



FEDERATION BANCAIRE DE
L'UNION EUROPEENNE
BANKING FEDERATION OF THE EUROPEAN UNION
BANKENVEREINIGUNG DER
EUROPÄISCHEN UNION



EUROPEAN SAVINGS BANKS
GROUP
GROUPEMENT EUROPEEN DES CAISSES
D'EPARGNE
EUROPÄISCHE
SPARKASSENVEREINIGUNG



EUROPEAN ASSOCIATION OF
COOPERATIVE BANKS
GROUPEMENT EUROPEEN DES BANQUES
COOPERATIVES
EUROPÄISCHE VEREINIGUNG DER
GENOSSENSCHAFTSBANKEN

HARMONISATION OF CORPORATE ACTIONS PROCESSING IN EUROPE

CASH DIVIDENDS

(March 2005)



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1. INTRODUCTION

1.1. Background

The Giovannini Group, acting as advisory body to the EU Commission on EU cross-border clearing and settlement arrangements identified, in two reports published in 2001 and 2003 respectively, a number of market practice, legal and tax barriers that must be removed in order to eliminate inefficiencies in EU cross-border clearing & settlement arrangements and to achieve an integrated post-trading environment for the EU securities market.

One of the market barriers, **Barrier 3**, relates to national differences in the rules governing **corporate actions**, beneficial ownership and custody.

The second report calls for the harmonisation by the market of the variety of national rules, information requirements and deadlines for Corporate Actions.

Mandate was given to the European Credit Sector Associations (ECSAs)¹ and to the European CSD Association (ECSDA) to take the lead in this initiative.

On behalf of the ECSAs, and in an effort to improve processing efficiency in European domestic and cross-border corporate actions, the Fédération Bancaire Européenne (FBE) has formed the Corporate Actions Task Force (CATF), with the aim of identifying the obstacles that prevent such efficiency and making recommendations with regard to their removal. This Task Force is comprised of expert practitioners from banks, as well as a correspondent member from the other two ECSAs to ensure appropriate coordination and consultation. Accordingly, the recommendations on cash dividends presented in this document have been endorsed by the three ECSAs and their respective members.

1.2. Approach to Recommendations

The approach taken to define these recommendations is a systematic analysis of the Corporate Actions processing and key indicators across the EU for a defined set of event types.

This document outlines a set of recommendations relating to a first set of event types, which is a simple **cash dividend**. Cash dividends are by far the most frequent corporate event, both in number of occurrences and in terms of values processed. They therefore mark an excellent starting point for the introduction of market standards.

The recommendations deal with specific aspects of **mandatory cash dividend processing**. Whilst the actors that perform the roles played in this process differ from country to country, the information and processing requirements are largely the same. The recommendations have been validated specifically against a number of major national and cross-border markets.

¹ The ECSAs are : The European Association of Cooperative Banks (EACB), the European Savings Banks Group (ESBG) and the Fédération Bancaire Européenne (FBE)



The ECSAs make a number of recommendations about the precise use of key dates that underlie the whole cash dividend process: ex date, record date and payment date.

They make a number of further recommendations with regard to specific elements of the process. These include:

- Payment Mechanisms
- Dematerialization and Interim Securities
- Notification process

Thus this document contains the first set of ECSA agreed recommendations, which will be put forward to national financial communities and governments to remove Giovannini Barrier 3. It should also be noted that these recommendations have been coordinated with other players working on corporate actions such as issuers (EALIC), infrastructures (ECSDA, FESE), as well as other market users (ESF).

1.3. Implementation Considerations

Recommendations are ideal market rules and practices. This ideal will not be achieved overnight and without sometimes the necessity to introduce changes at market level as well as institution level.

In terms of **implementation**, the ECSAs plan to seek Europe-wide endorsement of the recommendations at national level and identify major players who would be prepared to be early adopters and, thus, lead the market forward.

The application and actual implementation of the recommendations in each of the markets will need to be phased-in gradually.

Some of the recommendations might already be met in a market, which can therefore consider itself compliant with the recommendation.

When this is not the case, each market will need to evaluate the existing situation compared to the recommendation, identify what needs to be done to comply with the recommendation, what are the obstacles and what needs to happen to remove them, who should be involved and take the lead.

A timeline needs to be defined and agreed to achieve full compliance.

