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Points on the board

Japan has long been heralded as a centre of innovation, and it's easy to see why. Japanese video game developer Taito released the hugely popular Space Invaders game in 1978. Tomohiro Nishikado's highly addictive masterpiece saw players shoot and destroy wave after wave of aliens to earn as many points as possible. Nishikado had to design and create hardware and development tools from scratch to complete Space Invaders. Without his technological prowess, children (and adults) of the 1970s, 1980s and beyond would not have played a game that was apparently so popular when it was released that Japan suffered a nation-wide shortage of 100-yen coins, and coin production had to be increased to keep up with demand.

Japan is perhaps the ideal location for the 2012 Sibos conference. Attendees young and old will have played Space Invaders. If they didn't play the game personally, they will certainly know someone who did, and this underlines how important technology and related developments can be, even in this age of rapid technological change. People, businesses and entire industries rely and thrive on advancements in technology. Some would even say that industries do not drive changes in technology—it is in fact the other way around.

Technology is more important than ever to financial institutions that have to become more efficient and stable at the behest of clients and regulators. The technology sector is continually innovating in response to—and ahead of—market developments and client demands. While markets struggle to recover from what feels like one long financial crisis, the technology sector is doing the business—making institutions safer, more robust and more resilient.

The challenge facing the technology sector is competition. Some technology providers are playing games of one-upmanship, as competitors bid to outdo each other and carve greater shares of the market. While the going is certainly tough for providers, choice for clients is getting stronger and stronger. Roll-on Sibos 2012, where attendees get to see providers in action, and providers get to pitch for the year to come.

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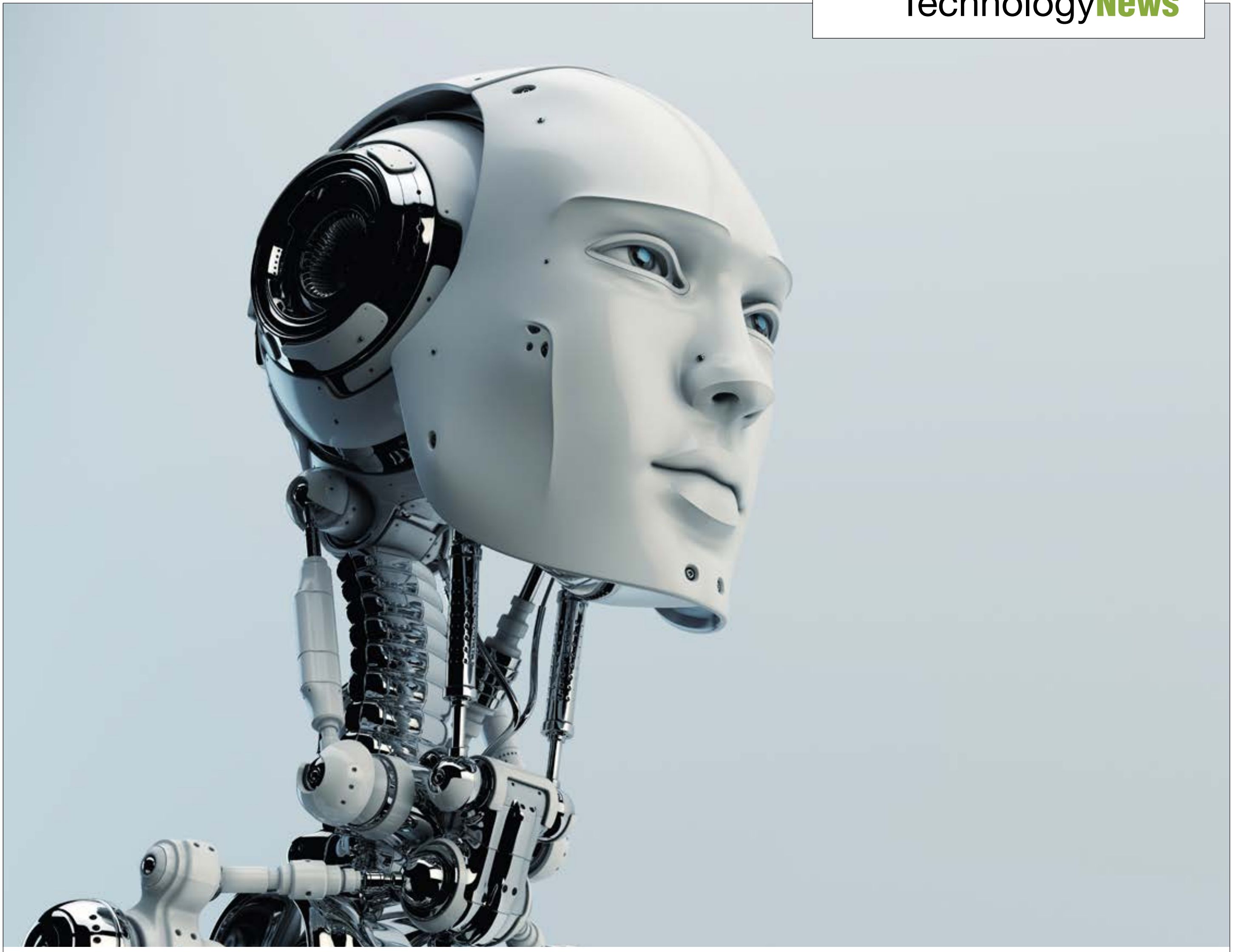

A tech takeover

AST looks back over recent advancements, from trading solutions to regulatory compliance tools

The **International Swaps and Derivatives Association (ISDA)** and **Markit** jointly released ISDA Amend, a technology solution that helps swap market participants to use ISDA's Dodd-Frank (DF) Protocol to comply with regulatory requirements.

The DF Protocol, which launched on 13 August, is part of ISDA'S Dodd-Frank documentation initiative to assist with the implementation of and compliance with the regulatory requirements of the US Dodd-Frank Act.

Markit-built ISDA Amend provides a single online tool that enables swap market participants to amend multiple ISDA Master Agreements and exchange information that is needed to comply with DF Protocol rules that are applicable to OTC derivatives transactions.

Robert Pickel, ISDA's CEO, said: "ISDA is proud to lead an industry-wide initiative with Markit that will facilitate compliance with Dodd-Frank regulatory requirements."

"We believe ISDA Amend is an effective solution to automate the information-gathering process and provide sharing of submitted data and documents to permissioned counter parties."

BNY Mellon's treasury services business plans to develop an enterprise payment hub (EPH) for clients globally.

The EPH will eventually support all global currencies, payment channels and geographic regions. The EPH is currently focused on delivering euro and pound sterling services in Frankfurt, London, Brussels and Luxembourg. It will eventually tackle clearing opportunities in Asia and Latin America.

BNY Mellon's executive vice president and global head of business strategy and market solutions, Susan Skerritt, said: "Our Enterprise Payment Hub will allow us to apply our acknowledged strengths as a processor of USD-denominated payments to global payments—irrespective of their currency denomination,"

BNY Mellon collaborated with **Clear2Pay** on the development of the EPH, using Clear2Pay's open payment framework (OPF) technology.

Financial software company **Bravura Solutions** has signed a 10-year deal with **BNY Mellon**. The contract sees BNY Mellon continue the consolidation of its transfer agency technology onto Bravura's platform.


