Letter from the President

"Due Bill" is Due North: Improving Processing of Client Accounts

The Canadian securities industry is on course to eliminate a major headache in reporting client securities holdings. By the end of this year, the industry is targeting to implement changes to the way certain corporate actions, most notably stock-splits and spin-offs, get processed in client accounts. The aim of the initiative is to bring more responsive and accurate client reporting in regard to stock revaluations and reorganizations. The approach will also harmonize Canada with U.S. processes. Professionals working in the industry's operations underbelly, or the infamous "REORG" departments, refer to this initiative as "Due Bill Tracking." The initiative should be viewed as a welcome development by Canadian advisors and their clients.

The Problem: Aligning Record-Keeping with Reality

To understand what problem the industry is trying to solve with this initiative, a quick refresher on current Canadian practices for processing such transactions is warranted.

When a Canadian listed stock announces, for example, a two-for-one stock split, the current process is for the ex-date (the date that purchasers of the security will no longer be entitled to the additional shares) to be set two days prior to the record date. While stocks will begin to trade on a post-split basis (at the lower price reflecting the additional shares) on the ex-date, the additional shares are not paid out to investors until the payable date – which can range from a few days to several weeks after the stock starts trading at the reduced price. As a result, in this interim period, shareholders entitled to the additional shares will see the value of their portfolios fall in proportion to the share price decline. Portfolios will be vastly undervalued, a situation further compounded if the split straddles month-end and the incorrect portfolio value gets reflected on the client's month-end statement. Incorrect valuation may also lead to other possible negative ramifications such as improper margin calls or incorrect performance reporting.

To avoid unfortunate consequences, Canadian investment dealers have had to resort to various manual workarounds. While the dealers' provisions have made this largely a non-issue for their clients, they are costly, inefficient, and prone to operational risk. Despite dealers' best efforts, things slip through the cracks, leading to negative client experiences.

Divergence Between Canada and U.S.

Adding a further complication is the fact the U.S. has adopted a different approach. In the U.S. the ex-date for these events is the first business day after the payable date. This means that the stock price in the U.S market drops after all shareholders of record have received their additional shares - thereby alleviating the valuation issues experienced north of the border and hence the need for manual intervention on the part of dealers.

The U.S also utilizes, through their depository, a system to track any trading done between and around the record and ex-date to ensure purchasers of the security receive their entitled shares at the expense of the sellers – otherwise known as "due-bill tracking."

The U.S approach creates a potential complication for Canadians investing in Canada's 163 dual-listed securities – among Canada's most widely held and traded. In particular, a stock inter-listed on both Toronto and New York that undergoes a stock split will have a different ex-date being applied in Canada and the U.S – meaning that the shares trade at differing prices for a period of time. This leads to client confusion, possible trading or FX errors, and again the need for manual intervention on the part of Canadian dealers.

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Canadian Industry Works to Harmonize Process with U.S.

The Canadian securities industry, through IIAC and CDS Clearing and Depository Services (CDS), is currently working on improving the Canadian processes by harmonizing them with the U.S. For eligible events (on all TMX and U.S inter-listed stocks), therefore, the Canadian industry will be moving the ex-date to the first business day following payable date, and CDS is implementing a tracking system comparable to the U.S depository for trading between the record and ex-date.

With implementation targeted towards the end of this year, Canada's "Due Bill" initiative will ensure accurate and timely security valuation in client accounts, eliminate industry costs and risks related to current manual processes, lead to shared industry development resourcing and reduce the need to track trades executed in the U.S market for inter-listed securities. In summary, it will make for a more efficient Canadian marketplace.

Yours sincerely,

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