

INSTRUCTIONS No7

SECURITIES ACCOUNTING BY HOLDERS OF ACCOUNTS

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CHAPTER I - GENERAL INFORMATION

SECTION 1 - GENERAL PRINCIPLES

The introduction of a new system for securities holding and transactions entails obligations for holders of accounts:

- A **double entry** bookkeeping system allowing for internal control and enhanced security;
- Recording of **established rights**. This means that as soon as a right is created and definitively established in a customer's name, it must be entered in the latter's securities account without waiting for any material results;
- A general accounting system, which requires the definition of a **minimal chart of accounts**. Each institution is free to fill in the details of the general outline according to its needs, provided that its system is described in an accounting plan, accompanied by an user manual.

SECTION 2 - STRUCTURE OF THE SECURITIES ACCOUNTING SYSTEM

1 - Securities accounting is based on **accounting by security**.

The basis of intermediaries' accounting is the individual security.

The term security refers to a group of instruments of the same type issued by a single issuer, whether quoted or likely to be quoted, which, in and of themselves, confer identical rights on the holders thereof. All rights deriving from a negotiable or potentially negotiable security are themselves equivalent to a security.

All intermediaries maintain individualized accounting records for **each security** for which they are accountable to their customers. These records should allow intermediaries to determine at any time their position in a given security, in order to ascertain, in particular, their holdings in that security for each of their customers, as well as, in general, the stock of securities conferring rights that must be exercised vis-à-vis the issuer (interest or dividend coupons, subscription or allotment rights, number of securities affected by a trade, etc.).

The securities accounting of an intermediary holder of accounts thus involves the juxtaposition of as many accounting records (identically structured and homogeneous) as the intermediary holds securities for the account of its customers; similarly, a given customer is the holder of as many accounts with his intermediary as there are securities in his portfolio.

The concept of a “customer portfolio” becomes an extra-accounting concept: an individual’s “portfolio statement” is simply the consolidation of the balances of his accounts in the various securities he owns in a single periodic document.

2 - Accounting records by security are subdivided by category of securities holder: individual customers, holder of accounts’ own securities. The same distinction, aimed at protecting the assets of securities holders, is found in Midclear accounting, which establishes separate accounts by category of securities holder.

CHAPTER II - SECURITIES CHART OF ACCOUNTS

The chart of accounts and the procedures for its use by members are generally applicable.

SECTION 1 - SECURITIES ACCOUNTING OUTLINE

- 1/ General journal for securities transactions
- 2/ List of accounts to be used:

Class 1 Accounts - Securities Holder Accounts

- 11 - Regular Individual Accounts
- 111 - Regular Individual Accounts
- 112 - Blocked Individual Accounts

- 12 - Individual Collateral Accounts

Class 2 Accounts - Cash Accounts

- 21 - Midclear Liquid Asset Accounts
- 211 - Regular Central Depository Accounts
- 2110 - Regular Midclear Accounts
- 2111 - Incoming Pending Midclear Confirmation
- 2112 - Outgoing Pending Midclear Confirmation

- 212 - Midclear Trade Transit Accounts

- 22 - Midclear Transactions Accounts

- 221 - Securities Receivable Accounts
- 2211 - Securities Receivable From the Regulated Market
- 2212 - Registered Securities Receivable From Issuers
- 2213 - Securities Receivable from Banks

- 222 - Securities Deliverable Accounts
- 2221 - Securities Deliverable to the Regulated Market
- 2222 - Securities Deliverable to Banks

Class 3 Accounts - Other Accounts

31 - Voluntary Suspense Accounts

311- Securities Pending Allocation Accounts

3111 - Individual Transactions Pending Verification

3112 - Miscellaneous Securities Transactions

312 - Securities In Process of Transaction Accounts

32 - Regularization Accounts

33 - Technical Suspense Accounts

331 - Transactions Pending Adjustment Accounts

3311 - Securities Receivable Pending Adjustment

3312 - Securities Deliverable Pending Adjustment

The above outline is adopted in the following sections. The numbering of these accounts will be used in the text.

