

Basic Corporate Action Concepts

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).

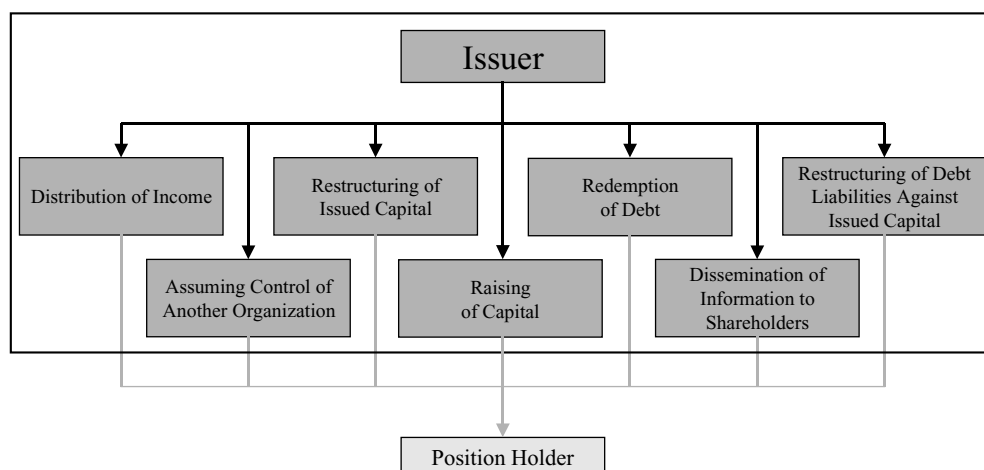


Figure 1.1 Purpose of corporate actions.

1.4 IMPACT OF CORPORATE ACTIONS

A corporate action event may be categorized in terms of its impact to the position holder, and in addition may be more broadly reflected in the market place by the change in price of the underlying security.

1.4.1 Impact from the Position Holder's Perspective

As a *position holder* the impact of a corporate action is measured in terms of its impact to securities and/or cash positions; consequently corporate action events can be categorized as follows.

Benefits

These are events that result in an increase to the position holder's securities or cash position, without altering the underlying security; for example, a bonus issue.

Re-organizations

These are events that re-shape or re-structure the position holder's underlying securities position, possibly also combining a cash element. For example:

- An *equity restructure* which results in, for example, the exchange of a security of one par value with a security of a different par value.
- A *conversion* where one type of security such as a convertible bond is exchanged for a different type of security, such as an ordinary share.
- A *subscription* where one type of security such as a Nil Paid Right is exchanged for a different type of security such as an ordinary share, upon the payment of a cash amount.

Issuer Notices

These events are used for the dissemination of information from the issuer to position holders (for example the notification of an Annual General Meeting), which results in no change to either the securities or cash position of the position holder.

Figure 1.2 illustrates the different impact that various corporate action events have upon the position holder's securities and/or cash positions.

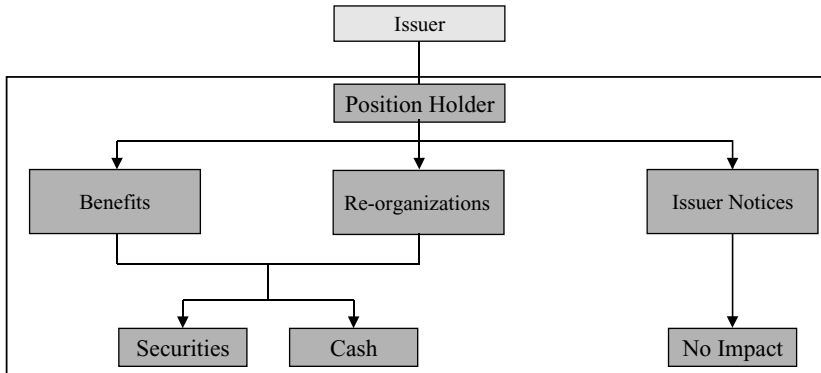


Figure 1.2 Impact from the position holder's perspective.

1.4.2 Impact on the Price of the Underlying Security

As well as directly impacting the *balance sheet* of the issuer and the securities and/or cash positions of position holders, a corporate action may also have an impact on the *market price* of the security to which it applies (known as the *underlying security*).

