

Practice reference: OF-OST-TRANSFO-01

## Transformations in mandatory reorganizations

<b>Versioning</b>	Version	1.0
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### I. DESCRIPTION OF THE EXISTING PRACTICE & OF THE IMPACTS

<b>Description of the existing practice</b>	<p>Today in the ESES platform, the transformation process is applied to the account of participants for corporate actions consisting in mandatory reorganizations.</p> <p>A transformation is defined as a process whereby a settlement instruction in a matched status, not settled as of the end of the day of the record date is cancelled and replaced automatically by Euroclear by one or more instructions according to the terms of the reorganization.</p>
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<b>Description of the T2S impact</b>	<p>In the context of T2S, the ESES platform was initially scheduled in the DSD Market Claims and Transformations to apply the standard defined by the Corporate Actions Sub-Group on the detection, the management and the payment of transformations on mandatory reorganizations in T2S.</p> <p>The transformation process defined by Euroclear consisted in two steps on the record date, end of day (Close of Business – COB), for settlement instructions in a ‘matched’ status and with an intended settlement date on or before the record date:</p> <ul style="list-style-type: none"> <li>- Cancellation of the initial settlement instruction</li> <li>- Creation of one or more new settlement instructions ‘already matched’ identified with the code ‘TRAN’ in the field settlement conditions, according to the terms of the mandatory reorganization in cash or securities – with possibly an indemnification in case of fractions.</li> </ul>
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<b>Description of the major issue</b>	<p>Euroclear informed the market on January 2016 that from September 12<sup>th</sup> 2016 onwards, with the launch of T2S, the full transformation process would not be available.</p>
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	<p>Only the first step, consisting in the cancellation of the underlying instruction, would be available, operation carried out either by:</p> <ul style="list-style-type: none"> <li>- The ESES platform (CTHP qualifier in sese.024 messages)</li> <li>- The T2S platform (qualifier CANS in sese.024 messages – business rules MVIC 313) based on data communicated by ESES</li> </ul> <p><u>but the creation of one or more new settlement instructions corresponding to the second step of the transformation would not be carried out by the ESES platform yet.</u></p> <p>This represents a regression in terms of service to custodians by Euroclear. A market practice must thus be defined allowing for custodians, from September 12<sup>th</sup> 2016, to keep on managing transformations on behalf of their clients.</p> <p>This market practice should get as close as possible to CAJWG standards and to CASG recommendations in order to make up for the regression by the time of the launch.</p> <p>Custodians will only handle the creation of one or more new settlement instructions for transformation purposes, in accordance with the terms of the mandatory reorganization in securities and/or cash, and must define a market practice allowing for the quick and efficient matching of settlement instructions in T2S, except when the cash leg of the instruction is in T2 (when the ISIN code no longer exists and that no instruction can be input in T2S).</p> <p>This market practice will be composed of 2 parts:</p> <ul style="list-style-type: none"> <li>- Part One will be dedicated to the implementation for mandatory reorganizations in securities. Participants will be in a capacity to send settlement instructions in T2S corresponding to transformation-related market claims.</li> <li>- Part Two will be dedicated to the design of a solution allowing to handle adjustments related to the transformation process for operations where the underlying security reaches its maturity. T2S will in effect reject instructions on securities which reached their maturity, the ISIN code no longer being presented in the referential. This applies to mandatory reorganizations in cash.</li> </ul>
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<p><b>Description of the roles and responsibilities of the actors involved (OPTIONAL)</b></p>	
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<b>Workflows (OPTIONAL)</b>	
<b>Links with other market practices</b>	OF-OST-RETRO-01

## II. RECOMMENDED MARKET PRACTICE

<b>Recommended practice</b>	<p>When transformations are made in securities (principal and indemnification), regularizations must be carried out in T2S: Free of Payment for principal, PFOD (Payment Free of Delivery) for cash indemnifications when the price of the security is known before the Record Date, with predefined characteristics facilitating matching for participants.</p> <p>When the price of the security is known before the record date, the regularization of fractions can be carried out based on a bilateral agreement between the parties.</p> <p>When the transformations must be made in cash, regularizations must be made in cash in T2.</p> <p><u>In scope of the procedure:</u></p> <ul style="list-style-type: none"> <li>– OTC transactions</li> <li>– Transactions on markets cleared by CCPs other than LCH SA are considered as OTC transactions for the purpose of the procedure.</li> </ul> <p>To be noted that this procedure can also apply to mandatory reorganizations with multiple proceeds (ex: credit of securities and cash, or credit several ISIN codes). Euroclear does not handle, and does not anticipate to handle these cases. Participants must thus continue to manage these transformations bilaterally.</p> <p><u>Out of the scope of the procedure:</u></p> <ul style="list-style-type: none"> <li>– Transactions on regulated market cleared by LCH SA are subject to transformations managed by LCH SA, and will remain so, LCH SA ensuring both the cancellation and the transformation according to CASG rules.</li> <li>– Settlement instructions mentioned in the Euroclear DSD are excluded from the transformation process: 'AUTO', 'CORP', 'COLI', 'COLO', 'ISSU', 'PLAC', 'NETT', 'TRPO', 'INSP', 'TURN', 'OWNE', 'OWNI' (*). NB: because of defect #27092 during the test phases, instructions types 'OWNE' and 'OWNI' are wrongfully not excluded from the transformation process.</li> </ul>
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Instructions eligible to transformation:

