



## **Corporate event management Package method Guide**

**Owner: Product Implementation  
Team**

**Document: Package method guide**

**Document Version: 1.1**

**Issue Date: 16 July 2008**

---

Although LCH.Clearnet SA has made every effort to make this document accurate, up-to-date and complete, LCH.Clearnet SA offers no warranty, express or implied, related to this document. You should be aware that the contents may be changed without prior notice. In no event shall LCH.Clearnet SA be liable for any loss of profits, loss of business, loss of use or data, interruption of business, or for indirect, special, incidental or consequential damages of any kind arising from any error in this document.

# Document History

Date	Version	Author	Summary of Changes
16 July 2008	1.1	Product Impelentation	

# Abbreviations

Abbreviation	Explanation

# Contents

<b>Document History</b>	<b>2</b>
<b>Abbreviations</b>	<b>2</b>
<b>Contents</b>	<b>3</b>
<b>1. Introduction</b>	<b>4</b>
<b>2. Liffe's rules for applying package method:</b>	<b>5</b>
2.1 General rules:	5
2.2 Examples:	5
2.2.1 The shareholders of AAA company will receive 1 BBB share for 1 AAA share, when the spin-off becomes effective.	6
2.2.2 The shareholders of AAA company will receive 1 BBB share for 10 AAA shares, when the spin-off becomes effective.	6
2.2.3 The shareholders of AAA company will receive 2 BBB shares for 5 AAA shares, when the spin-off becomes effective.	7
<b>3. Exercise of the basket options in the C21® clearing system:</b>	<b>8</b>
3.1 General rules for exercises:	8
3.2 Examples:	9
3.2.1 The shareholders of AAA company will receive 1 BBB share for 10 AAA shares, when the spin-off becomes effective.	9
3.2.2 The shareholders of AAA company will receive 2 BBB share for 5 AAA share, when the spin-off becomes effective.	9
<b>4. Reports:</b>	<b>10</b>
4.1 The derivatives markets:	10
4.2 The cash market:	10
<b>5. Fees</b>	<b>11</b>
5.1 The derivatives markets:	11
5.2 The cash markets:	11
<b>6. Margin requirements:</b>	<b>12</b>
6.1 Normal process:	12
6.2 Cross Margining:	12

# 1. Introduction

The purpose of this document is to detail the solution chosen by LCH.Clearnet in order to process automatically the corporate event in the C21® clearing system.

In the case of option contracts, on exercise, delivery sellers are required to deliver the ex entitlement shares and the proportionate number of entitlements in consideration for the exercise price multiplied by the contract size.

This procedure can be used on equity options of all Liffe 's markets cleared in the C21® system (Amsterdam, Brussels and Paris). No equity options are currently listed on the Portuguese segment. The Portuguese stock futures are cash settled. Therefore, this procedure will not be applied on the Portuguese market.

The publication of this document is intended to minimise uncertainty over the method of contract adjustment to be adopted by Liffe when a company announces a Corporate Action and, consequently, to limit any unanticipated effect on the clearing process when Liffe thereafter announces its specific intentions on the contract adjustment.

LCH.Clearnet has taken care for minimising the impacts of this new process for its clearing members. This corporate event has no impact on the format of the clearing messages and reporting.

- The format of the clearing messages will remain unchanged.
- No new file will be created. The reporting of this corporate event will be done in the current clearing files.

The change of this new functionality is mainly identified at the exercise / assignment process:

- The exercise / assignment of the standard equity option generates one cash trade on the underlying of the option.
- The exercise / assignment of the basket option will generate one cash trade per component of the basket. As a result, the exercise of one option will generate few cash trades.

<p><u>The Operations Department would like to underline the fact that this solution can have potentially an impact in the clearing member's internal systems.</u> LCH.Clearnet recommends strongly to its clearing members to use the same method as described hereafter.</p>
---

## 2. Liffe's rules for applying package method:

### 2.1 General rules:

The rules of the corporate events are defined by Liffe and they must be applied by LCH.Clearnet.

A company can decide to de-merge a part of its activity and the shares of the de-merged company can be delivered and settled in the domestic market. The demerger results in the creation of two or more companies.

When the spin-off becomes effective an adjustment of the Liffe options on shares will be required.

