Middle and Back Office

Introduction to Corporate Actions

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Welcome to an introduction of corporate actions, part of the BNY Mellon Client Training Program for Asset Owners.

I'm Adam Moyseowicz, a member of the custody product team of BNY Mellon, and I'm excited to share with you an introduction to the world of corporate actions.

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In this session, we will discuss what a corporate event is and provide examples of various types of corporate action events. In addition, I will walk through the lifecycle of corporate action events, and spend a few minutes discussing income events, which are the most common type of all corporate action event.

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Firstly, what are corporate actions exactly, and why do companies announce them?

At the highest level, corporate action is the term used to describe events that bring material changes to a company and impact its financial stakeholders, most notably, shareholders and bondholders.

There are a number of reasons why companies may choose to announce corporate events, some examples of which are outlined in this slide.

Firstly, income distributions to investors are the most common and reoccurring type of corporate event. These event types involve the distribution of company profits proportionately to shareholders in the form of either cash or stock dividends, or payment of interest to bondholders to service debt owed by the borrower.

In the case of debt redemptions, issuers may choose to redeem their bonds at maturity, or potentially prior to maturity, should the terms of the loan permit it. In such cases, the company is paying back the entirety of the principal balance owed back to the lender.

In another example, companies may attempt to raise capital using corporate actions. One way in which companies do this is through rights issue. The rights issue grants existing shareholders the right and opportunity to purchase additional shares of the company at a set price per share. This can be advantageous for investors wishing to acquire additional shares of the company, while also benefitting the company by raising additional funds.

Lastly, companies may from time to time wish to share important information related to the company through corporate action channels. These informational notifications may be related to operational changes within the organization, or profitability.

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While there are dozens of different types of corporate actions, each can be classified into three primary categories. Specifically, Mandatory Events, Mandatory Events with Elections, Voluntary Events.

Let's go through what each category is all about:

- Mandatory Events are events which are decided on by the board of directors and impact all shareholders upon effective date. No action is required to be undertaken by or on behalf of the underlying investors.
- Mandatory Events with Elections. Like typical mandatory events, these are events which are primarily mandatory, but provide optionality in the form of entitlement. For example, while all investors will be paid a dividend, certain mandatory events with elections will allow the investor to select the form of dividend (stock or cash), or even currency in which the investor is paid, for example USD, EUR or GBP.
- Lastly, Voluntary Events. These events are more operationally complex, as they involve an offer to shareholders or bondholders of a company and require solicitation and tracking of instructions from underlying investors. These events typically involve an offer to buy or sell shares at a specific price or exchange something you own with something new.

As alluded previously, amongst the three categories of corporate action event types, Mandatory Corporate Actions are the most straight forward and account for the greatest number of events.

Voluntary Corporate Actions – along with mandatory events with elections – are more operationally complex and involve greater risk of errors to both clients and the bank. While there are many more events which fall under these categories, we will only highlight the key ones in this training session for illustrative purposes.

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First, let's take a closer look at Mandatory Events. Again, these are events whereby there is no solicitation of investor feedback. All holders receive the same entitlement based on their holdings as of effective date.

Some examples include:

- Bonus Issues – For these events, shareholders receive additional shares in proportion to their original holdings.
- Stock splits – For these event types shares of a company are divided based on a rate announced by the company. In the case of a 2:1 stock split, shareholders receive 2 new shares for every one which they held originally. The total value of all outstanding shares remains unchanged.
- Mergers – In this case, shareholders of both companies announce a merger, which typically result in the issuance of 'new' security or swapping shares of respective companies.
- Dividend and interest payments – For these event types, entitlements are owed and paid to investors of securities as of a certain date.

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Next, let's look at Mandatory Events with Elections. Unlike standard mandatory events, mandatory events with elections provide investors with an opportunity to elect the form of entitlement they wish to receive.

In the case of optional dividend events, investors have the opportunity to select the type of entitlements they wish to receive. One example of this includes stock/cash options, whereby the investor can elect to receive their dividend in either stock or cash.

Currency options act in a similar manner. Rather than requiring the investors to receive cash dividends in a single currency, these events provide investors with the opportunity to select the currency in which their cash distribution will paid.

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Lastly, the final type of corporate action category includes voluntary events. These events are time sensitive and require solicitation and processing of client instructions during tight timeframes. They also present high levels of potential risk to the bank from a processing perspective. Some examples of voluntary events include Tender Offers, Rights Exercises and Exchange Offers. We will discuss each of these briefly now.

In the case of Tender Offers or Share Buy-backs represent a bid by the company to purchase some or all of shareholders' stock. These offers are made at a specific price and are typically offered at a premium to the current market price of a security.

Rights Exercises are multi-stage events which include a mandatory rights distribution to holders of a given security. Once issued, there is typically an option to exercise certain rights, in which investors have an opportunity to a) subscribe to additional underlying shares of a company, b) sell their rights, or c) take no action and allow these rights to lapse.

Third type of example discusses Exchange Offers. These offers provide holders of an existing debt security with an opportunity to exchange their holdings with new equity or debt securities, or potential other consideration.

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Next, let's take a closer look at the entire corporate action lifecycle, which begins from the announcement of the corporate action event through the ultimate cash credit to the underlying shareholders' account. It is a complex process which involves numerous intermediaries that operate between securities issuers and investors.

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The first stage of the corporate action lifecycle is the official market announcement of the event.

This occurs when the issuer announces the event to the stock exchange. The stock exchange then announces critical event details to vendors who continue to disseminate the information downstream. This communication includes all critical event details such as type of corporate action, options, deadline and rates.

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The next stage includes scrubbing the corporate action event details. This is a critical step in the process, as BNY Mellon needs to ensure that an accurate, golden copy of the corporate action is communicated to clients.