Free of Payment with matching, or Delivery Versus Payment with matching:

- In ‘matched’ status at the time of the Record Date (RD) at end of day, “Close of Business” (COB).
- With a Trade Date (TD) or on before the RD, whatever their intended settlement date (ISD) and of which the actual settlement date (ASD) is not on or before to RD COB.
- Without the OPT-OUT indicator (\*\*).

(\*) No configuration should normally lead to the processing of market claims for this type of instruction

(\*\*) The OPT-OUT indicator being defined as ‘NOMC’ mentioned on the underlying instruction.

NB: CUM/EX indicators are not applicable to transformations. If they are mentioned on the underlying instructions, they should be ignored.

Eligibility rules to ensure the generation of transformations:

Case	TD <or= RD	ASD <or=RD	OPT-OUT Indicator	CUM/EX Indicator	Creation of a transformation
1	Yes	Yes	No	N/A	No
2	Yes	No	No	N/A	Yes
3	Yes	Yes	Yes	N/A	No
4	Yes	No	Yes	N/A	Cancellation only
5	No	No	No	N/A	No
6	No	No	Yes	N/A	No

**Part One**

**Transformations in securities**

This first part will be dedicated to transformations in securities, included cases of reorganizations with an indemnification of fractions in T2S.

Scope of operations

The below mentioned list is not exhaustive, all corporate action event (CAEV) the settlement of which is due in securities will be subject to the transformation procedure described in the present market practice.

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As examples, the following CAEV can result in transformation in securities:

- CHAN : Change in the characteristics of the security (with change in the ISIN code)
- CONV : Conversions in securities
- EXOF : Exchange of securities
- EXWA : Warrants exercise (against securities)
- MRGR : Mergers
- PARI : Assimilations
- REDO : Change in the currency of the nominal
- SOFF : Split of securities
- SPLF : Divisions
- SPLR : Reconstitution
- LIQU : Liquidation

Process steps:

- At the time of the record end of day (RD COB), Euroclear cancels the underlying transaction and custodians identify instructions eligible to the transformation (*see section Transaction eligible to the Transformation*) (\*)
- To this end, a solution is to use the cancellation report “Cancelled by Third Party” (CTHP) when the cancellation is triggered by ESES which is the most frequent case, or “Cancelled by T2S” (CANS) when the cancellation is triggered by T2S (see appendix 9 of the DSD) with the motive ‘MVIC313’ in the field ‘Additional reason information’.  
**To be noted** that when clicking on ‘Status’ in Euroclear Connect for Screens, one gets the ‘reason narrative’ of the cancellation, with the business rule when applicable (ex: ‘cancelled by yourself’, ‘no related business rule’, ‘business rule mentioned’). These reportings can be exported through a selection of the cancelled instructions (filter by status). One gets the output (list of cancelled instructions), but a priori not with the details ‘reason narrative’ nor the T2S reference.
- On the next business day in the morning, custodians send the settlement instructions resulting from the transformation according to the eligibility and management rules mentioned below.  
DCPs send their requests for creating instructions in T2S, and ICPs send their requests for creating instructions to the CSD.
- (\*) According to CASG rules, the detection period of 20 business days after the record date should not apply, in a first step, when the maturity date of the security is filled with the payment date of the corporate action (until the delivery of T2S CR-0515).

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Characteristics and format of transformation instructions:

In order to facilitate matching and settlement in T2S, settlement instructions directly created by the custodian must respect the rules below:

- Mention the T2S reference of the underlying T2S instruction ‘Matching reference’ in the field ‘Common Identification-CMONLD’.

The table below mentions the fields in which such data is available depending on the type of messaging (ISO 15022, ISO 20022, Euroclear Connect for Screens).

