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ICMSA Bulletin – Guide to the Treatment of Financial Instrument Fungibility and Related Conditions (where the ICSDs act as the Issuer CSD)

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1. Introduction

The purpose of this document is to provide guidance to market participants on fungibility scenarios that can be supported by Euroclear Bank and Clearstream Banking Luxembourg (respectively the "ICSDs") in respect of requests to treat and handle fungibility between separate tranches of a financial instrument. This has been triggered by scenarios presented to the ICSDs that could not be supported due to the operational complexities that were associated with handling the requests.

2. Fungibility – Definition (as per ISO 6166 (ISIN) standard principles)

As per the ISO 6166 (ISIN standard), fungibility principles are defined as follows:

"A set of goods which are equivalent, substitutable, and interchangeable and which are not individualized. Since financial instruments can be individualized by numbers or through the issuance in registered form, we will use the following definition:

Fungibility within the financial instruments industry means that a security ranks pari passu in all respects with a different version of the same security and can be exchanged into the other form and vice versa at any time.

- Rights potentially attached to fungible financial instruments
- Right to sell
- Right to vote
- Right to receive payments (interest, dividend, in kind, redemption amount)
- Right to participate in a corporate action in the same way
- Right for any holder to hold any form
- Right to callability, conversion, extension of redemption etc"

Note: This paper has been designed to focus specifically on international market instruments issued in the ICSDs and thus from a practical and operational perspective, each tranche, at the point fungibility, must have the same legal terms and conditions as the parent instrument – for example the denomination configuration of each tranche must be the same to allow the fungibility.

3. Scenarios the ICSDs and Issuing & Paying Agents (IPAs) may support:

a) A subsequent financial instrument that is identical in largely all respects with a previously issued financial instrument and the ICSDs are requested to funge the two securities together immediately upon issuance of the second financial instrument. Such a scenario would therefore result in an immediate increase of the issuance amount of the original financial instrument 'parent ISIN' to reflect the new aggregate total issue amount resulting from the fungibility being actioned.

NOTE 1: Tapping (increasing) total outstanding amounts of 'up to' global notes effectively result in an immediate fungibility and thus have been included in the scope of the above scenario

b) A subsequent financial instrument that is largely identical in all respects (but with some exceptions e.g. the new tranche is subject to Tefra D certification) with a previously issued financial instrument and the ICSDs are requested to funge with the initial security issuance upon a defined future date (future coupon date or otherwise). For the interim period that would result, the two securities will not funge together under a single ISIN. Therefore, the subsequent security issuance will be represented by an 'interim/temporary ISIN' until such time when all fungibility aspects are met and the two securities can funge into the original 'parent' ISIN.

   For international debt instruments, the most common event which would enable all the above fungibility criteria to be achieved, would be the completion of the 40-day lock-up period in order to comply with TEFRA D and Reg. S, category 2 and 3, requirements.

   A subsequent issuance of a TEFRA C and a Reg S, category 1, would normally allow immediate fungibility with previous tranches, again based on the premise that all the basic fungibility criteria had been met.

   NOTE 2: Handling of associated accrued interest is also a financial instrument attribute that the ICSDs will factor into the possible fungibility determination.

4. Scenarios the ICSDs and Issuing & Paying Agents cannot support:

Fungibility scenarios have been presented to the ICSDs for consideration where, for example, the request was made to reset the initial seasoning period of the parent ISIN; back to day one, to allow an immediate fungibility of an envisioned new (unseasoned) tranche to occur. In this case the completion of the seasoning period of the first ISIN had taken place. Such scenarios cannot be supported for various operational [and legal] reasons and thus the ICSDs would require the second instrument to have a temporary ISIN and funge at a later date. By comparison, where the initial seasoning period of the parent ISIN will not yet have completed by the time of issuance of a new (unseasoned) tranche, the ICSDs can accommodate a request to reset the seasoning period of the parent ISIN to match the seasoning period of the new tranche.

As a general rule for all market actors, fungibility scenarios that deviate from those set out in Section 3 above must always be reviewed, validated and approved by the responsible IPA and the ICSDs prior to determining that such a scenario can and will be supported.