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THE EUROPEAN CENTRAL SECURITIES DEPOSITORIES ASSOCIATION'S
RESPONSE TO THE GIOVANNINI REPORT
BARRIER 3, CORPORATE ACTIONS
- PART 2 MARKET CLAIMS

July 2006



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Executive Summary

Third ECSDA Report relating to the Giovannini barriers

The first response from the ECSDA relating to the second Giovannini report published in 2003 was released in April 2004. This response proposed standards for two of the three barriers that the ECSDA was asked to address, namely barrier 7 relating to operating hours and barrier 4 relating to settlement finality. The ECSDA agreed 10 Standards for implementation to address these barriers and updates on progress were released at the end of April 2005 and in July 2006.

The ECSDA has also been mandated, along with the European Credit Sector Associations (ECSA), to address barrier 3 which related to corporate actions. Given the size of this field both ECSA and the ECSDA have agreed to split the subject into a number of manageable areas. The second ECSDA report on the Giovannini barriers, published in June 2005, dealt with the first of these areas relating to corporate actions. 16 standards (numbers 11 – 26¹) relating to mandatory distributions (e.g. cash dividends or bonus issues) were identified.

This third ECSDA report concentrates on market claims. Market claims are processes that redistribute corporate action proceeds where needed so that the entitled party receives the benefit.

Whilst the ECSDA recognises that the implementation of standards 11 – 26 will greatly reduce the situations that give rise to market claims, the ECSDA realises that until there are 100% settlement rates there will always be the necessity to process market claims. The standards suggested in this paper will lead to a much higher degree of STP in domestic and cross border processing in the area of clearing and settlement within Europe. For the participants in this market it will lead to a reduction of cost and risk.



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Cooperation in the private sector

The ECSDA is not alone in working on this barrier. Consequently, all implementation timescales are preliminary and the ECSDA is working with others associated with the Giovannini process to determine definitive target timescales. Also, significant progress has been made by the different associations to ensure that their work is consistent and moving in the same direction. To this end, the parties (ECSDA, ECSA (including the European Banking Federation), the European Securities Forum and the European Association of Listed Companies) meet regularly and will publish on each other's websites details of all the recommendations made so far.

Standards on market claims

As in ECSDA's previous reports this paper identifies the need for standards, proposes which standards should be implemented, when implementation should occur, the benefits of doing so and any potential barriers that may stop or delay implementation of the standards.

The table below lists both the standards and the proposed implementation timetable. In terms of the timescale for implementation the ECSDA has chosen to follow the process used in the Giovannini report itself. This report set out priorities for implementation and the timing of the removal of each barrier was dependent on other ones having been removed. The ECSDA have discussed this issue and have concluded² the following priorities:

1. All standards relating to distributions should be implemented two years³ after the standards proposed by ECSA and the ECSDA have been agreed. The rationale behind implementing these standards first are based on the fact that these events are by far the most common meaning that maximum benefits can be achieved by implementing standards in this area.

¹ A full list of previous standards relating to barrier 3 can be found in Appendix 3

² This point needs to be discussed with ECSA and the market before a final timetable can be confirmed.

³ Except standard 23 which is relates to settlement cycles and is a separate Giovannini barrier in its own right.



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2. Secondly, implementation of standards relating to reorganisations should occur. This should take place within three years of point 1 being completed. The reason for this being the second priority is that reorganisations, whilst less common, are typically more risky.
3. Standards relating to market claims, automatic transformations and buyer protection (referred to collectively as transaction management) should be implemented 3 years after point 2.
4. The implementation timetable of standards relating to company meetings and shareholder transparency has yet to be considered.

<u>Standards</u>		<u>Proposed implementation timeline</u>
<i>Standards relating to entitlement</i>		
27	<p><i>For all transactions that give rise to a transfer in ownership other than collateral transactions:</i></p> <ul style="list-style-type: none"> <i>i) Market claims associated with fixed income cash distributions should be raised if the intended settlement date is on or before the record date but the actual settlement date is after record date.</i> <i>ii) For all other instruments and types of distributions claims should be raised either if:</i> <ul style="list-style-type: none"> <i>a) Trade date is before ex date and actual settlement date is after record date; or</i> <i>b) Trade date is on or after ex date and actual settlement date is on or before record date.</i> <i>iii) For all bilateral input trade date must be a matching field.</i> 	Within 3 years after all standards relating to reorganisations have been implemented.
28	<i>It should be possible for parties on OTC transactions to indicate that their trade is ex or cum if not in line with the default status as defined by the ex date.</i>	
29	<i>The giver of collateral can be considered as the party who will be entitled to receive the equivalent of any corporate action benefit unless otherwise agreed</i>	



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<i>Standards relating to raising market claims</i>		
30	<i>All SSS should generate and process market claims on behalf of their clients.</i>	Within 3 years after all standards relating to reorganisations have been implemented.
31	<i>If a SSS raises claims for market participants the market claims must be clearly identified and reported at both the time of identification (regardless of whether they can be settled or not within that SSS.) and when the claim settles.</i>	
32	<i>If any SSS automatically raises claims for market participants, the claim must reference both the corporate action and the underlying transaction that gave rise to the claim.</i>	
33	<i>For collateral transactions: Based on standard 30 market claims should be raised for all outstanding returns of collateral</i>	
<i>Standards relating to the processing of market claims</i>		
25	<i>All market claims associated with cash distributions should be in cash and not coupons</i>	Within 3 years after all standards relating to reorganisations have been implemented.
34	<i>Market claims must never be settled prior to the payment date of the relevant corporate event.</i>	
35	<i>The default settlement of a market claim for transactions other than collateral is that it should, if possible settle at the same time as the underlying transaction. However, it should be allowed to settle the underlying transaction before the market claim.[finality to be mentioned and the debate on claim settling before the underlying to be included in text as outstanding issue]</i>	
36	<i>For collateral returns the market claim should settle as soon as possible after the start of the payment date.</i>	

Next Steps

The ECSDA welcomes any comments on this paper and the proposed standards. Responses should be sent to the association by the end of September 2006.



