Transformations on reorganizations corporate actions

Versioning	Version	2.0
	Publication date	24/05/2018

I. DESCRIPTION OF THE EXISTING PRACTICE & OF THE IMPACTS

Description of the existing practice	Prior to T2S platform roll-out, the transformation process was applied to the account of participants for corporate actions consisting in mandatory reorganizations. A transformation was 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 was cancelled and replaced automatically by Euroclear by one or more instructions according to the terms of the reorganization.

Description of the T2S impact	In the context of T2S, the ESES platform implemented the standards defined by the Corporate Actions Sub-Group on the detection, the management and the payment of transformations on mandatory reorganizations in its March 2017 release (detailed in the DSD Market Claims and Transformations). Important: this Market Practice Document will need to be updated as soon as; Stream 6 will be implemented on the French Market and the market participants do agree on the Transformation for Reorganizations. Moreover, in June 2019 a new T2S Change Request to implement a new "CANT" status for cancellations of parent trades further to the tranformation process execution. The transformation process defined by Euroclear consists at record date, end of day (Close of Business – COB), for settlement instructions : - In "pending" status with an intended settlement date before or equal to RD. and - In "matched" status with intended settlement date after RD. This is divided in: - Cancellation of the initial settlement instruction in all cases.

- For some cases by 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 and the COAF reference.

The detection period is limited to 20 business days from Record Date.

Illustrative table of the transformation process:

Trade date before (RD or PD – 1)	Settlement before or = (RD or PD-1)	OPT OUT indicator	Transformation exec
Yes	Yes	No	No
Yes	No	No	Yes for Reorg withou options [2]
No	No	No	
Yes	Yes	Yes	No
Yes	No	Yes	Cancellation only
No	No	Yes	

[2] solely the cancellation of the instruction for mandatory reorganizations with options

Description of the major issue	Instruction types excluded from the transformation processing

linstruction transaction code	Spécific use
AUTO	Auto collatéralisation
CORP	Ost sur solde
COLI/COLO	Collateralisation
ISSU/PLAC	TCN et Emission
NETT	Netting LCH Clearnet
INSP/TURN	Instructions Euroclear

Comment : LCH Clearnet directly handles the transformation corporate actions

Including OWNE, CONV, TRPO, TRVO

The cancellation of the initial instruction is always done and depending on:
- ESES platform (CTHP qualifier in sese.024 messages)
- T2S platform (qualifier CANS in sese.024 messages – business rules 311 or MVIC313) based on data communicated by ESES

Creation of one or multiple transformation instructions:
List of transformation instructions not automatically created/processed by Euroclear :

– Mandatory Reorganisation with options
It will not be generated until Stream 6 implementation on the FR market whereby pending settlement instructions will be identified at the closing of the corporate action (market deadline COB) with the execution of the default option.

– Deferred Settlement Services instructions eligible to transformations will be cancelled by Euroclear. The processing needs to be handled bilaterally.

	– <u>T</u>ransformations with multiple proceeds Euroclear cannot generate transformations if there are multiple proceeds to deliver. – Cross Border transformations instructions For all above cases, custodians must contact their counterparty to process the transformation. Therefore a market practice is required. Note on mandatory reorganization corporate actions with odd lots indemnification: the market claim is not handled by ESES when the reference price is communicated after the record date. In such case, a bilateral transaction must be put in place by counterparties as soon as the reference price is published by the issuer or its agent.

Description of the roles and responsibilities of the actors involved (OPTIONAL)	

Workflows (OPTIONAL)	

Links with other market practices	OF-OST-RETRO-01

II. RECOMMENDED MARKET PRACTICE

Recommended practice	When transformations are made in securities (principal and indemnification), regularizations must be carried out in T2S: via FOP (Free of Payment) for principal and via PFOD (Payment Free of Delivery) for cash indemnifications when the price of the security is known after the Record Date, with predefined characteristics facilitating matching for participants. When the transformations must be made in cash, regularizations must be made in cash in T2. Two participants may mutually agree to input PFOD trades in T2S as well.

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.

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).