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Under the agreement, BNY Mellon will deploy Bravura's STP messaging platform, Babel, as well as its taWeb real-time portal, which provides third-party administrators, fund managers and their distribution networks with online access to consolidated investor transactional data across multiple back-office systems.

Taxation is the single largest expense and the most complex regulatory requirement for Australian funds

"We are delighted to extend our already well-established partnership with Bravura. Our strategic aims are perfectly aligned and will support the development of both businesses providing value added benefits to our clients and prospects in this dynamic market place, which is challenging all providers to take a more global view whilst also reacting to more local regulatory and industry challenges," said Jon Willis, head of EMEA transfer agency services at BNY Mellon.

National Australia Bank (NAB) Asset Servicing launched TaxEdge to help clients manage their after-tax investment outcomes and meet regulatory requirements.

TaxEdge encompasses various client offerings including accounting and tax compliance, unit pricing control, and analytics, as well as the newly formed partnership with **GBST Holdings** for the pre-trade tax analysis tool.

NAB Asset Servicing partnered with GBST to strengthen its tax and accounting offering to custody clients through GBST's Pre-Trade Tax Analyser tool.

Peter Hele, managing director of product and strategic alliances at NAB Asset Servicing, said: "Taxation is the single largest expense and the most complex regulatory requirement for Australian funds. TaxEdge solution can help clients' finance, investment and operations teams to better understand the taxation issues within their organisation and equip their management teams with the information and tools they need to manage taxation and alert stakeholders to areas of risk."

UBS selected London-based technology company **MYRIAD's** technology platform.

MYRIAD's technology platform aims to provide a framework for the complete network management 'cycle', from RFPs in new markets to reviews of established providers.

A statement from the firm said that commercial and operational benefits include lower fees and costs, as well as greatly improved processes, consequent efficiency gains and lower overheads.

The platform is available via the internet, giving global access to users at any time, as well as via a bank's intranet.

Torstone Technology provided its Inferno solution for post-trade securities processing and trade accounting to London-based **Daiwa Capital Markets Europe (Daiwa Europe)**.

The four-year deal will involve the ongoing use of Torstone's Inferno for convertible bonds and associated equity/hedge products, and for FX/MM treasury functions.

The firm's cash equity business will also move to the system by the end of 2012 and fixed income securities will follow in 2013. Inferno will then become the sole back office system in use by Daiwa Europe.

J.P Morgan Worldwide Securities Services (WSS) launched the Online Portfolio Analytics Lab (OPAL), the firm's first web-based portfolio analytics tool.

The new service helps institutional investors assess risk across individual portfolios, and optimise asset allocation and investment manager selection.

OPAL targets Australian superannuation funds working to comply with Financial Services Council and the Association of Superannuation Funds of Australia guidance on the disclosure of investment risk, in the new Shorter Product Disclosure Statements (SPDS) regime, via the Standard Risk Measure classification system.

Under the new classification system, which was launched on 22 June 2012, superannuation trustees must disclose a Standard Risk Measure for each investment option that is offered in a superannuation product covered by the SPDS regime, using a seven level classification system.

The seven-level classification system runs from 1 to 7, where 1 is 'very low risk' of negative returns, and 7 is 'very high risk'.

David Braga, investor services product head for Australia and New Zealand at J.P. Morgan WSS, said: "The OPAL tool gives superannuation trustees a powerful, web-based tool that enables them to analyse their underlying data and quickly assess their level of investment risk, as part of their wider responsibility in considering and disclosing investment and other risks for each investment strategy to comply with the new FSC/ASFA guidelines."

Canadian Western Trust Company implemented **SunGard's** Global Plus multi-currency asset management and custody solution to support its institutional trust and custody business.

The company has more than $6 billion of AUM and provides solutions to clients of all sizes with retirement trustee and custodial needs.

Canadian Western has also implemented Global Plus's internet-based front- and middle-office workstation for administering client accounts. The Global Plus workstation can help Canadian Western to "more efficiently access client information, manage and monitor transactions, and retrieve documents", according to SunGard.

Matt Colpitts, Canadian Western's vice president and general manager, said: "We chose SunGard's Global Plus as our processing solution because it helps us to further personalise our services while supporting continued business growth."

The OPAL tool gives superannuation trustees a powerful, web-based tool that enables them to analyse their underlying data

Omgeo has updated its ALERT database, which deals with settlement and account instructions, with new legal entity data capture functionality.

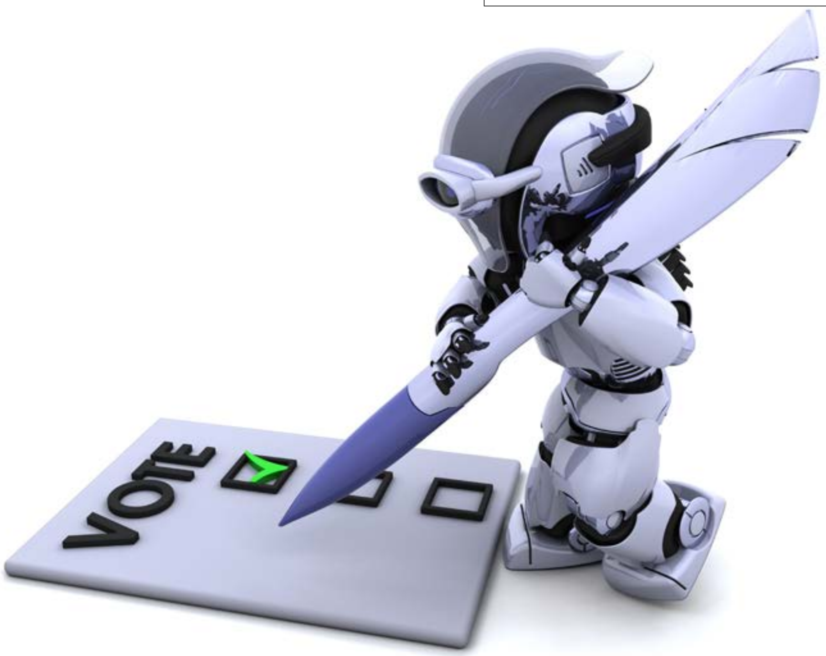
With these enhancements, investment managers and broker-dealers can automatically view 23 new legal entity fields containing the names and identifiers of their counterparties, said a statement from Omgeo.

The functionality was added in response to requests from market participants that wanted to gain a better understanding of which legal entities they were trading with.

Avox, a subsidiary of the **Depository Trust & Clearing Corporation (DTCC)**, will maintain the legal entity data that populates the additional 23 data fields, including legal name, trading status, date updated, aliases, BIC, and registered and operating addresses.

Ahead of the proposed implementation of regulatory requirements for a global Legal Entity Identifier (LEI) standard, a field has also been created to capture and populate LEIs in ALERT.

Bill Meenaghan, global product manager for ALERT at Omgeo, said: "While this is an independent initiative, in anticipation of a mandated Legal Entity Identifier (LEI), we have added an LEI data field in accordance with regulatory requirements and in support of the LEI." **AST**



Taking a page from North America

Patricia Rosch of Broadridge Financial Solutions tells AST that the mature technology market in the US is a yardstick for global electronic voting

JENNA JONES REPORTS

Given that even the healthiest global economies are still recovering from a recessionary period, how would you describe the health of equity markets around the world?

