

To: LGPS Board

## **LGPS Report on Corporate Actions and Script Dividends**

*By: Dr. Anna Tilba  
Associate Professor in Strategy and Governance  
Durham University Business School  
Mill Hill Lane, Durham, DH1 3LB  
Tel: +44 (0)191 3349428  
Email: [anna.tilba@durham.ac.uk](mailto:anna.tilba@durham.ac.uk)*

### **Executive Summary**

The aim of this report is to provide insight into the operational approach of investment fund managers to corporate actions and how the outcomes of these events are communicated to LGPS clients. In particular the report will elaborate on how asset managers ensure that best value is being achieved for the LGPS investor in the area of scrip dividends. The Report starts by outlining the research context, background and motivation, highlighting the need to map out the process and instructions associated with corporate actions and script dividend decisions. Namely, what decisions are being made and how and whether those decisions are being reported on. The Report then outlines its research methodology, followed by the description of findings. Some thinking points on the implications of the findings on value are offered in conclusions.

### **1. Research Context and Background**

This research was motivated by the initiatives<sup>1</sup> on transparency on costs and charges in the efforts to help achieve better value for money for consumers. Asset managers have a fiduciary obligation to maximize the value for their beneficial owners. Frequently, asset managers need to make decisions with regard to corporate actions such as scrip dividends, rights issues, tenders and mergers. In a specific example of a scrip dividend, shareholders and/or asset managers can choose to receive their dividend in either cash or in additional shares in the company. When shareholders/asset managers make their election, often one of the options (cash or stock) is worth more than the other.

Frenchman and Carr (2020)<sup>2</sup> have highlighted in their White Paper that 'while script dividends are not everyday events, the total amounts involved are large. There are around 200 scrip dividends every

---

<sup>1</sup> FCA Asset Management Market Study (2016) <https://www.fca.org.uk/publications/market-studies/asset-management-market-study>

Tilba, A., Baddeley, M. and Yixi, L. (2016) Report for the Financial Conduct Authority. 'The Effectiveness of Oversight Committees: Decision-Making, Governance, Costs and Charges. *UK Financial Conduct Authority*, <https://www.fca.org.uk/publication/research/tilba-baddeley-liao.pdf>

Transparency Taskforce's initiatives around costs transparency, disclosure, reporting and value for money <https://www.transparencytaskforce.org/>

<sup>2</sup> Robert S. Frenchman, Esq and Emre Carr, Ph.D., CFA (2020) Corporate Actions: The Case of the Missing Billions' [available at: <https://scorpeo.com/corporate-actions-the-case-of-the-missing-billions/#:~:text=Robert%20S.&text=Asset%20managers%20are%20failing%20to,significant%20losses%20to%20beneficial%20owners> ]

year worldwide, and the amount distributed in scrip dividends reaches around \$70 to \$80 billion annually'.

Their US evidence suggests that investors and/or their asset managers frequently can and do make the suboptimal election in scrip dividends with around \$1.3 billion of missed value by investors each year. According to Frenchman and Carr (2020), some asset managers optimize corporate action decisions in some names or positions, but others do not. Nor do other asset managers attempt to optimize at all, and simply default. Such sub-optimal default decisions not only detract from the value for money to ultimate beneficiaries. In this case this could be pension funds and their scheme members. Systematic sub-optimal decisions can also pose governance and legal risks for asset manager fiduciaries.

Table 1 below summarizes the scrip dividend activity around the world between 2011 and 2017. Frenchman and Carr estimate that a total of around \$8.9 billion was missed by not making the optimal election. The authors highlight that the missed value is, in effect, a transfer of wealth from one group of shareholders (who made the suboptimal election) to another group of shareholders (who made the optimal election).

