Corporate Actions
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Corporate Actions


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John Wiley & Sons, Ltd
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Introduction

Historically, within the securities industry the topic of corporate actions has been regarded as a specialist subject, yet one involving relatively few specialist people. In addition, Corporate Actions Departments have traditionally been manually intensive, with a low-level of Straight Through Processing (STP). However, organizations within the industry have increasingly recognized the risks (and indeed some organizations have suffered losses directly) and as a result a much greater level of attention is now being given to this topic. This includes the automation of many aspects of corporate actions processing.

Such an important and diverse topic requires a very good level of understanding, if those who hold securities positions are to ensure they receive the assets due to them, whilst controlling the numerous risks that inevitably exist in the processing of corporate actions.

This book aims to demystify the topic of corporate actions and to make the subject more easily understood by a broad audience.

The authors’ intention is to explain the topic from first principles, and to take the readers to a point where they have a very good (but not expert) understanding of the subject. Readers will gain an understanding of the topic from a practical operational use perspective, enabling the application of such principles to specific market and workplace situations; in addition, the book is intended to be used as a reference of corporate action terms.

It is important to note that prior to reading the book, readers will need to possess a good fundamental understanding of securities settlement practices and associated operational procedures. It is intended that this book will build upon the basic settlement and operational principles described within Securities Operations: a Guide to Trade and Position Management (ISBN 0-471-49758-4), published in spring 2002 by Michael Simmons, one of the authors of this book.

This book is aimed at the following audiences:

- those who are new to the securities industry and who wish to gain a thorough understanding of a major aspect of securities operations (such readers are recommended first to read Securities Operations: a Guide to Trade and Position Management in order to gain a sufficient background understanding of the topic of corporate actions);
- those who work within securities industry firms (including investment banks, broker/dealers, institutional investors, retail and agency brokers, etc.) who have had no direct involvement with the subject of corporate actions, and who wish to (or are required to) broaden their
knowledge. This category includes traders, salespeople, risk controllers, auditors, compliance officers, static data personnel, settlement staff, reconciliations staff, accountants, etc.; 
• those who work within a corporate actions department and wish to broaden their knowledge.

Additionally, the target audience also includes those who provide services to the securities industry, such as:

• software vendors
  – facilitating meaningful discussion with clients, increased understanding of business requirements by software designers and engineers when developing software and appropriate testing of software
• corporate action data providers (vendors)
  – allowing a greater appreciation of managing corporate action events, after the event data have been supplied to their clients
• management consultants
  – enabling peer-level discussion with clients and a greater understanding of clients’ aims in this business area, particularly in light of the increased focus on financial reporting via the Sarbanes Oxley act
• custodians
  – providing assistance in understanding the processes their clients undergo in the successful management of corporate action events.

In order to provide a viewpoint enabling the reader to appreciate more easily the connectivity between the various sub-topics, the book is written primarily from the perspective of a Securities Trading Organization (STO).

We define an STO as operating in the following manner:

• It buys and sells securities for its own account.
• It typically maintains proprietary trading positions (whether positive or negative).
• It borrows and lends securities.
• It borrows funds to cover its positive trading positions.
• It undertakes repo transactions to minimize the cost of borrowing cash.

Furthermore, an STO may provide safe custody services to its clients, requiring the STO to hold securities (and possibly cash) in safekeeping on behalf of the client. The STO will need to ensure that it protects the interests of its clients (as well as itself), in relation to the management of corporate actions.

The majority of the concepts contained within the book, and the perspective from which the book is written, are applicable to any individual or organization (such as investment banks and fund managers) that owns securities or manages securities on behalf of others.

The book contains the following attributes and features:

• Structured development of reader understanding through logical and sequential explanation.
• Chapter topics restricted to easily digestible portions of information.
• Focus on corporate action event lifecycles and their components, in order to build a practical operational understanding of the management and impact of corporate actions.
• Explanation of industry terminology.
• Description of generic market practices and common conventions.
• Illustration of subject matter by use of diagrams, examples and analogies.
• Depiction of the full event lifecycle by use of detailed and sequential worked examples.
• Identification of the operational points of risk, control, STP and automation.