Certainly, economic instability has caused volatility in equity markets around the world, and investors are looking at fixed-income and alternative investments as a way of protecting themselves from this volatility. In emerging economies, stock markets still remain somewhat inaccessible to private investors. But with that said, equity markets globally are still very healthy. We process client trades executed in more than 50 markets and handle investor communications and proxy processing in more than 90 countries. In North America, we represent the majority of outstanding shares across all annual meetings, and then across the globe, we participate in tens of thousands of additional meetings. We have a truly global view of equity markets, and we're seeing not only robust activity, but significant interest on the part of participants in improving how the markets function.

Increasingly, technology is underpinning the investor communication process. Has there been an increased take-up of technology-based communication solutions?

Absolutely. Technology is driving more efficient communications, greater cost-effectiveness, and perhaps most significantly, better engagement with investors.

On the institutional side, more than 4000 institutional investors and financial advisors worldwide are using ProxyEdge, our electronic communications and voting platform. During the 2012 proxy season in the US, institutional investors voted more than 201 billion shares through electronic channels, and ProxyEdge accounted for more than 85 percent of those votes. A significant number of retail investors are also adopting e-voting.

This year, we saw significant uptake of really exciting communication tools, such as Mobile ProxyVote and our virtual shareholder meeting platform. We also launched a pilot programme featuring QR codes—known as Quick Response codes—on proxy forms for six issuers to more than 1.1 million shareholders. QR codes are incredibly data-rich, and by scanning them with a smartphone or tablet, investors are immediately directed to the voting site. These are two really exciting solutions that we've developed that make participating in the proxy process easier and ultimately will encourage greater investor engagement. Issuers and their retail and institutional investors are responding very enthusiastically.

End-to-end vote confirmation has been discussed as an industry goal. How close is it to achieving this?

That's a question that clients around the world ask me often. I point to the progress that has been made in the US. Broadridge is taking a leading role in implementing a University of Delaware working group's recommendations, and this past season, four issuers made end-to-end vote confirmation available to more than 1.5 million institutional and retail shareholders. As end-to-end vote confirmation is considered in other markets, it is critical that all market participants are engaged in collaboratively developing a solution that is relevant and appropriate in their jurisdiction.

In the North American market, electronic voting and delivery solutions are relatively mature. What lessons can be learned from this internationally?

I think it's really important for participants in emerging markets to understand the enormous value electronic voting and delivery solutions can deliver. In North America, technology has enabled tremendous improvements in the investor communication process in the past 25 years. It has delivered significant efficiencies, reduced costs and improved the speed and accuracy with which issuers communicate with investors. It has increased equity in investor communications, and allows for greater engagement of investors. What this means is that technology is making markets more transparent and ultimately improving investor confidence. This is critical in established capital markets, and even more so in emerging markets.

Further to your point about strong capital markets, can you comment on how an entire geographical market can convert from a manual to fully automated solution?

Japan is a great example. We have a very successful joint venture between Broadridge, the Tokyo Stock Exchange and the Japanese Securities Dealers Association. It's called Investor Communications Japan, or ICJ.

ICJ is an electronic voting solution that is based on STP. It's greatly improved the flow and transparency of information to shareholders and back to issuers, increasing the timeliness of materials delivery to shareholders for review from days to weeks. The unique process also provides assurances to all participants that votes cast, both in Japan and globally, reach the shareholder meeting in a timely and accurate manner and are cast at the meeting as directed by shareholders.

Right now, 400 issuers are using the solution. That number includes 96 of Japan's 100 largest listed companies by market cap. Of companies with a market capitalisation of more than 200 billion yen ($2.5 billion), more than 75 percent leverage the platform. Additionally, well over 50 percent of companies with foreign ownership ratios above 20 percent use the Broadridge solution. This fact highlights the value that these companies place on facilitating the proxy process for all their shareholders, including foreign investors.

Is this replicable in other markets?

Certainly, the technology exists to support electronic investor communication solutions globally. We've built the solutions, and know that they can support issuers, custodians, brokers and investors in any market where the regulatory framework exists.

In a slightly different way than in Japan, Broadridge has collaborated with the Singapore Exchange—the issuer—with an innovative approach to stimulate greater investor adoption of e-delivery. The solution is designed to support the transition from the paper-intensive, manual process in place today to an efficient and environmentally-friendly interaction between listed issuers and their shareholders, both in Singapore and overseas. The proxy process will be dramatically streamlined by the introduction of shareholder-specific communications, enabling better reconciliation of voting activity by the issuer and assurances to shareholders that their votes have been received and accurately reflected in the shareholder meeting.

This year, the Singapore Exchange introduced a new approach to shareholder communication and encouraged shareholders to sign up for future e-communications. This new approach was managed by Broadridge, and the Singapore Exchange received three times the number of proxy forms, and approximately 20 percent more shares were voted than had been previously. The results have been so positive that the solution is being marketed to other issuers that are listed on the exchange.

What role does proxy voting play in the advancement of corporate governance?

Good corporate governance and the effectiveness of the proxy process depend on informed decision-making and active participation by all shareholders. Transparent, efficient communication is fundamental to good corporate governance and a strong capital markets globally.

Broadridge supports voting in 90 countries around the world, and we see participants in all those markets using the technology-based solutions that will enable better communications between corporations and their investors. At Broadridge, we want to connect investors, issuers and intermediaries, including brokers and custodians, around the world. Broadridge plays a key role in proxy communications and we look to continue to support strong corporate governance in markets around the globe. AST

Patricia Rosch
President of investor communication solutions international
Broadridge Financial Solutions

Solvency II time: lenders prepare

Solvency II goes live on 1 January 2014, but the sell side still has work to do. MX Consulting's Adrian Morris reports

Beneficial owners that lend insurance funds are contending with Solvency II, which is driven by the European Insurance and Occupational Pensions Authority (EIOPA). Like Basel II for banks, Solvency II is pushing insurance companies to supply large quantities of information to the regulator, including securities lending, repo and collateral data. Recent events have meant that EIOPA and the UK FSA both currently state that the new regime will go live on 1 January 2014, a year later than originally intended (speculation suggests that implementation could even be pushed back to 2015). It will replace Solvency I requirements and the current regulatory regime for insurance supervision for firms in the UK.

There are three pillars of Solvency II: 'Quantitative Capital Requirements' (Pillar 1), 'Qualitative Supervisory Review' (Pillar 2) and 'Supervisory Reporting and Public Disclosure' (Pillar 3). Pillar 3 concerns market discipline and it contains a provision that means that any agent lending on behalf of insurance funds will need to supply the required information to the insurance companies. Agreement will need to be made on whose responsibility it is to put this data into the required Solvency II format. Ultimately, it is the insurance company that will report the data to EIOPA in the form of quantitative reporting templates (QRTs) for all securities on loan in QRT D5 and all types of collateral, including cash, in QRT D6.