	ISO 15022	ISO 20022 via Euroclear	EuroclearConnect
Instruction status	MT 548	Sese.024	View Transactions screen
(cancellation)	:20C::MITI	Market Infrastructure Transaction Identification	
MITI		<MktInfrstrctrTxld>	T2S reference
Instruction statut	MT548	Sese.024	View Transactions screen
(cancellation)	:20C::PROC	Supplementary Data	
Matching reference		SplmtryData\RltdTxld	T2S matching reference

- On the contrary to the standards, these instructions issued by custodians will not present the ISO settlement condition code ‘TRAN’, which is a privilege of the CSD.
- Keep when appropriate the same indicator ‘Partial Settlement’ as in the underlying instruction
- Keep when appropriate the same ‘Hold and Release’ as in the underlying instruction
- Keep the same Trade Date of the underlying instruction.
- Fill the intended settlement date with the latest of the CA payment date and the intended settlement date of the underlying instruction.
- Keep the same counterparty details as the underlying instruction (the BIC11 in the field Party1 must be identical to that of the original transaction), as well as all optional fields (\*).
- Conform to the ratio method, full balance or ratio compliant as defined by the issuer (see the section Reorganizations in securities with fractions).
- If several transformation instructions must be created, they must not be linked (case of transformations with an indemnification of fractions)
- Where instructions concern registered securities of the type VEN ‘Valeurs Essentiellement Nominatives’ (essentially nominative shares), the ‘Code Type Opération’ (‘CTO’) ‘GO’ must be mentioned in the field 22F ‘Registered Transaction Type’ (REGT) in ISO 15022 messages, or

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<Regn><Prtry><Id>00GO</Id><Issr>EGSP</Issr></Prtry></Regn> in ISO 20022. Each participant should use the appropriate account structure.

(\* ) In order to avoid mismatching, it is not recommended that the optional field 'SAC Account' is used in the counterparty details.

## Part Two

### Transformations in cash

For most reorganizations in cash, it will not be possible to send to T2S settlement instructions because the security will have reached its maturity at the time the corporate action is paid. As a consequence, these operations will usually be paid in T2.

### Scope of operations

The below mentioned list is not exhaustive, all corporate action event (CAEV) the settlement of which is due in cash will be subject to the transformation procedure described in the present market practice.

As examples, the following CAEV can result in transformation in cash:

- REDM : Final redemptions
- MCAL : Anticipated redemptions / calls
- EXWA : Warrants exercises in cash
- CHAN : The qualifier used by Euroclear to advise mandatory repurchase (TEND MAND)
- EXOF : Exchange of securities against cash (the underlying security having reached its maturity)
- PCAL : Partial redemption / call with reduction in the nominal (debit of part of the underlying securities – in this case the security will not have reached its maturity, but it will be included in the part two of the procedure for simplification purposes)
- LIQU : Liquidations

### Process steps:

The party due to receive the difference must **initiate the reclaim** of the amount to its counterparty via e-mail, providing its banking details and the details of the corporate action in the form (see Appendix 3)

- At the time of the record end of day (RD COB), the CSD cancels the underlying transaction and custodians identify instructions eligible to the transformation (see section Transaction eligible to the Transformation)
- To this end, a solution is to use the cancellation report "Cancelled by Third Party" (CTHP) when the cancellation is triggered by ESES which the most frequent case, "Cancelled by T2S" (CANS) when the cancellation is triggered by T2S (see appendix 9 of the DSD).

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	<p>- The regularization of the transformation in cash will be made <b>through a netting in T2</b>: in order to avoid multiple instructions, it would be desirable that a single transfer instruction is created, with an amount corresponding to the difference between the initial instruction amount and the amount of the corporate action.</p> <p><b>Both parties must bilaterally agree</b> on the amount and details of the cash transfer.</p>
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Description of the roles and responsibilities of the actors involved (OPTIONAL)	
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Workflows (OPTIONAL)	
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### III. IMPLEMENTATION

Implementation timeline	Before the migration to T2S	Upon go live on T2S	After the migration to T2S
	<input type="checkbox"/> Date: _____	<input checked="" type="checkbox"/> Date: 12/09/2016	<input type="checkbox"/> Date: _____



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## APPENDIXES

### Business rules for creating transformation instructions

#### APPENDIX 1 – Mandatory reorganizations in securities

Ex. Stock split (SPLF). According to the terms of the corporate action, each former security A is replaced by 2 new securities B.

At the time of the Record Date end of day (RD COB), the following instruction against payment is matched and settled.