**Table 1 Value Missed in Scrip Dividends Globally by All Investors and by The Asset Managers in The Sample**

Year	Global Missed Value (Million US\$)	Missed Value by The Asset Managers (Million US\$)
2011	1,018	95.0
2012	1,598	100.4
2013	823	115.9
2014	1,182	119.1
2015	1,591	122.2
2016	1,547	162.2
2017	1,184	188.0
<b>Total 2011-2017</b>	<b>\$8,943</b>	<b>\$902.9</b>

*Source: Robert S. Frenchman, Esq and Emre Carr, Ph.D., CFA (2020) Corporate Actions: The Case of the Missing Billions'*

In the UK, Scorpeo<sup>3</sup> produced an analysis<sup>4</sup> of the missed value using data of all the UK Scrip dividends that have paid since 2011 -2019 inclusive. Scorpeo explains that:

*'The shareholder has 2 choices, CASH or STOCK. The default option in the UK market is cash. Therefore, when CASH is the OPTIMAL decision, we see that in general less than 10% of all shareholders elect SUB-optimally. i.e. less than 10% of shareholders PRO-ACTIVELY elect for something that is of less value. However, when STOCK is the OPTIMAL decision, we see that on average between 65%-70% of shareholders are electing sub-optimally.'*

*Of the 243 instances of a Scrip dividend on the FTSE 100 between 2011 and 2019, 140 have been instances where STOCK was optimal. However, these 140 instances make up*

<sup>3</sup> Scorpeo was founded in 2012 to provide market leading technology to enable investors to capture value from corporate actions <https://scorpeo.com/about/>

<sup>4</sup> Scorpeo (September 2020) Notes and Analysis on Missed Value, Report

*\$2,141,316,585.26 of the \$2,607,411,484.47 of the total FTSE missed value. That is \$15,295,118.46 per instance. The 140 instances is 57.613% of the total of 243. Yet the missed value is 82.12% of the total missed value. This leads us to the opinion that when the NON-DEFAULT option is more valuable, many shareholders do not elect for it because they are simply taking the default option, no matter what the value (Scorpeo Report on UK Scrip Dividends, September 2020).*

For pension funds, this means that trustees may not be aware of the potential missed value because trustees do not monitor specific asset managers' operational decisions (including corporate actions and script dividend decisions) that their asset managers take on their behalf. Linked to this, are the three main implications: [1] potential loss of value from sub-optimal script dividend decisions; [2] governance and due diligence, if this evidence is not explored<sup>5</sup>; [3] potential risk of legal liability in the context of trustees' fiduciary duty to act in the best interests of scheme members<sup>6</sup>.

This report is carried out in order to explore the corporate action and scrip dividend process further in the context of LGPS and also as part of the governance due diligence in the presence of evidence presented above. It is hoped that that transparency of corporate action and script dividend decisions will enable beneficiaries to ensure that such decisions are aligned with their own economic interests.

## 2. Methodology

The report is informed by the insights from a survey of investment fund managers of the LGPS. The survey was sent to 72 LGPS investment fund managers<sup>7</sup>. Out of the 72 managers this was sent to, there are 20 fund managers that are currently managing LGPS equities. Fifteen of those have responded. Therefore, the **response rate by manager count** is approximately 75%.

The estimated **response rate by assets under management** is around 65%. This represents around £90,348bn as the total value managed by those fund managers that responded/£138,924m as an estimate of the total equity holding of the LGPS (as at 31 March 2020).

The survey questions were developed as a result of discussions within the Research Steering Group. Appendix A contains the information on the steering group participants, timings of group meetings and content of meetings that have taken place in preparation for the survey. Appendix B contains a survey invitation letter sent to the LGPS Fund Managers. Appendix C contains the Survey Questions.

