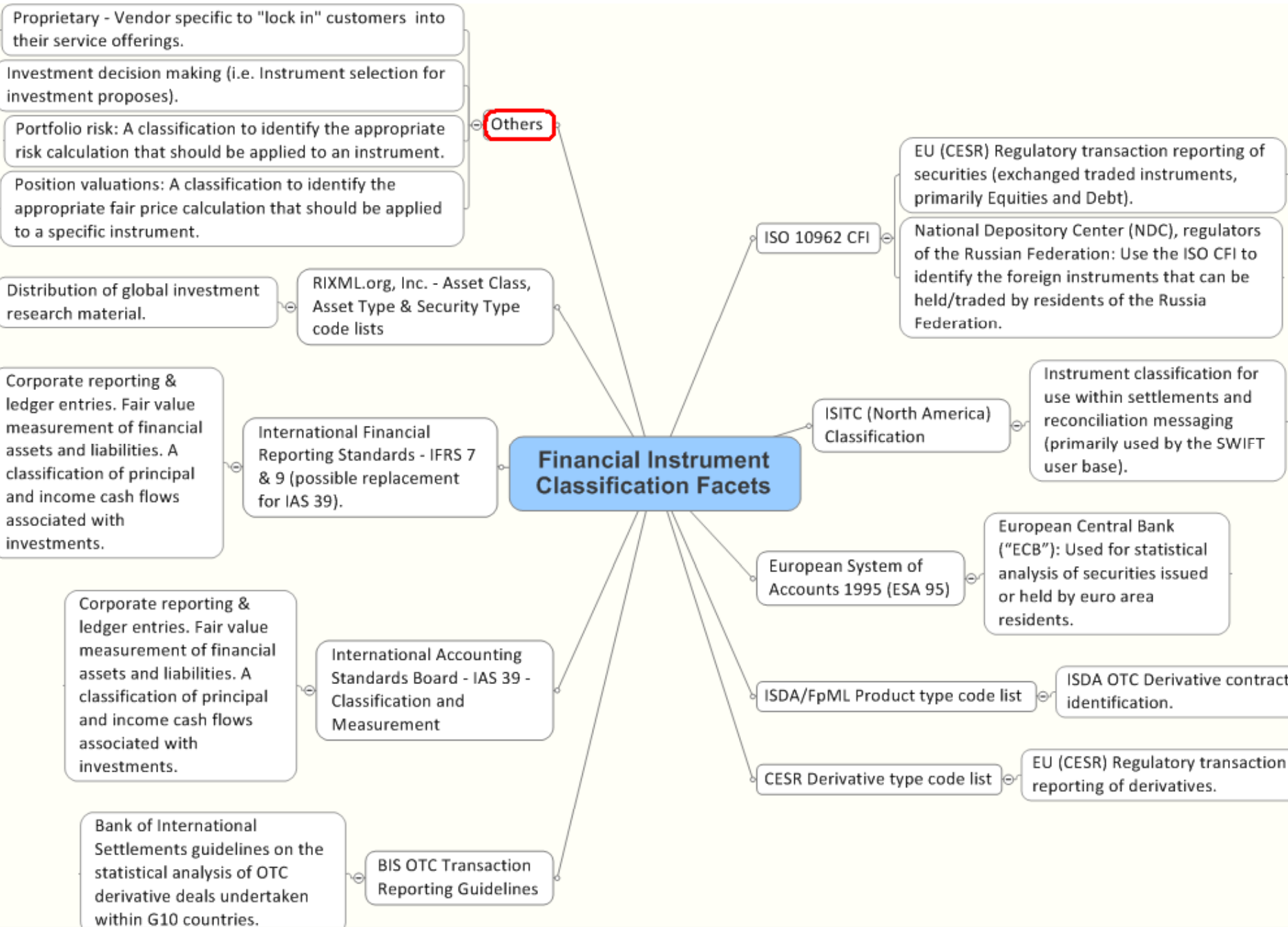
ISDA/FpML Product type code list

ISDA OTC Derivative contract identification.

CESR Derivative type code list

EU (CESR) Regulatory transaction reporting of derivatives.

Financial Instrument Classification Facets



Key Institutional Needs

- ❑ Portfolio risk: A classification to identify the appropriate risk calculation that should be applied to an instrument.
- ❑ Position valuations: A classification to identify the appropriate fair price calculation that should be applied to a specific instrument.
- ❑ Regulatory reporting: A single classification for all asset classes.