It is fair to say that some of the information that is required is not standard to securities lending. Also, the provision of data between loan and collateral positions does not align itself well when compared to how it is used for current regulatory disclosures such as the agent lending disclosure (ALD) or normal day-to-day business management reporting. EIOPA has not ceded any changes in its July 2012 response to the International Securities Lending Association's concerns about the scale and types of data that are required.

Agent lenders will need to carefully analyse the meaning of the requirements and spend time educating those individuals working for insurance companies on the wider Solvency II data projects about their securities lending businesses. Clients may also demand additional data for their own internal risk models, which can further complicate matters.

In the past, many agent lenders have relied on spreadsheets or tactical solutions to supply clients with regulatory data, or they have found current in-house reporting packages to be sufficient. The problem with Solvency II reporting for both insurers and their agent lenders is that it has unusual complexities involved in the gathering and mapping of data, and this is further complicated by the requirement to provide cumulative daily loan and repo positions for the entire year. Now that agent lenders face so much additional scrutiny from beneficial owners, it is up to them to ensure that the data that is supplied to insurance fund clients is correct in order to protect this discretionary activity and its income stream. If an insurance fund client has issues with the regulator because incorrect data is provided, the fund's first and most likely course of action will be to review its lending programme.

Beneficial owners have become very sensitive to any issues that arise with regulators.

The addition of attributes that are not normally required means that those managing Solvency II data delivery will need to find a way to source the data, either internally from in-house securities databases or externally from securities vendors such as Bloomberg or Reuters. Loan and collateral securities per trade and collateral positions also have to be mapped according to new Solvency II-defined identifiers that are known as complimentary identification codes. These do not exist outside of Solvency II and they are applied in a way that requires convoluted programming, as EIOPA's requirements consistently misunderstand the relationship between a single loan or repo and its collateral.

As a further example of these complications, Solvency II balance sheet codes must be applied within QRT D6. This means that for every line of collateral, the corresponding loans from the fund legal entity per counterparty are aggregated by security type to a balance sheet category and assigned as a string in a single cell!

In recent years, the majority of agent lending businesses have switched to using triparty agents to collateralise their daily loan positions. Many agent lenders only hold the total collateral value for each borrower and lending legal entity within their systems for exposure monitoring purposes. This is problematic for Solvency II reporting purposes as the underlying positions of the collateral will need to be communicated to the beneficial owner and regulator. Issues also arise as in-house securities databases will not necessarily be able to reference the required clean price for bonds because collateral securities that are allocated by the triparty agent each day will not always be part of the normal daily loan position pricing universe.

These are only some of the issues that Solvency II creates concerning the management and submission of securities loan and collateral data. The analysis and solution requirements for this regulatory regime require a high level of analysis and thought. Tactical solutions are unlikely to give the level of comfort that is required.

Given that insurance company beneficial owners are running large and complex programmes of work for Solvency II, they will be demanding the full attention of their agent lenders in the remainder of 2012 and in 2013 to help them to understand the challenges of Solvency II for the QRT D5 loan and D6 collateral submissions.

MX Consulting has been working with both insurers and agent lending clients to help them to understand the issues. It has also recently implemented its Securities Lending and Collateral Solvency II solution with a large UK-based agent lender and insurance client. The application can be white labelled for use via a client's intranet and it can manage the entire process from end-to-end. The system can work equally well for agent lenders wishing to submit the completed Solvency II QRTs to multiple underlying insurance clients or where the insurance client wants to take raw securities lending and collateral data from their agent lenders and manage the data and subsequent submissions themselves. **AST**

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The QFII avenue

Samuel Zhao and Sheldon Liu of Brown Brothers Harriman discuss the scheme that gives investors access to China's capital market

The Qualified Foreign Institutional Investors Scheme (QFII) is China's effort to allow, on a selective basis, global institutional investors to invest in its RMB-denominated capital market. Approved investors can benefit from an opportunity to access China's capital market, which is otherwise insulated from the rest of the world.

QFII and China's capital markets

China's equity market boasts a capitalisation of around $3.4 trillion or RMB21.5 trillion with more than 2000 stocks at 2011 year-end, 77 percent of which are floatable, according to public data from the China Securities Regulatory Commission (CSRC). The price/earnings ratios at the Shanghai and Shenzhen stock exchanges—the only two in the country—were 13.4 and 23.1 respectively at 2011 year-end, down from 21.6 and 44.7 a year earlier. China's bond market has similar capitalisation, though it is predominated by government bonds rather than corporate bonds.

Launched in 2003, the QFII scheme allows access to Chinese equity, bonds and other financial instruments, such as exchange-traded funds (ETFs), warrants and mutual funds. The scheme takes precedent from Taiwan and South Korea, both of which had adopted similar measures many years ago. It aims to diversify the investor base and boost the professionalism of the domestic fund industry, while keeping a firm grip on capital inflows. As a result, a thorough and cumbersome licence application process was put into place in order to discourage all but the most dedicated global investors.

However, it is worth noting that QFII is only one of a few ways in which global investors can have exposure to Chinese markets. Other alternatives include H Shares (those Chinese companies that are listed on the Hong Kong Stock Exchange), B Shares (a small market that is targeted at foreign investors) and Chinese firms that are listed on other international exchanges, such as Nasdaq, the New York Stock Exchange and the London Stock Exchange. In addition, ETFs with China A-Shares as underlying assets are also an option. Some innovative investors go as far as investing in other proxies for the Chinese economy, such as infrastructure-related companies that sell coal, steel and iron ore.

Characteristics of QFII investors

Compared with local Chinese asset managers, QFII investors tend to adopt a long-term, buy-and-hold strategy, which is exactly what Chinese regulators hope for. However, when it comes to deciding whether to hire local advisors, or not, QFII investors tend to differ. Some investors regard a QFII investment to be just a small proportion of their global portfolios, so they see no need to retain local advisors. Since China is a policy-driven economy, other investors deem local expertise from partners, such as asset managers, brokerages and banks, to be essential for identifying viable investment opportunities. In addition, relationships that are forged with Chinese institutions, through QFII, can help global asset managers to win the business of advising Chinese companies on their Qualified Domestic Institutional Investor (QDII) endeavours (QDII is China's outbound investment scheme).

The licence-approval process

In typical Chinese fashion, the QFII regulations are straightforward, and can be subject to further interpretations by regulators as well as evolving policies. As we can see in Figures 1 and 2, licence approval is quite unpredictable, and any attempts to extrapolate from history can be challenging. It is widely believed that the approval process is highly subject to market dynamics (such as the pressure on China to allow the RMB to appreciate, signs of dramatic capital inflow and outflow, volatility shifts in equity markets, and so on). However, the rapid increase in late 2011 and 2012 (Figure 2) seems to indicate that regulators are making a concerted effort to ramp up foreign investment. By August 2012, Chinese regulators had granted 181 QFII licences (Figure 1) and $30 billion in quotas. The newly appointed CSRC chairman vowed to speed up QFII approvals in the future.

Encouraging news reports in 2012 signalled regulators' determination to welcome more global investors and make the application process easier and faster: the available QFII quota was raised from $30 billion to $80 billion; applicants' eligibility requirements (such as the number of years of business experience and the size of AUM) were dramatically eased (see QFII eligibility as of September 2012 box out); multiple entities within the same corporate group were eligible to apply for individual licences; the maximum aggregate shareholding limit in a single listed Chinese company by all QFIIs was raised; long-term investors such as mutual funds, insurers, pension funds and sovereign wealth funds were shown preference; the licence approval process was to be streamlined and shortened; and so on. It is widely anticipated that QFII regulations will be relaxed further.