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The standards are in some areas already widely accepted and used throughout Europe but in other areas there is very little adherence. As an important next step, the ECSDA will complete a full adherence analysis and include it in an update report at a later date.

ECSDA is working very closely with other bodies to implement standards. To this end all national markets are currently setting up implementation committees at the local level to ensure momentum and progress is continued. Currently, these committees are looking at standards 11 – 26 but will also look at standards 27 – 36 if and when the standards are considered final.

The ECSDA will now focus on distributions with options with the aim to release any associated standards during H2 2006.



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Introduction

In response to Giovannini barrier 3, this document looks at market claims and defines the standards needed to bring maximum benefits for all in this area of the market.

Market claims are processes that redistribute corporate action proceeds where needed so that the entitled party receives the benefit. This could be necessary due to transactions (e.g. a fail) or positions (e.g. due to a lent position). In all cases the process is related to distribution type corporate actions and looks at who is the actual holder of security on a record date as well as the entitled holder. For example, if a buyer is entitled to a cash dividend benefit but the seller is still the holder on record date, a market claims process recognises this and creates an obligation from the seller to the buyer to ensure the cash dividend reaches the entitled party.

This paper looks at inefficiencies in the current processes in Europe and recommends 10 new standards to be implemented as soon as possible so as to reduce the costs of clearing and settlement within Europe, particularly in a cross border environment.

Corporate Action Barriers

As a reminder, the Giovannini report identified corporate actions as key area that needed to be harmonised:

Removing Barrier 3

National rules relating to corporate actions processing should be harmonised. The local agent banks acting through the European Credit Sector Associations and together with ECSDA should coordinate private-sector proposals. National governments should co-ordinate their response via the relevant EU Council. This barrier should be removed within three months of removing Barriers 7 and 1

Corporate Actions are often considered complex, inefficient processes that are destined always to be highly risky, paper based and outside the straight through processing world. The ECSDA



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does not subscribe to this view. Whilst the ECSDA recognises that it will be some time before 100% automation can be achieved, all corporate actions can be broken into component parts allowing a high degree of harmonisation to be achieved without reducing the flexibility and complexity that issuers need.

This paper deals with market claims, as explained above, and for the purpose of this paper, this field of corporate actions can be broken into the following component parts:

- Standards relating to entitlement;
- Standards relating to the raising of market claims; and
- Standards relating to the processing of market claims

Each of these areas is addressed in turn.



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Standards relating to entitlement

As explained in the introduction, market claim processing is based on ensuring that an entitled party receives all corporate action benefits that it should receive. To this end it is important to note that market claims are associated with transactions and, potentially, holdings and the standards in this section are dedicated to providing clarity across markets about who should or should not (eventually) receive corporate action proceeds.

In the first ECSDA report on corporate actions⁴, the concept of three different dates associated with distributions was introduced. These dates were:

1. Ex date. The date at which point trading occurs without expectations of receiving the benefit associated with a distribution and is a key date in relation to pricing of securities, market claims and entitlement positioning. It can be defined as: ‘The date as from which trading (including exchange and OTC trading) occurs on the underlying security without the benefit.’⁵
2. Record date. The date at which it is determined who will receive any benefit associated with the distribution. This can be defined as: ‘The date at which positions are struck at the end of day to note which parties will receive the entitlement’. This date is not applicable to holders of physical bearer securities outside of (I)CSDs or other SSS, as in these cases entitlement is proved by presenting a coupon to a paying agent.
3. Payment date. ‘The date at which the distribution is due to take place (cash and/or securities)’.

These dates are vital in the area of market claims as they are key to determining the process of who is entitled to any given corporate action benefit.

From the definition of ex date already agreed it is clear that any trade completed in ordinary circumstances prior to the ex date is one where the buyer has bought ‘cum’ and can expect to receive any benefit from corporate actions on the traded security. For any trade completed on or after the ex date the trade is dealt ‘ex’ and the seller can expect to receive any benefit from corporate actions on the traded security.

⁴ *The European Central Securities Depositories Association’s response to the Giovannini report barrier 3, Corporate Actions – Part 1 Mandatory Distributions*, published in June 2005.

⁵ The ex date relates to trading in pricing terms, but the concept of ex date is used when raising claims for all transfers of securities. Consequently, claims are raised on portfolio transfers that are not really trades.



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In its first report the ECSDA spent some time discussing the most efficient order of dates and it is worth repeating its conclusions here as it impacts the number of market claims that could be raised based on the standards later in the paper. *Standard 17* stated that: “**For fixed income⁶ only record date and payment date will be provided on any announcement. For any other distribution the announcements of the corporate action data associated with the event will include an ex date (defined as a ‘start of day’ date), record date (defined as a ‘close of day’ date) as well as a payment date.**”⁷ This proposed timeline is the basis of analysis for the rest of this paper.