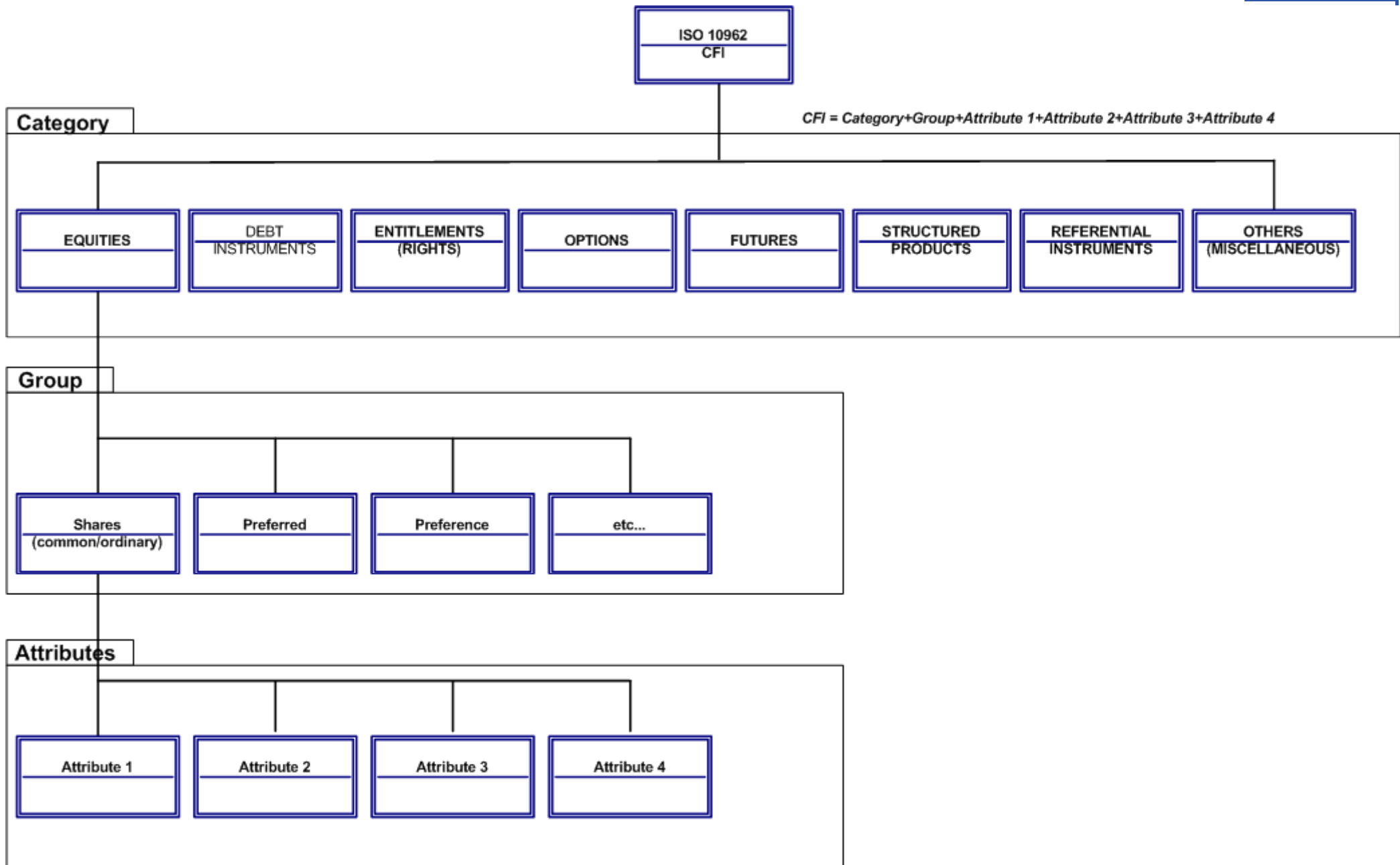
Classifications deployment

- ❑ ISO 10962 (CFI) – Global standard
 - A hierarchical taxonomy
 - A structured Code-list (ESxxxx)
 - Does it cut the Mustard?

- ❑ Organisation develop in-house solution

- ❑ Non-hierarchical “Quick-win” solutions regularly adopted
 - Single character code-list

ISO 10962 (CFI)



In-house developed

- Three tier hierarchy commonly deployed:

Tier 1	Tier 2	Tier 3
Debt	Bonds	Convertible Bond Fixed Bond Floating Rate Index Linked
	MM	Asset Backed CP CD CP Deposit
	Structured Assets	ABS CMO MBS Pass Through Pfandbriefe Structured Note TBA

Flat Instrument Type classifications

- EU (CESR) Derivative Type Classification
 - Used for regulatory transaction reporting
 - Single character:
 - O = Options
 - W = Warrants
 - F = Futures
 - D = Contract for Difference (CfD) & Total Return Swap (TRS)
 - X = Spread bets
 - S = Swaps, excluding CfD, TRS and CDS
 - Z = Credit Default Swap
 - K = Complex derivatives

Complications defining a taxonomy

- New draft version of the ISO CFI
 - Under the category of Debt, we have:
 - B = Bonds
 - C = Convertible bonds
 - W = Bonds with warrants attached
 - T = Medium term notes
 - Y = Money market instruments
 - A = Asset-backed securities
 - G = Mortgage-backed securities
 - N = Municipal bonds

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Constructing an unbreakable classification is difficult

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**Duration
related**

Where do we stand?

- ❑ There is NOT an Über-classification

- ❑ Inconsistent approach to designing classifications:
 - Method not normally documented
 - Attributes containing multiple CTs

- ❑ Resulting in confusion and duplication of effort:
 - with in-housed developed alternatives
 - some opting for the instrument type solutions

How do we move forward?

- ❑ Identify the requirements of a classification
- ❑ Identify the important CTs (characteristics) of each instrument
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- ❑ Identify the requirements of a classification
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- ❑ Advantage of creating a taxonomy independent of the CTs:
 - Applying separate views (taxonomic hierarchies) depending on the business context, if required.
- ❑ Document the method for each facet
 - Rules that need to be applied when extending the taxonomy

- ❑ Resulting in an industry-wide multipurpose classification

Ongoing Maintenance

- ❑ Licence free / Open source standard

- ❑ Online collaboration based solution (i.e. Wiki)
 - Supported by an appropriate change request/approval mechanism

- ❑ Managed and maintained in the ISO 20022 repository
 - The ISO 20022 repository supports hundreds of code lists
 - A classification is merely a code list, albeit with structure

Next steps

- ❑ How do we get the ball rolling?

Next steps

- How do we get the ball rolling?
 - Using a collaborative model

Can an industry-wide instrument classification ever hit the spot?

I believe so

Questions?



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