---

<sup>5</sup> Occupational Pension Scheme Governance. Assurance about internal controls (March, 2019)

<https://www.icaew.com/-/media/corporate/files/technical/audit-and-assurance/assurance/occupational-pension-scheme-governance-assurance-about-internal-controls.ashx>

The Pensions Regulator. A guide to Investment governance To be read alongside our DC code of practice no. 13 (June, 2019) <https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/dc-investment-guide.ashx>

Financial Reporting Council. Practice note 15 (Revised) The audit of occupational pension schemes in the United Kingdom (2017) [https://www.frc.org.uk/getattachment/f77a8ced-853a-44f8-9632-f1f4d675c835/Practice-Note-15-\(Revised\)-November-2017.pdf](https://www.frc.org.uk/getattachment/f77a8ced-853a-44f8-9632-f1f4d675c835/Practice-Note-15-(Revised)-November-2017.pdf)

<sup>6</sup> For a recent discussion on the remit of fiduciary duty, see Tilba, A. and Reisberg, A. (2019) 'Fiduciary Duty under the Microscope: Stewardship and the spectrum of Pension Fund Engagement'. Modern Law Review 82(3): 456-487. <https://onlinelibrary.wiley.com/doi/abs/10.1111/1468-2230.12413>

FRC and FCA (January 2019) 'Building a regulatory framework for

<sup>7</sup> The reason for sending the survey to the 72 managers was that these managers manage a range of assets that may have included some public equities. Currently, there is not enough information on the LGPS system to make this assessment as accurately a few weeks ago – it is still a work in progress.

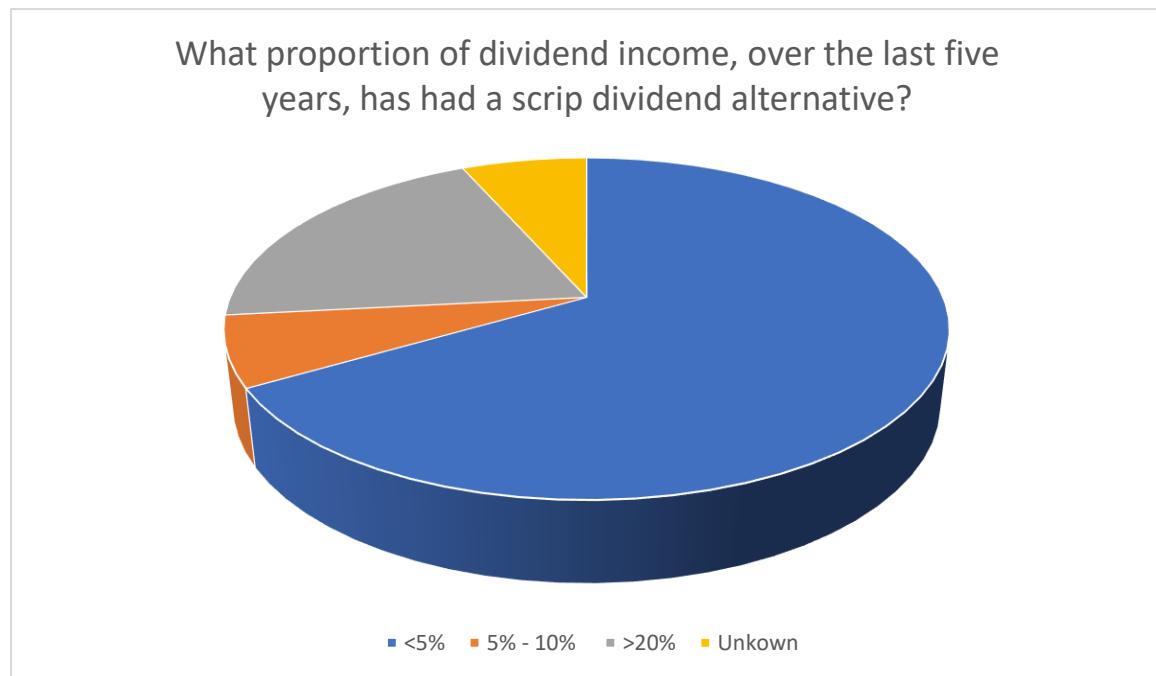
### 3. Findings

This section presents the analysis of survey answers.

