T2S CORPORATE ACTIONS STANDARDS

BUYER PROTECTION

This document sets out the market standards for the processing of buyer protection in the context of TARGET2-Securities (T2S).

The standards have been endorsed by the T2S Advisory Group (AG), and are addressed to all CSDs and NCBs in T2S and to their users, including CCPs.

All CSDs and their users, including the CCPs, should abide by these standards for all activity on T2S, and from the first day of such activity on T2S. CSDs and their users including CCPs, should have already implemented these standards prior to the start of T2S user testing, in accordance with the relevant synchronisation point[1] in the T2S Programme Plan.

It is also to be hoped that all European CSDs will, where applicable, abide by these standards for non-T2S settlement, so that a single harmonised European process be achieved.

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[1] A synchronisation point is a key milestone that seeks to ensure the alignment of the readiness status of a CSD with the T2S Programme at key stages of the project by determining whether the stakeholders deliver what they expect from each other at specific points in time.

The AG mandated the T2S Corporate Actions Subgroup (CASG) to support and monitor implementation of the standards.

1.   General comments

- The standards set out in this paper are based on a functional approach to buyer protection processing. The standards have been drawn up as best T2S market practices with the aim of introducing harmonisation in cross-CSD settlement in T2S.

- The CASG gap analysis aims at identifying any potential barriers (legal, regulatory, operational or fiscal) for their timely implementation (prior to T2S testing) by T2S markets.

- The T2S CA standards are based on the Standards of the CESAME2 mandated Corporate Actions Joint Working Group (CAJWG) i.e. the *market standards for CA*. These market standards have been endorsed by all relevant industry associations[2] (July 2009). These same associations are using a revised version of the market standards (2012).

- The standards are built on the principle that it is possible to distinguish functionally between the processing related to a corporate action on *stocks* or holdings (for example, the distribution of a cash dividend to record date holders) and the processing related to a corporate action on *flows* (for example, the generation and processing of a market claim).

- The CA standards are valid for all transactions on T2S[3] (i.e. both for transactions between two participants of the same CSD as well as for cross-CSD settlement).

- In line with the market standards, cash payments which are the result of corporate action events should be paid via the same "payment mechanism" as any standard DVP activity. In the T2S context this means that the T2S currency cash entitlements which are the result of corporate actions should be paid via the T2S Dedicated Cash Accounts (DCAs) and not outside of the CSD/T2S environment.

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[2] EuropeanIssuers, European Central Securities Depositories Association (ECSDA), European Association of Clearing Houses (EACH), Federation of European Securities Exchanges (FESE), European Banking Federation (EBF), European Association of Cooperative Banks (EACB), European Savings Banks Group (ESBG), European Securities Services Forum (ESSF/SIFMA)

[3] In line with CAJWG standards, T2S CA standards should apply to all securities used for direct investments (equities, fixed income instruments) deposited and settled in Book Entry form with an (I)CSD in Europe; investment funds listed and traded on a regulated trading venue should be processed, where possible, in accordance with the applicable standards.

- The standards take as working assumptions the T2S functionalities as reflected in the T2S User Requirements Document (URD) v5.02.[4]

Definitions

In line with market standards for CA, buyer protection (BP) is a process whereby a buyer who has yet to receive the underlying securities of an elective Corporate Action, instructs the seller in order to receive the outturn of his choice.

Automated Buyer Protection mechanism: an institutionalised and automated service provided by market infrastructure organisations (i.e. where the election instruction is routed through the CSD/CCP, and where the CSD/CCP uses the BP instruction to process the transformation)

Manual Buyer Protection mechanism: a bi-lateral agreement between the respective trading parties by means of a manual process (no intervention of the market infrastructure regarding the exchange of BP instructions)

BP invocation

Buyer protection deadline is invoked on "*the last date and time at which a 'buying counterparty'[5] that has the legal right to choose a particular event option but does not yet hold the securities (i.e. a party in an unsettled transaction) may instruct its counterparty to deliver the specified proceed/s*". The standards presented below provide more clarification of how the reference to "the last date and time" is defined.

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[4] http://www.ecb.europa.eu/paym/t2s/pdf/URD_v5_02.pdf?9ec374be60248c6f40739664402afd66
[5] The reference to buying counterparty may extend beyond the buyer in a standard securities trade. As a consequence, reference to the "buyer" should be considered synonymous with the securities receiver in all types of transactions (securities lending, collateral provision etc)

2. Scope of BP standards

- These BP standards should be applied only on matched and pending transactions.