The ECSAs as well as ECSDA will take a coordination role in the adoption of the proposed recommendations at national level. To support this role effectively, the ECSAs will carry out a communication strategy to disseminate the recommendations in the market and encourage industry-wide endorsement by all players involved in corporate actions processing in domestic and/or cross-border markets.

A two-tier approach will be implemented to support this process:

- *Endorsement* the first goal will be to seek a Europe-wide endorsement of the proposed recommendations. To achieve this goal, the members of the ECSAs will seek consensus at national level to achieve an industry-wide endorsement of the proposed recommendations.



- *Implementation* to accelerate implementation by the market place, the ECSAs will bring together a number of key players with the objective of convincing them to implement the recommendations, thereby giving other players an incentive to follow suit.

A Review of progress achieved towards endorsement and implementation of the recommendations will be carried out annually and, for the first time, at the end of 2005. For this review to function effectively, the ECSAs will conduct a Survey to establish the degree of acceptance of the recommendations and identify the remaining barriers or constraints to the implementation of these recommendations. On the basis of the results of the Review, the ECSAs will revisit, enhance and add to the proposed recommendations.

When the recommendations are embraced by the industry, the ECSAs believe they will serve to deliver the efficiency improvements sought and contribute to the creation of a true EU single financial market. At the heart of these efficiency improvements is a move to Straight Through Processing (STP), with firms communicating electronically, using messages constructed to international open market standards (ISO 15022 and 20022), and universally recognised unique identifiers (ISO 6166 ISIN).

The benefits of STP are well known. These include the reduction of operational costs and risk, scalability of operations and improved customer service.

1.4. Future developments

The recommendations contained in this document are not exhaustive since based on only one event. However some of the issues highlighted (as well as the associated recommendations) are not specific to this particular event and can be extended to other event types.

This document is the first deliverable of the CATF. Other sets of recommendations will follow for other types of Corporate Actions.

The ECSAs are currently reviewing interest payments and redemptions at maturity and plan to finalize recommendations in the near future,

In the longer term, the ECSAs propose to consider other key areas and more complex events, such as shareholders meetings, stock distribution or voluntary corporate actions where a lack of harmonization is considered to present a barrier or constraint to the efficient processing of corporate action activities.



2. SUMMARY OF KEY ISSUES

Issue 1 - Key Dates and their definitions

One of the major challenges for a typical cash distribution is the issue of dates. Entitlement definition claims processes and payments are often done based on different dates.

Nearly all EU countries do have an “ex date” (even if its meaning may differ) for cash dividends. However, not all countries have a “record date” and when there is a record date it may not have the same definition and be before or after the ex date for the same event across the various markets.

This situation creates:

- Uncertainty and lack of clarity for the investor
- Complexity and additional costs for the professional actors
- Risks for all parties on traded but unsettled transactions,
- Even more complex environment for dual-listed securities

Therefore, the ECSAs believe that the issue of dates must be clarified and harmonized within the EU for the benefit of all interested parties.

The harmonized solution must aim at reducing complexity, risk and increase transparency. This solution must also comply with related recommended best practices on settlement cycles and be defined taking into consideration other barriers.

The adopted approach is to find a solution that reduces risks and market claims while establishing a common definition of key dates across Europe.

Issue 2 - Payment Mechanism

The current environment for dividends (more generally speaking cash disbursements) is heteroclitic. Payments are made by various actors: the CSD, the issuer itself, through a paying agent or third party. Payments are also made using various payment mechanisms: payment in central bank money, transfers in commercial bank money, cheques, even cash sometimes.

All these payment mechanisms do not offer the same level of guarantee for the investor and its intermediaries. The costs and timing associated with various payment methods vary. **In order to establish a level playing field environment where all actors benefit from safe and cost-efficient payments of dividend, the ECSAs believe that some harmonization is needed regarding the payment mechanism.**



Issue 3 - Dematerialization and Interim Securities

Physical securities are still used in the EU. Even if it creates its specific inefficiencies, materialization as such does not create a barrier. However, its by-products and the related processes in case of non dematerialised securities cause differences in treatment within the EU, especially for dividend payments.

In the case of dividends, one specific process is considered problematic: the booking of intermediate (sometimes called interim) securities. This booking reflects the separation of the coupon from the securities. However, this coupon is booked under a proprietary ISIN code and serves as a basis for claims.