Based on standard 17, the following diagrams show the entitlement position for all securities:

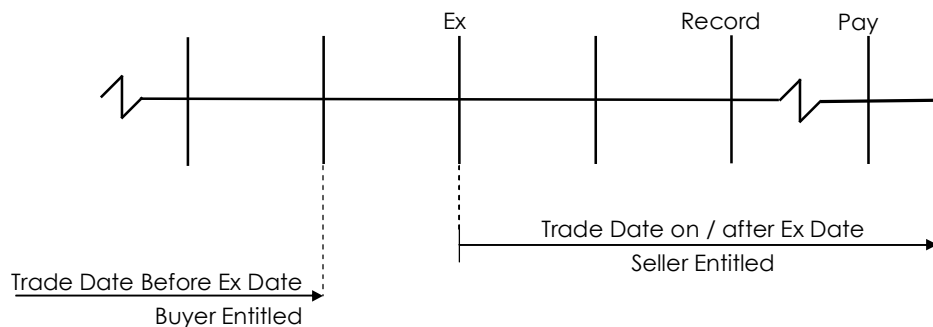


Diagram 1: Equity

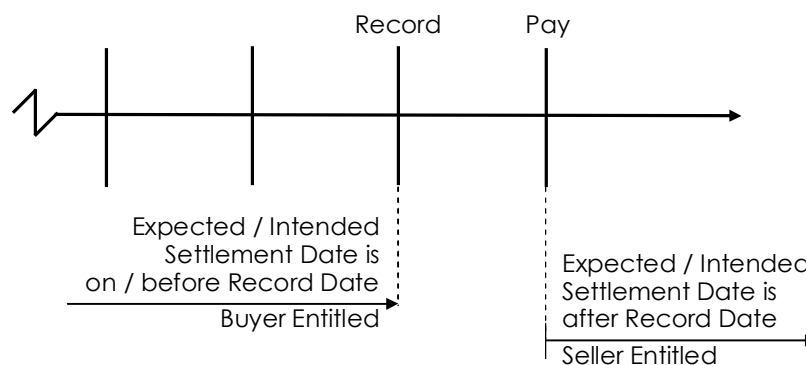


Diagram 2: Fixed Income

⁶ In the area of fixed income, this paper refers to fixed income in percentage form.

⁷ The reasoning and basis for this standard (including why no ex date is needed for fixed income is discussed in *The European Central Securities Depositories Association’s response to the Giovannini report barrier 3, Corporate Actions – Part 1 Mandatory Distributions*, published in June 2005 on from page 25 onwards.



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Following this rationale it is then possible to determine when a claim should or should not be raised. As presented in the ECSDA report on corporate actions from 2002 a number of questions need to be asked to determine the rules for market claims

1 – Who is entitled to the benefit? This is determined using the rules associated with ex date/trade date for equity type securities or intended settlement date/record date for fixed income type securities.

2 – Who receives the benefit? This is determined by whether the transaction relevant to the investigation has settled or not prior to the record date. If the transaction has not settled it can be assumed the seller receives the benefit and if it has settled by this time, the buyer. ECSDA recognise that the seller may itself be awaiting the relevant securities but this does not affect the rationale or process.

3 - Are the answers to questions 1 and 2 the same? If yes, there is no need for a market claim. However, if no, a market claim must be raised.

Based on this rationale the ECSDA has concluded that the first standard in this area should be:



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Standard 27

For all transactions that give rise to a transfer in ownership other than collateral transactions:

- i) Market claims associated with fixed income cash distributions should be raised if the intended settlement date is on or before the record date but the actual settlement date is after record date.*
- ii) For all other instruments and types of distributions claims should be raised either if:*
 - a) Trade date is before ex date and actual settlement date is after record date; or*
 - b) Trade date is on or after ex date and actual settlement date is on or before record date.⁸*
- iii) For all bilateral input trade date must be a matching field.*

Diagram 3 shows what this standard would mean in practice. Following this standard, transactions number 2 and number 4 in the following diagram would give rise to market claims in favour of the buyer and seller respectively but transaction numbers 1 and 3 would not.

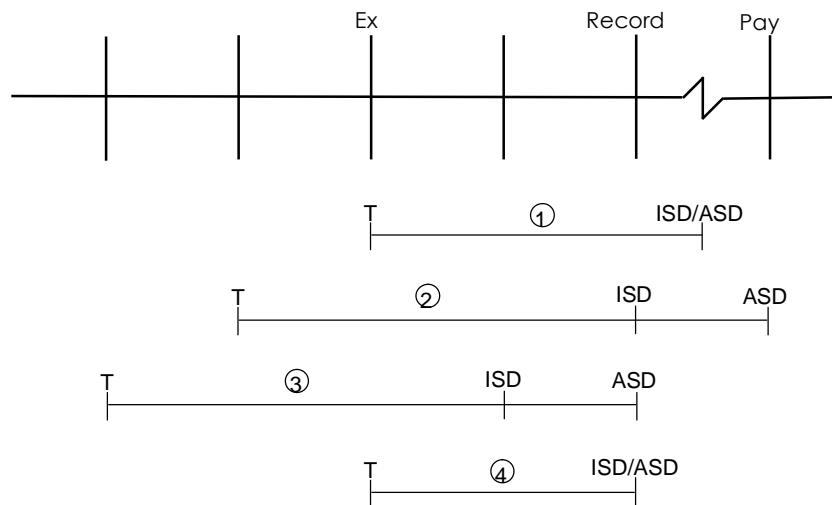


Diagram 3: Equity (ISD = Intended Settlement Date for the transaction, ASD = Actual Settlement Date for the transaction)

For fixed income diagram 4 shows that transactions numbers 6 and 8 would give rise to market claims but transactions numbers 5 and 7 would not.

⁸ This is most likely to occur for OTC transactions.