100 Securities A  
Seller X ----- → Buyer Y  
< -----  
500 EUR

After the cancellation of the underlying instruction by ESES, market participants will have to send the following instruction:

- A delivery vs payment from the seller to the buyer to transfer the corporate action proceed in exchange for the amount of the initial transaction

DVP (Delivery Versus Payment) = settlement instruction in T2S aiming at delivering securities against payment

200 Securities B  
Seller X ----- → Buyer Y  
< -----  
500 EUR

In the case where the initial underlying transaction is not against payment (free of payment), a settlement instruction (free of payment as well) must be created by market participants from the seller to the buyer to transfer the proceeds of the corporate action.

FOP (Free Of Payment) = settlement instruction in T2S aiming at transferring securities only

200 Securities B  
Seller X ----- → Buyer Y

#### Mandatory reorganizations in securities with fractions

The issuer can decide to announce the ratio for the corporate action according to one of the two methods described below.

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The use of one method or another influences the calculation of the proceeds to be received and market participants must apply the method chosen by the issuer, both for the calculation of the payment based on positions settlement at RD COB, but also for the calculation of market claims on eligible instruction not settled.

If transformation instructions are not created by both parties using the method chosen by the issuer (\*), quantities calculated may be different, resulting in mismatching of the instructions in T2S.

(\* ) this information is presented in the forms of paying agents, in the Euronext advice and in SWIFT messages from the CSD (field MILT = 1 if the method is full balance or field MILT = nb of former securities & denominator of the ratio for the ratio compliant method

- The 'Full balance' method means the corporate action proceed is calculated by applying the ratio to the total quantity of former securities. This method is recommended by CAJWG standards, allowing to maximize the proceeds to be received.
- The 'Ratio compliant' method means that the corporate action proceeds is calculated by applying the ratio to the quantity of former securities multiple of the ratio. This method is not recommended as it does not allow to maximize the proceeds of the corporate action for the beneficiary.

### 'Full Balance' Method

**Example 1:** reverse stock split (SPLR). According to the terms of the corporate action, 3 former securities A must be replaced by 5 new securities B.

At RD COB, the following instruction against payment must be matched and not settled.



The buyer is eligible for a quantity of 22 securities A. The application of the ratio leads to a total quantity of former securities \* ratio (5/3) = 36.66666 new securities B.

**Scenario 1:** the issuer does not indemnify fractions OR fractions are indemnified but the reference price is communicated after the RD.

After cancellation of the underlying transaction by ESES, market participants must send the following instruction:

- A delivery versus payment instruction from the seller to the buyer to transfer new securities rounded to the inferior in iexchange for the initial amount of the transaction
- The remaining fraction of the transformation will be handled at the discretion of the custodian of the buyer.

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DVP:



**Scenario 2:** the issuer announces that fractions are indemnified AND the reference price is communicated before the record date (at the latest on D-1 of the record date according to the standards and the market practice defined by AFTI Corporate Action Expert Group).

The reference price for the indemnification of fractions is 9 EUR for each security B.

After cancellation of the underlying instruction by Euroclear, market participants must send the following instructions:

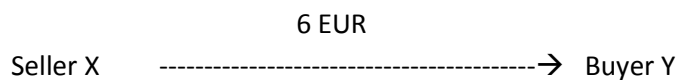
- A delivery versus payment instruction from the seller to the buyer to transfer new securities rounded to the inferior in exchange for the initial amount of the transaction
- A second instruction in cash from the seller to the buyer to transfer the amount corresponding to the indemnification of the fractions.

Instruction 1: DVP



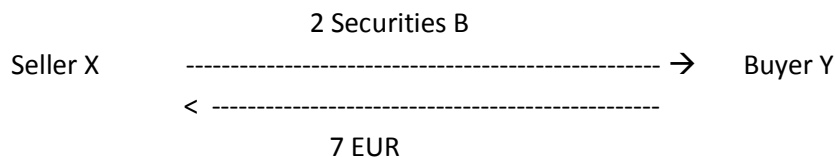
The fraction part of 0.66666 must be indemnified at a price of 9 EUR:  $0.66666 * 9 \text{ EUR} = 6 \text{ EUR}$

Instruction 2: PFOD



**Example 2:** Reverse stock split (SPLR). According to the terms for the corporate action, 3 former securities A must be replaced by 1 new security B.

At RD COB, the following instruction against payment is matched and not settled.





**T2S Market Practice Adaptation Workgroup  
Market Practice Sheet**



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At RD COB, the following instruction against payment is matched and not settled.



The buyer is eligible to a quantity of 21 securities A. After applying the ratio on the quantity of former securities, he is eligible to receive 35 new securities B.

