ADVISORY

INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÉRES

MEMBER ADVISORY

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Due Bill

Background

Over the last few years, the industry has been exploring possible changes to the processing of entitlement events, such as stock splits and spin offs, in Canada, to help improve the accuracy and timeliness of the valuation reporting of client's holdings when securities are undergoing a material corporate action event. In the United States (US) the issue is less pronounced as they have a "Due Bill" tracking process for eligible entitlements. Due Bill tracking is the methodology that allows securities to carry their appropriate value until the entitlement event has been processed, whereas, in Canada the value may decrease substantially in value during the period between the record date of the entitlement and the payable date effectively. Canada is now looking to synchronize valuation and entitlements for these types of events.

Currently, in Canada, these events reflect a post-split price two days prior to the record date (ex-date) which often leads to confusion as the client's account position is not adjusted until the payable date. As such, the market value of a client's account is undervalued for the period of time between the ex date and the payable date which can be anywhere from a few days to six weeks or more. This situation is further complicated if that period crosses a month end as the client's statement will also reflect values that are inconsistent with the true value of the account holdings. Another complication that arises under the current system is that the processing of such events in Canada is different from the processing of such events in the US which is especially problematic for inter-listed securities. For instance, the securities will trade in the Canadian market at a different price than the US market during the Due Bill period. All these issues create a great deal of confusion, manual pricing solutions, costly infrastructures and bad client experiences.

Canadian Process

The current Canadian process is that the ex date is always two days prior to the record date. As such, in the event of a stock split, securities begin to trade on a post-split basis (reduced price) on the ex date, and since stock transactions settle in Trade Date +

ADVISORY

three business days, purchases that occur on or after the ex date are settled without entitlement to additional shares. Valuation issues occur because the 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 several weeks after the record date.

US Process

The current US process is that the ex date is usually on the first business day after the payable date and the shares are paid out after the ex date in order to capture all trades done on the ex date. In addition, all share allocations from DTC are done two days after the ex date so that all Due Bill trades get pick up.

Current Industry Initiative

IIROC's Financial Administrators Section (FAS) has endorsed and approved a Canadian Due Bill initiative that was initiated by its member firms. The IIAC has been working with representatives of the FAS Operations Committee and CDS – Clearing and Depository Services Inc. (CDS) towards implementing a Due Bill tracking system as a solution to the inefficiencies currently experienced in the industry.

The changes that will be implemented would allow for a standardized approach for the booking of an eligible entitlement event that is the same or substantially similar to the US practice for all Canadian listed securities, including those inter-listed on US exchanges.

There are a number of reasons that favoured choosing the US method of Due Bill processing including the following:

a) Consistent and timely market value in client's account;

b) Harmonize the treatment of such events;

c) Due Bill entitlements will be processed correctly the first time and in a consistent manner as there will no longer be a need to track trades executed in the US marketplace for inter-listed trades;

d) Shared development costs; and

e) Reduced reliance on in-house pricing and valuation adjustments/processes to deal with existing timing differences.

Over the last several months, the IIAC and our Due Bill Working Group have been meeting with various vendors and stakeholders and, along with CDS, have targeted **November 2011** to implement the new system.

In January of 2011 CDS issued high level business requirements for Due Bill processing. IIAC member firms should begin looking at their systems and contact their

ADVISORY

vendors to discuss the planned changes and their specific technology requirements to meet the implementation date.

For more information please contact Jack Rando at jrando@iiac.ca or Deborah Wise at dwise@iiac.ca.