Rather than cover the practices within specific locations around the globe, we have attempted to convey concepts that will be applicable to the majority of locations. The intention is for the reader to apply these concepts in any location, as each of the major points covered within the book are typically practised within each market, but there is every possibility that each market has its own nuances in dealing with a particular point.

In compiling the information contained within this book, the authors have listed those types of events that they consider to be fundamental and the most common of corporate actions; not every conceivable event has been stated, nor will every possible variation of those events that are included, be covered. Nonetheless, we believe that readers will find that the method of explaining concepts will allow such concepts to be applied to variations of, and new types of, corporate action.

We have in general attempted to develop the reader’s knowledge gradually by describing the various components of a topic conceptually, providing examples and making forward reference to later topics, and backward reference to earlier topics. Our objective has been to enable the reader to gain a complete overview of corporate actions, subsequently enabling communication with other people on any and all of the topics covered.

Due to the cumulative effect within the book, the chapters (particularly in the second half of the book) make numerous references to points covered within previous chapters; consequently it is recommended that the book is read sequentially, chapter-by-chapter (although as far as possible we have designed chapters to be read on a standalone basis).

Words and terms explained within the Glossary of Terms are highlighted in italics within the main text.

We have written this book entirely independently and not for and on behalf of any organization, for whom we have been an employee or for whom we have worked in a consulting capacity.

Although every effort has been made to remove errors from the text, any that remain belong to the authors! If the reader has observations on the style and content of the book, we would appreciate being informed of such comments, via the following website: www.info@mike-simmons.com.

Elaine Dalgleish and Michael Simmons
The authors of Corporate Actions occasionally refer to well known organisations within the financial community in order to illustrate the context of typical trading and corporate actions scenarios. The scenarios created and the relationships and transactions referred to are for illustrative purpose only and have no factual basis.

The authors accept no responsibility for any loss that purports to be incurred as a result of the content of this book.
Acknowledgements

We would like to express our gratitude for the contributions of the following:

Jon Foord
Harvey Colborne
Mark Rigby
Colin Baker
Sue Woods.

We would also like to thank Viv Wickham and Sam Hartley at the publisher John Wiley & Sons, for their help in the production of the book.

In particular, we would like to say a special thank you to Ailean Maclean and Graham McCormack, who have dedicated their time to the review of the entire book, ensuring both accuracy and continuity throughout. Without their input and efforts it would not have been possible to complete this book.

Finally we would like to say thank you to Allyson Simmons and Paul Andrews for their patience, support and objective comment during the writing of this book.
About the Authors

Michael Simmons has spent the majority of his working life within the operational areas of international investment banks, most notably within the S.G. Warburg group in London. Having gained a detailed understanding of various back office tasks through many years of hands-on experience, he assumed managerial responsibility for a number of operational areas.

In recent years, Michael has worked as head of business consultancy within a global computing services firm, and is now an independent analyst and trainer. Michael’s areas of expertise include all aspects of the trade lifecycle and related activities including operational risks and control. Recent assignments include the offshoring of operational activities to India and operational risk analysis (the Sarbanes Oxley act). In addition, he creates and delivers training courses on the workings of the securities industry and associated operational aspects to audiences around the world.

Michael is author of Securities Operations: A Guide to Trade and Position Management published by John Wiley & Sons, which describes the fundamental components of operational activities from a first-principles perspective.

Elaine Dalgleish has spent her working life within the operational areas of investment banking and stock broking, working directly for international banking firms and financial software providers. Elaine’s hands-on experience spans various middle and back office operational disciplines in multiple markets. Whilst working directly in investment banking and stock broking, this has ultimately included the managerial responsibility for a number of operational areas.

The focal point of Elaine’s working history is the consistent involvement with Corporate Actions operations, initially with the manual processing of events as a custodian, and subsequently working as a Senior Business Analyst, specializing in Corporate Actions, analysing client requirements, and consulting in process re-engineering for Tier 1 and Tier 2 investment banks.

As a consequence, Elaine has both observed and been directly involved in the evolution of global market practices of Corporate Actions operations and the move to automation.