The remaining fraction to be indemnified corresponds to the number of underlying former securities remaining (non multiple of the ratio), times the ratio :

1 former security A (=remaining quantity of former securities), that is 22 (quantity of former securities multiple of the ratio, that is 21) \* ratio (5/3) = 1.66666 security B to indemnify.

The cash amount corresponding to the fraction is: 1.66666 security B to indemnify \* reference price (9 EUR) = 15 EUR

After cancellation of the underlying transaction by Euroclear, market participants will have to send the following instructions:

- A delivery vs payment instruction from the seller to the buyer to transfer new securities rounded to the inferior, in exchange for the initial amount of the transaction.
- A second instruction in cash from the seller to the buyer to transfer the amount corresponding to the indemnification of the fractions.

Instruction 1: DVP



The remaining fraction of 1.66666 must be indemnified at the price of 9 EUR: 1.66666 \* 9 EUR = 15 EUR

Instruction 2: PFOD



**Scenario 2** : the issuer does not indemnify fractions OR fractions are indemnified but the reference price is communicated after the RD.

After the cancellation of the underlying instruction by Euroclear, market participants will have to send the following instructions:

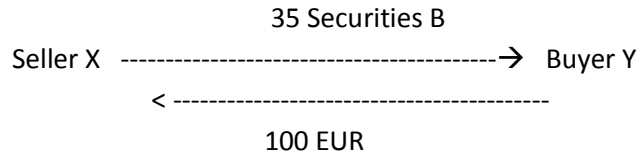
- A delivery vs payment instruction from the seller to the buyer to transfer the new securities rounded to the inferior in exchange for the initial transaction amount
- The fractions in the transformation is ignored.

**T2S Market Practice Adaptation Workgroup**  
**Market Practice Sheet**



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A DVP instruction



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## APPENDIX 2 – Mandatory reorganizations in cash

**Example 1:** Final redemption (REDM). According to the terms of the corporate action, each bond C is redeemed for 3,000 EUR.

At RD COB, the following delivery vs payment instruction is matched and not settled.

100 Bonds C  
Seller X -----> Buyer Y  
<-----  
300,005 EUR

After the cancellation of the instruction by Euroclear, market participants will have to bilaterally agree and make one single cash transfer.

The amount corresponding to the final redemption is 300,000 EUR = 100 bonds \* 3,000 EUR.

The initial transaction amount is 300,005 EUR. The difference between the two amounts to 5 EUR. In this case, the buyer owes the seller 5 EUR.

The seller will reclaim 5 EUR to the buyer by e-mail using the form. It will be the party that must receive the cash that will send its request to its counterparty by e-mail.

**Example 2:** Final redemption (REDM). According to the terms of the corporate action, each bond C is redeemed at 3,000 EUR.

At RD COB, the following delivery vs payment instruction is matched and not settled.

100 Bonds C  
Seller X -----> Buyer Y  
<-----  
290,000 EUR

In this example : the seller delivers 100 bonds C which are redeemed at 3,000 EUR, amounting to a total of 300,000 EUR.

The initial amount of the transaction is 290,000 EUR. The difference between the two amounts to 10,000 EUR. The seller owes 10,000 EUR to the buyer.

The buyer must reclaim 10,000 EUR to the seller on the next business day after the RD using the form below.

In case the initial underlying transaction is free of payment, only the amount of the corporate action will be transferred. In that case, it will be the buyer who will send its reclaim to the seller in order to get the proceeds back.

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### Appendix 3 – Form for Transformations in cash

#### Transfer request after Transformation corporate action

<b>Corporate Action</b>
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Name of the requestor	
Account number of the requestor at the custodian	

Name of the counterparty	
Identification of the counterparty at its custodian	

<b>Corporate Action details</b>			
Type of corporate action (REDM/MCAL/EXWA)		ISIN	
Name of the security		Ex-date	
Payment date		Record date	
COAF/CORP		CA price	

<b>Transaction details</b>			
Trade date		Amount	
Delivery/Receipt			
Intended Settlement Date		Quantity	
Transaction reference (T2S matching reference)		Indicators (OPT-OUT)	

<b>Requested amount</b>		
Description	CCY	Amount
Transaction amount - CA amount = difference to be reclaimed	EUR	
Value date		

<b>Details of the account to be credited</b>	
Name of the intermediary Bank	
BIC Code of the intermediary Bank	
Name of the Beneficiary Bank	
BIC Code of the Beneficiary Bank	
IBAN of the account of the Beneficiary at the Beneficiary's Bank	

Contacts

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Signatures