

Revised version
7 August 2006



Abstract of proposals to harmonise and standardise key corporate actions processes

1. Introduction

Corporate actions processing is considered one of the most complex, costly and risky part of post trade activities, a situation that is aggravated by a high diversity of national rules and market practices in Europe.

EALIC, EBF, ECSDA, ESF and FESE have agreed on a joint strategy, a plan, a methodology and on a process to interact and cooperate in order to remove Barrier 3 of the Giovannini Report which asks for the harmonisation of national rules relating to corporate actions processing.

2. Objective

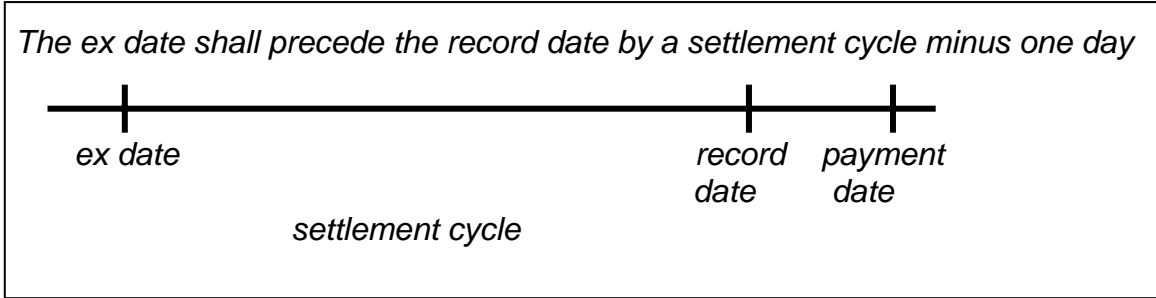
In this cooperation and in accordance with the ESF Action Plan 2005 the ESF Corporate Actions Expert Group has taken the lead to develop standards covering key corporate actions processes with a view to significantly reduce the main sources of cost and risk.

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3. Proposed standards

3.1. Record and ex date for cash and stock dividends processing

- Proposed standard

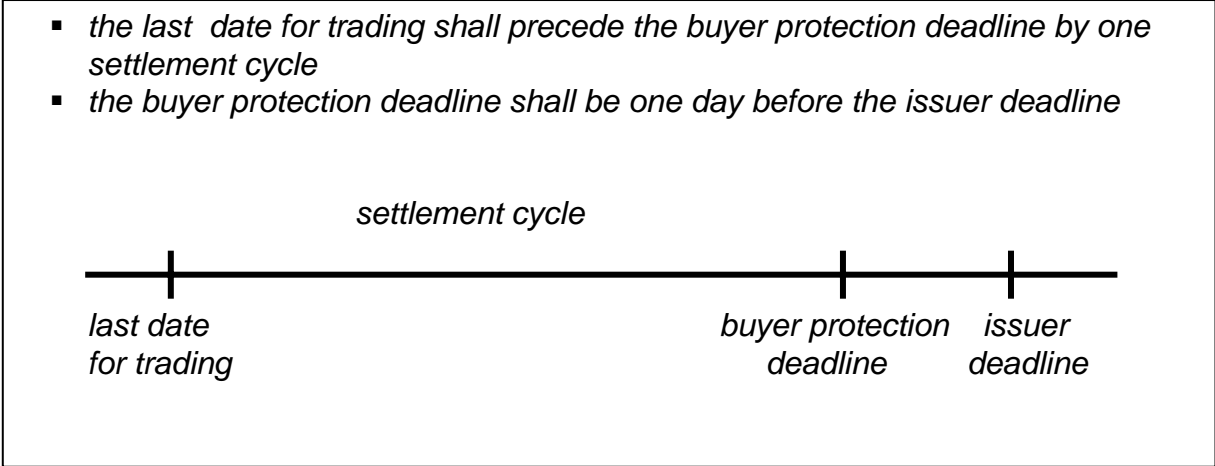


- **Scope of application**
 - all DvP equities transactions
 - those FoP equities transactions that include a transfer of ownership
- **Settlement cycle:** two step concept to cover current differences in settlement cycles:
 - 1st step: relevant for multi-listings is the settlement cycle of the primary exchange
 - 2nd step: harmonisation of settlement cycle
- **Quantified cost benefits:** see cost benefits analysis on ESF's website www.eurosf.com (Publications / ESF documents)

