

PERSPECTIVE

The Corporate Actions Landscape



In an end to end trade cycle, straight through processing is taken for granted in most cases but move over to the post trade and settlement cycle and there exist one of most critical area in securities operations which is not fully automated. Corporate actions processing remains highly manual and is often replicated across a number of different business areas throughout an organization.

A Quick Look

A corporate action is any event that results in a material change to a company and affects its stakeholders. The ranks of stakeholders include shareholders, both common and preferred, as well as bondholders.

A major factor that determines how a corporate action is processed is whether it is mandatory or discretionary. In a mandatory action, the shareholder has no option or ability to take action or influence the timing of the event. The event will take place, and the shareholder has no choice, such as in a stock split. In a discretionary (or voluntary) action, the shareholder has an option to

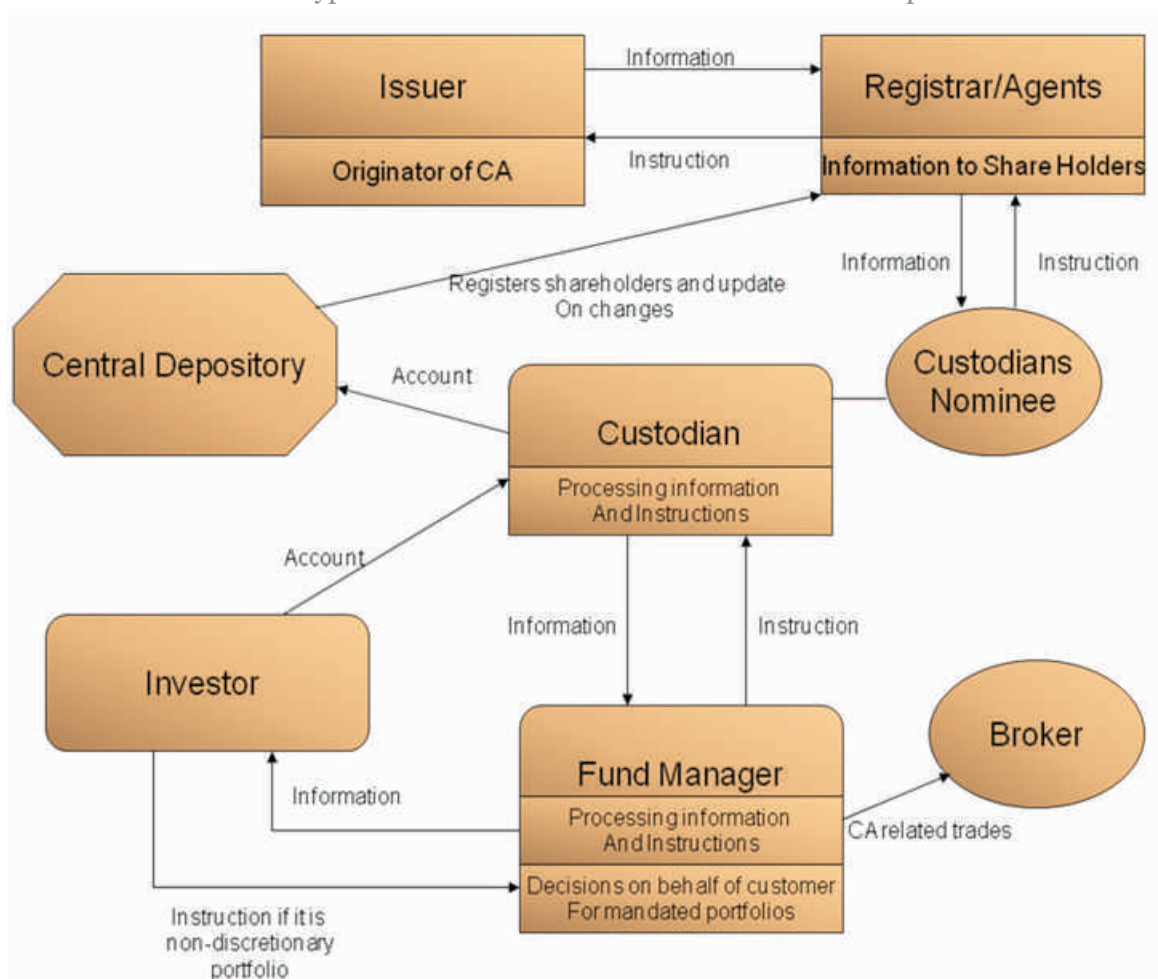
have his/her holdings affected. In short, the event may or may not happen and/or the holder can elect to participate or not, such as in a tender offer.