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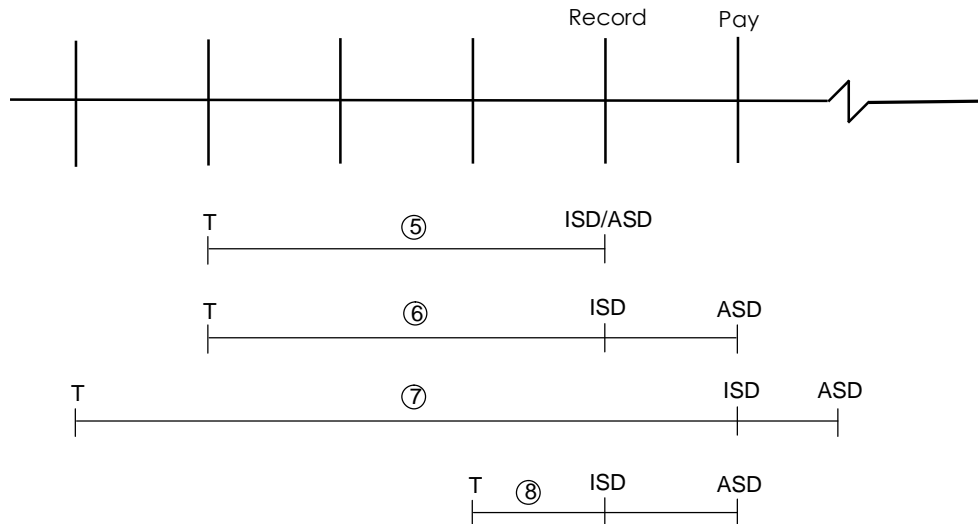


Diagram 4: Fixed Income (ISD = Intended Settlement Date for the transaction, ASD = Actual Settlement Date for the transaction)

Whilst this process is straightforward for stock exchange transactions, during the discussion process the ECSDA members noted that in the area of OTC transactions parties often choose not to trade on a standard settlement cycle or agreed bilaterally who should be entitled to any benefits irrespective of the ex date. Although the same rules could apply in these circumstances it should be possible for parties to note that a transaction differs from the default rules as proposed in standard 27:

Standard 28

It should be possible for parties on OTC transactions to indicate that their trade is ex or cum if not in line with the default status as defined by the ex date.

Finally, the ECSDA noted that collateral movements follow different rules. It is unreasonable for example, to expect a stock loan return to be based on an ex date. ECSDA believes that it is common practice and right that any corporate action benefit should be with the party who has temporarily sold / transferred them to another party.

Standard 29

The giver of collateral can be considered as the party who will be entitled to receive the equivalent of any corporate action benefit unless otherwise agreed.

For both DVP transactions and collateral movements the ECSDA noted that there is an ISO field available for parties to show to the system raising market claims if these rules are not to be followed.



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Benefits of standards 27- 29

As in previous papers by the ECSDA, this paper follows each set of standards with the benefits of their introduction and any barriers to their implementation that can be envisaged at this stage. In the case of these four standards, the ECSDA has identified the following benefits:

- Straight through processing. By providing clarity on the rules all parties can build systems and processes across borders that allow for STP without needing manual intervention.
- Efficiency. By creating an environment where there is STP and very little manual processing the efficiency of the process will be increased. Associated with this process is that the level playing field issues that today affect holders in different circumstances (retail or institutional, different countries etc) will be eliminated.
- Reduced risk. One of the problems with market claims processing is to do with counterparty risk, financial risk etc and by minimising the issues associated with market claims, risk will be reduced as well.
- Harmonisation. By having one set of rules for all markets harmonisation is achieved.
- Transparency. Perhaps the most important benefit is transparency of the parties to a transaction.

Barriers to Implementation for standards 27 – 29

As with all changes there will always be reasons why implementation cannot be immediate. For these four standards there are a number of practical difficulties that the ECSDA foresees and these will make implementation challenging in some areas.

- Legal . Firstly, transfer of ownership rules need to be changed or clarified in some markets for this process to gain all benefits (e.g. Belgium, Finland, France, Greece, Italy, Lithuania, and Spain). This will take time and is an issue for the Commission's Legal Certainty Group to take forward.
- Trade Dates. As mentioned above for the process to work, trade date will need to be input in all cases so that it can be compared to ex date. This is not currently the case in all markets and will require infrastructure and market practice changes.
- Settlement cycle. Settlement cycles need to be harmonised before the full benefit of these standards become effective.



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Standards relating to raising claims

Once it has been identified that a claim needs to be processed, it is important to create an obligation for the seller and buyer to move the appropriate corporate action benefit between them. Whilst many in the industry believe that whether this process is run by the SSS or its clients should be a matter of choice for each SSS and their clients, after much discussion, the ECSDA felt that this process should be processed centrally if the maximum benefits are to be achieved. This debate centred on the fact that due to the standards set out in the ECSDA's first report on corporate actions the incidence of market claims should be reducing and thus, the cost benefit analysis for building such functions may differ in and between markets. However, given the importance of ensuring that buyers and sellers complete any contract between them, the ECSDA believes that an SSS should provide a service especially so that cross border there could be no situation where one SSS leg in one country was left to the parties on the transaction and one processed by the SSS in another creating cross border risk. This means, for example, that in any netted environment clients or the SSS must be able to identify and settle the component parts that might give rise to the market claim.

Standard 30

All SSS should generate and process market claims on behalf of their clients.

In addition to the SSS processing market claims for their clients, the ECSDA debated whether SSS clients should have the ability to input their own market claims in the system. The ECSDA did not feel comfortable with clients being able to input transactions identifiable as market claims and agreed this should not be allowed.