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Once the event details are scrubbed and our corporate actions team is confident that the event is accurately captured internally, BNY Mellon will announce the event to all eligible security holders. How investors receive these announcements varies by client, however, the preference is to send via SWIFT (MT564) given both the level of automation and timing and security of delivery method.

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Next, we arrive at the most critical stage of the corporate action lifecycle. For both Mandatory Events with Elections and Voluntary Events, BNY Mellon collects responses from clients in advance of expiration and passes them on to the registrar or sub-custodian. Given the importance of this step in the process, we will review in greater detail shortly.

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On or about payment date, the issuer pays out new shares/cash based on responses received via registrar or paying agent. BNY Mellon reconciles this activity with the client accounts to ensure that everything ties out.

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Lastly, once the payment has been fully reconciled from the agent, BNY Mellon allocates event entitlements to our underlying client accounts. For most events, this is the final step in the corporate action lifecycle.

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Take a closer look on the critical dates associated with the Voluntary Events. As noted earlier, Voluntary Corporate Actions are more operationally complex and create greater risk of errors and liability exposure if not managed closely. The most time sensitive period exists between event announcement and market deadline, during which timely instructions must be solicited from underlying investors regarding how they wish to elect on a given event.

Let’s go through these critical dates:

- Custodian deadline date: This is the date by which all clients must send their choices on the elective event to their custodians. The custodian deadline time is specified along with the date. Any responses received by clients after this date are processed on a best-efforts basis.
- Market deadline date: Market deadline date is the date by which all choices on elective events should be sent to the Issuer or CSD. This is the date by which custodians need to provide all client elections.
- Pay date: This is the date when the issuer of the declared event is scheduled to pay to the eligible investors

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One of the most significant volume drivers under the broader corporate actions umbrella includes the events processed in relation to the distribution of cash back to underlying investors. While the lifecycle underpinning these events is a bit more straight forward than that for Voluntary Events, the volumes and nature of underlying cash flows adds a significant level of complexity.

As you can see, the corporate action lifecycle for Income Events is very similar to that of Voluntary Events – the major difference is that there is no response gathering and instruction period, as shareholders typically have no option to elect or amend their resulting entitlements.

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While Income Events represent a significant volume of Corporate Actions activity, they are various types of Income Events, representing different relationships between the parties involved.

Let's go through the most common types of Income Events:

- Cash Dividends are the most common type of income events. These are payments made from a company to its stockholders in the form of periodic distributions. These may also take the form of special cash dividends, which are commonly one-time events declared by issuers.
- Coupon Payments represent the cost of borrowing money and are the amounts paid by borrower to the lender on a periodic basis until the entirety of the loan is paid off. Coupon payments – otherwise known as interest payments – are based on the stated annual interest rate agreed to at the start of the loan on the total amount outstanding.
- Lastly, Principal Paydowns represent a repayment of principal (or amount of money borrowed) by the issuer to its underlying bondholders. Principal paydowns can be complex, as the net cash amount can include both a principal and interest component, increasing the challenges from a reconciliation and allocation perspective.

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In the income space, there are several key dates which determine who is entitled to the proceeds of an event (ex-date), and who the market recognizes as being the holder of record as of a specific date and party to which the issuer remits payment (record date).

Let's detail what each of these key dates represent.

- First, Ex-date – otherwise known as Entitlement Date – this is the key date which determines if the security holder is entitled to participate in an event.
- The Record Date represents the date upon which the issuer or custodian identifies account holders of the underlying security.
- And lastly, Pay Date represents the date when the issuer of the declared event is scheduled to pay to the eligible investors.

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To see how these critical dates come together, let's go through an example.

In this example below, the buyer has executed a trade on trade date prior to the ex-date of the event. As such, the buyer is entitled to the proceeds of the event ($1/share).

Given that the trade is settled prior to the record date, the custodian for the buyer will be credited with the entitlement and allocated the proceeds. Should the trade fail for an extended period and not settle until post-record date, the buyer would still be entitled to the dividend, however, these funds would need to be claimed from the counterparty as they were the holder of record on that date (record date).

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The last and final topic to discuss around income processing is withholding taxes. Investors who receive dividend or interest income on cross-border investments may be subject to withholding taxes imposed by the tax authority of the foreign government where the security was issued. In certain markets, investors may avail of at source benefits from the local sub-custodian to secure preferential tax rates. On other markets, tax reclaims must be submitted to the local markets to recoup funds which may have been over withheld on pay date.

In the case of at source markets, investors may be subject to a reduced tax rate based on certain documentation requirements being fulfilled in the market or double taxation avoidance treaties in place between two countries. The benefits of at source withholding is timing, resulting in beneficial tax treatment at time of pay date, with no further action being required by the investor.

Other markets, however, only operate through the filing of tax reclaims. In markets where at source withholding is not offered, or where documentation requirements may have been missed, a tax reclaim provides the investors with a means by which to recoup excessive withholding tax payments to a foreign agent. This often requires the completion of supplemental documentation confirming their eligibility for reduced withholding tax. The biggest drawback to filing tax reclaims is timing. Often investors are subject to a statute of limitation for submitting tax reclaims. This varies by market, and in certain cases, can be as short as six months. Even when a tax reclaim is properly submitted, investors are often at the mercy of foreign tax authorities. Certain markets are well known for taking exceptionally long periods of time to process reclaims (i.e., Italy), and in such markets, it is critical to ensure that accounts are appropriately documented upon opening to ensure proper at source withholding.

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This slide summarizes some of the key parties involved in the Corporate Actions lifecycle. While some of these parties have been discussed in this training session, others may be new to you. Please take a minute to review the roles each of these participants plays in the process.

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