- The form of the adjustment has been chosen so that the result at the time of the adjustment will be value neutral.
- Following the spin-off, the value of a contract will be calculated as follows:  
(number of shares of the original company\* price of the original company)+  
(number of shares of component 1 \* price of the component 1)+ (number of shares of component 2 \* price of the component 2).....
- In order to settle the basket of components, a new pseudo ISIN code will be affected to the underlying of the basket option. This pseudo ISIN code will be published in a Liffe's notice before the corporate event.

The exercise price and contract size of the option will remain unchanged.

No new series will be created by Liffe on the basket option after the corporate event.

A new option on shares of the original company can be introduced for trading on the Liffe's markets. The decision is taken by Liffe. It depends on the interest of the investors.

### 2.2 Examples:

A company called AAA has decided to de-merge a part of its activity and the shares of the de-merged company can be delivered and settled in the

domestic market. The de-merger results in the creation of the AAA company and BBB company.

Before the corporate event, two options on the AAA company were listed on the Liffe's markets.

- The first option has the mnemonic AA1 and a lot size at 100.
- The second option has the mnemonic AA2 and a lot size at 10.

The package method has to be applied on both options as follows.

### **2.2.1 The shareholders of AAA company will receive 1 BBB share for 1 AAA share, when the spin-off becomes effective.**

- One lot of option AA1 is exercised:
  - quantity of AAA share = 100
  - quantity of BBB share = 100
  - value of the basket option =  $(100 \times \text{price of AAA share}) + (100 \times \text{price of BBB share})$
- One lot of option AA2 is exercised:
  - quantity of AAA share = 10
  - quantity of BBB share = 10
  - value of the basket option =  $(10 \times \text{price of AAA share}) + (10 \times \text{price of BBB share})$

### **2.2.2 The shareholders of AAA company will receive 1 BBB share for 10 AAA shares, when the spin-off becomes effective.**

- One lot of option AA1 is exercised:
  - quantity of AAA share = 100
  - quantity of BBB share = 10
  - value of the basket option =  $(100 \times \text{price of AAA share}) + (10 \times \text{price of BBB share})$
- One lot of option AA2 is exercised:
  - quantity of AAA share = 10
  - quantity of BBB share = 1
  - value of the basket option =  $(10 \times \text{price of AAA share}) + (1 \times \text{price of BBB share})$

### **2.2.3 The shareholders of AAA company will receive 2 BBB shares for 5 AAA shares, when the spin-off becomes effective.**

- One lot of option AA1 is exercised:
  - quantity of AAA share = 100
  - quantity of BBB share = 40
  - value of the basket option =  $(100 \times \text{price of AAA share}) + (40 \times \text{price of BBB share})$
  
- One lot of option AA2 is exercised:
  - quantity of AAA share = 10
  - quantity of BBB share = 4
  - value of the basket option =  $(10 \times \text{price of AAA share}) + (4 \times \text{price of BBB share})$

Before the corporate event, the AA1 and AA2 options had the same underlying with the YYYYYYYYYYYY ISIN code (FR0000120529 for Suez). This is the ISIN code of the share AAA listed on the Euronext cash market.

After the corporate event, a pseudo ISIN code will be affected to the underlying of the options. This pseudo ISIN code VVVVVVVVVVVV (FR4444120251 for SZ1 and FR4444120251 for SZ3) doesn't exist on the cash market. It represents the basket of the option. This pseudo ISIN code will be available in the 5A messages (products referential) to be sent by Connect (Euronext Liffe's trading system) at the effective date of the corporate event.

A new Liffe option on AAA share could be introduced for trading. The ISIN code of its underlying will be YYYYYYYYYYYY. It will have a new mnemonic as follows:

- AA3: option with the lot size at 100
  
- AA4: option with the lot size at 10

The mnemonics are defined by Liffe.

### 3. Exercise of the basket options in the C21® clearing system:

#### 3.1 General rules for exercises:

As a result of exercises / assignments on the basket option, some cash trade legs are generated and injected in the C21® cash clearing system. One cash trade leg is created for each component of the basket.

The cash trade on the original component of the basket has a price equal to the strike minus the cash adjustment (also called the fraction) of the basket option. The other cash trade legs have a price at 0. They are free of payment.

