



EUROPEAN CENTRAL BANK

EUROSYSTEM

Status update Substream 2: Corporate Actions, Non-Euro Collateral Management and Taxation Forms

CMH-TF 25 October 2017

Substream 2 is analysing the need/merits of **harmonisation CA and tax processes** from a collateral management perspective (incl. handling of non-euro CAs).

1) Harmonisation of CA processes

- **A survey was launched to analyse around 20 CA processes**, identifying existing and new issues/discrepancies across markets which have potential for harmonisation.
- **The aim is to highlight the main issues/discrepancies with strong relevance to collateral management**, and thereby creating a momentum in the market to address the issues (because of the commitment by collateral givers/takers and providers to improve current CA handling). The endorsement of the issues by the market should occur in December AMI-SeCo.

Feedback to the survey Harmonisation of CA processes:

- confirms that **issues exist in CA processing** that impact collateral management.
- indicates that either **existing** harmonisation standards/efforts should be reinforced for collateral management (i.e. existing market standards need to be implemented) **or new harmonisation standards** may be needed.
- Specific considerations from a collateral management perspective:
 - with Transfer of Title, CA announcements are sent out to the collateral taker. However, with pledge/ earmarking, CA announcement is sent out to the collateral giver.
 - With bilateral transactions, CA announcements are typically sent out to the collateral taker. However, with triparty transactions, it's the collateral giver.
 - It does not allow the collateral giver to have a clear vision on the events that will impact the positions that have been transferred to the collateral taker. As result, members considered the need to inform both collateral giver and collateral taker. (Exists in some markets)

Main areas for CA harmonisation, which should be addressed for collateral management:

- I. Provision of CA Information from the (I)CSD to the Collateral Taker/Giver;
- II. CA Payments;
- III. Handling of Non-Euro CA;
- IV. CAs with Negative Cash Flows;
- V. CA Events Requiring Manual Processing (local requirements);
- VI. CA Events Requiring Specific Handling (blocking, substitution, quotation types);
- VII. Handling of Elective CA Events;

Additional analysis needed:

- (i) Workflow for Mandatory CAs, (ii) Workflow for Elective CAs, (iii) identification of parties (inform both collateral giver-taker).

I. Provision of CA Information from the (I)CSD to the Collateral Taker/Giver;

No.	Process	Process Description	Summary	Priority
1	Provision of Sufficient Information to Calculate Expected Payment Amount / Security Movement in the Corporate Action Notification	Identifies if sufficient information is provided in the corporate action notification message provided by the (I)CSD to the collateral giver and collateral taker in order to calculate the expected payment amount and / or security movement	In some cases, insufficient information is provided in the CA notification in order to enable the collateral giver / collateral taker to calculate the expected payment amount / security movement in advance of the corporate action payment date. There is a need to ensure that a minimum set of information is provided in the CA notification in order to ensure the collateral giver / collateral taker can always <i>estimate the impact of the corporate action event on the collateral pool</i> in advance of the corporate action payment date. (Further analysis needed to ensure that all data needed is provided by the (I)CSD)	1
2	Provision of Complete Corporate Action Notification in Advance of the Payment Date	Identifies if there are any potential constraints to the provision of final (complete) corporate action notifications by the (I)CSD to the collateral taker / collateral giver in advance of the payment date	In some instances, the collateral giver / taker is not in receipt of sufficient information in advance of the payment date e.g. the corporate action notifications is sent late or with incomplete information. (Further analysis needed)	2

I. Provision of CA Information from the (I)CSD to the Collateral Taker/Giver;

No.	Process	Process Description	Summary	Priority
3	Consistency of Information Provided by Issuer CSD and Investor CSD for Same CA Event	Identifies if the information provided by the Issuer CSD and Investor CSD for the same CA event is consistent e.g. usage of CA same event types, messaging format and data fields necessary for the calculation of payment amount / security movement.	<p>The are instances where the information provided by the Issuer CSD and the Investor CSD for the same underlying CA event differs.</p> <p>There is a need to ensure that the information provided by Issuer CSD is passed on in a consistent manner by the Investor CSD in line with the agreed market standards.</p>	1