In relation to whether an SSS client could delete the centrally generated market claim or not, the ECSDA agreed that the market claim should allow the same settlement rules (e.g. hold and release or deletion) as the underlying transaction (e.g. if clients can delete the underlying transaction they should be allowed to delete the market claim) but ultimately this was a matter for each SSS.

However, it was felt that the CSD could not stop (or even identify) clients settling the resources associated with a market claim elsewhere, either via normal settlement transactions (if securities) or outside the system if they so wish.

The ECSDA spent some time debating the characteristics of the market claim. These market claims are part of the original contract between buyer and seller and so are related to the underlying transaction although the market claim is not expected at time of the trade. Therefore, the ECSDA felt strongly that any market claim centrally generated needs to be clearly identified as a market claim to ensure that both buyer and seller understand why a new obligation between them has been created.



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Standard 31

If a SSS raises claims for market participants the market claims must be clearly identified and reported at both the time of identification (regardless of whether they can be settled or not within that SSS) and when the claim settles.

The ECSDA discussed when identification should take place. There was agreement that claims should be raised on matched⁹ (e.g. transaction 2 in diagram 3) or settled (e.g. transaction 4 in diagram 3) transactions from the end of Record date onwards. Although it was noted that a claim for transaction 4 in diagram 3 could be raised from before the end of record date (i.e. on its settlement) it was felt that the minimum requirement was to raise claims from the end of record date as this would ensure notification before the payment date and the corporate action itself should be confirmed at this time (which might not be the case before record date).

The ECSDA then went further into how and when an SSS should identify market claims. Discussion was held on those cases when the corporate action benefit could not be settled through the SSS (due to its currency or security characteristics). It is proposed that SSS should identify such claims even if it cannot be settled within that SSS and that it must be clear to parties which claims can settle or not either through SLAs, flags or some other indicator.

The ECSDA noted that identifying the market claims as market claims is not enough for the parties associated with the market claim. They also need to know why the market claim has been identified. Consequently:

Standard 32

If a SSS raises claims for market participants, the claim must reference both the corporate action and the underlying transaction that gave rise to the claim.

Finally in terms of identifying market claims the ECSDA had a long discussion on how best to manage collateral movements. It was noted that SSS have two methods for identifying returns of collateral, either via transactions or by special balance types. In either case:

Standard 33

For collateral transactions: Based on standard 30 market claims should be raised for all outstanding returns of collateral

Benefits of standards 30 - 33

As with the standards relating to entitlement the standards relating to identify the market claims have significant benefits for the market:

⁹ Matched includes any transaction that is ready for settlement (e.g. those transactions that need bilaterally matching plus those that only require single sided input). The ECSDA is aware that whether single sided input will be allowed in the future is dependent on other initiatives (e.g. the ESF and ECSDA Recommendations for standardised pre-settlement date processes)



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- Reduced risk. By identifying the market claims early, participants will be able to better manage their open transactions, obligations and counterparty risk.
- Improved efficiency, simplicity, clarity and STP. By providing clear and concise reporting, parties will be in a position to have automation and efficiency.
- Reduced cost. With centralised reporting and processing the manual cost of each party will be vastly reduced allowing cost efficiency throughout the markets.
- Increased transparency. By identifying market claims before they settle, there should be clarity to CSDs, CCPs, parties, regulators.

Barriers to Implementation for standards 30-33

The following issues need to be addressed.

- CCPs. Today, it is often the case that CCPs net claims with all other transactions with no extra reporting. To change this process will mean a cost to all members of the CCP.
- Cost. Although the benefits of SSS market claims processing are large, particularly across borders, the ECSDA recognise that other standards (e.g. ECSDA's standard 18) relating to the order of ex and record date are designed to minimise market claims. As such, the cost benefit of building such market claims processing systems may become harder to justify.
- Timing. Aligned with the cost issue faced by all, timing is significant. There are some major issues in the markets at the moment (e.g. the implementation of TARGET2) meaning there is only limited scope for extra change. This could delay the process of implementation.
- Legal. In many cases implementation will be based on best practice rather than regulation. Whilst this should be feasible, it may be that implementation efforts show that in certain areas legal changes may be needed to ensure all standards can be met. The ECSDA believes the legal certainty group should analyse possible fiscal and legal aspects associated with market claims. Following and as part of this work, local regulations (such as Stock Exchange rules) will be needed to be taken into account and potentially changed.
- Market acceptance. Although all (I)CSDs have discussed the point with members of their markets, obtaining market acceptance cannot be taken for granted but will be needed before implementation can occur. This is true for all types of market members including exchanges, CCPs, brokers, custodians, central banks etc.



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Standards relating to the processing of market claims

Once the market claim has been identified it needs to be processed. One of the key elements within this processing is that parties across all markets believe they are processing the same resources. As identified in the first ECSDA report on corporate actions there is one issue that needs to be standardised in this area. This ECSDA report from June 2005 noted that in some markets cash distributions are still processed using coupons. Although this should be phased out over time the ECSDA already noted that any market claims associated with this process should be in cash in all markets.

Standard 25

All market claims associated with cash distributions should be in cash and not coupons

The ECSDA discussed in great detail when the market claim should settle in relation to the payment date of the corporate action and the transaction that caused it to be created. This was contentious and is dependent on the rules in each market associated with matching and settlement. Consequently, it is unlikely that these standards can be finalised until such time as these rules are harmonised.

The ECSDA recognised that as any market claim was associated with a contract (and underlying transaction) then the market claim should, when possible, settle with the rest of the contract. However, the ECSDA looked at three particular issues in this area.