Processing scenarios for corporate actions are many and varied and pose a serious challenge to any attempt to automate. Some events are simple and in a sense passive as it results in automatic disbursement of cash or securities or other entitlements. However the discretionary or voluntary options e.g. rights, buy backs or dividend options require the investor to make a decision and are complex and more difficult to automate.

A Normal Working Day.....

Every day, market participants are treated to with information of various corporate actions from different sources in different formats and different modes. The information is then used to service proprietary and customer positions, manage proprietary and customer portfolios and make decisions related to sales, trading and arbitrage.

Typical CA Information flow between Market Participants

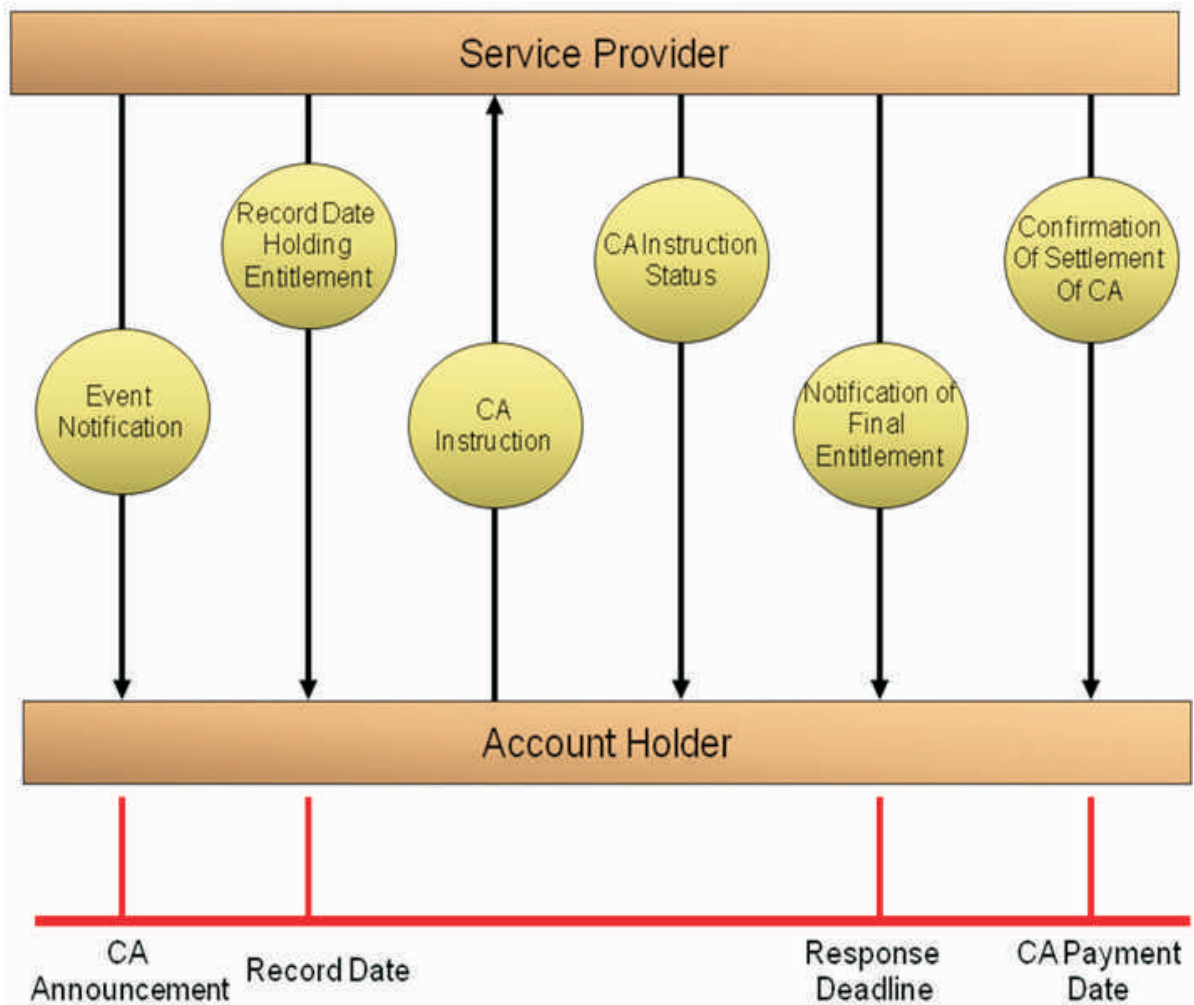


A single corporate action event can send a chain reaction throughout the market participants and in turn through thousands of investors both retail and institutional. Interpreting the notification, understanding the implication of that event notification across the organization, followed up with reconciliations of holdings and following up for mismatches and then the final allocation----- there are endless 'holes' in the automation process. Add to this the tight time frames, voluntary events and complex instruments and it is a perfect example of 'data' chaos.

The pain points and the automation balm

Accurate, comprehensive, timely corporate action information---- yes, that is what plagues the CA processing and all market participants involved in the process. Issuers and Agents announce events in different ways, using various means of describing the terms applicable to an event. This lack of standards makes it difficult to identify, understand, interpret and process announcement information, introducing a great deal of risk and cost into the process.