SECTION 2 - GENERAL JOURNAL FOR SECURITIES TRANSACTIONS

As they affect an account in a given security, and regardless of their nature, securities transactions are posted to a general journal: market trade, establishment of rights, exercise of rights, delivery or receipt of securities, transfer of accounts to or from another institution.

Intermediaries may use as many separate journals as they maintain different sets of records. A single general journal can be used, however, provided that the securities relating to each set of records can be clearly identified.

The general journal should be:

- kept chronologically,
- closed daily,
- track all transactions affecting accounts,
- each line should include the designation of the accounts credited and debited by the transaction,
- the description of the transaction should be specific enough to permit access to the supporting documents.

This journal allows for the retrieval and authentication of transactions, any necessary research, and audits.

The general journal can be subdivided into auxiliary journals, specifically for recording transactions of a given type.

SECTION 3 - CLASS 1 ACCOUNTS: SECURITIES HOLDER ACCOUNTS

Class 1 accounts include all of the individual accounts of an intermediary's customers. These accounts keep track of the securities for which that intermediary is accountable vis-à-vis each of its individual customers.

1/ Regular individual accounts: Heading 11

a) Two principles govern the holding of these accounts:

- any transaction that creates or modifies an account holder's rights must be posted to the latter's account as soon as the right is established, i.e., when it becomes certain;
- corollary: any securities operation involving the transfer of cash or rights to a customer's account must be recorded in the form of securities entries and cash or concomitant rights entries.

At no time should there be any lag between the creation or modification of a customer's right and the recording of that right in his securities account, particularly when the acquisition or sale of the right debits or credits his cash account with the corresponding price.

Example:

A customer has issued an order to the intermediary holding his account to buy shares. The order was executed on day D, the advice of execution was sent to him immediately, notifying him of the debit to his cash account of the gross amount of his purchase, plus charges. The customer's securities account should be credited at the same time with the corresponding number of shares. Ideally, the outflow of cash should be offset simultaneously with an inflow of securities; in practice, this should occur only with the minimum delay required to process the transaction.

The question of whether the intermediary has indeed received the securities purchased is of no concern to the customer, as responsibility for this matter lies entirely with the intermediaries, participants in the market.

The natural result is that the credit to the customer's securities account is normally balanced (in double-entry bookkeeping) with a debit to a cash account (Class 2 - Securities Receivable), which in this case reflects the holder of accounts' position vis-à-vis its correspondents on the market. This "securities receivable" transit account will be balanced upon receipt of the securities resulting from a transfer for the latter's account at the Central Depository. This transaction results in a balancing credit to the "securities receivable" account and a debit to another cash account, the "Midclear liquid assets" account.

b) Functioning of regular individual accounts

These accounts, which must show a credit balance at all times, record the each customer's holdings of a given security.

Posting of entries:

- The account is credited with inflows of securities as a result of physical deposits, purchases, securities transactions, releases of collateral, and transfers from another holder of accounts;
- It is debited with outflows of securities in the same circumstances, but with the opposite effect.
- In double-entry bookkeeping, the counterparts of these entries are the balancing entries posted to a class 2 account (Cash), a class 3 account (Other Accounts), or a class 1 account (Customers, in the case of a transfer between two customer accounts with a single intermediary).

Description of debit or credit entries:

- Date of posting
- Brief or coded explanation of the transaction, including a reference to the supporting documents
- Number of securities debited or credited.

The basic accounting documents include:

- Market orders executed and recorded in a trading file;
- Instructions to transfer of securities to or from another holder of accounts, issued by the securities holder himself or a third party.

Time limits:

- For purchases or sales of securities or other negotiable instruments on a regulated financial market, simultaneous securities and cash entries must be made in all cases within a maximum of 2 calendar days of the trade.

Presentation of the account:

- Specific mention of the securities holder and description of the securities;
- previous balance;
- entries described above;
- new balance.

Note: During certain securities transactions, the intermediary should temporarily block securities or rights posted to securities holders' individual accounts. They are then credited to a specific "blocked securities" individual account opened under subheading 112, subheading 111 being reserved for regular individual accounts.