1. Firstly, it is possible, and often likely, that the rest of the contract (the underlying transaction) has settled before the payment date of the corporate action. All the ECSDA members felt it would be unfair that any debit party on a market claim should have to give up any resources before it had received them from the issuer. In this case it would be prudent to allow the underlying transaction to settle prior to the claim and that the claim never settles before the payment date of the corporate action.
2. The second and third issues were based around the possibility that liquidity and settlement would be adversely affected if the market claim and underlying transaction would have to settle together. This is because more resources would be needed to settle with the two transactions settling together than if they were independent. Firstly, the ECSDA recognised that if the underlying transaction could settle before the market claim there would be no issue in it doing so and that it should not be held up due to a market claim not being able to settle. It was recognised, however, that in doing so counterparty risk is created for the buyer as they have paid for both the bought securities and the benefit but only received the bought securities.
3. The more complex issue was where the market claim could settle before the underlying transaction. All felt that the market claim was part of the contract but there were differing views on the irrevocability of such a contract in different scenarios. For standard DVP transactions many felt that a market claim should never settle if the underlying transaction had not settled. Others felt that if the underlying transaction had been matched then the parties had shown that a valid contract had been entered into and



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a claim could be settled but in this case there would be seller risk due to giving up resources before being paid for them. In this case any deletion of the underlying transaction would mean the parties would have to reverse the market claim. The ECSDA then recognised that for collateral movements the position was more complicated still as the collateral returns may often not settle for many months and it would be strange not to settle the market claim in these circumstances if it could be settled.

Taking these issues into account the ECSDA proposes that:

Standard 34

Market claims must never be settled prior to the payment date of the relevant corporate event.

Standard 35

The default settlement of a market claim for transactions other than collateral transaction is that it should, if possible, settle at the same time as the underlying transaction. However, it should be allowed to settle the underlying transaction before the market claim

At this stage the ECSDA could not agree on a standard regarding whether the claim should settle before the underlying transaction for DVP transactions. The ECSDA felt this could only be agreed once irrevocability rules associated with matching were finalised, which is expected later in 2006. The ECSDA will revisit this issue at that time but would welcome market views on the issue. However, for collateral returns the ECSDA did agree a standard.

Standard 36

For collateral returns the market claim should settle as soon as possible after the start of the payment date of the corporate event.

Finally tax was considered and it was felt that market claims need to take into account any relevant tax. However, as this was part of the overall data within a claim, the work did not constitute standards but would be part of the implementation work to introduce the standards into all markets. However, at a minimum market claims should be raised taking into account a default tax rate for all.

Benefits of standard 25 and standards 34 – 36

- Reconciliation. This benefit can be attributed to the standards as a whole but is in this section as it is the end of the process. For the business of any given day it is important that investors can reconcile easily and efficiently their cash and securities associated with the securities business. This is true for expected movements to take place and for reconciling what has settled. An automated market claims process allows such reconciliation to be more efficient.



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- **Contractual.** It is important that the complete contract of any trade or collateral movement can settle in the same place. This creates efficiency in the back office and STP etc.
- **STP.** As for reconciliation STP is enhanced if one set of processes are used for the financial industry compared with multiple ones.
- **Liquidity.** By allowing an automated movement of the resources liquidity should be enhanced.
- **Risk.** The three points above as well as back office efficiency reduce risk in this area.

The benefits of these barriers are based around efficiency, STP and liquidity. Clearly, in cases where the end benefit can be received without any need for an interim security such as coupons, costs are reduced whilst efficiency, STP and liquidity are increased.

Barriers to Implementation for standard 25 and standards 34 - 36

Given the size of the change significant implementation concerns have been raised:

- **Central Banks.** As the majority of (I)CSDs now process in central bank money it will be important to gain agreement from all relevant central banks. In some markets the idea of corporate action proceeds being paid via the same cash process as for other types of security business is very new and discussions with the central banks will be necessary.
- **Irrevocability.** As mentioned above, until matching rules are finalised it is impossible to have a final decision on standards in this area. The ECSDA will revisit this issue at that time but would welcome market views on the issue.
- **Cost.** Any such change may mean that SSS would have to change their IT systems in an area where other standards mean the benefits are minimised.



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Appendix 1 – Terms and Definitions

Definitions are taken mainly from the Second Giovannini Report but all terms from the first ECSDA report from April 2004 are repeated for consistency regardless of whether they are used in this paper or not. Definitions should be considered only in terms of this report.

Batch or batch processing:	the transmission or processing of a group of payment orders and/or securities transfer instructions in batches at discrete intervals of time.
Broker-dealer:	a person or firm sometimes acting as broker and sometimes as principal intermediary in securities transactions.
CESR:	Committee of European Securities Regulators
CET:	Central European Time (GMT + 1).
Clearing:	the process of transmitting, reconciling and, in some cases, confirming payment orders or security transfer instructions prior to settlement, possibly including the netting of instructions and the establishment of final positions for settlement. Sometimes the term is used (imprecisely) to include settlement.
Clearing house:	an entity which provides a range of services related to the clearing of transactions and payments, and the management of risks associated with the resulting contracts.
Collateral:	assets used / pledged as a guarantee to obtain liquidity.
Collateral transactions:	movements of resources to transfer resources on a temporary basis with a pre agreement to return them at a certain time. E.g. a stock loan, repo or movement related to ‘collateral’.
Corporate actions:	In this paper, we use the term “corporate actions” to cover all the processes which arise from the announcement by an issuer or his agent that an event affecting holders of the