II. CA Payments;

4	Usage of Standardised Calculation Formula	Identifies if any local market practices exist for the calculation of CA payment amounts	<p>In general, corporate actions payments are managed differently depending in the instrument type behind and the event type (which should follow international standards*). However, further analysis is needed to check if the information used in order to perform the calculation differs depending on the CSD / market due to different population of data fields</p> <p><i>* Four different international standards exist today: European/French method, English, Effective and German method.</i></p>	1
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CA Processes: draft survey findings and priority

No.	Process	Process Description	Summary	Priority
5	Reconciliation of Actual CA Payment Amount vs. Expected CA Payment Amount	Identifies if there are any specific issues where the actual CA payment amount does not match the expected CA payment amount	Several discrepancies may occur leading to a difference between actual and expected CA payment amount .	1
6	Processing of Delayed CA Payments	Identifies how cases of delayed CA payments are handled per CSD and whether a harmonised procedure for the notification of delayed payments exists.	No standardised procedure or message is used to inform clients of delays in the execution of a corporate action event. In some markets the client is not informed of a delay in the payment.	2
7	Corporate Action Payments in CoBM and CeBM	Identifies any differences which may emerge in the handling of CA payments made in Central Bank Money vs. Commercial Bank Money.	Payments may be made in either commercial bank money or central bank money depending on the account setup of the participant (i.e. the (I)CSD). Foreign currency payments are always made in commercial bank money.	1

II. CA Payments;

No.	Process	Process Description	Summary	Priority
10	Payment Procedures per CSD	Identifies how CA payments are made by the (I)CSD e.g. a single payment per ISIN or an aggregate payment for all ISINs	<p>Differences per market.</p> <p>While the majority of markets make one payment per ISIN, some CSDs aggregate the payment (in the case of the German market this will change in 2018)</p> <p>In some CSDs a single payment aggregating the total amount due for coupons and redemptions is made, whilst in other cases a payment per ISIN per CA is made allowing a clear link to be made between the CA notification and the CA payment.</p>	1
11	Handling of Rounding Differences	Identifies how rounding differences which may emerge as a result of different calculation approaches per CSD are handled	The number of decimals used differs per market e.g. usage of 6 or 8 decimals	1

III. Handling of Non-Euro CA;

No.	Process	Process Description	Summary	Priority
8	Handling of Non-Euro Corporate Action Payments	Identifies if there are differences in how foreign denominated cash flows are handled amongst (I)CSDs.	The process is heterogeneous across CSDs. Some (I)CSDs convert the cash proceeds of a CA event related to non-euro denominated collateral into the euro equivalent before crediting the collateral taker, whilst other CSDs always remit the FX proceeds.	1

IV. CAs with Negative Cash Flows;

No.	Process	Process Description	Summary	Priority
9	Handling of Negative Cash Flows	Identifies how (I)CSDs currently process negative cash flows	Different per market. The process is heterogeneous and may involve a number of complex processes (e.g. coll taker/giver). As negative cash flows are not currently handled by all CSDs no standardised procedure exists.	1

V. CA Events Requiring Manual Processing;

No.	Process	Process Description	Summary	Priority
12	Corporate Action Events Requiring Manual Processing	Identifies those events which currently rely upon the use of free format messages should be listed.	A significant number of CA events and business processes require manual processing . Further analysis on the reason why free format messages are used should be conducted with a view to later defining standardised rules and ISO 20022 messaging to allow the transmission of CA data in a structured message thus facilitating straight through processing of all CA events.	1

VI. CA Events Requiring Specific Handling;

No.	Process	Process Description	Summary	Priority
13	CA Events where Participation Requires the Blocking of Securities	Identifies those CA events where participation in the CA event requires the blocking of securities.	Further input / analysis is required in order to clarify if the same set of CA events are subject to blocking across all CSDs.	2

VI. CA Events Requiring Specific Handling;

No.	Process	Process Description	Summary	Priority
14	Process for the Substitution of Fungible Securities	Identifies how the substitution of fungible securities (Pari-Passu CA event) takes place across different markets.	Further input / analysis is required in order to clarify if and how processes differ	1
15	Processing of CA Events Using 'Modified Following Business Day Convention'	Identifies those markets who pay corporate actions using the ' Modified Following Business Day convention ' which means that, for the purposes of payment, in the event that the payment date falls on a holiday, the payment will be due on the immediately following day, or, if that day falls in the following month, on the day immediately preceding the original payment date. In the case of Monte Titoli a CA notification message is sent containing the balances and indicating the "record time", on which the payment will be based.	As the practice may be specific to securities issued in Monte Titoli, further input from Monte Titoli should be collected.	1
16	Handling of CA Events with Different Quotation Types	Identifies any differences which may exist in the processing of a CA event for securities denominated in UNIT and FAMT.	The calculation approach for UNIT securities (i.e. data fields to process in the message) differ to that used for FAMT securities.	1