**Q1. What was the approximate value of directly held listed Equities you held on behalf of the LGPS as at 31/08/20? Please answer to the nearest £m**

The approximate value of listed Equities directly held on behalf of LGPS at the end of October 2020 ranged from 99m to 52000m.

**Q2. Approximately what proportion of dividend income, over the last five years, has had a scrip dividend alternative?**

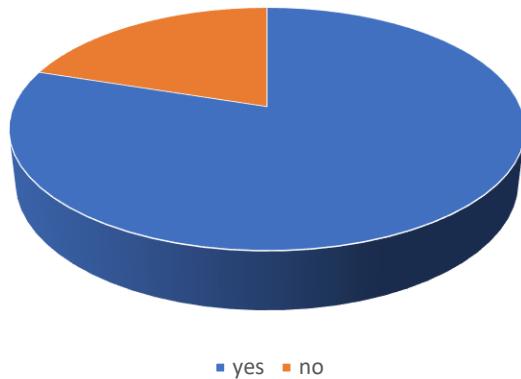


**Q3. Do you have a defined Corporate Action (CA) process to determine your response to the scrip option at the Election Date?**

Survey results show that 80% of the respondents have indicated that they have a defined Corporate Action (CA) process to determine a response to the script option at the election date. This 80% represents £93,269.5bn of LGPS total listed equities directly held on behalf of LGPS.

However, survey also shows that 20% of the respondents do not have a defined Corporate Action process. This 20% represents 1,079bn of LGPS total listed equities directly held on behalf of LGPS.

**Q3 Do you have a defined Corporate Action (CA) process to determine your response to the scrip option at the Election Date?**



**Q4. If you do not have a defined CA process in place, please describe how you approach the scrip option**

There were only 4 asset managers (with combined equity assets under management of that have answered this question. One of the asset managers with £147m in equities under management said that:

*'Our default is to take cash if the economic value of the offered shares are in line with the cash option. If there is a material spread between the two, the portfolio manager of the strategy decides which option to take'.*

The following asset managers who DO NOT have a defined Corporate Action process explained that:

*'Every time an equity stock declares scrip dividend, the fund managers are made aware to choose their option between cash or scrip. the fund managers analyse each event and take decision' ( £625m in equities under management).*

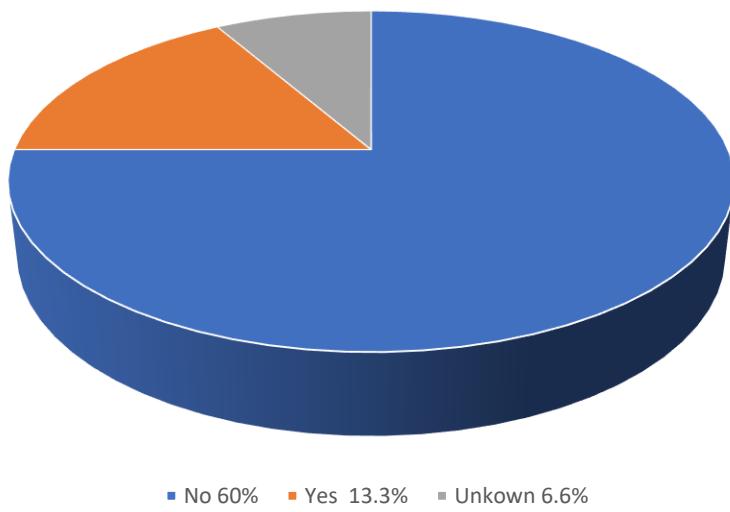
*'Each DRIP is passed to the fund manager to provide election unless it is for a fund that has pre-defined standing instruction.' ( £99m in equities under management).*

*'We evaluate each scrip dividend separately' ( £355m in equities under management).*

**Q5. Is your CA process for scrip dividends informed by client choice?**

60% of respondents indicated that their CA process is NOT informed by client choice.