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	relevant security is to take place up until the moment when all effects of that event are complete ¹⁰ .
Counterparty:	the opposite party in a financial transaction or in a transfer of financial instruments.
Credit risk/exposure:	the risk that a party will not settle an obligation in full, either when due or at any time thereafter.
Cross-border settlement:	a transfer of financial instruments and / or cash which takes place between accounts located in different countries.
cross-system settlement:	a transfer of financial instruments and / or cash which takes place between accounts located in different SSS.
Custodian:	an entity, often a bank, which safekeeps and administers financial assets on behalf of others and which may also provide various other services.
Custody:	the safekeeping and administration of financial instruments on behalf of others.
Dematerialisation:	the elimination of physical certificates or documents of title, which represent ownership of securities so that securities exist only as accounting records.
Distributions:	events where an issuer of a security delivers to a holder of those securities a particular benefit or “resource” (e.g. cash, securities, rights, etc) and where the underlying holding which gave rise to the distribution is unchanged by the event. The most obvious example is a cash dividend where a shareholder receives cash (or coupons) but his original shareholding is unaffected. These events can be mandatory or mandatory with options but cannot be voluntary.
Domestic settlement:	a settlement, which takes place in the country in which both parties’ accounts to the transaction are located.

¹⁰ By announcement it should be noted that this includes both original documentation at time of issue as well as specific documentation relating solely to an event. Equally, it should be noted that a few specific occurrences, such as default proceedings, are announced by a court or a trustee rather than an issuer or his agent directly.



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DvP:	delivery versus payment, including both net and gross settlement.
ECB:	European Central Bank.
ECSDA:	the European Central Securities Depository Association.
Ex date:	The date as from which trading (including exchange and OTC trading) occurs on the underlying security without the benefit.
ESCB:	European System of Central Banks.
Fail / failed transaction:	a failure to settle a securities transaction on the contractual settlement date, usually because of a lack of resources. Fail is usually distinguished from “default”. It is also called a failed transaction.
Financial instruments:	all types of securities including fixed income, money market instruments etc. that are not necessarily counted as securities in a particular market.
Fixed income securities:	means any bond (government or corporate), note, or other debt instrument with the exclusion of any debt instrument giving access to the Issuers’ share capital.
FoP:	free of payment, including both net and gross settlement.
Integrated:	Settlement method that uses for the payment leg central bank money accounts located on the SSS platform although they remain "property" of the NCB.
Interfaced:	Settlement method that uses for the payment leg central bank money accounts located in the central banks, while securities accounts are with the SSS.
International central securities depository (ICSD):	a securities settlement system, which clears and settles international securities or cross-border transactions in domestic securities. At present, there are two ICSDs located in EU countries, Clearstream Banking Luxembourg, Euroclear Bank and one in Europe outside the EU, Sega Intersettle.



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Irrevocable

Transfer / settlement:

a transfer that is legally enforceable and is, even in the event of insolvency proceedings against a participant, binding on third parties.

Link between SSS:

a link consists of all the procedures and arrangements, which exist between two SSS for the administration / transfer of financial instruments and cash between the two SSSs.

Mandatory events:

events that will occur without any action required by individual holders of the security. They may involve, for example, an issue of securities, a reorganisation (i.e. mandatory exchange) or certain payments.

Mandatory events with options: those events that will occur without any action on the part of the holders of the security, but in relation to which the holders have some choice as to the type of benefit they may receive.

Market Claims

Market claims are processes that redistribute corporate action proceeds where needed, so that the entitled party receives the benefit. This could be necessary due to transactions (e.g. a fail) or positions (e.g. due to a lent position). In all cases the process is related to distribution type corporate actions and looks at who is the actual holder of security on a record date as well as the entitled holder.

Next value date settlement:

the transfer of financial instruments and / or cash on the business day before the agreed settlement date.

Operational risk:

the risk of human error or a breakdown of some component of the hardware, software or communications systems, which is crucial to settlement.

OTC:

over the counter transactions, i.e. outside of a regulated exchange.

Participant:

a party who participates in a SSS, is allowed to send payment and/or securities' transfers orders directly to the SSS or which is directly bound by the rules governing the SSS. The term participant as used in this text may also



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	include, as the case may be, the Account Operators of an SSS.
Payment date:	The date at which the distribution is due to take place (cash and/or securities).
Pledge:	a delivery of property to secure the performance of an obligation owed by one party (the debtor/pledger) to another (the secured party). A pledge creates a security interest (lien) in the property so delivered.
Pre banking day settlement:	any transfer of financial instruments, and / or cash, prior to the opening of the relevant central bank on any given day. It is also often referred to as overnight settlement.
Record date:	The date at which positions are struck at the end of day to note which parties will receive the entitlement.
Registration:	the listing of ownership of financial instruments in the records of the issuer, its transfer agent/registrar, or a CSD.
Reorganisations:	events where the issuer replaces a security with another resource ¹¹ . The issuer will deliver a benefit to a holder of the security affected by the corporate action. The shareholder's holding in the original security will be removed from the account or become valueless as part of the event. For example, a security (A) is replaced by another security (B) or other resources (stock and /or cash). There are, of course, exceptions where a reorganisation leads to no change in holdings, such as a name change.
Resources	Financial instruments and cash.
Security Settlement System (SSS):	a system which permits the holding and transfer of securities, either free of payment (FOP) or against payment (DvP). It comprises all the institutional arrangements required for the settlement (and sometimes the clearing) of securities trades and the safekeeping of securities.

¹¹ It is noted that this is a generalisation as there are events, e.g. exchanges where the rights of holders change but the actual ISIN, holdings and transactions do not. In these cases, the new "resource" is not apparent. However, for the sake of this document these events are noted but not dealt with.



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Settlement of securities occurs on securities deposit accounts held with the CSD, ICSD or institution in charge of operating the system.

Settlement:

an action which discharges obligations in respect of funds or financial instrument transfers between two or more parties. A settlement may be final or provisional.