- They are applicable to automated BP services provided by CSDs as well as to the manual buyer protection regimes.

- If the Issuer CSD offers automated BP services, then all Investor CSDs involved in the underlying transaction should offer BP services for pending transactions on securities issued in the Issuer CSD. The investor CSD(s) do not necessarily need to implement an automated BP service, but can also offer a manual BP service, as long as this complies with the T2S standards and issuer CSD's timelines.

- If both Investor CSDs offer automated BP services, all securities transactions between their participants can be subject to BP, including transactions in securities for which the issuer CSD does not provide BP.

Location of BP processing

BP instructions and requirements thereof are detected, generated and communicated between the buyer and the seller, outside T2S' operational framework. In case of automated BP, the BP instructions are communicated between buyer and seller through and up to the chain of intermediaries, including the CSDs. Only the potential resulting settlement (securities or cash) of the BP agreement, also referred to in this document as *protected entitlements*, is processed in T2S.

BP cross-CSD

In line with the CA market standards (CAJWG), the T2S CA standards do not impose that all T2S markets should implement an automated BP functionality. The AG has left the choice of implementing an automated BP functionality to each Issuer CSD. In addition, the AG fully supports the market CA standards on BP, including the requirement that when automated BP is in place, it should be done according to the agreed market standards.

This situation, i.e. potentially not all CSDs offering an automated BP functionality, leads to the following scenarios:

If the IOC offers a BP service, it will handle the execution of the BP i.e. take the actions on the underlying transaction (Hold / cancellation / transformation): these actions will be generated automatically by the IOC on behalf of its buyer/seller involved in the BP.

If the IOC does not offer a BP service, the cancellation, transformation are carried out by the buyer/seller of the IOC. The objectives being that bilateral cancellation is successfully processed followed by the matching and settlement of the new transformed instructions.

The table below summarises the four possible scenarios depending on whether the buyer and/or seller IOC provide BP services or not:

Buyer CSD offers BP	Seller CSD offers BP	Comments / Results
Y	Y	Both CSDs generate automatically the cancellation followed by the transformation instructions that need to match and settle
Y	N	The buyer CSD generates automatically the cancellation/ reinstruction. The seller participant in the seller CSD takes in charge the cancellation and transformation to ensure matching and settlement.
N	Y	The seller CSD generates automatically the cancellation/ reinstruction. The buyer participant in the buyer CSD takes in charge the cancellation and transformation to ensure matching and settlement
N	N	Both the buyer and the seller take in charge the cancellation and transformation to ensure matching and settlement

3. Buyer Protection Lifecycle standards

AG would like to underline that the text adjacent to the standards (Rationale/Background Info) is an integral part of the body of the standards since it provides the rationale of the Group's standards and important background information. All the standards apply to both automated as well as manual BP models. Where relevant, differences between the two different models are clearly underlined.

Sub-process	Standard number	Topic / Question	T2S Standard	Explanatory Comment
BP Invocation	1	*Who will generate the BP instruction?*	For a given transaction and prior to the BP deadline, the BP requirement will be invoked by the buyer (the buyer will issue BP instructions to the seller).	**Rationale**: It is the buyer who wants to protect his rights who will invoke the BP. **Background Info**: The buyer of securities will be awaiting settlement of a securities transaction on which he is entitled to make an election due to a corporate actions event. At this stage the seller's CSD will be aware of the open transactions but not of the intentions of the buyer. The best practice would be for the buyer to send the BP instruction to the seller as early as possible thus allowing the receiver of the BP instruction enough time to allocate and pass on the chosen election by the BP deadline. To the extent that CSDs/CCPs are involved in the BP management, CSDs/CCPs should pass on that instruction to the seller. CSDs should pass on any instructions received as quickly as possible. This is to avoid a situation where a CCP/CSD may collate all instructions then release them just prior to the deadline. Assuming that the IOC offers an automated buyer protection mechanism, the IOC should freeze (put on hold) the underlying settlement instruction in T2S, in accordance with standard 14.