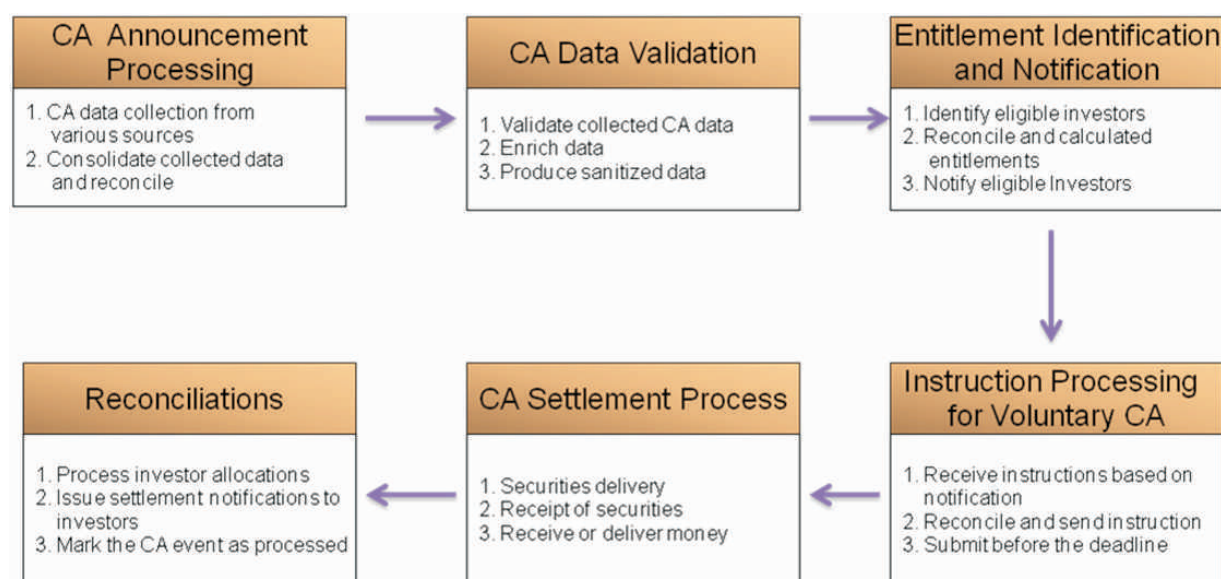
Corporate Actions Process Flow



The potential exposure of a single event involves huge sums of money if a financial institution has to make good on opportunities that were missed or erroneously processed on behalf of clients. Financial institutions prepare for such contingencies and it is a common practice in the industry for financial institutions to allocate funds to cover losses attributable to corporate action liabilities. Between three and ten percent of total operating income can go to cover costs associated with failed corporate actions.

There are many financial intermediaries which are a part of the corporate action processing chain, so information has to be exchanged, for example, from issuer to agent, through one or more layers of custodians, and ultimately to the investor. Voluntary offerings, which involve options, add to the complexity and level of risk.

Corporate Actions-related Processing and Activities



Accurate and Comprehensive Information

Acquiring comprehensive, accurate announcement information about corporate action events is both complex and difficult because there are no global standards. The problem starts at the top or rather at the source where the information originates, typically from the Issuer or the Agent and the information flows down in different ways in different formats:

- Transmitted electronically from multiple data vendors (some in proprietary formats),
- Communicated by custodians or broker/dealers via faxes (occasionally annotated with handwritten notes), emails, and phone calls, or
- Discovered by the firm's own research that draws on company/stock exchange websites, wire services, SEC EDGAR filings, etc.
- To add to the potential for miscommunication with these fragmented sources and delivery methods, there is always the possibility that a given notification can be re-issued with amended or additional information

Additional Complexities

- There is no single securities identification system universally accepted and universally used to cover all instruments and all markets.
- Processing details can be very specific to the markets or to complex instruments

The information can often be confusing, contradictory and sometimes just plain wrong. Data Cleansing or Scrubbing or Data Sanitization involves validation of the accuracy and completeness of the data.

Solution : Standardize CA Announcement Information

