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## Spanish Equity Cash Dividends: Market Practice for Failed Settlements

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### ***Introduction***

This document is intended to provide the details for a market practice to handle cash compensations (formally known within the industry as 'market claims'), between trading counterparties, related to failed settlement of Spanish equity transactions over dividend record date (RD) post the market changes as part of the Spanish Market Reform (SMR). Agent banks are not expected to be involved in the compensation process and their only involvement will be limited to the provision of information necessary so that counterparties to the transaction can discuss and agree the way that the cash compensation will be handled. The market practice comes into effect from pay date on or after 5<sup>th</sup> June 2017.

The market practice has been created by the collaboration of AFME members.

The current process within the Spanish market for unsettled transactions on record date (RD), which fail, and then match/settle after the RD (i.e. RD+n), is that Iberclear is to auto-compensate the Receiving Party (RP) (by initiating a cash compensation) at 100% of the dividend regardless of the entity at fault for the fail. The base case scenario for this market practice is where the Delivering Party (DP) fails to settle with the RP, due to a fault with the RP.

If, for example, the DP has sufficient stock and correctly instructs Iberclear, but the RP does not instruct Iberclear until at least the next business day, the transaction will settle after the RD. As a result, the RP would receive the dividend amount compensation at 100%, whereas the DP is debited 100% but only receives the net rate of the real dividend.

The above scenario arises through no fault of the DP. Furthermore, there is a concern that the RP may deliberately block the receipt of the dividend to benefit from the enhanced dividend amount (i.e. the difference between the net rate and the gross rate). The opportunity to receive an additional amount of money from the DP, with no practical recourse to the RP, appears to be particularly inequitable.

This market practice will facilitate the reimbursement of such charges faced by the DP where they are not at fault for the failure of settlement.

### ***Market Practice***

This market practice guide describes the reimbursement scenarios and process for reimbursement and gives clarity for entities trading Spanish equities over RD. The scenarios below help to show some common fail scenarios between the securities DP and RP.

This market practice also details the process by which the DP can claim reimbursement from the RP and expect to be reimbursed bilaterally. Whilst other permutations may exist which are not covered below, the spirit of the practice should be taken into consideration and participants are encouraged to partially settle transactions where possible to help reduce risk and increase settlement efficiency.

**Please note that it is the responsibility of each counterparty to seek their own independent advice with respect to the tax (including but not limited to capital gains tax) implications resulting from any compensatory payment or reimbursement amount.**

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A key overarching premise is that the settlement instruction of the RP should be in release status from COB ISD-1 (intended settlement date minus one business day) and remain in release status thereafter.

The scenarios described below are not exhaustive and only represent the most common reasons for settlement failures. The settlement status is taken as of the Iberclear settlement cut off on the respective RD of the security on the failing transaction. When considering other unmatched scenarios not covered below, the applicable scenario to be followed should be based on the settlement status of the fail upon matching.

| Scenario | Delivering Party (DP) Status | Receiving Party (RP) Status | Settlement Status (as of Iberclear settlement cut off on record date) | Dividend Tax Reimbursement |
|----------|------------------------------|-----------------------------|---|----------------------------|
| 1        | Instructing (released)       | Instructing (hold)          | Matched-RP Hold   | RP to reimburse DP         |
| 2        | Instructing (released)       | Instructing (released)      | Matched-RP insufficient cash  | RP to reimburse DP         |
| 3        | Instructing (released)       | Not instructing             | Unmatched   | RP to reimburse DP         |
| 4        | Instructing (hold)           | Instructing (hold)          | Matched-DP&RP Hold  | RP to reimburse DP         |
| 5        | Instructing (released)       | Instructing (released)      | Matched-DP insufficient securities                                    | No reimbursement           |
| 6        | Instructing (hold)           | Instructing (released)      | Matched-DP Hold   | No reimbursement           |
| 7        | Not instructing              | Instructing (released)      | Unmatched   | No reimbursement           |

### ***Eligibility & Reimbursement Amount***

In order to set a universal standard, the RP may reimburse the DP for any shortfall in the cash compensation (up to the current market tax rate at the time of the transaction) subject to the agreement of both counterparties.

This will require bilateral agreement between trading counterparties (on the basis of this market practice) to settle the resulting reimbursement amount. It is a decision between the two counterparties of a transaction to reach an agreement with regards to the shortfall. The party entitled to the reimbursement is expected to solely rely on these bilateral funds to satisfy their respective shortfall and the total income should not exceed 100% of the dividend amount due, including any reclaim of withholding tax from the Spanish Tax Authorities.

The application for a valid reimbursement claim will require the claimant to submit the following supporting information using the template provided below:

1. Root cause of failed settlement (Iberclear settlement instruction validation) along with details of the transaction (ISIN, quantity, cash amount, currency, trade date, settlement date etc.)
2. Cash account instructions (to receive the payment of the reimbursement)

Please note that it is the responsibility of each counterparty to seek their own independent advice with respect to the tax (including but not limited to capital gains tax) implications resulting from any compensatory payment or reimbursement amount.

The DP must issue the reimbursement notice and template to the RP in writing up to 30 business days following the respective pay pte. The RP then has 15 business days to respond and settle the reimbursement.

**Reimbursement Template**

|                                       |   |
|---------------------------------------|---|
| <b>Delivering Party Name</b>          | <i>Name of entity requesting reimbursement</i>                                  |
| <b>Delivering Party BIC11</b>         | <i>BIC11 of entity requesting reimbursement</i>                                 |
| <b>Receiving Party Name</b>           | <i>Name of entity being claimed for reimbursement</i>                           |
| <b>Receiving Party BIC11</b>          | <i>BIC11 of entity being claimed for reimbursement</i>                          |
| <b>ISIN</b>                           | <i>ISIN code for security of failed settlement instruction</i>                  |
| <b>Quantity</b>                       | <i>Quantity of securities of failed settlement instruction</i>                  |
| <b>Trade Date</b>                     | <i>Trade date of failed settlement instruction</i>                              |
| <b>Intended Settlement Date</b>       | <i>Intended settlement date of failed settlement instruction</i>                |
| <b>Iberclear Reference</b>            | <i>Common Iberclear reference for matched and failed settlement instruction</i> |
| <b>Iberclear Fail Reason</b>          | <i>Screenshot of Iberclear fail reason (TBC)</i>                                |
| <b>Dividend Amount (EUR) and rate</b> | <i>To be verified by the receiving party</i>                                    |
| <b>Reimbursement Amount</b>           | <i>Final reimbursement amount being claimed from the receiving party</i>        |
| <b>Payment Details</b>                | <i>Payment information for the delivery party claiming the reimbursement</i>    |