Issue 4 - Notification Process

The ECSAs have noted considerable variations in dividend announcements across the EU.

Obviously, there are legal requirements for an issuer to inform holders of the dividend.

These requirements are different and often based on domestic paper communication (newspaper announcement).

It seems necessary to achieve a minimum standard within the EU and to ensure a more efficient and transparent information distribution from the issuer to the holders (and their intermediaries).

Conclusion

The abovementioned recommendations on key dates and notifications are especially important, in particular for more complex corporate actions than cash dividends, given that market practices vary considerably across European countries.

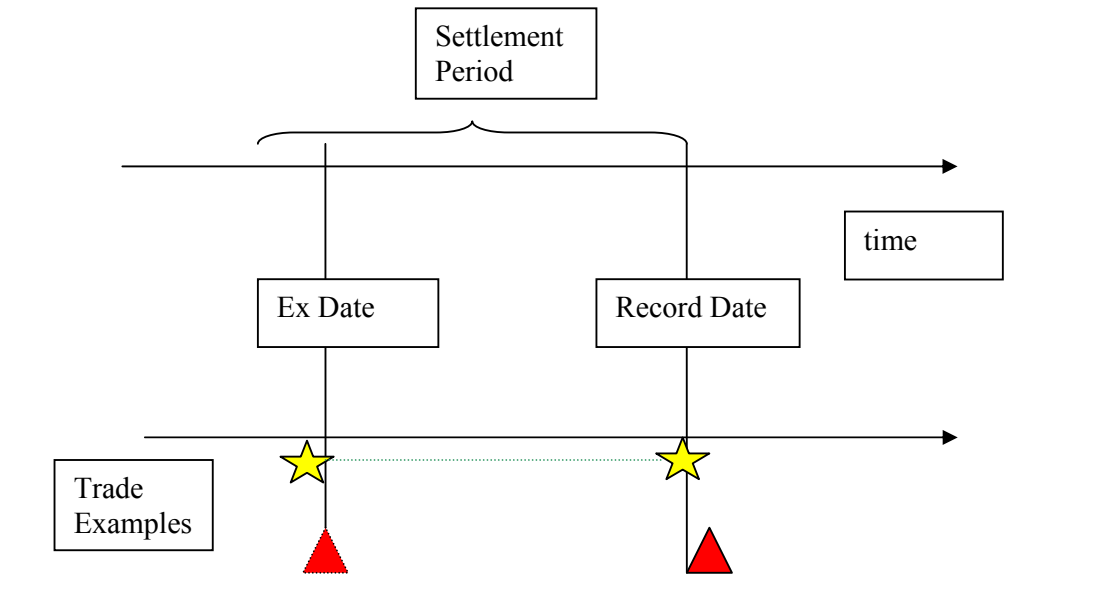
Therefore, with the aim of improving market transparency, the ECSAs consider that, for future discussions, special attention should be given also to the definition of the “deadlines” between announcement, notification, ex date, record date and payment/distribution.