Settlement finality:

irrevocable and unconditional settlement.

TARGET:

Trans-European Automated Real-Time Gross Settlement Express Transfer: the TARGET system is defined as a payment system composed of one RTGS system in each of the countries which participate in stage three of EMU and the European Central Bank (ECB) payment mechanism. RTGS systems of non-participating countries may also be connected, provided that they are able to process the Euro alongside their national currency. The domestic RTGS systems and the ECB payment mechanism are interconnected according to common procedures (“interlinking”) to allow cross-border transfers throughout the European Union to move from one system to another system.

Transaction management

the processes available to ensure that any parties involved in a transaction are assured of receiving the correct economic benefits due to them if the transaction is affected by a corporate action.

Unconditional:

A transfer that may not be revoked by a participant in a system, nor by a third party.

Voluntary events:

events in which holders of a security need to act if the event is to affect their holdings. The issuing company will usually inform all holders of the event that is about to take place; sometimes this notice is provided in the original offering documentation for the security. If no action is taken by the holder then his holding will be unaffected by the event.



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Appendix 2 – Current Participating Members of ESCDA Working Group 5

Elisabeth Karner / Georg Fink

Rudi De Pauw

Ozren Cvjetic

Julian Dinkov

Vesna Zivkovic

Nodas Cl. Metaxas

Jaraslava Vlková

Kjeld Christensen

Peter Jensen

Katrin Sagar

Ana Maria Valdes

Hanna Vainio / Kimmo Koskinen

Veronique Jehan

Mathias Papenfuß

Vagelis Tsekrekos

Tamas Madlena / Erika Gabányi

Einar Sigurjonsson

Michael Kempe (Chairman)

Carla Bachechi

Angelo Gilardi

Raitis Vancans

Saulius Merkys / Arturas Keleras

Hans Hengeveld

Katja Goldsworthy

Leszek Kolakowski

Helena Lopes

Adriana Tanasoiu

Nikolay Egorov

Austria – OeKB

Belgium – Euroclear Belgium

Bosnia & Herzegovina – CRS and RSFB

Bulgaria – CD AD

Croatia – CDA

Cyprus – CSE

Czech Rep – SCP and UNIVYC

Denmark – VP

Denmark – VP

Estonia – ECSD

Euroclear Bank

Finland – APK

France – Euroclear France

Germany and Luxemburg – Clearstream

Greece – HCSD

Hungary – Keler

Iceland – ISD

Ireland and UK – CREST

Italy – Monte Titoli

Italy – Monti Titoli

Latvia

Lithuania – CSDL

The Netherlands – Euroclear Netherlands

Norway – VPS

Poland – NDS

Portugal – Interbolsa

Romania – BSE

Russia – NDC and DCC



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Vida Uzelac / Vesna Korosec

Dagmar Kopuncová

Boris Tomaz Snuderl

Mark Jones

Eva Hellstrom

Martin Trueb

Tanju Gunel / Filiz Kaya

Serbia & Montenegro – CSD and CDA

Slovak Rep / CDCP SR

Slovenia – IBER

Spain – Iberclear

Sweden – VPC

Switzerland – SIS

Turkey – Takas



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Appendix 3 – Previous ECSDA standards relating to Giovannini barrier 3.

<u>Standards relating to Mandatory Distributions</u>	
	<i>Standards Relating to announcements</i>
11	<i>All issuers whose securities are held via a CSD must ensure their primary CSD is informed of the official details of a corporate event, at a minimum, as soon as the announcement has been made. This includes any official intention, change or confirmation of an event.</i>
12	<i>This must be by using formatted electronic messaging from the issuer at least throughout the chain of intermediaries.</i>
13	<i>At a minimum announcements should be made three days before ex date for cash distributions</i>
14	<i>All CSDs receiving this information should make the information available, without undue delay of receipt from the issuer, at a minimum to all their participants (including other SSS) who have a direct holding or pending transaction in the corporate action security within the CSD at the time of the announcement. The announcement should also be made available to any participant who obtains a new holding or is subject to a new transaction that will be affected by the event. The announcement should be formatted and transmitted electronically in an agreed standard.</i>
15	<i>In case of non-formatted text on the announcement by the issuer (or its agent) the announcement should include a translation into English.</i>
16	<i>If a reversal of an event is necessary, an announcement should be made prior to processing and all aspects of the event should be reversed.</i>
	<i>Data relating to announcements</i>



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17	<i>For fixed income only record date and payment date will be provided on any announcement. For any other distribution the announcements of the corporate action data associated with the event will include an ex date (defined as a 'start of day' date), record date (defined as a 'close of day' date) as well as a payment date.</i>
18	<i>For cash distributions, the ex date should be n business days before the record date, where n is one day less than the settlement cycle. i.e. For a T+3 market the ex date should be 2 days prior to record date.</i>
19	<i>For stock distributions the ex date should be n business days before the record date, where n is one day less than the settlement cycle</i>
20	<i>Payment date should be as close to record date as possible, preferably the next working day.</i>
21	<i>The issuer should be responsible for setting and announcing the ex date, record date and payment date. Where necessary the issuer should set these dates with its primary exchange and / or its primary (I)CSD.</i>
22	<i>The dates for a distribution should be the same in all countries.</i>
23	<i>Settlement cycles should be harmonised across Europe</i>
	Resources
24	<i>All mandatory cash distributions should be in cash and not coupons.</i>
25	<i>All market claims associated with cash distributions should be in cash and not coupons</i>
	Processing
26	<i>For financial instruments held within an SSS, all cash relating to corporate actions and market claims should have the default of being distributed via the SSS system.</i>