2/ Individual collateral accounts: heading 12

These accounts are used to record securities that have been presented as collateral and that should therefore be blocked, i.e., set aside in a specific account.

The individual collateral account is credited with inflows of securities presented as collateral and the regular account of the customer pledging his securities is debited. The individual collateral account is debited with outflows of released securities and the customer's regular account is credited.

Description of entries

- Date of posting;
- Reference to the pledge agreement or means of accessing it;
- Number of securities.

The basic accounting document is the pledge agreement, in the forms prescribed by law.

SECTION 4 - CLASS 2 ACCOUNTS: CASH ACCOUNTS

Cash accounts record securities transactions between various market participants: banks, financial intermediaries, issuing institutions, and Central Depository.

Class 2 is divided into two headings:

- Heading 21 is for liquid asset accounts with the Central Depository; it is normally used for the securities for which holders of accounts, members of the depository, are responsible vis-à-vis all of their customers;
- Heading 22 is for transactions accounts (inflows and outflows) with the Central Depository; pending securities transactions are temporarily posted under this heading.

1/ Liquid asset accounts with the Central Depository: heading 21

Two subheadings are provided:

- 211: Regular Central Depository Account
- 212: Midclear Trade Transit Account

a) Regular Central Depository Account - subheading 211

This account must always show a debit or zero balance. It represents the amount of the holder of accounts' regular assets with the Central Depository, in a given security.

The transactions debited to this account correspond to securities entries to Central Depository current accounts: physical deposits, deliveries against payment in its favor originating in the market, and transfers of any type credited to its member account with Midclear.

The transactions credited to this account are the opposite of those mentioned above.

The balancing entries for these transactions are posted, as appropriate, to accounts of all types. For example:

- Transfer of a customer's account to another holder of accounts: the departing customer's account (Class 1) is debited and the regular Central Depository account is credited;
- Purchase of securities: the securities receivable account (Class 2) posted at the time of purchase is credited and the regular Central Depository account is debited;
- Securities have been delivered to an intermediary without any information concerning their allocation. When these securities enter the intermediary's account with Midclear, the regular Central Depository account is necessarily debited and a regularization account (Class 3) is credited, pending receipt of the information needed either for the final allocation of these securities or their return.

Entries to the regular Central Depository account include:

- Date of posting;
- Brief description of the transaction;
- Reference to the basic accounting document;
- Reference to the counterpart account debited/credited;
- Number of securities.

The basic document is the statement of account issued by the Depository. Postings are made upon receipt of this statement.

Note: The regular Central Depository account is not credited or debited before receipt of the statement of entries actually posted by the Depository. Meanwhile, deliveries received by Midclear may be recorded temporarily, on the presumed date of processing of the entry by the Depository, in a specific account - account 2111, "incoming pending Midclear confirmation," or 2112, "outgoing pending Midclear confirmation, depending on the direction of the transaction - or will remain there until Midclear confirms that they have been posted.

The Midclear inflow/outflow technical accounts are initially debited or credited to balance the debit or credit entries posted to the securities deliverable or receivable accounts. They are then cleared to offset the entries to the regular Central Depository account, upon receipt of the notice of posting transmitted by the Depository.

b) Midclear trade transit account - subheading 212

This account records the transit through Midclear of securities traded on the market by a broker.

The debits and credits to this account correspond to deliveries of securities traded for the account of intermediaries.

Balancing entries are posted to securities deliverable or receivable accounts opened in the name of intermediaries receiving orders.

2/ Transactions accounts with the Central Depository: heading 22

These accounts record deliveries of securities to be carried out at the Central Depository between the holder of accounts and other members of the Depository. The entries to these accounts very generally offset the entries posted to Class 1 customer accounts.

They include two subheadings:

- 221: securities receivable
- 222: securities deliverable.

a) Securities receivable accounts: subheading 221

These are debit accounts by definition.

Account 221, “securities receivable,” records securities transactions for which the intermediary is waiting, either because of the usual amount of time allotted for transactions by the regulations or by custom, or because of unforeseen events.