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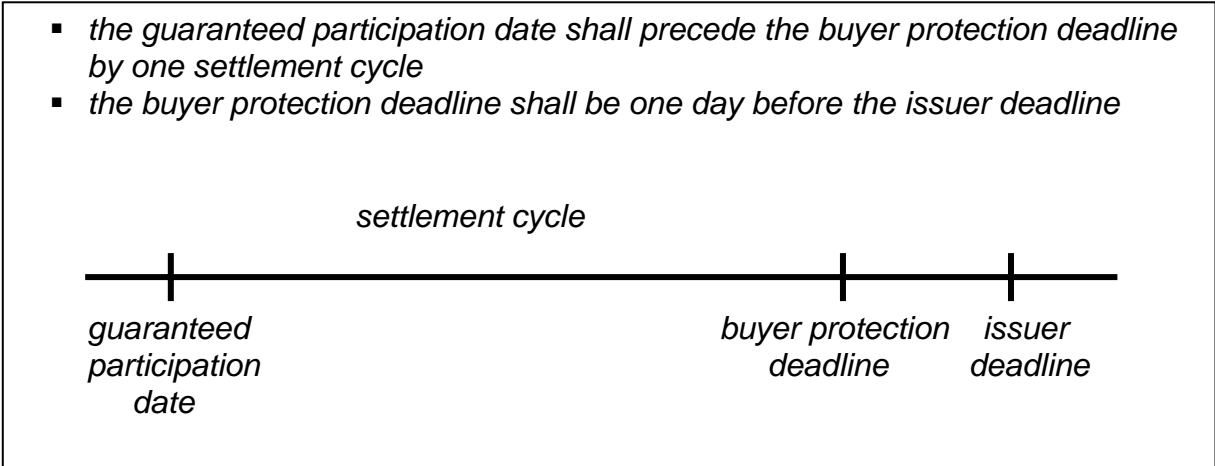
3.2. Key dates related to corporate actions processes

- **Proposed standard # 1 for Mandatory Corporate Actions with Options**



- **Scope of application:** Reference for this standard is specifically to instruments on which there is an option and the instrument will expire on or soon after the issuer deadline. For instance, expiring warrants, subscriptions rights and stock dividend rights. Equally, the Last Day For Trading applies to the same type of securities that will expire once the option deadline has passed. Currently in the UK market, rights will cease trading before the market deadline. This allows participants with high trading volume to reconcile positions after trading has ceased and allows for increased settlement before the market deadline, in turn reducing buyer protection. The application of the UK market approach across Europe to all expiring securities will considerably reduce risk to high trade volume participants.

- **Proposed standard # 2 for Voluntary Corporate Actions**



- **Scope of application:** The proposal is that any On Market transaction has to be traded before the eligibility deadline (usually Buyer Protect Deadline minus 3 days) in order to participate in the event. Additionally, for matched OTC transactions with a trade date before the buyer protect deadline, a facility should exist within the CSD for the buying party to initiate buyer protection. The method envisaged is similar to the current ACON/ACOP process in CREST. Clearly for these types of events, and unlike expiring instruments detailed in Proposal 1, trading in the security cannot stop. Although it is agreed that in general there needs to be a final trading date for eligibility to a Voluntary event, there will continue to be considerable pressure from institutional investors who should not be disenfranchised before the market deadline. As such, there will continue to be sizeable activity in high risk and manual buyer protection. The proposal is therefore that matched OTC trades dates dealt between the Guaranteed Participation Date and the Buyer Protection Deadline may participate subject to bilateral agreement.

- For **optional dividends** that currently would not fit either model, we concur with the proposal for **interim securities**, which would then fit standard # 1.