VII. Handling of Elective CA Events;

No.	Process	Process Description	Summary	Priority
17	Handling of Elective CA Events	Identifies how an (I)CSD handles counterparty responses to corporate action elective events.	Both individual and aggregated options are used.	2
18	Usage of Default Options in CA Events	Identifies whether there are any instances / markets where a default option for the processing of a CA event does not exist	A default option appears to be available in all CSDs. (To be confirmed)	2
19	Handling of Fees for Participation in Elective CA Events	Identifies whether there are differences in how fees related to the processing of certain CA events are handled	To be further clarified if the fees for participation in the CA event are linked to the CA event or form part of the standard monthly billing invoice per CSD account.* * In certain CA events (eg. BMET) sometimes an early consolidation fee is paid to the customer - depending on the instructed option. This cash amount must be credited on the customer cash account	1

Tax processing

- A draft note “**Tax processing in the context of collateral management**”:
 - Topic is important for collateral management, because certain CSDs may apply restrictions on holding the asset, which prevent the use of the asset for collateral management.
- Some (I)CSDs offer tax services and some not (but do substitution). Differences in processing by CSDs may depend on the cross-border nature of the asset and the role of the client.
 - **Creation of map is being considered (To be confirmed)**
 - Type of collateral, market (issuer country), issuer.
 - The map should show the different national withholding tax requirements and also the (I)CSD processes, to detect the differences, the common issues and to analyse the possibilities to standardize processes if possible
- **Take into account other work** on efficient tax processing efforts by the European Commission.

Considerations on Tax processing

- **Impact of harmonisation** to manage the tax reclaim process: i) (I)CSDs would need to have a process to manage the tax (not taking into consideration the collateral management aspects), and ii) the participants would need to include this in their processing and behavior.
- Complex Tax processing is due to the **lack of harmonization of Tax procedures in Europe, i.e. securities used as collateral** for a Repo or securities lending transaction could have a different treatment than the ones used for sell or purchase.
 - market practice (GMRA or GMLSA): proceeds resulting from a CA event on securities used as collateral is owned by the collateral giver even in a case of Transfer of Title. A compensation should therefore take place to collateral taker.
 - Logic to apply the collateral giver tax status to the proceeds? If this would become an harmonized rule in Europe it will reduce the complexity/uncertainty around the tax treatment on collateral.
 - Analyse similar mechanism (e.g. in US)?

Considerations on Tax processing

- To manage the tax process, it should be possible to:
 - 1/ identify the collateral transactions
 - 2/ record who is the collateral giver
 - 3/ apply the Tax status of collateral giver to the proceeds of the CA
 - 4/ credit directly the collateral giver's account
- This will reduce the complexity market participants are facing when delivering or accepting collateral.
 - Although this may be challenging in the bilateral world, it is something that could be achieved today in a Triparty environment as long as the Tax rules to apply the collateral giver tax status (and not the account owner) are harmonized across Europe.
 - This will increase mobility of the collateral and the opportunity to use collateral at any time irrespective of the Tax process to be applied.
- **Additional analysis needed:** (i) Creation of map different national withholding tax requirements (TBC), (ii) identification of parties in common tax process (TBC).

Actions Required:

CMH-TF are invited to:

- **Confirm the summary findings and classification of preliminary priority.**
- **Agree to analyse for CA:** (i) Workflow for Mandatory CAs, (ii) Workflow for Elective CAs, (iii) identification of parties (inform both collateral giver-taker) in CA process and the possible update of current ISO 20022 message.
 - More detailed analysis on each CA event to commence after January.
- **Agree to analyse for Tax processing:** (i) Creation of map different national withholding tax requirements (TBC), (ii) identification of parties in common tax process (TBC), and (iii) Workflows.
 - May only be possible to have high level issue identification by December 2017. More detailed analysis to commence after January.