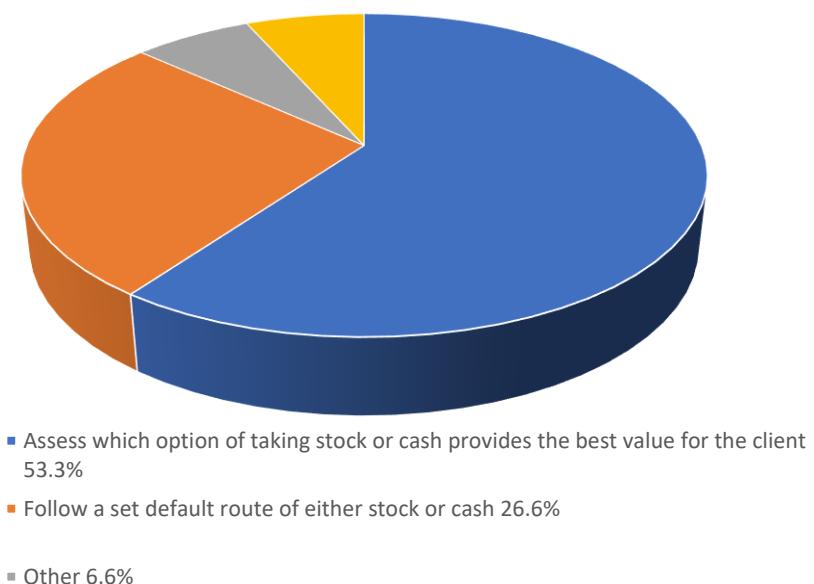
**Q5. Is your CA process for scrip dividends informed by client choice?**



**Q6. (i) Which of the following best describes your CA process in respect of scrip dividends?**

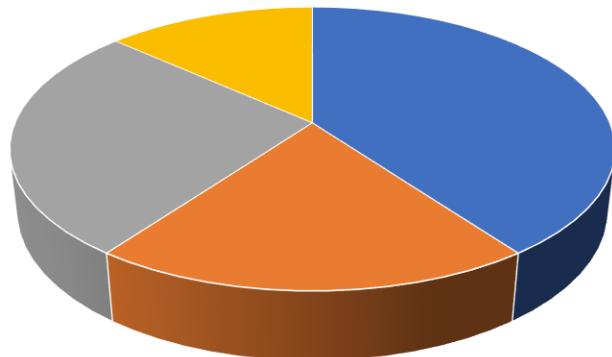
Survey results indicate that over half (53.3%) of asset managers assess the option of taking stock or cash would provide the best value for the client. 26.6% of asset managers follow a default route of either stock or cash. One asset manager (with £597m in equities under management) requests cash for the majority of their portfolio holdings, with the exception of our less liquid stocks, where we will opt for stock instead.

**Q6 Which of the following best describes your CA process in respect of scrip dividends?**



**Q7. (i) Which of the following best describes the 'checking' element of your CA process in respect of scrip dividends?**

Q7 Which of the following best describes the 'checking' element of your CA process in respect of scrip dividends?



- a) There is no check of the decision 40%
- b) The decision is checked by the CA team and may be referred back for reconsideration 20%
- c) The decision is checked by another manager within the firm and may be referred back or reversed 26.6%
- Unknown

**Q7. (ii) If you answered b) or c) please briefly describe in the box below how the process works and how long it usually takes**

The following explanations were provided:

*'As Corporate Actions are received we ensure that default is cash otherwise the Portfolio Manager is contacted for further review'*

*'The decision is decided by the manager - we then reflect our decision on the custodian's website and it is approved by a member of the operations team.'*

*'We will assess the different terms of the event and also take into consideration the current and likely future positioning of the stock in question within the portfolio.'*

