Reverse Stock Splits & Fractional Shares: Best Practices for Issuers

A Guide to Transparent and Effective Corporate Actions

Reverse stock splits have become increasingly common for maintaining exchange listing compliance, but their execution requires careful attention to operational details and market dynamics. With a 191% increase from 2023 to 2024, issuers must navigate complex fractional share treatments, evolving arbitrage strategies, and heightened regulatory scrutiny.

While key stakeholders such as transfer agents and Depository Trust and Clearing Corporation (DTCC) play important operational roles, responsibility for effective execution ultimately lies with the issuer. Market participants should standardize fractional share treatment through cash-in-lieu payment to eliminate arbitrage opportunities; enhance plain English disclosure requirements; and establish coordination among market participants through standardized communication protocols.

This guide provides best practices to help issuers execute reverse splits transparently, minimize operational risks, and maintain investor confidence. While this guidance originated from concerns related to reverse stock splits, the operational risks and arbitrage incentives described here apply to a wide range of corporate actions that result in fractional share entitlements, including stock dividends, mergers, and spin-offs. Issuers should consider applying these best practices consistently across all such events. For a more in-depth guide, please review SIFMA's white paper on the matter here.

Critical Risks for Issuers

Litigation & Regulatory Exposure

- Changing announced terms in the middle of the corporate action process creates shareholder confusion and potential liability.
- Inconsistent fractional share treatment can trigger regulatory scrutiny.

Unintended Economic Consequences

- "Round-up" abuse by bad actors purchasing shares just before splits to profit from fractional share treatment.
- Social media promotion of arbitrage strategies targeting your reverse splits.
- Examples of Round-Up Arbitrage:
    - Record Date Gaming: acquiring shares immediately prior to the record date to qualify for an outsized round-up allocation.
    - Account Fragmentation: splitting holdings across multiple accounts to qualify for multiple round-ups.
    - Broker Fractional Program: holders of pre-existing fractional shares requesting additional round-up shares despite no entitlement under standard conversion logic.

Shareholder Fairness Issues

- Different treatment between registered and beneficial holders undermines market confidence. The framework clarifies that DTCC or intermediaries are not required to process beneficial-owner instructions for every event; clients can continue their own cash-in-lieu processes, avoiding delays or operational burden.
- Settlement delays and operational errors damage issuer reputation.

SIFMA Best Practice Recommendations

1. Make Cash-in-Lieu the Default Treatment for Fractional Shares

- Consider adopting cash-in-lieu as the standard method for settling fractional shares.
- This removes "round-up" abuse opportunities, prevents unexpected increases in outstanding shares, and ensures all shareholders receive fair value without issuing additional shares that could dilute perception.
- Clearly communicate this default treatment in all announcements.

2. Optimize Fractional Share Treatment (When Cash-in-Lieu Is Not Used)

- Consider cash-in-lieu payments for fractional shares instead of rounding up.
- All round-up approaches at the beneficial-owner level can create arbitrage opportunities, for example when sophisticated investors intentionally fragment accounts or purchase small quantities to receive extra shares. Issuers should set clear limits on the economic impact of any rounding method, such as capping the total additional shares distributed or the maximum dollar value of fractional share benefits per shareholder. However, issuers may need to estimate the number of shares required based on proxy information and account for potential increases in holders following announcement, particularly from investors acquiring minimal positions. If authorization limits are exceeded despite good-faith estimates, issuers should communicate clearly with shareholders about the resolution process.
- Clearly communicate your chosen method of fractional shares in plain English, including concrete examples of how rounding or fractional payments will be applied.
- Avoid complex rounding methods that create arbitrage opportunities. Clear communication reduces the risk of arbitrage and ensures no individual shareholder disproportionately benefits.
- Where round-up provisions are retained, they should be applied consistently across all shareholder categories and subject to clear limits on economic impact to the issuer.
- Issuers should establish clear policies for handling pre-existing fractional shareholders (those holding fractions before the corporate action). While many fractional holdings may result from broker-dealer fractional programs that issuers may not be aware of, clear disclosure of rounding methods should address whether pre-existing fractional holders will receive the same treatment as those created by the corporate action. The industry

should consider developing standard practices for handling fractional shares prior to corporate actions to ensure consistency across market participants.

3. Enhance Disclosure Quality

- Use clear, plain English in all public announcements and SEC filings.
- Explicitly describe impact on both registered and beneficial holders.
- Provide detailed timeline and process information.
- Do not rely on technical jargon that confuses retail investors.

4. Maintain Term Consistency

- Most operational challenges and investor complaints stem from issuers changing round-up eligibility or fractional share treatment mid-process. Such changes should be avoided unless legally or operationally required. Issuers should obtain necessary shareholder approvals or adjust terms prior to the public announcement rather than making mid-process changes. This ensures compliance with share authorization limits while maintaining the prohibition on mid-process alterations. However, issuers face the challenge of not knowing exactly how many shares will be requested until after announcement, when holder counts may increase significantly. Therefore, issuers should use available data (such as proxy information) to make reasonable estimates and build appropriate buffers into their authorization requests.
- Adhere to announced terms throughout the entire process.
- Where possible, avoid post-announcement modifications that create market uncertainty.

5. Coordinate with Market Infrastructure

- Ensure consistent economic outcomes between registered and beneficial holders for the same type of transaction.
- Many intermediaries operate their own fractional cash payout programs, which may process faster than issuer-led programs. These programs should remain permissible, provided they deliver outcomes equivalent to those of registered holders and do not create timing or value disparities that disadvantage investors.
- Work closely with your transfer agent on implementation details.
- Plan for potential volume spikes from arbitrage activity.

Implementation Checklist

Before Announcement:

1. Finalize all terms with legal and transfer agents.
2. Prepare clear, plain English disclosures.
3. Coordinate timing with market infrastructure partners.

During Announcement Period:

1. Monitor for unusual trading activity.
2. Maintain consistent messaging across all channels.
3. Prepare for increased shareholder inquiries.

Post-Split Execution:

1. Ensure timely settlement of all obligations.
2. Address shareholder questions promptly
3. Document process for future reference.

Why This Matters

- Maintains investor confidence and market reputation.
- Reduces litigation risk and regulatory scrutiny.
- Streamlines operational execution.
- Promotes fairness and transparency and reduces systemic risk.
- Enhances overall market integrity.

Contact Information

For questions about reverse stock split best practices or to discuss specific situations, please contact members of SIFMA's Operations & Technology division below:

Stephen Byron
Managing Director, Technology, Operations, Business Continuity
sbyron@sifma.org

Anthony Macchiarulo
Vice President, Financial Services Operations & Assistant General Counsel
amacchiarulo@sifma.org

Jenessy Dominguez
Assistant Vice President, Financial Services Operations
jdominguez@sifma.org

This guidance reflects industry best practices developed through extensive consultation with exchanges, broker-dealers, transfer agents, and other market participants. The considerations presented are entirely voluntary and not intended as mandates or industry standards. Each firm must independently evaluate the relevance and applicability of this information in light of its own business model, regulatory obligations, competitive strategy, and risk tolerance.

This was developed in accordance with SIFMA's antitrust compliance policy and is intended to promote a lawful and competitive marketplace. It does not encourage or facilitate the discussion or coordination of competitively sensitive information such as pricing, costs, strategic plans, or vendor selection. Nothing herein should be construed as a call for collective action, agreement, or standardization of market structure or practices. All contributors and readers are reminded that antitrust laws prohibit any agreements, explicit or implicit, that may restrain trade or reduce competition.