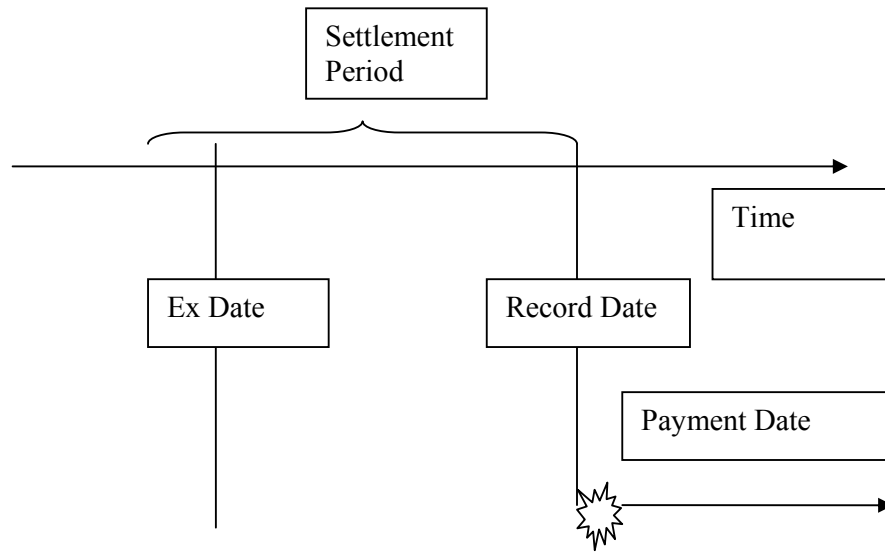
3. CASH DIVIDEND RECOMMENDATIONS

A. Recommendations on Key Dates

- A.1** All cash dividend events must have an **ex date**, a **record date** and a **payment date** and these three dates must be part of the dividend announcement.
- A.2** **Ex date** is defined as the date as from which trading (including exchange and OTC trading) occurs on the underlying security without the benefit. Ex date must be understood as start of the business day on the specified date.
- A.3** The ex date must be set by the issuer (in co-ordination with the exchange)
- A.4** By default OTC transactions follow the ex date definition (i.e. are ex dividend if the trade date is on or after the ex date). In OTC transactions, counterparties may still agree on special dividend arrangements. However, such specific arrangements, when deviating from the market standards, may not automatically be supported in the processing further down the chain. This will lead to exception processing and ultimately are likely to bear extra costs for the counterparties.
- A.5** **Record Date** is defined as the date at which positions are struck at the end of the day to note which parties will receive the relevant entitlement. Record date must be understood as being the end of the business day on the specified date.
- A.6** In order to minimise claims, an explicit record date should be set by the issuer (Issuer model) or, in markets where the issuer does not set a record date, by the primary CSD (primary CSD defined as per ECSDA terminology).
- A.7** The record date comes after the ex date and is determined on the basis of the normal settlement cycle for the instrument concerned. The record date should be the ex date minus 1 business day + the length of the settlement period. (see figure 1 below)



- A.8** In case of multiple listings, Issuer and Exchanges must liaise to enforce the application of the rules listed above in order to ensure a coherent situation across markets.
- A.9** In cases where the issue is eligible in more than one CSD, Issuer and CSDs must liaise to enforce the application of the rules listed above in order to ensure a coherent situation across markets.
- A.10** Since trading/settlement cycles are not harmonised yet, the cycle determining the ex/record date time lag should be the one of the primary exchange. In the longer term, the settlement cycle for similar instruments should be harmonized (see Barrier 6: Settlement periods for all equity markets within the EU should be harmonised).
- A.11** **Payment date** is defined as the date at which the distribution is due to take place.
- A.12** For equal treatment of investors and reduction of risk, the payment date should be as soon as possible after the record date, and ideally be the day after record date (see figure below)



A.13 The payment date should be the same in all countries.

A.14 The value date applied to clients is a SLA (Service Level Agreement) issue between the clients and their account servicing institution.



B. Recommendations on the Payment Mechanism

- B.1 The payment from the issuer or his agent to the financial intermediaries should be made **in central bank money** where possible (regardless of the settlement model used, integrated or interfaced model).
- B.2 Final and irrevocable payments must be made on **payment date** by the issuer or his paying agent.
The issuer or his paying agent should make payments as early as possible and before noon at the latest.
- B.3 Non electronic forms of payments such as cheques should be gradually eliminated as they create inefficiencies (extra costs, extra delays, risk of theft, money laundering) for both the issuer and the final investor.



C. Recommendations on Dematerialisation² and Interim Securities

- C.1** Securities in Europe should be totally dematerialised and therefore distribution of dividends should be made in cash only.
- C.2** During the transition period towards dematerialisation, the creation of interim securities related to mandatory cash dividends should be gradually removed.
- C.3** When used, these existing interim securities should have a proper and valid ISIN.
- C.4** However, any claims should be made in cash only and not in interim securities.

² Dematerialisation in this context means, to remove the obligation of presenting a coupon in order to obtain the cash dividend.