Observations on the style and content of this book can be conveyed to the authors by e-mail: info@mike-simmons.com
1.1 INTRODUCTION

For any holder of securities, whether an organization or individual, remaining in control of securities and cash positions is fundamental to the efficient management of its investment portfolio. This is not simply a matter of recording trading and settlement activity, but also the accurate processing and recording of the impact of corporate action events on those securities and cash positions.

This chapter serves to introduce the fundamental concepts and terminology associated with the processing and management of corporate actions.

1.2 DEFINITION OF CORPORATE ACTIONS

A corporate action is an event in the life of a security (typically) instigated by the issuer, which affects a position in that security.

If and when the issuer of an existing security distributes benefits to shareholders or bondholders (referred to throughout this book as position holders), or chooses to change the security’s structure, such events are commonly known as corporate actions.

Many types of corporate action events exist, often with subtle variations, but it is possible to define and group these events based upon a combination of:

- the issuer’s purpose;
- the impact of the event from the position holder’s and market place’s perspectives; and
- the lifecycle of the event.

The term ‘lifecycle’ is used in the context of this book to refer to the series of logical steps in the processing of a corporate action. Such lifecycles are determined by the nature of the corporate action. Note that detailed descriptions of numerous corporate action types are contained within Chapter 2, ‘Event Description and Classification’.

1.3 PURPOSE OF CORPORATE ACTIONS

The purpose of a corporate action is (typically) driven by the aims of the issuer, and will vary according to the specific type of corporate action. Purposes include:

- Distribution of Income
  This relates to the distribution of profits on equities and the payment of interest on bonds, by the issuer. Profits (or earnings) are distributed to shareholders in the form of dividend payments, whilst interest is distributed to bondholders via interest payments (commonly known as coupon payments). Note that the payment of a dividend is dependent upon a
decision by the issuer’s board of directors (dividend payments are not guaranteed), whereas coupon payments are made at pre-stated intervals and (for fixed-rate bonds) at the specified coupon rate in accordance with the terms of issue of the bond.

- **Raising of Capital**
  When the issuer wishes to raise further capital it may do so either by the issue of new equity via shares, or alternatively via the issue of bonds (also known as debt). The market place as a whole may be permitted to purchase either the new shares or debt, or the issue may be restricted to existing position holders only. In those instances where the issue of new equity at a price is offered to existing position holders only, then the event is considered to be a corporate action.

- **Restructuring of Issued Capital**
  From time to time the issuer may choose to restructure or re-organize the issued capital of the company. The issued capital is the total value of issued shares in the company; the total value is calculated by multiplying the par value of each share, by the quantity of shares issued.

  From time to time the issuer may choose to change the quantity of shares issued and/or the par value of those shares, for example by way of share splits or buy-backs.

  Many reasons exist for restructuring, including:
  - the reduction or increase of the total value of issued capital;
  - the reduction or increase of the current market price of the shares.

- **Redemption of Debt**
  In accordance with the terms of individual debt issues (in the form of bonds), the issuer will redeem the bonds at the maturity date (or prior to the maturity date if the issue terms permit).

  Upon issuance of bonds, the debt will appear as a liability in the balance sheet of the issuer; at redemption the liability will be reduced accordingly.

- **Restructuring of Debt Liabilities Against Issued Capital**
  From time to time an issuer may choose to restructure its balance sheet, by the conversion of debt liabilities to issued capital (where the bond issue terms permit). Such conversions will simultaneously reduce the debt liabilities of the issuer, whilst increasing the capital in issue.

- **Assuming Control of Another Organization**
  One organization, in this case not the issuer, may wish to gain control of (i.e. takeover) another organization, in order to, for example:
  - control competition in the same market;
  - control either supplier or distribution networks in the same market;
  - extend or diversify product range or market.

- **Dissemination of Information to Shareholders**
  The board of directors of an issuer is obliged to inform shareholders of various activities that affect the operation and profitability of the company, and in some cases will also need to seek the shareholders’ approval of such activity before it is undertaken. Such information includes notification of company year-end results, capital investment programmes, notification of an A.G.M.

  Figure 1.1 illustrates the various aims of the issuer (as described above), whilst also showing that in each case the corporate action event information is intended to be communicated to the position holder (the owner of the underlying security).