Choosing the right custodian

According to China's regulations, only QFII custodians can submit applications for licences and quotas on behalf of global investors. The application process is a rigorous one, and not

too many applications receive approval. Therefore, custodians can be very important local partners for establishing QFII schemes. Currently, around 10 custodians, both global and local, are servicing QFII investors. The global custodians hold around half of the market share and local Chinese custodians hold the rest. Many custodians also provide local distribution channels that are valued strategically by some global investors.

Beyond these roles, QFII custodians are crucial to global investors achieving success in China, as they are valuable resources for research, interpretation and forecast of Chinese market dynamics and regulations. Some well-connected custodians are believed to be able to help global clients navigate the time-consuming and bureaucratic QFII licence-application process more effectively and efficiently.

In summary, the QFII scheme is one of the methods that is available to global investors for investing in China's high-potential capital markets. Due to its rigorous application process and the ensuing scarcity of approvals, a QFII licence is a valuable resource for investors. Since QFII custodians are key to success in China, global investors should analyse the pros and cons of both global and local Chinese custodians to help them to identify and partner with the one provider that can help achieve their investment objectives. **AST**

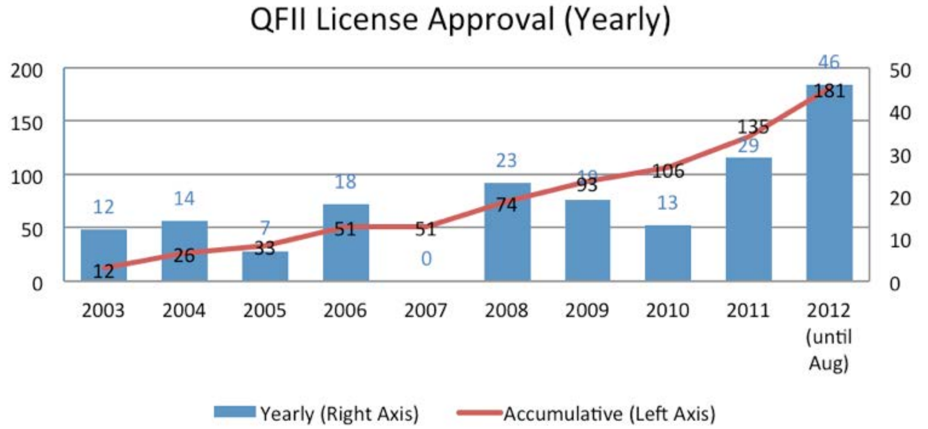


Figure 1 Source: China Securities Regulatory Commission, September 2012

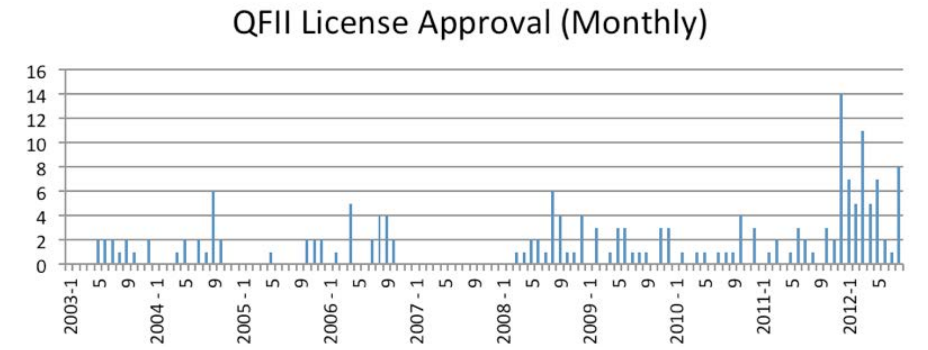


Figure 2 Source: China Securities Regulatory Commission, September 2012

QFII eligibility as of September 2012

Type of Institution	Business Experience	Assets Under Management
Asset management	Two years	Minimum of $500 million in the last financial year
Securities companies	Five years	Minimum of $5 billion in the last financial year; Minimum of $500 million in net assets
Insurance companies	Two years	Minimum of $500 million in the last financial year
Other institutional investors (pension funds, charitable foundations, endowment foundations, trust companies and government investment companies)	Two years	Minimum of $500 million in the last financial year
Commercial banks	10 years	Minimum of $5 billion in the last financial year; Tier 1, paid-in capital of at least $300 million

Source: China Securities Regulatory Commission, September 2012

The views expressed are as of October 2012 and are a general guide to the views of Brown Brothers Harriman ("BBH"). The opinions expressed are a reflection of BBH's best judgment at the time this interview was conducted and any obligation to update or alter our views as a result of new information, future events, or otherwise is disclaimed. Furthermore, these views are not intended to predict or guarantee the future performance of any individual security, asset class or markets generally.

From West to East

Simon Cleary of Standard Chartered discusses some prominent issues in the custody industry

Key industry trends

Lower returns from the established markets in the West are driving an increasing focus towards emerging markets, perpetuating an increasing shift from the West to the East. New wealth is increasingly being driven from these regions, combining to create a greater interest from service providers (custodians and brokers) looking to support clients with assets coming in to and, increasingly, clients investing within and from these markets.

An enhanced regulatory focus towards investor asset protection is driving changing behaviours, increasing the focus on risk, and forcing significant ongoing investment in core servicing capabilities. More specifically, the impacts of the Alternative Investment Fund Managers Directive and potentially UCITS V in Europe are changing roles and responsibilities to such an extent that the appointed depositories will be required to assume oversight, monitoring, and ultimately, responsibility for the investment activities and underlying assets that are transacted and held for their clients—a significant step beyond purely being an agent for settlement and safekeeping.

This gives rise to a number of possibilities. Firstly, custodians will need to price additional risk, resulting in increased costs to the end-investor. Secondly, some custodians may decide to withdraw support for certain higher risk assets classes and/or markets. Thirdly, the contractual arrangements between global and sub-custodians will change as the European depositories look to pass on risk further down the chain. Finally, we are already seeing a blurring of previous boundaries as some large scale global custodians seek to establish their own direct custody and clearing capabilities in local markets in order to retain the ability to better manage the risks by bringing the entire custody chain in-house.

Client demands

Local/regional custodians typically transact with two core types of market participant—the investors (real money funds, hedge funds, sovereign wealth funds, insurance companies, and so on) and intermediaries (global, regional and local custodians and brokers, private banks and wealth managers). Each has its own specific focus and requirements, which vary based on size, sophistication and markets of investment. The one common theme is that both investors and intermediaries seeking access to emerging markets are increasingly affected by the challenges resulting from evolving local market conditions and the broader market trends that are mentioned above. This increases the expectation for providers to enhance levels of automation, real-time reporting, asset segregation and the provision of local liquidity solutions. From a custodian's perspective, this dictates the need for a highly flexible securities services infrastructure that enables a rapid response to changing demands and integrates seamlessly across a whole suite of other capabilities, typically including cash, foreign exchange and other financial markets capabilities.