D. Recommendations on the Notification Process

- D.1** Requirements in terms of information and distribution mechanisms should be harmonised in the medium term in Europe for the various key stakeholders in the notification chain (issuers, CSDs, custodians) starting from the issuer announcement.
- D.2** The issuer (or his agent) should publish details of the event at the minimum in electronic format (e.g. website) on a non-discriminatory basis and as soon as possible on the day of the announcement. The issuer (or his agent) should make available a summary of the event details at least in English.
The issuer (or his agent) should also inform immediately the relevant CSD of the dividend information in formatted form defined and used by the industry such as the ISO 6166 and ISO 15022/20022 standards.
Clear European liability rules determining responsibilities should be established for communication from the issuer through to other parties on the event announcement.
- D.3** The CSD must inform its participants of the official details of the event as communicated by the issuer under the following conditions:
- CSD should inform at least participants that have holdings or any pending transactions impacted by the event.
 - CSD should continuously inform the participants of any subsequent information on the event.
 - When the payment is made by the CSD and inside the CSD, the CSD should also provide payment confirmation.
 - When the payment is made by the paying agent or the issuer within the CSD, confirmation should be provided by the CSD or the paying agent.
 - Communication should be made in electronic format using industry standards (ISO 6166 and ISO 15022 / 20022). Paper communication should be eliminated in the medium term as the legal requirement for paper is eliminated.
 - The CSD announcement should be made as soon as possible following the issuer announcement.
 - Clear liability rules determining responsibilities are needed for the announcements and the payment confirmations made by the CSD to its participants.
- D.4.** The custodian banks and/or CSD members should pass on information received to their clients:
- The custodian banks and/or CSD members should inform at least their clients that have holdings or any pending transactions impacted by the event.
 - The custodian banks and/or CSD members should continuously inform the participants of any subsequent information on the event.
 - Communication should be made in electronic format using industry standards (ISO 6166 and ISO 15022 / 20022). Paper communication should be eliminated in the medium term as the legal requirement for paper is eliminated.



- The custodian banks and/or CSD members announcement should be made as soon as possible following the issuer/CSD announcement.
- Clear liability rules determining responsibilities are needed for the announcements and the payment confirmations made by the custodian banks and/or CSD members to their clients.



4. POSSIBLE BARRIERS TO THE IMPLEMENTATION OF THE RECOMMENDATIONS

4.1. Recommendations on key dates (A.1 to 14)

Legal:

- The issue of beneficial ownership is still an open point and should be discussed by the legal certainty group.
- Record Date is not a “legal” concept in all markets.

Investment costs:

- The implementation costs for the banks and the infrastructures, especially if the costs are borne by a small number of entities.

Market Practices

- In practical terms it needs to be ensured that the trade date - expressed in local time following the issuer model – is properly transmitted in settlement instructions, within the whole transaction chain especially for OTC trade reconciliations.

4.2. Recommendations on the Payment Mechanism (B.1 to 3)

- The final investor may not be reachable through a payment in central bank money. In this case, the alternative is to pay in commercial bank money.
- Central bank money is difficult to achieve when dealing with non-domestic currencies.
- Appropriate communication of the benefits of the new payment method must be put in place. For example, the end customers may see their habits changed (e.g. receiving money on a bank account rather than a cheque by mail) and will need to get used to that method.

4.3. Recommendations on Dematerialisation and Interim Securities (C.1 to 4)

- Commission processes and paying agent remuneration are to be revised and adapted as a result of the disappearance of physical coupons (e.g. so called “classical payment”). It could lead to a potential loss of revenue for certain agents.
- The treatment of related securities (e.g. VVPR strips in Belgium) should also be adapted.

4.4. Recommendations on the Notification Process (D.1 to 4)

- A harmonised legal basis is needed to establish harmonised information and distribution process from issuers to intermediaries to start and possibly also further down the chain.



- Legal prescriptions are to be modified to allow electronic communication only.
- Various levels of liability exist for issuers and CSDs.
- IT investments and cost of change for implementing a common electronic format.



5. CORPORATE ACTIONS TASK FORCE MEMBERS

Ms Dagmar Habersack	Deutsche Bank
Ms Paola Deantoni	Unicredito
Mr Ben van der Velpen	ING
Mr Xavier Bonneru	Crédit Lyonnais / AFTI
Mr François Drazdik	Dexia-BIL
Mr David Farbon ('til June 04)	Lloyds TSB Registrar
Mr Norman Evans (from July 04)	HSBC Bank
Ms Vivie Tourogioannis ('til Sept 04)	National Bank of Greece
Mr Yannis Houzouris (from Oct 04)	National Bank of Greece
Ms Ruth Wandhöfer	FBE
Mr Didier Hermans	FBE (TF Chairman)
Correspondent Members:	
Ms Elisa Bevilaqua	EACB
Ms Fiona Joyce	ESBG