The account includes the references of the counterpart institution in the delivery: there are as many “securities receivable” accounts as there are participants in the market. These accounts may also be subdivided, depending on the needs of the holder of accounts, into as many subaccounts, for example, as there are types of transactions or delivery dates.

Account 221, “securities receivable,” is debited to offset the credits posted to Class 1 “customer” accounts. It is credited, following physical delivery, with the securities debited to the “regular Central Depository” account.

As these “securities receivable” accounts are used only to offset entries to Class 1 or 2 accounts, the relevant basic documents are the same and the entries are made simultaneously.

b) Securities deliverable account: subheading 222

The mechanisms of these accounts are identical to those of the securities receivable accounts, but have the opposite effect.

SECTION 5 - CLASS 3 ACCOUNTS: OTHER ACCOUNTS

It often happens in securities management that a transaction cannot be immediately posted to the account designated to receive it.

There are three reasons for this:

- The transaction is, in and of itself, perfectly routine, but final posting must be delayed either because it involves procedures or verifications which must be carried out, or because it technically requires a certain amount of time;
- The transaction is not routine and requires prior instructions or research.
- An adjustment involving the counterpart is necessary before posting.

In the first case, the transaction is temporarily accounted for under heading 31 of the chart of accounts: voluntary suspense account.

In the second case, the transaction is recorded under heading 32: regularization accounts.

In the third case, heading 33 is used: technical suspense accounts.

1/ Voluntary suspense accounts: heading 31

(a) Securities pending allocation accounts: subheading 311

1. Individual transactions pending verification: 3111 accounts

A typical example of a transaction temporarily posted to this account is that of the transfer of a customer account. When such a transfer is effected from one holder of accounts to

another, and before posting to the customer's account, the recipient must check the bank identification form, the name of the account to be credited, and the customer's capacity to use the account. During this period, entries are posted temporarily under "individual transactions pending verification."

2. Miscellaneous transactions: 3112 accounts

These accounts are used to resolve bookkeeping problems related to securities transactions, such as bonus issues, subscriptions, trades, public offerings, conversions, etc. between a holder of accounts and the domicile institution.

(b) Securities in process of transaction: subheading 312

This subheading is used in the context of securities transactions. When, for the account of its customer, an intermediary presents rights or securities to the institution processing the transaction by means of a transfer through Midclear, it credits its Central Depository assets account on its books and debits the “securities in process of transaction” account. In reality, rights or securities will be deducted from securities holders’ assets only upon receipt of the new securities, i.e., after the intermediary receives the securities from the institution processing the transaction by means of a transfer through Midclear.

2/ Regularization accounts: heading 32

Any irregular item in securities accounting is posted to these accounts.

Examples:

- Allocation to a customer’s account impossible for any reason (false or ambiguous identity, incorrect account number, etc.): the holder of accounts has nevertheless been credited at the Central Depository; it therefore debits its account recording assets with the Central Depository and credits the "regularization" account, not a customer account.
- An error has occurred: staff has inadvertently sold more securities than a customer held. The excess securities sold are posted to the "regularization" account pending a repurchase that will remedy the situation.
- An intermediary is credited by the Central Depository with securities from an unknown source. All such securities are posted to the “regularization” account until more information is received.

Regardless of whether errors are attributable to the staff of the holder of accounts (bank or broker), its correspondents, or its customers, correcting them takes time. The transactions are recorded in "regularization" accounts pending their investigation and correction.

3/ Technical suspense accounts: heading 33

Transactions pending adjustment accounts - subheading 331

Expected securities transactions between intermediaries are not considered semi-certain until the adjustment processes yield a positive outcome.

In the meantime, these transactions are temporarily recorded in specific transit accounts pending adjustment of the corresponding operations. These transit accounts, which are designed to record deferred entries to cash accounts, are subdivided into:

- 3311 accounts - securities receivable pending adjustment
- 3312 accounts - securities deliverable pending adjustment

These accounts are initially debited or credited to offset the entries posted to Class 1 "securities holder" accounts. Then, following effective adjustment of the operations, they are cleared in order to offset the entries posted to the Midclear transactions accounts (heading 22).