*'CAs will feed into our proprietary CA system. At least one member of the team will go through the details of the CA and its implications for the funds it is held in. He/she will then input the decision along with the rational for this decision. Within our system we elect on a fund-by-fund basis. As such we can and often do elect differently depending on the circumstances of each fund. The final step is for another member of the team to review the CA, the rational for the decision we have taken and to lastly authorise the CA for each and every fund'.*

*'The fund manager will have the final sign off as to whether to take stock or cash'*

*'The CA team checks the portfolio manager's decision prior to sending the decision to the custodian banks. We are checking for accuracy not for reconsideration'.*

*'A third party perform this operational activity for us with our internal corporate actions team providing oversight.'*

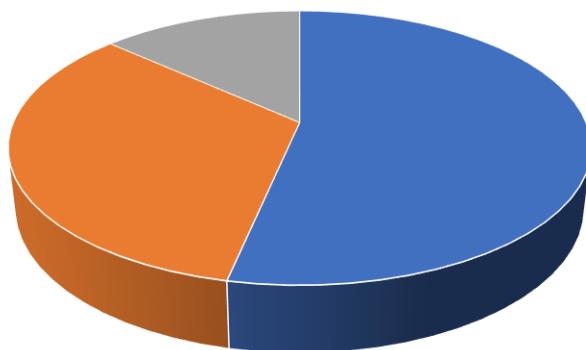
**Q8. Which of the following best describes your reporting of corporate actions to the LGPS client?**

Survey results indicate that only 13.2% of respondents provide detail reporting on corporate actions, including the decision made and the outcome realised.

53% of respondents do not regularly report on corporate action (but this information may be disclosed upon request).

33.3% of respondents said that they provide a high level reporting on corporate action at an aggregate level.

**Q8. Which of the following best describes your reporting of corporate actions to the LGPS client?**



- a) CAs are not regularly reported but may be disclosed on request 53.3%
- b) CAs are included in high level reporting at an aggregate level 33.3%
- c) CAs are reported in detail including the decision made and the outcome realised 13.2%

### **Conclusions and Implications**

In the context of some of the existing US and UK evidence of missed value due to sub-optimal scrip dividend decisions made by asset managers on behalf of their clients, this research used LGPS pension funds as the case study to map out the process and instructions associated with corporate actions and script dividend decisions. Namely, what decisions are being made and how and whether those decisions are being reported on.

The research findings show that the majority of survey respondents (80%) have a defined Corporate Action (CA) process to determine a response to the script option at the election date. This 80% represents £93,269.5bn of LGPS total listed equities directly held on behalf of LGPS.

When it comes to the CA process in relation to scrip dividends, over half (53.3%) of asset managers assess the option of taking stock or cash would provide the best value for the client. 20% of asset managers checked the scrip dividend decision within the CA team with an option for this decision to be referred back for reconsideration. Furhter 26.6% of asset managers had scrip dividend decision

checked by another manager within the firm with an option for this decision to be referred back or reversed. However, 40% of asset managers had NO CHECK of the scrip dividend decisions.

26.6% of asset managers follow a default route of either stock or cash. One asset manager (with £597m in equities under management) requests cash for the majority of their portfolio holdings, with the exception of our less liquid stocks, where we will opt for stock instead.

Significantly, the survey shows that 20% of the respondents DO NOT have a defined Corporate Action process. This 20% represents 1,079bn of LGPS total listed equities directly held on behalf of LGPS.

Interestingly, 60% of respondents stated that their CA process is NOT informed by client choice. Furthermore, only 13.2% of respondents provide detail reporting on corporate actions, including the decision made and the outcome realised. 53% of respondents DO NOT regularly report on corporate action (but this information may be disclosed upon request) and 33.3% of respondents said that they provide a high-level reporting on corporate action at an aggregate level.