Standard Chartered's securities services business has continued to evolve and is benefitting hugely from expanding levels of investment by the bank over recent years. To demonstrate the scale of this commitment, the bank has increased our custody coverage from 16 markets in Asia to 39 across Asia, Africa and the Middle East within the past three years, both organically and with the strategic acquisition of the Barclays Sub-Saharan African business in 2010. Additionally, and since 2010, we have fully upgraded our corporate actions technology and associated operating model and are currently rolling out our new, highly innovative, strategic core custody platform across our entire network—the single biggest investment in core securities services infrastructure made by Standard Chartered to date and one that fully integrates associated interfaces to our other transaction banking and financial markets capabilities.

The term 'innovative' is not one that has been widely used when describing participants and/or capabilities within the securities services industry. It is, however, an appropriate one when considering the capabilities and potential of our new platform. For the first time, we are installing a single instance platform across all markets of operation, (ensuring that any enhancement that is added for one benefits all others) but also, and importantly, ensuring that we can apply a single, best-of-breed global operating model that will deliver the same, world class service delivery from each of our individual markets—a significant benefit for clients using Standard Chartered in more than one market.

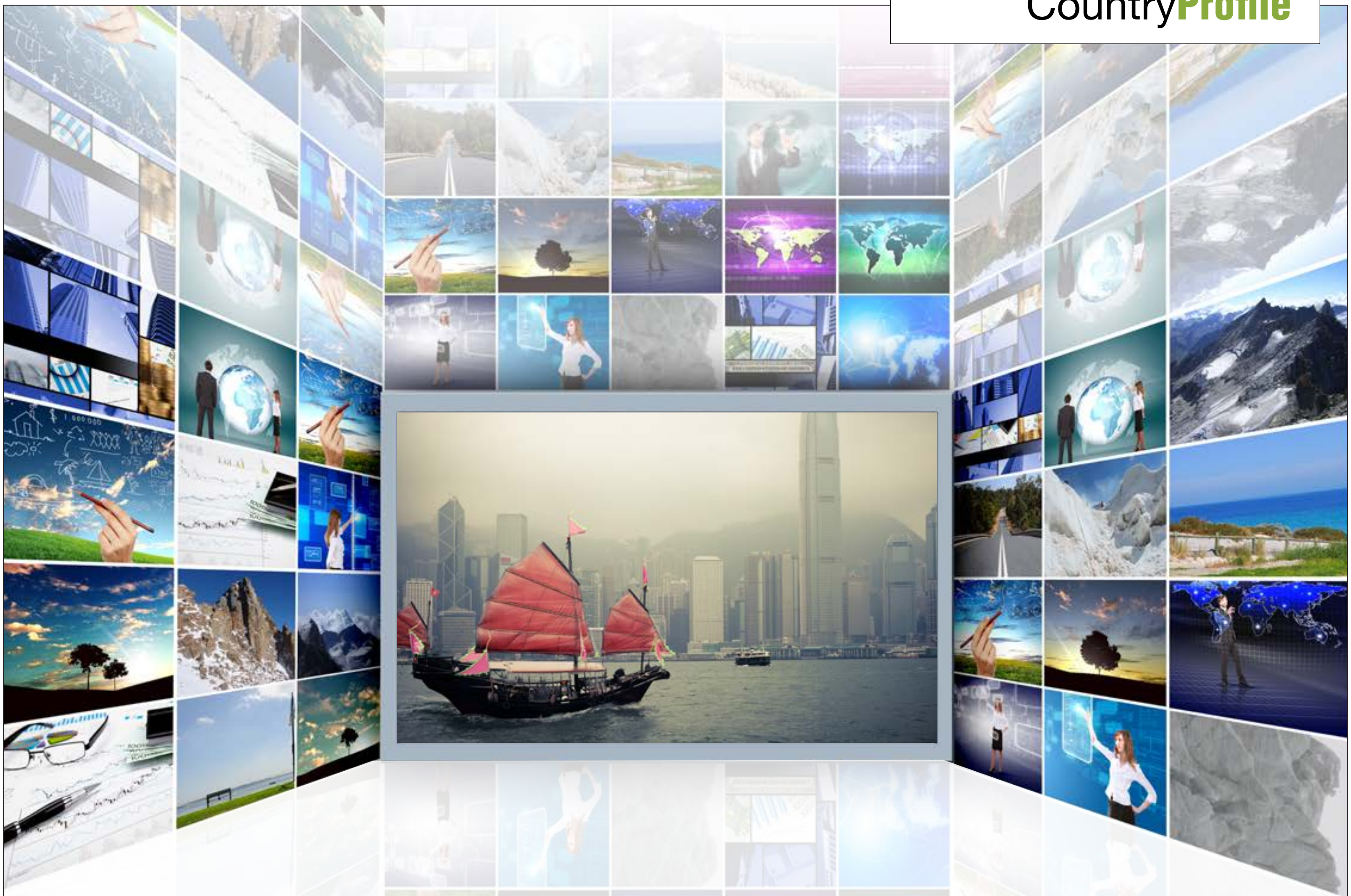
The addition of the single instance platform enables Standard Chartered to introduce a new concept that we believe redefines the provision of regional custody services. We have called this capability Single-Touch. By intelligent routing within the platform client instructions are automatically passed to the market of settlement for processing. The single instance platform enables the collation of data in a way that provides clients with a consolidated view across all markets. These two capabilities combine to avoid the need for the traditional duplication of processing and record-keeping at the regional hub. In short, through Single-Touch our multi-market clients can retain all of the convenience of regionally consolidated, hubbed access with the added benefits that are normally only associated with direct access; improved cut-off times, more real-time reporting and access to local expertise. As we progressively roll out the new platform to each of our markets through 2014, the benefits of this approach will grow incrementally.

Shifting focus

Markets may have been depressed for some time but the general investment trends are certainly towards, and increasingly from, faster growing emerging markets and, accordingly, from the West to the East. Rates of regulatory change are increasing and will do so for the foreseeable future, incrementally and dynamically affecting the needs of both investors and their intermediaries, and driving a need for a dynamic and flexible approach to securities services.

Standard Chartered has a broad and focused network of custody services across its strategic footprint of Asia, Africa and the Middle East. The bank has been present in these markets for many years and supports clients with integrated solutions across securities services, cash, trade and financial markets products, combining technology with local knowledge, relationships and experience. Our core focus has long been to support clients investing to, from and between these three regions in which we primarily operate. Recent investments are reinforcing that stance. **AST**

Simon Cleary
Managing director and global head of custody services
Standard Chartered



Japan in high definition

The country is famous for its precision in service, which comes in handy when keeping the reins tight on assets, as AST finds out

GEORGINA LAVERS REPORTS

It only takes one trip around the districts of Tokyo to realise that Japan is a country that refuses homogeny. From harajuku girls, to businessman, to Shinto Buddhists, the identity of Japan's citizens is difficult to pin down; a fact that can also be applied to the financial sector.

Japan has experienced highs and lows during the last 50 years, spanning from high economic growth during the 1960s and 1970s due to a regulated financial sector, through to a lost appetite for borrowing in the 1980s, and what economists called a 'lost decade' in the 1990s.

