



# Canada's 'Due Bill' Initiative

## The Time Has Come

**IIROC FAS Conference**

**June 2011**

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# What is the 'Due Bill' Initiative?

- ❑ Initiative aimed at improving the accuracy and timeliness of the valuation of client's holdings when securities are undergoing a material corporate action event such as a stock split or spin-off
- ❑ Due Bill tracking is the methodology that allows securities to carry their appropriate value until the entitlement event has been fully processed in client accounts

# Current process in Canada

**(for processing entitlement events such as stock splits, spin-offs, stock dividends and stock distributions)**

- ❑ The ex-date is always two days prior to the record date
- ❑ As such, securities begin to trade on a post-split basis (reduced price) on the ex-date
- ❑ Purchases that occur on or after the ex-date are settled without the entitlement to additional shares, because stock transactions settle in trade date plus three business days
- ❑ Market price drops to the reduced price on the ex-date, but entitlement for the additional split shares to eligible security holders is not made until the payable date, which can range from a few days to six weeks or more after the record date.

# Current process in the U.S

(for processing entitlement events such as stock splits, spin-offs, stock dividends and stock distributions)

- ❑ The ex-date is set on the first business day after the payable date
- ❑ For stocks, the period of time between record date and two days after the ex-date is the due bill tracking period
- ❑ A due bill is created and is an agreement that the seller will pay the entitlement due to the buyer upon presentation after trade settlement
- ❑ Due bill tracking is done in an automated way and book-entry messages are used
- ❑ The shares are paid out after the ex-date in order to capture all trades done on the ex-date
- ❑ All share allocations from the Depository Trust Company (DTC) are done two days after the ex-date (known as the 'Due Bill Redemption Date') to ensure that all due bill trades get picked up.

# illustration: Potash 3-for-1 stock split

## February 2011

Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
Potash Corp. of Sask. Inc. 3-for-1 Stock Split - Announced Jan 26 2011 Record Date: Feb 16 2011 Payable Date: Feb 24 2011		1	2	3	4	5
6	7	8	9	10 TSX C\$ 184.71 NYSE US\$ 185.02	11 185.49 188.30	12
13	14 <b>CDN Ex-Date</b> Price on CDN exchange drops by 2/3 62.76 189.94	15 60.63 183.64	16 <b>Record Date</b> 61.05 185.53	17 61.44 186.25	18 59.17 180.00	19
20	21	22 56.01 170.13	23 US Due Bill Period 56.80 172.47	24 <b>Payable Date</b> 57.06 173.78	25 <b>US Ex-Date</b> Price on US exchange drops by 2/3 58.87 60.00	26
27	28 US Due Bill Period 59.86 61.60	March 1 US Due Bill redemption date 59.39 60.85	2 US Due Bills processed			

# Current Issues and Challenges

## Valuation

- Incorrect market values and/or positions in clients' accounts/statement/online/book values/valuations.
- Investor confusion based on suspect valuations.
- Incorrect margin calls with respect to price drop.
- Incorrect margin allocations with respect to deemed short sells.

## Inconsistency with U.S

- Inconsistent treatment of prices and process of events for U.S. and Canadian inter-listed securities, leading to internal and external confusion.
- Inconsistent transaction processing and pricing manipulation can lead to capital and segregation issues.
- Leads to operational competitive disadvantage in Canada

# Current Issues and Challenges (cont'd)

## Reliance on Manual Processes

- Manual adjustments required to track trades and fail activity that fall within the due bill trading is elongated (approx. 2-6 weeks).
- Risk of error and inconsistent treatment of like events by financial intermediaries present in existing practices.
- Manual identification of true margin deficiencies is challenging.

## Revenue & Losses

- Lost fee revenue based on incorrect or lagging portfolio valuations.
- FX losses can result when moving securities cross border between DTCC and CDS due to differing treatments.
- Trade errors due to inter-listed complexity and inconsistency.

# Solution

Adopt a due bill process in Canada similar to the US model for all Canadian listed and inter-listed securities.

- Generally Due Bill process to be used for events where **25%** of the value of the company is distributed or as determined by the exchange.
- Exchanges to instruct depositories and participants on which events are due bill eligible based on standard approach.
- Direct industry to new standard which aligns processing in North American for all due bill eligible events.

# Solution

## Covered Events

- Cash Dividends/Distributions
- Stock Dividends/Distributions
- Stock Splits
- Stock Spin Offs
- Rights/Warrants Distributions

# Benefits of Adopting Due Bill in Canada

- ❑ Results in consistent and timely market value in a client's account;
- ❑ Harmonizes the treatment of those entitlement events for securities that are interlisted in Canada and the U.S.;
- ❑ Eliminates the need to track trades executed in the U.S. market for interlisted securities;
- ❑ Allows for processing entitlements consistently and correctly;
- ❑ Eliminate ongoing support costs for explaining pricing and valuation inconsistencies for these events for front and back offices.
- ❑ Shared development cost allowing for reduction of investment on manual processes.
- ❑ Reduces reliance on in-house pricing and valuation adjustments and separate processes; and
- ❑ Allows operations staff to focus resources on other aspects of the business.

# Development Schedule

- ❑ Business Requirements published by CDS January 2011
  - Reviewed and accepted by members of the industry
  - FAS, SDRC, TMX, ALPHA, Transfer Agents, Service Bureaus, Custodians, OSC
  
- ❑ Using DTC dates for interlisted issues
  - to ensure consistency with US
  - To take into account cross border holiday processing
  
- ❑ Using TMX dates for Canadian only traded issues

# Development Schedule

- ❑ Total cost - \$1.1 million
- ❑ Industry testing – to start November 7<sup>th</sup> for two weeks
- ❑ Implementation – first event with Due Bills after November 28<sup>th</sup>