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 (cancellation) MITI	MT 548	Sese.024	View Transactions screen T2S reference
	:20C::MITI	Market Infrastructure Transaction Identification <MktInfrstrctrTxId>	
Instruction status (cancellation) Matching reference	MT548	Sese.024	View Transactions screen T2S matching reference
	:20C::PROC	Supplementary Data SplmtryData\RltdTxId	

– On the contrary to the standards, these instructions issued by custodians will not present the ISO settlement condition code 'TRAN'.
– 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 <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). - The regularization of the transformation in cash will be made **through a netting in T2**: 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. **Both parties must bilaterally agree** on the amount and details of the cash transfer.

Description of the roles and responsibilities of the actors involved (OPTIONAL)	

Workflows (OPTIONAL)	

III.   IMPLEMENTATION

Implementation timeline	Before the migration to T2S	Upon go live on T2S	After the migration to T2S
	☐ Date: _____	☑ Date: 12/09/2016	☐ Date: _____

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 secuirities against payment

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

In the case where the initial underlying transaction is not aga`int 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.

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 issued, both for the calculation of the payment based on positions settlement at RD COB, <u>but also for the calculation of market claims on eligible instruction not settled</u>.

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.

```
                        22 Securities B
Seller X        -------------------------------------------------- →    Buyer Y
                <  ------------------------------------------------
                         100 EUR
```

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 <u>after</u> 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 <u>rounded to the inferior</u> in exchange 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.

DVP:

```
                        36 Securities B
Seller X      -------------------------------------------------- →     Buyer Y
              < ----------------------------------------------
                        100 EUR
```

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 particiapnts must send the following instructions:

- A delivery versus payment instruction from the seller to the buyer to transfer new securities <u>rounded to the inferior</u> 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

```
                        36 Securities B
Seller X      -------------------------------------------------- →     Buyer Y
              < ----------------------------------------------
                        100 EUR
```

The fraction part of 0.66666 must be indemnified at a price of 9 EUR: 0.66666 * 9 EUR = 6 EUR

Instruction 2: PFOD

```
                        6 EUR
Seller X      ------------------------------------------→   Buyer Y
```

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

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

```
                        2 Securities B
Seller X      -------------------------------------------------- →     Buyer Y
              < ----------------------------------------------
                        7 EUR
```

The buyer is eligible to receive 2 new securities A * ratio (1/3) = 0.66666 new security B, meaning that the proceed only corresponds to fractions.

Scenario 1: The issuer announces that fractions are indemnified AND the reference price is communicated before the record date (at the latest D-1 of the RD 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:

- An instruction in cash from the buyer to the seller to transfer the amount of the initial 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: PFOD

Seller X   Buyer Y
                < --
                        7   EUR
                (amount for the initial transaction)

The remaining fraction 0.66666 must be indemnified at the price of 9 EUR: 0.66666 * 9 EUR = 6 EUR

Instruction 2: PFOD

                    6 EUR
            (Indemnification of the fractions)
Seller X   --→   Buyer Y

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 take no action because the fraction musst not be handled in this case.

'Ratio Compliant' Method

Back to 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.

Scenario 1: the issuer announces that fractions are indemnified AND the reference price is communicated before RD (at the latests on D-1 of the RD according to standards and 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.

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

```
                    22 Securities A
Seller X    ------------------------------------------------- →    Buyer Y
            < ----------------------------------------------
                    100 EUR
```

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

```
                    35 Securities A
Seller X    ------------------------------------------------- →    Buyer Y
            < ----------------------------------------------
                    100 EUR
```

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

Instruction 2: PFOD

```
                    15 EUR
Seller X  -------------------------------------→  Buyer Y
```

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

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

Practice reference: OS-OST-TRANSFO-01

- 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.

<u>A DVP instruction</u>

```
                        35 Securities B
Seller X   -----------------------------------------→  Buyer Y
               < ----------------------------------------
                        100 EUR
```

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.

Practice reference: OS-OST-TRANSFO-01

Appendix 3 – Form for Transformations in cash

Transfer request after Transformation corporate action

Corporate Action	

Name of the requestor	
Account number of the requestor at the custodian	

Name of the counterparty	
Identification of the counterparty at its custodian	

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

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

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

Details of the account to be credited	
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

Philippe Dupont +33 1 42 98 46 23

Signatures