Now, in order to pull itself out of its economic malaise, Japan is continuing to focus on market orientation in a bid to achieve economic reform, and custodians are there to help.

Players include Mizuho Corporate Bank, Trust & Custody Services Bank, and Sumitomo Mitsui Trust Bank, with 'foreigners' such as J.P. Morgan and HSBC also having a sizeable presence in the market.

Fumihiko Yonezawa, head of Worldwide Securities Services in Japan at J.P. Morgan, used "unique, precise, and stable" to describe custody in Japan.

Though he agrees that it would be remiss to pigeonhole Japan into certain clichés about honesty, loyalty or fastidiousness, Yonezawa asserts that it is important for global custodians to realise that they must fit into a country where familiarity and loyalty are highly prized.

"It is very important to commit to this market as well as to demonstrate consistency. Japanese clients' requirements are unique (in terms of zero tolerance) and the ability to maintain a high level of precision and client service. However, once you meet these requirements, you are often rewarded with a stable and long lasting relationship with them."

"Whilst the Asian market is still sometimes perceived to be a single entity, there are considerable nuances within individual countries. And there is a common notion that if you become best-in-class in Japan, you can be the best in region and around the world."

As for comparing custodial services in Japan to those in other countries, Yonezawa acknowledges that as with most clients, Japanese clients look for stability and delivery of high quality, state-of-the-art technology as well as accuracy and timeliness of information delivered.

"As financial markets around the world continue to evolve, our increasingly sophisticated clients are demanding more of us as a partner. Things like strategic advice, delivering cost efficiencies as well as ongoing training programmes are all critical to our clients. It's about the end-to-end value that we deliver to them each and every day."

GPIF and its effects

A vital shift in the makeup of the Japanese custody industry took place in 1995, with the de-regulation of the Japanese public pension systems. Following this, the country's financial system began to shift, and asset management companies spent the next decade or so going through rounds of consolidation.

One of the final reshuffles was Sumitomo Trust & Banking, which also owns Nikko Asset Management, combining with Mitsui Trust Holdings to form Sumitomo Mitsui Trust Holdings.

The Government Pension Investment Fund's (GPIF's) entrance into market investment, "changed the custody industry," says Yonezawa.

"Pension funds with assets under management of about $1.4 trillion emerged in the market, and GPIF requested a custodian to provide not just sophisticated services, but the highest level of asset security. GPIF subsequently unbundled the asset management and custodian businesses to ensure segregation, a best practice that other pension funds followed soon after."

"From our perspective, our relationship with industry leaders is becoming even more comprehensive, transparent and collaborative, which we believe will be equally important in terms of the industry's future development."

Getting the house in order

Political paralysis and a deficit problem have had negative effects on Japan. The former is thought to have finally been dealt with, after a recent agreement between the government and leading opposition parties led to an increase in consumption tax—from 5 percent to 8 percent in 2014, and then to 10 percent in 2015. Yet the agreement is but a small factor in the entire reform process.

Though the International Monetary Fund projected a relatively sunny forecast for Japan over the next two years in a recent report, it warned that an outlandish budget deficit would push economic indicators to breaking point.

"Without more action than currently planned, debt ratios are expected to reach 256 percent in Japan," stated the report.

Legal issues such as bankruptcy remoteness are also an important issue. Yonezawa says: "Since the financial crisis in Japan in the late 1990s, custody is one of the most sensitive markets regarding asset security and/or bankruptcy remoteness. Every client poses this question during periodic reviews of their global custodian."

Trending now

One of the most fundamental trends over the years has been a surge in cross-border flows, states Yonezawa. "This means that as an asset servicing industry, we have to quickly evolve the way we are servicing clients and the way we conduct and prioritise our own business development to meet these growing asset pools."

Furthermore, clients are starting to demand more from global custodians to provide support on reducing risk, increasing revenue and enhancing efficiency. "This puts a greater emphasis on a global custodian's balance sheet, capitalisation, wallet for investment into technology, talent as well as level of disclosure. Another key factor is to hire and retain talented and experienced executives in-country," he says.

"It's by combining all of the above with a committed service that allows us to establish a 'trusted partner' relationship with clients in Japan." **AST**

Game, set and class action

Stephen Everard, CEO of GOAL Group, discusses reclaiming your dues

At the end of September this year, a highly prominent case of corporate misdemeanour came to the Japanese courts. Almost a year previously, Olympus Corp was shaken by an accounting scandal that wiped out four-fifths of its stock's value within a month. The alleged fraud had taken place at the highest levels in the company's management structure. Among the senior staff who subsequently stood down were the then-Olympus chairman, the former CEO, an executive vice president, and the corporate auditor. The case is now being heard in the Tokyo district court, in the first criminal prosecution to take place since the suspected culprits were arrested.

The company's share price has recovered significantly, but is still in the region of 40 percent down on its pre-scandal levels. On the international stage, the company is being sued by an investor in its American depositary receipts business (ADRs) seeking class-action status. Because the action affects US investors, even though it concerns a foreign-domiciled company, other investors internationally—including those from Japan—can participate in the class action in the hope of recovering some or all of their losses.

An analysis conducted here at GOAL Group, utilising our expertise as class action specialists, shows that between 2000 and 2007 Far Eastearn institutional investors' non-participation in US securities class actions litigation resulted in nearly $1.5 billion being left on the table. Almost $225 million of this was attributable to Japanese investors. We are currently working on an estimate of unreclaimed losses for 2008 to 2011 and, given that the volume of securities class actions that have been filed annually has remained steady over the last 15 years, we expect the sums pro-rata to be of a similar scale. In fact, the projected number of actions that will have been filed by the end of 2012 is expected to be marginally up on the long-term average.

It is increasingly recognised that helping clients to reclaim their due returns through class action is a fundamental duty of Japanese custodians and fund managers. The average value of a settlement in the first half of 2012 was $71 million, considerably up on the previous average value of $46 million that was recorded between 2005 to 2011. Twelve and a half percent of all foreign investment in US equities can be attributed to Far East investors. When US investors control the litigation, there is an increasing possibility that foreign investors may not automatically be included, because the fewer the claimants, the greater the cut of any settlement. This is inspiring Japanese shareholders to become active litigants in US courts (in cases against US and foreign companies alike).

However, keeping track of the opportunities to make a claim and the processes that are required to do so successfully can be a complicated and daunting task—and many institutional investors believe that the cost and time that are involved is likely to outweigh the benefits. This is often a misapprehension, but perhaps explains why 25 percent of claims that could be filed by entitled parties are left unprocessed. In reality, there are several established services that are available today that help investors to participate in class actions. So custodians and fund managers now have the tools to ensure that their clients obtain the totality of their due returns.

A friend in technology

Simon Shepherd of MYRIAD Group Technologies offers a helping hand to the network management industry

The value of technology to any institution is that once it learns the 'administrative truth', it can innovate, adapt and even improvise when market conditions change.

Capable and informed network managers can point to a single version of that administrative truth and, with confidence, provide close to real-time answers to senior management's questions. In this respect, modern network managers can leverage technology to their best advantage and avoid the constant playing of catch-up that is so often seen in recent years. As senior network managers are organising the data under their stewardship far better than they ever could before, they are driving their businesses forwards and shaping their own destinies, certainly within their own organisations. Failure to do otherwise runs significant corporate and personal risk.