LCH.Clearnet has chosen this solution for two reasons:

- This principle is simple. It can be easily duplicated in the internal systems of the clearing members.
- The cash trade legs free of payment are often used in the corporate events of the cash market.

In order to facilitate the reconciliation of the clearing members, all cash trade legs consecutive to one exercise will have the same C21 external trade number.

The field “mailing comment” of the “notice of trade leg creation” message (5011) for the exercise/tender/assignment trades delivered to the cash clearing will include the following information:

- The derivatives member code of the member holding the position
- The position account external id of the member holding the position

DATA	DESCRIPTION	FORMAT
Member Code	C21 Derivatives member code of the member holding the position	X (5)
Split character	« / »	X (1)
Position account	External identification of the position account of the	X (12)



external id	member holding the position	
Total field length		18

## 3.2 Examples:

The call with a strike at 200 and maturity March 2007 is exercised by the member on the basket option.

### 3.2.1 The shareholders of AAA company will receive 1 BBB share for 10 AAA shares, when the spin-off becomes effective.

- One lot of option AA1 is exercised:
  - Transaction 1: delivery of 100 AAA shares with a price at 200
  - Transaction 2: delivery of 10 BBB shares with a price at 0
  - The transaction 1 and 2 have the same C21 external trade number (1111111)
  
- One lot of option AA2 is exercised:
  - Transaction 1: delivery of 10 AAA shares with a price at 200
  - Transaction 2: delivery of 1 BBB share with a price at 0
  - The transaction 1 and 2 have the same C21 external trade number (2222222)

### 3.2.2 The shareholders of AAA company will receive 2 BBB share for 5 AAA share, when the spin-off becomes effective.

- One lot of option AA1 is exercised:
  - Transaction 1: delivery of 100 AAA shares with a price at 200
  - Transaction 2: delivery of 40 BBB shares with a price at 0
  - The transaction 1 and 2 have the same C21 external trade number (3333333)
  
- One lot of option AA2 is exercised:
  - Transaction 1: delivery of 10 AAA shares with a price at 200
  - Transaction 2: delivery of 4 BBB share with a price at 0
  - The transaction 1 and 2 have the same C21 external trade number (4444444)

## 4. Reports:

The process of exercise /assignment on basket options generates some cash trades on the underlying of the options at the closing of the derivatives clearing session. These trades are integrated on the same day in the C21® cash system. The settlement date is D+3 (D is the date of the exercise / assignment). These cash trades are managed as other normal cash trades (i.e.: corporate events). The same process is used on the standard equity options.

### 4.1 The derivatives markets:

The exercise / assignment on basket option is available in the PR3 position file (OpxxxS3 – xxx is the C21 code of the clearing member) and in the OPEJ file (EXAS record).

As general rules, the exercises / assignments on basket options are managed in the reports as the normal equity options.

The pseudo ISIN code of the basket option will appear in two records of the OPEJ J2 file:

- CLAS record: long instrument id of the underlying securities
- SERI record: long instrument id of the underlying securities

### 4.2 The cash market:

The cash trade legs consecutive to exercise / assignment on basket options are available in the TLRF file.

The postings of the cash trade legs consecutive to exercise / assignment on basket options are available in the PR3 position file (OpxxxxxS3 – xxxxx is the C21 code of the clearing member).

As general rules, the cash trade legs consecutive to exercises / assignments on basket options are managed in the reports as the normal cash trade legs.

## **5. Fees**

LCH.Clearnet will not apply specific fees grid for the basket options in order to minimise the impact to its clearing members.

### **5.1 The derivatives markets:**

The clearing members will have to pay the same clearing fees and exercise fees on the basket option as on the equity options. The same fees grid will be applied on the basket options.

### **5.2 The cash markets:**

The clearing members will have to pay the same clearing fees on the cash trade legs consecutive to exercises on basket option as the normal cash trade legs. The same fees grid will be applied.

## **6. Margin requirements:**

### **6.1 Normal process:**

After the corporate events, the margin requirements on the basket option remain unchanged with the same Span® parameters.

### **6.2 Cross Margining:**

After the corporate events, the cross margining between the basket option and the stocks in the basket won't be allowed on the French segment for the market makers.

Anyway, a new option on shares of the original company can be introduced for trading on the Liffe's markets. The clearing members will be able to take advantage of the cross margining between this new option and the stocks.