The demand for a security reflects many things; for example the supply, the perceptions of the market place as to the profitability of the issuer, the perceptions of the issuer's solvency and the state of its *capital reserves* and debts. Therefore, when an event occurs to alter any of these, the perception of the market place and the change in the demand for the security will be reflected in its price.

Therefore the event can also be considered to impact potential buyers and sellers of the underlying security, as the price a buyer may pay and a seller may receive may change.

1.5 THE LIFECYCLE OF A CORPORATE ACTION

Across the range of specific types of corporate actions a number of different lifecycles can apply from their initial announcement until the actual receipt and distribution of securities and/or cash *resultant entitlement* (where applicable). As previously indicated the term 'lifecycle' is used in the context of this book to refer to the series of logical steps, predominantly determined by the nature of the corporate action.

These different lifecycles can be categorized as follows:

- Mandatory
- Mandatory with Options

- Voluntary
- Multi-stage
- Issuer Notices

Each of these is described below.

1.5.1 Mandatory (Generic) Lifecycle

For those events that are defined as mandatory, the position holder has no choice as to whether and/or how it participates in the event. The event will be applied to all position holders, and the securities and/or cash positions of each position holder will be impacted in the same fashion. The logical steps of the mandatory lifecycle are common to all event lifecycles (with the exception of the Issuer Notices lifecycle), and therefore in the context of this book they form the generic lifecycle. Mandatory events are detailed in Chapters 6–15.

1.5.2 Mandatory with Options Lifecycle

By contrast to standard mandatory events, these events will offer the position holder a choice as to how it participates in the event. The position holder will be given two or more alternatives as to the combination of securities and/or cash that it will receive as a result of the corporate action. The lifecycle of this event will incorporate the steps of the mandatory (generic) lifecycle, and will in addition incorporate steps to manage the position holder's choice as to the securities and/or cash it wishes to receive. Mandatory with Options events are detailed within Chapters 16 and 17.

1.5.3 Voluntary Lifecycle

For voluntary events, participation in the event is purely based upon the choice of the position holder. This is in contrast to the two lifecycles introduced above, where participation is mandatory. The position holder will be given the option to 'take no action' (or not to participate), and in addition may also be given a choice as to the combinations of securities and/or cash it receives should it choose to participate. The lifecycle of voluntary events is very similar to that of the mandatory with options lifecycle, supporting the management of the position holder's choice. Voluntary events are detailed within Chapters 16 and 18.

1.5.4 Multi-Stage Lifecycle

These are complex events that combine two or more stages (lifecycles) in their overall life. From the issuer's perspective each of these events is a single action, nonetheless from the position holder's perspective the event can be viewed as containing many interdependent lifecycles. Furthermore, each lifecycle can be categorized as being mandatory, mandatory with options or voluntary. Multi-stage events are detailed within Chapters 19–21.

1.5.5 Issuer Notices Lifecycle

These events are used for communication purposes only to position holders, and do not involve any securities and/or cash entitlements. Therefore these events have a significantly shorter

operational lifecycle than those previously mentioned, as there is no impact to the position holders securities and/or cash positions as a result of the event. Issuer Notices events are detailed within Chapter 26.

Figure 1.3 illustrates the different lifecycles described above.

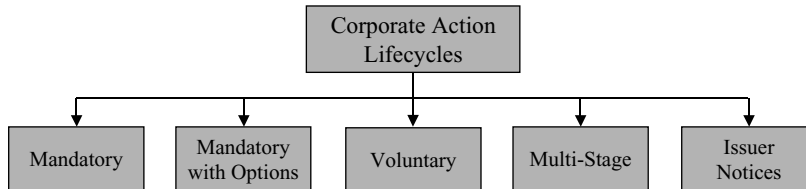


Figure 1.3 Corporate action lifecycles.

1.6 SUMMARY

It is important to appreciate that issuers of securities and their advisers will continue to find inventive ways of raising further capital, offering income options to their shareholders and re-organizing their capital structure.

Understanding the basic principles of a corporate action, i.e. the issuer's aim, the impact on securities and/or cash positions, and the lifecycles, provides a fundamental structure that can be applied to the current and future corporate actions environment. In this way practitioners are well equipped to deal with this ever-evolving area of the securities industry.