Ex-Dividend Date: Why is it Important?

There are a number of questions on the Series 7 examination that involve the determination of the ex-dividend date, which we will abbreviate as 'XD' below. The terms "stock" and "share" are used interchangeably below and represent an ownership interest in the corporation. It is important to make a distinction between ***cash dividends*** and ***stock dividends*** on the Series 7 examination, which we also detail below.

First, what is the ex-dividend date? It is the date when the stock price of the company paying a dividend on shares is marked down by the amount of that dividend.

For example, if common stock of XYZ Corporation is trading at $20 by the close of trading on the previous day and a cash dividend of 50 cents is due, XYZ will open for trading on the ex-dividend day at $19.50.

For a better understanding of what is going on here, one must know 4 important dates and their sequence. The dates and their sequence on a calendar are:

- DD   Declaration Date
- XD   Ex-dividend Date
- RD   Record Date
- PD   Payable Date

Declaration Date – DD
This is the date on which the board of directors of XYZ declares a dividend to ***'shareholders of record'***.

Ex-dividend Date – XD
For cash dividends this is 2 business days before the Record Date (defined below) for "regular way" transactions. If you buy XYZ stock on the XD day, you will not be eligible for the cash dividend, because you will not own it by the Record Date. You will not own the stock until the settlement date, which in a 'regular way' transaction is T+3: the trade date plus 3 business days. In this case you will not own the stock in time to be on the list of shareholders of record.

Record Date – RD
This is the date by which you must be an owner of common stock in XYZ to be eligible to receive the dividend.

Payable Date – PD
This is the day when the dividend is distributed to shareholders of record. For a cash dividend, you will owe taxes on this distribution for the year in which it is received.

Example of Series 7 Question Involving the Ex-Dividend Date – Cash Dividend

(The Series 7 will display a calendar for the month in question. Please refer to a calendar for February, 2011 to answer the following question.)

1.) The board of directors of XYZ declares on February 3, 2011 a quarterly cash dividend of $0.15 to shareholders of record on February 23, 2011, payable on February 28, 2011. To be eligible to receive this dividend, what is the last day you can buy the shares?

a.) February 23, 2011
b.) February 18, 2011
c.) February 17, 2011
d.) February 28, 2011

The correct answer is "c." Answer "a" is incorrect because, although you are buying it on the record date, you are not a shareholder of record until the settlement date 3 business days later. Answer "b" is incorrect because, although it is 3 days before the record date, it is not 3 ***business days*** before the record date: February 21, 2011 was Presidents' Day, a holiday and thus not a business day. When counting back from the record date, you must always skip intervening Saturdays, Sundays and holidays. The ex-dividend date in this case is February 18, 2011, 2 business days before the record date.

Stock Dividends

Some corporations prefer to pay dividends in extra shares of stock rather than a cash dividend. These stock dividends are treated differently than cash dividends both in regard to taxation of the distribution and for calculation of the ex-dividend date (XD). For example, if MNO Corporation declares a stock dividend of 5%, each shareholder of record will receive an additional 5 shares for every 100 shares they own.

For stock dividends, the ex-dividend date is one business day ***after*** the payable date (XD = PD+1 for a stock dividend). If you are a shareholder of record of MNO and sell 100 shares **AFTER** the record date (RD) but **BEFORE** the payable date (PD), you will lose your right to the dividend. See the SEC's interpretation of this rule at http://www.sec.gov/answers/dividen.htm
Instead, a ***due bill*** will be attached to the transaction insuring that the party you sold it to will get the stock dividend rather than you.

Stock dividends are not a taxable event when received. Instead, they reduce your per share cost basis and will not be taxable until the year you sell them.

Example of Series 7 Question Involving the Ex-Dividend Date – Stock Dividend

(Again refer to a calendar of February, 2011 for the following example.)

2.) The board of directors of MNO declares on February 3, 2011 a stock dividend of 5% to shareholders of record on February 23, 2011, payable on February 28, 2011. If XYZ's stock price at the close of trading on February 17, 2011 is $20/share, by what amount must XYZ be marked down at the opening on February 18, 2011?

a.) $1 per share
b.) $4 per share
c.) $5 per share
d.) $0 per share

The correct answer is "d." Since this is a stock dividend rather than a cash dividend, it will not be marked down until the ex-dividend date, which for stock dividends is PD+1. The ex-dividend date (XD) for this transaction is March 1, 2011. Before the opening on that date the stock price will be marked down by $1 if it closed at $20 on February 28th (5% of $20 is $1.)

Other Facts to Remember about Ex-Dividend Questions

For mutual fund shares, the DD, XD, RD and PD may all fall on the same business day, usually during the last trading week of December.

A registered representative that wants to boost his or her commissions by incentivizing a client to buy stocks or mutual fund shares before the ex-dividend date to "get the dividend" may be guilty of an unethical practice and may be sued by the client for the recommendation. This practice is generally not in the client's best interest financially. The share price will most likely drop by the amount of the dividend on the ex-dividend date, nullifying the gain, and the client will have a tax bill on the amount of the dividend they could have avoided by buying the shares on the ex-dividend date or after. Remember that as a registered representative you have a fiduciary duty to always put the client's interest ahead of your own.