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3.3. Default rules applicable to corporate actions processes

- **Proposed standards**
 - **Dividend distribution with stock / cash option**

The default rule applicable to dividend distributions that provide the option of stock or cash should be: **cash in the declared currency**.
 - **Voluntary corporate action event with election**

The default rule applicable to voluntary corporate action events, providing the alternative of taking action or no action should be: **no action**. *Examples of these types of voluntary events would be subscription/tender offers, conversions*
 - **Bonus rights issue**

The default rule applicable to bonus rights issues should be: **exercise the rights**, provided there is no cash disbursement on exercise (cash disbursement being an exchange against payment as opposed to a free exchange).
 - **Rights issue**

The default rule applicable to rights issue should be: **lapse the rights**. As opposed to Bonus Rights above, the decision to subscribe to new shares is an investment decision based on many factors. The proposed default therefore is to lapse unless explicitly instructed, buy the buyer, to subscribe.
 - **General clause**

The default rule for any corporate action event with option not specifically covered above should be: **take no action**.
- **Scope of application**
 - all corporate action events with an election to be made, both Voluntary and Mandatory with Options.
 - any type of transaction, on exchange or OTC, securities financing transactions, DvP, FoP, open trades (buyer protection), processed by a CSD or a CCP
 - It should be noted that these defaults apply to open transactions between market counterparties only. The default between a participant and its client will be determined by specific contractual agreement. The default applied by the issuer or CSD on uninstructed positions will be detailed within the terms of the issue and may not necessarily be identical to the default on open transactions.

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3.4. Buyer protection rules

- **Proposed standards**

Core proposal: Introduction of a new key date by which all buyer protect instructions would be required to be submitted by.

- **Timing of instruction:** on or prior to buyer protection deadline, i.e. one day before issuer deadline.
- **Conditions precedent to buyer protection:**
 - the trade is matched
 - after buyer protection deadline settlement will generally be restricted *
 - if traded on or before the guaranteed participation deadline / last date for trading, unilateral buyer protection will apply
 - if traded after the guaranteed participation deadline / last date for trading, only bilaterally instructed buyer protection will apply
- **Content of instruction:**
 - Security Identifier
 - Trade Date
 - Contractual Settlement Date
 - Trade Consideration
 - Trade Reference
 - Corporate Action Event Details
 - Nominated election
 - Contact Details
- **Form of instruction:** consideration choice in line with SWIFT standards: matched electronic instruction to warrant STP, i.e. legally binding electronic instruction issued by the receiving party on or prior to buyer protection deadline; for transactions with a trade date after guaranteed participation deadline / last date for trading the instruction must be matched by the remitting party by the buyer protection deadline.

**It is proposed that settlement of transactions that have been buyer protected should be restricted between the buyer protection deadline and market deadline to avoid dumping of an electable security close to the deadline. This could be achieved by the CSD enforcing a blanket settlement restriction, or by facilitating the lowering of settlement priorities to prevent settlement – probably the latter.*

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- **Scope of application**
 - market participants: any affected market professional
 - events: any corporate action event with an option (equity proxy voting not within scope of application), including convertible bonds, where applicable
 - transaction coverage: failed or pending transactions entered into on or off exchange, past record date positions and outstanding securities financing transactions (repos, stock loans and stock borrows)

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4. Benefits of proposed standards

Proposed corporate actions harmonisation introduces a standardised process across all European markets and currencies, which

- eradicates market diversities
- reduces specialisation needs and systems complexity
- increases fungibility and liquidity
- reduces cost and risk

5. Terminology

Buyer protection The process by which in respect of an elective corporate action, a buying¹ counterparty that has the legal right to participate in the event doesn't yet hold the securities (i.e party to an unsettled transaction) is able to (directly or indirectly) receive the required consideration choice.

Corporate action default rule The standard instruction to be applied to a corporate event in the absence of an instruction.

Ex date The date from which trading, including exchange and OTC trading, occurs on the underlying security without the benefit, the underlying security being the security that is affected by the relevant corporate action; ex date is understood as start of the business day on the specified date.

Guaranteed participation date The last day to trade to guarantee participation in the respective corporate action event.

Issuer deadline The date by which, at the end of the day, all intermediaries have to communicate to the issuer, or to the agent(s) appointed by issuer, the legally binding elections made by the parties identified to receive the benefit of the respective corporate action.

Record date The date on which positions are struck at the end of the day, the exact deadline to be specified, to identify which parties will receive the benefit of the respective corporate action.

¹ NB "buyer" might be lender in the case of a stock loan

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