Standardizing the information included in corporate action announcements is the first step in bringing greater STP to corporate actions. Standardizing announcements eliminates the variability and risk associated with the individual interpretation of announcement documentation, and ensures access to consistent and comprehensive information. There are various initiatives on to standardize these requirements, promoting these standards with issuers and agents, and to implement these new standards as the normal way of processing corporate action transactions

Information Flow and the Risks

Adding to the challenges of obtaining accurate and comprehensive information is the challenge of managing the flow of information across all market participants. The notification information is transmitted across a chain of financial intermediaries and due to non standard and manual modes of information dissemination, there are information loopholes existing in each of these intermediaries. Communication between custodians and investment managers is particularly complex .A custodian would have many accounts affected

by a single corporate action, whereas an investment manager may have multiple custodians that it must deal with individually for a single event as the securities held for clients or proprietary accounts are spread across custodians. Communicating across different time zones and markets adds more complexity, and greater operational risk and cost

Solution : Automated Creation and Dissemination

The Automation should take place at the announcement level with the Issuer and then routed to a distribution chain of custodians, sub custodians, exchanges and agents and ultimately to end investors. Thus centralization of the information hub and automating the distribution process would lead to eliminating manual process of collecting data, keying in data and then transmitting it through different modes. In the new process data once created and sent is essentially the same across the various entities accessing the event data. This eliminates both a major source of potential error and significant delays in the onward distribution of information, giving the investor more time to assess and make decisions about the transaction involved

Complex Instruments and Events

As the financial markets continue to grow and the appetite for new product types increase, the markets have seen increased sophistication in financial instruments like structured products and notes, asset-backed securities (ABS), collateralized mortgage obligations (CMOs) and other structured securities. The monthly distributions from these issues are much more intricate than regular income payments, reflecting the changing balance between interest income and principal prepayments. Market participants need greater effort to understand and effectively process securities.