**Discussion Points:**

The process of voluntary corporate action decision making is classified by the FCA as an investment decision. Therefore, only those with the ability to make an investment decision can have the final say on the election in a voluntary corporate action. However, it is very possible for both of these processes to be carried out correctly and diligently, with no wrong doing on any part, but still not be beneficial to the underlying client. I.e. both the manager and the corporate actions processor are doing the right thing, the process however is falling short of the asset managers fiduciary obligations.

Therefore, to say that asset managers have all of their processes in place, may not necessarily mean that the underlying beneficiary is being catered for. It simply means that there is no wrong doing in terms of the governance processes that has been laid out. Ensuring that the asset managers' decision is executed in the best way, is something that should be done by the operations team but they will only be able to do this if they have the operations mandate and process to do so.

All this is important in understanding the corporate action and script dividend processes so that trustees can begin to ask questions around these processes and how they are fulfilled. This is something that the LGPS Board could explore further. In the spirit of transparency, due diligence and appropriate reporting, trustees could ask themselves whether they want their asset managers to consider their choice when it comes to script dividends and how trustees wish script dividend decisions to be reported on.

---End of Report---

## Appendix A Methodology

### Industry Steering Group Meetings

Date	Participants	Notes
1 July 2020	Andy Agathangelou, TTF Chairman Anna Tilba, Associate Professor, Durham University Sander Eijkenduijn, Co-Founder, Scorpeo Jonny Ruck, CEO, Scorpeo Jeff Houston, Head of Pensions: Local Government Association, Board Secretary: Local Government Pension Scheme Advisory Board James Mirza Davies, Senior Committee Specialist, Department of Work and Pensions, UK Parliament Joshua Osborne, Policy Advisor (Financial Services) HM Treasury Matilda Embling, Policy Advisor, HM Treasury	Discussed is there an interest in pursuing scrip dividends as a potential issue to explore
28 July 2020	The same group	Discussed the White Paper on Corporate Action. Agreed to do some preliminary research into this matter. Jeff and Anna to carry out the talks
17 August 2020	The same group	Jeff and Anna reported on the initial talks with Bailey& Gifford and Legal and General, Discussed the formulation of research/survey questions
24 August 2020	The same group	Further discussion about developing the research and survey questions.
16 September	The same group	Finalizing and approving the survey questions. Thinking about the interviewing stage 2 after the surveys results come back.
13 <sup>th</sup> October	The same group	Catch up re: survey questionnaire. Questionnaire

		to be sent out by the end of October
1 <sup>st</sup> December	The same group	Catch up on the initial responses. AT to produce a Report on the survey responses.

#### Initial Discussions

1. Piers Lowson, Director, Bailey & Gifford & Jeff Houston, LGPS – initial chat about corporate actions research (30 July 2020)
2. Jeff Houston, and Legal and General, 7<sup>th</sup> of August
3. Euan Miller, Assistant Director at Greater Manchester Pension Fund (largest LGPS at £24bn) (Jeff Houston/Anna Tilba)
4. Alex Younger at Norfolk LGPS pension fund to see if he would be willing to discuss this
5. Imran Razi at the Investment Association agreed to facilitate the circulation of the questionnaire to the Investment Association.

#### Written Responses

1. Jonny Ruck, CEO, Scorpeo, Email from 17<sup>th</sup> August

## Appendix B Fund Manager Survey Invitation Letter

**From:** Liam Robson

**Sent:** 30 October 2020 19:58

**To:** [Investment Manager correspondence email]

**Subject:** LGPS Advisory Board - Corporate Actions; Questions for LGPS asset managers

Dear [Salutation]

In furthering its work on transparency in the asset management space the Scheme Advisory Board wishes to gain an insight into the operational approach of managers to corporate actions and how the outcomes of these events are communicated to LGPS clients.

In particular the Board are interested in learning how asset managers ensure that best value is achieved for the LGPS investor in the area of scrip dividends.