Sub-process	Standard number	Topic / Question	T2S Standard	Explanatory Comment
	2	*What default rules apply for elections and when?*	When a BP requirement is not invoked by the buyer, then the market default rules for elections should apply.	**Background Info:** Market default election rules are usually set by the issuer of the underlying security. These default rules may be available to intermediaries via the Issuer CSD.
	3	*What mechanism is used to trigger BP?*	The buyer will be tracking open transactions to which he is entitled to elect and will decide whether or not he wants to invoke a BP.	**Background Info:** Once BP instruction is in place, the seller should always be notified of the BP instructions. The notification process may be facilitated by a mechanism or process established directly between the buyer and the seller or via services offered to them by their investor CSD(s) or other third service providers.
	4	*Which transactions can be subject to BP?*	As per scope in the introduction, all transactions still pending on BP deadline in securities which are subject to a corporate action and a BP regime in the CSD of Issuance can be subject to a BP mechanism.	**Background Info:** BP instructions on any pending transactions can also be invoked before the BP deadline.

Sub-process	Standard number	Topic / Question	T2S Standard	Explanatory Comment
BP Instructions	5	*Does the BP instruction require matching outside T2S?*	No matching is required in the CSDs' systems. However it is recommended that the seller acknowledges to the buyer, the receipt of the BP instruction.	**Rationale:** BP instructions are either exchanged directly between buyer and seller or processed in CSDs' custody services systems as CA instructions. **Background Info**: BP is only applicable on matched underlying settlement instructions. BP instructions are not matched against any counterparty instructions since there are none. However, BP instruction details are compared by the receiver of the BP instruction (seller, CSD, other) against the terms of the events for a coherence check. In the situation BP instructions are processed in the CSD custody systems, if the trade date is after guaranteed participation date and/or the BP is sent after the BP deadline, then the seller may be required to match/confirm the instruction from the buyer. The seller should always act on the basis of a BP instruction sent by the buyer.
	6	*With which references is the BP generated?*	The buyer should include in BP instructions, references to the underlying CA and the underlying transaction to which the CA applies (securities trade or other)	
	7	*Should late BP instructions be entertained or is the cut-off the point of finality?*	This should be established on the basis of bilateral agreement between the buyer and the seller, or the CSD/CCP rules – where and when CSDs/CCPs are offering such BP processing services.	

Sub-process	Standard number	Topic / Question	T2S Standard	Explanatory Comment
	8	*What format will the instructions take?*	It is recommended that the ISO20022 standards are referred to as the basis for such instructions.	
Lifecycle of the BP	9	*What BP deadlines should be followed?*	<u>*Automated BP mechanism*</u> For trade date T (which is the guaranteed participation date/last trade date of the underlying CA), the BP deadline should be on T+n (where n = settlement cycle) and the market deadline on T+n+1 day Taking as working assumption a T+3 settlement cycle: · business day 1 = T; · business day 4 = T+3: buyer protection deadline; · business day 5 = T+4 market deadline <u>*Manual BP mechanism*</u> For BP instructions from actors other than CCPs, the BP deadline is T+n. For BP instructions from CCPs the BP deadline is T+n+1 hour See <u>Diagram 1</u> below.	**Rationale:** In line with the market standards for CA: In case of automated BP, • The buyer protection deadline should be interpreted as the end of the T2S daytime settlement (indicative 18:00). In case of manual BP, • The one hour period after the T2S day time settlement (indicative 19:00) allows CCPs some time for the allocation process vis-à-vis the seller based on valid BP instructions. • The buyer, in addition to sending the BP instruction to the seller, should ensure that both buyer and seller cancel their instructions before start of the next settlement day in T2S in order to prevent settlement of the protected transaction.

Sub-process	Standard number	Topic / Question	T2S Standard	Explanatory Comment
	10	*Should the BP deadline be identical across all (I)CSDs for a given security?*	Yes	<u>*Automated BP mechanism*</u> The BP deadline should be T+n for all CSDs in T2S for all securities that offer automated BP. In case of a manual BP, this also applies to all CSD participants other than CCPs. <u>*Manual BP mechanism*</u> For CCPs with a manual BP regime, BP deadline should be T+n+1 hour. In case issuer CSD offers automated BP, and an investor CSD does not, the CCPs in the investor CSD should adhere to the BP deadline of the issuer CSD. **Background Info:** The linked CSDs should agree between them how to exchange BP messages before the end of T2S day time settlement in case of automated BP. In case the issuer CSD offers automated BP, the BP deadline is at end of day (indicative at 18:00). Even though in general the CCPs with a manual BP are allowed to instruct BP until 19:00 (indicative), as it is beyond issuer CSD's BP deadline in this case, it should be fixed at 18:00.