Solution : Uniform standards and Market practices

Effective interpretation of data and back office processing depends to the extent of standards existing across market participants for processing sophisticated financial instruments with unique characteristics. Industry standard communications and market practices are crucial as it will facilitate the receipt and delivery of information and also help in processing global transactions.

Using Information for Multiple Purposes

A financial institution has multiple departments and also global operations in multiple markets, which result in different process for each department and local market operations. They depend on multiple data vendors and also use proprietary software. The same corporate action information is used in different way by Investment advisory group, Traders and Back office operations.

Solution : Automated Exchange of Instructions

Institutions need to relook at their internal process and streamline such activities where they would plug into a centralized data hub for all Corporate Actions information.

Front and Back Office Integration

A typical operations setup would see a loosely integrated front , mid and back office system which would result in CA information being received and interpreted by 'three' different systems without analyzing the impact on the entire operations of the institution.

Solution : Seamless data flow across front and back office systems

While it is evident that firms would continue using specialized systems for front and back office operations, it is important that the same data is captured or transmitted though a single touch point and these data flows across these systems using standard formats and descriptions.

Processing Investor Instructions

Handling of Individual Investor instructions for Corporate Actions is a cumbersome process. The Institutions faces an enormous task of gathering instructions received through paper based modes, fax and entering them in their systems and then communicating this to the custodians and agents. Inefficient, non-automated processing increases the potential for delays and/or errors communicating instructions, which may result in failure to meet a deadline

Solution : Standard Formats for Investor Instructions

While there is a definite issue in expecting automated instructions from investors, the Institution can capture these instructions in standard formats recognized by other market players and route them through standard interfaces either in batches or as individual instructions based on the holding patterns.

Other challenges in automation lies in resource management as the Industry have employed a huge no of skilled resources as large parts of the processing cycle are essentially manual. Volume of corporate actions is also cyclical depending on market conditions and firms find it difficult to scale up rapidly on such specialized domains. Automation would also help organizations plan better and handle processing effectively.

As the securities markets are moving towards a complete dematerialized trading and holding patterns, the risks and delays involved in shipment of physical certificates are going down and it is expected that in an ideal dematerialized trading environment such challenges will cease to exist.

Barriers to Straight Through Processing

Recent analyst surveys clearly established that Corporate Actions processing was the greatest barrier in the straight through processing efforts especially for Instruments like Equities and Bonds.

The other important observation was that the Corporate Actions as a barrier in Straight Through Processing is also dependent on the role of the market participant.

Benefits

Automating the Corporate Actions processing capability has resulted in benefits for the institutions but the extent of automation possible is largely based on uniform standards and the market practices the market follows and will adopt in future.

Large Institutions in their approach to adopt complete STP, have gone for major automation projects which included the following as mandatory features:

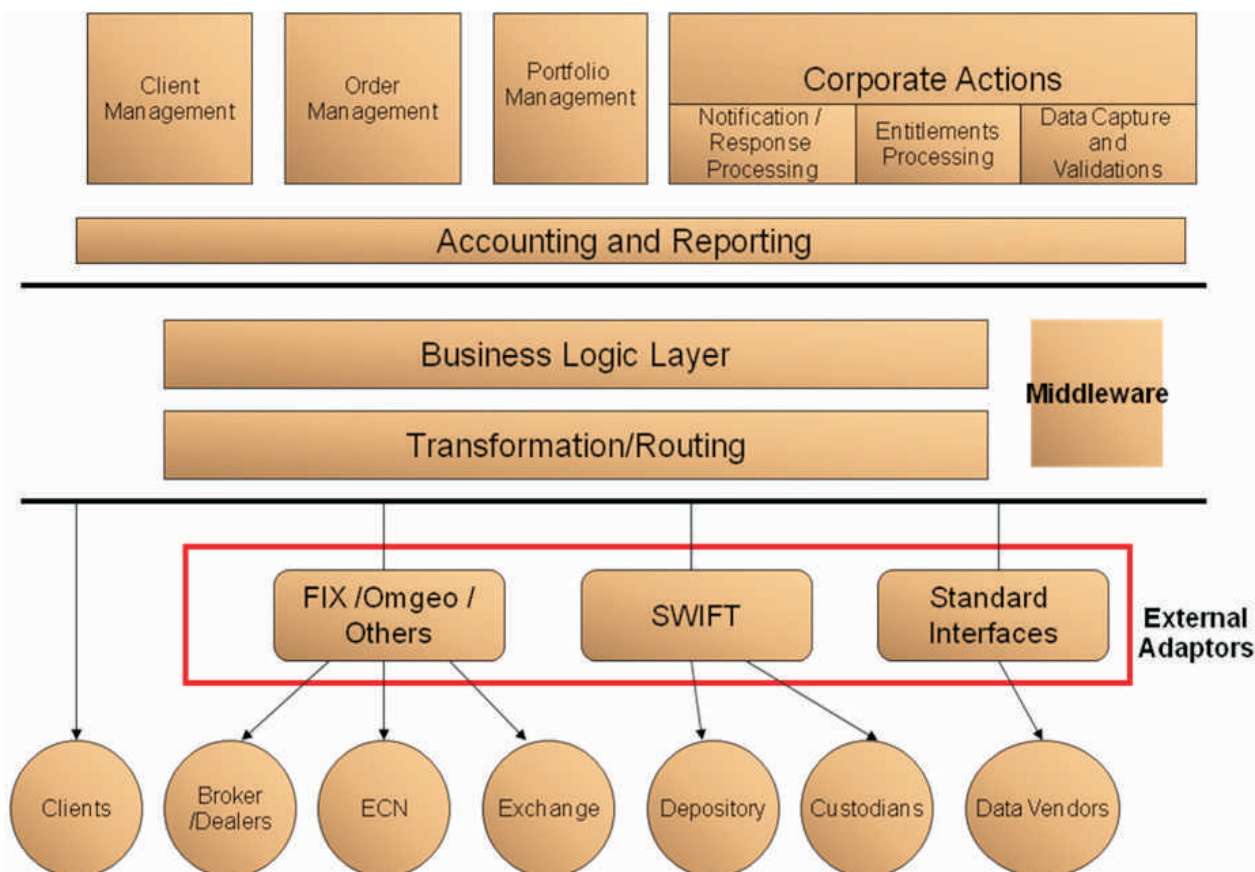
- Implementing corporate actions automation
- Implementing standards such as ISO 15022
- Reducing the number of custodians

- Implementing in-house or third-party reconciliation tools
- Consolidating accounting and/or trading platforms
- Implementing a trade monitoring hub, and
- Implementing a data hub/middleware

Surveys conducted for institutions where automation projects have been implemented have shown numerous benefits, including:

- Improved quality of corporate actions information
- Greater staff productivity
- Lower error rates
- Improved visibility into exceptions

Typical IT infrastructure after STP Automation in Trades and Corporate Actions



Conclusion : The Ideal Solution?

Virtual Straight through Processing (V-STP) was collaboratively piloted in 2007 by SWIFT, Citi and service bureau GlobeTax. V-STP is the new business model for SWIFT users to automate corporate actions processes.

Instead of trying to automate the corporate action process internally, when it's patently not possible, it creates a standard process so that, for the institution concerned it's automated, in other words "virtual" STP. The V-STP leverages ISO standards, SWIFT IP network and a "value node" where all the things that would otherwise be manual for the institution are handled (still manually) but by someone else. Corporate actions vendors can do the same thing instead of building functionality into a platform that cannot possibly deliver STP. The Vendor builds an interface to a place where the manual work gets done, thus giving the institution an STP process.

Currently the suggested model is for withholding tax handling but the important benefit is that this technology model is not restricted to withholding

tax and can be extended to other corporate actions. Institutions would be following the developments closely as would the Corporate Actions vendors. V-STP looks to be the future.

References

- DTCC publications
- SWIFT publications
- Straight Through Processing journals

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