The Board would therefore be grateful if you (or colleagues in corporate actions) could take the time to answer a short survey/questionnaire in respect of your dealings with LGPS clients:

[https://docs.google.com/forms/d/e/1FAIpQLSch\\_IFIxvkhD2vX-b0IX4dxNd4X\\_pMltrAi2xef6AZwiTBeBg/viewform?usp=sf\\_link](https://docs.google.com/forms/d/e/1FAIpQLSch_IFIxvkhD2vX-b0IX4dxNd4X_pMltrAi2xef6AZwiTBeBg/viewform?usp=sf_link)

The Board commits to maintaining the confidentiality of managers and undertakes not to publish or pass onto third parties any individual responses from any manager\*. Any information that is published will be aggregated and anonymised to the extent that no manager can be individually identified from it.

\*The Board is working alongside Dr. Anna Tilba, Associate Professor in Strategy and Governance Durham University Business School, to analyse the responses to the questions. Dr Tilba will also be required to ensure the anonymity of managers in any academic work she undertakes on this subject.

By agreeing to take part in this survey are giving consent for data to be included in a summative analysis and reporting of the research study. Please be assured that the information you provide will be kept entirely confidential and your anonymity will be maintained. Any academic research findings will be reported in a summative, non-attributable to you form, and you are not committed to any further involvement in the study.

Please respond fully to as many questions as you are able in respect of the direct holdings of Equities that you manage on behalf of the LGPS. It would be much appreciated if you could do so by

**Friday 13<sup>th</sup> November 2020.**

Many thanks

Liam

Liam Robson  
Analyst  
Local Government Association  
Phone: 07920 246513

Email: [liam.robson@local.gov.uk](mailto:liam.robson@local.gov.uk)

## Appendix C Survey Questions

### Questions

**Please respond fully to as many questions as you are able in respect of the direct holdings of Equities that you manage on behalf of the LGPS?**

*Q1. What was the approximate value of directly held listed Equities you held on behalf of the LGPS as at 31/08/20?*

Please answer to the nearest £m

*Q2. Approximately what proportion of dividend income, over the last five years, has had a scrip dividend alternative?*

- a) <5%
- b) 5-10%
- c) 10-20%
- d) >20%

*Q3. Roughly how many CA's would an individual mandate or fund manager within your firm deal with each year.*

*Q4. Do you have a Corporate Action (CA) process to determine your response to the scrip option at the Election Date? If yes please go straight to Q6*

- a) Yes
- b) No

*Q5. If you do not have a CA process in place please describe how you approach the scrip option here then jump straight to Q11*

Brief description of approach

*Q6. Is your CA process for scrip dividends informed by client choice?*

- a) Yes
- b) No
- c) Partially

*Q7. Which of the following best describes your CA process in respect of scrip dividends?*

- a) Follow a set default route of either stock or cash
- b) Assess which option of taking the stock or cash best meets the needs of the mandate/fund

- c) Assess which option of taking stock or cash provides the best value for the client
- d) Assess which option including taking and immediately selling the stock provides the best value for the client
- e) Other – please provide details

*Q8. If your answer to the above is c please provide further detail on the following in the comments box below*

- a) Whether the assessment of value is short or long term in nature?*
- b) Whether there are circumstances here you would elect to take the cash despite either taking and keeping or taking and selling the stock would provide a greater financial advantage to the client?*

*Q9. Which of the following best describes the ‘checking’ element of your CA process in respect of scrip dividends?*

- a) There is no check of the decision
- b) The decision is checked by the CA team and may be referred back for reconsideration
- c) The decision is checked by another manager within the firm and may be referred back or reversed

*Q10. Please provide a broad estimate of the length of time this check takes on average*

*Q11. Which of the following best describes your reporting of corporate actions to the LGPS client?*

- a) CAs are not regularly reported but may be disclosed on request
- b) CAs are included in high level reporting at an aggregate level
- c) CAs are reported in detail including the decision made and the outcome realised
- d) As in c above plus an analysis of the potential outcomes for alternate decisions