Sub-process	Standard number	Topic / Question	T2S Standard	Explanatory Comment
	11	*Who can amend the BP instruction?*	The BP instruction itself can only be amended by the buyer, before the BP deadline.	**Background Info**: Amendment needs to have been agreed before between buyer and seller. *For CCP transactions:* Only the buyer can input, amend or cancel a BP instruction. *For non-CCP transactions:* With a trade date on or before guaranteed participation date and intended settlement date no later than the Buyer Protection Deadline, the BP input before the BP deadline only needs to be instructed by the security receiver for it to be valid. Any non CCP transactions that do not meet these criteria need to be matched.
	12	*What elements of the BP instruction can be amended?*	Only the BP election (i.e. corporate action option) can be amended.	

Sub-process	Standard number	Topic / Question	T2S Standard	Explanatory Comment
	13	*After generation of the BP instruction, is the settlement of the BP affected by the lifecycle of the underlying transaction?*	Yes. If the underlying transaction can be settled prior to the BP deadline, it should settle and the BP instruction should be cancelled by the Instruction Owner CSD (IOC) if the IOC offers such a BP service. When BP is handled bilaterally, the BP is void.	**Rationale:** The buyer protection is valid as long as the underlying transaction is still pending. Once the underlying transaction settles, the related BP instructions become void (In case of automated BP mechanism the IOCs should immediately cancel the relevant BP instructions in their systems). As partial settlement will be offered in T2S, the BP will remain eligible for the quantity that has not yet settled but this does not require the quantity to be amended in the BP instruction itself. *Automated BP mechanism* CSD/CCP will automatically apply the transformation according to the remaining quantity in the underlying unsettled transaction. *Manual BP mechanism* The seller and buyer should consider only the remaining quantity for transforming the transactions.

Sub-process	Standard number	Topic / Question	T2S Standard	Explanatory Comment
	14	*What should be the process for pending transactions on BP deadline?*	*Automated BP mechanism* Transactions attached with a valid BP that are still pending at the BP deadline should be frozen (put on hold) by the IOCs until their transformation on market deadline/record date. The Transformation of the underlying transaction should be carried out by the IOCs, in accordance with the BP instruction, at the Market Deadline / Record Date of the voluntary reorganisation. *Manual BP mechanism* If the CSD does not provide an automated BP service, then buyer and seller shall cancel the underlying transaction and re-instruct, in accordance with the BP instruction, at the market deadline / record date of the voluntary reorganisation.	**Rationale:** This should ensure that the seller executes the buyer's BP instruction. If the buyer does not elect, via a BP instruction, on open/pending transactions, such transactions should result in the default options of the event.
Settlement of protected entitlements (BP resulting settlement)	15	*What are the conditions for settlement of the protected entitlement (new transformed transaction)?*	*Automated BP mechanism* The IOC will set on hold (freeze) and transform in T2S the underlying transaction based on BP instruction it receives (from the buyer). *Manual BP mechanism* The buyer and seller shall amend the underlying transaction (as per current practice: cancel and re-instruct).	

Sub-process	Standard number	Topic / Question	T2S Standard	Explanatory Comment
	16	*How are the resulting settlement instructions in T2S affected by the buyer's partial elections?*	If a buyer wants to make a partial election, they would need to split the original transaction into the shapes they require.	**Background Info**: The original pending instruction must be both cancelled and replaced in T2S by the IOCs (or by the buyer and seller if the IOCs do not offer such a service) by several settlement instructions in line with his partial CA election. The same principle (split) might apply to the allocation process of CCP transactions against the seller(s).
	17	*When will the entitlement be paid to the buyer?*	The Settlement Date (SD) of the *protected entitlements* should be the payment date of the underlying CA.	**Background Info:** The BP resulting entitlement will be delivered to the buyer with the transformation of the pending transaction, on the payment date of the underlying CA.
	18	*How will the BP instruction settle?*	Settlement should take place as specified in the T2S transformations standards.	

4. Diagram 1 – Buyer Protection Time-frame - CASG