The best network managers are driving change themselves. Restructuring their operations, generating ideas on how best to service their clients (no matter what flavour), and using the best tools available to them.

And market conditions are changing constantly around them. Current and growing themes in the network management industry include regulation, risk management and value-added services. While the big themes of recent years have not gone away—transparency, operational efficiency and cost management—they have recently been eclipsed by regulatory pressure. What is exercising many senior network managers at the moment is the need to hit regulatory deadlines so that their employers can show that their respective houses are in order. Failure to do so may lead to financial penalties and sanctions, including the withdrawal of licences to practise. It is unclear how long this regulatory pressure will persist, but the suspicion has to be that it is here to stay and that if anything, it is likely to intensify in the coming years. This will play to a change in the 'buying lifecycle' and also, ultimately, how network managers are viewed by their own institutions.

Examples of the types of regulatory requirement currently confronting operational managers include the provision of lists of foreign bank accounts, the provision of lists of accounts in general, lists of documents, audit trails of RFPs, audit trails of account opening authorisations, audit trails of account opening processes and more. The list is long but not overly complex: imposing a greater degree of structure and organisation at an institution can position it to provide all the necessary answers quickly and accurately for the powers that be, and using clever solutions is increasingly the preferred route for a growing number of operators in this market.

There is a danger that the scramble to do this may lead to an unseemly stampede, especially where external systems are being introduced to meet these needs. There is always a suspicion—sometimes an expectation—that the authorities will relax deadlines and extend timelines to accommodate the tardy. This often leads to late decision-making and hasty, sometimes ill-considered or poorly structured solutions. But this misses the point: running an operation such as network management should mean that basic requirements for audit trail and the like are in place anyway and already positioned to satisfy the regulator's requirements.

All too often, a bank's approach to crossing a regulatory hurdle will be that it is okay to demonstrate that a particular exercise to solve a problem 'is in hand'. But this should not be a question of having to play catch-up in the first place. Having robust, easily maintained systems that facilitate the quick capture and subsequent reporting of data, and ultimately the production of high quality management information, should be a fundamental pre-requisite for any operational department, let alone one as important as network management.

It should be easy to run a report on all accounts that are held with or by providers, it should be easy to audit which mandatory documents are missing, and it should be straightforward to generate an audit trail to confirm who has provided what authorisation at each stage of, for example, an account opening process. It may be possible to do each of these tasks manually, and at times of low stress, take the time necessary to gather the information, but in times of greatest need, when time is at a premium and the demand for high quality, accurate information is keenest, the absence of a comprehensive system, providing 'one version of the truth', can be critical and cost large amounts of money.

From a risk management point of view, the challenge is that seemingly ever-fewer people are prosecuting ever-more complex tasks with ever-more limited resources. Simply throwing bodies at the problem demonstrably does not work in the medium and long term. Furthermore, the cost of labour is rising and as recent contributor to AST Phil Cook noted, "adding people to the payroll is not the path to sustainable and scalable growth".

The 'informational challenge', coping with the vast quantities of disorganised information that needs to be processed and acted on in limited timeframes, often without proper analysis, frequently leads to poorly informed decisions. The aim of a targeted, discipline-specific technology must be to simplify and distil much of the information accruing that is otherwise amplified by disparate systems and poorly specified solutions.

Technology can help to filter information quickly and accurately, and not having as clear and full a picture as possible brings a new meaning to being 'economical with the truth'. Weak technology, poor systems and processes may make this inevitable, regardless of intent, and an unavoidable consequence of a failure to invest in the right solution.

A good example of this is the changing dynamics behind due diligence. Network managers cannot afford to scrimp on the operational side of due diligence. The increasing breadth and sophistication of due diligence demands by both internal and external clients means that managers increasingly have to bring to bear technology to match—they will simply not keep up otherwise.

Understanding a jurisdiction, getting the documentation right, structuring an account properly and keeping a record of all of this activity in a transparent and easily accessible manner is fundamental to a network manager's responsibility.

Furthermore, having an integrated, highly flexible RFP 'engine' as part of a battery of functionality, like that in MYRIAD, is increasingly seen as the starting point for a whole host of linked activities, which ultimately inform the bigger picture. There has to be a complete, seamless audit trail through RFP and selection of counterparties, account opening and authorisations every step of the way, documentation—mandatory and otherwise—performance measurement, ongoing due diligence and cost capture and control, right through to the beginning of the cycle again. It would be nice for the external client to be able to rely on the standards of the internal client, be it a trading desk, treasury team or compliance unit, but this is rarely the case. Having a single, integrated solution that meets these needs all in one place is a huge advantage. Accessing one version of the truth across the organisation increases transparency, eases communication woes and reduces risk.

How is it possible to balance low cost with top-notch service? The answer is that is very difficult without help, and help, typically, can only come in the form of new technology. For example, there is a current trend for suppliers and providers to the network management industry to look at revamping their billing systems. These upgrades may involve process improvements to a degree, but fundamentally these changes are being addressed by superior technology and in this instance, improved billing systems are seen as a key differentiator in the marketplace. Presenting machine-readable invoices, perhaps in conjunction with the traditional hard copy, is seen increasingly as a 'must have' not simply a 'nice to have'. The hard copy element has to be preserved, usually to satisfy regulatory requirements, but there should be no reason why the hard copy cannot also be accompanied by an intelligent file, containing the same information, but one that facilitates automated processing.

The 'burden' of regulation generally is exercising many players at the moment. But the reality is that regulation does not need to be an encumbrance. Indeed, for many outside observers, the constant reference by the banking industry to the regulatory burden merely confirms their suspicions that houses are not in order. The reality should be that proper systems and processes with clear and accessible audit trails should automatically meet regulatory demands, eliminating the supposedly burdensome nature of new regulations. Indeed, it could be argued that a better degree of control and transparency in the past might have meant less draconian measures now and a lurch, arguably, too far the other way. Either way, it doesn't matter because regulation is here to stay, and in a market near you.

Persisting with the value-added approach to providing network management services, it is worth re-visiting cost management as a constant theme. The debate about whether the whole function of network management is an art or a science can be picked up another time, but where these different definitions collide is on the subject of cost. The internal client is going to be sharply focused on actual cost and 'put through' in the absence of a mark-up, while the external client will likely require increased transparency on costs but has to accept a 'cost plus' approach because otherwise it will be a short-lived relationship.

The common element is cost and a granular understanding of every aspect thereof. Anyone can do the maths, but creating a robust framework within which all cost variables and complexities can be modelled in a repeatable manner is the key to automation. Spreadsheet-based systems, which are still very much the norm both for in-house systems and a couple of third-party suppliers, fall a long way short of what is really required, and this is before considerations of business continuity and disaster recovery enter the equation.

In conclusion, much of the pressure being felt by network managers can be addressed through technology. The human factor remains paramount and there is no substitute for experience and how best to react to a new situation. But risks that are associated with human endeavour—errors, timeliness, forgetfulness and fraud—can still be mitigated by technology. Business process re-engineering, knowledge transfer and business continuity are some of the areas that are better handled in the robust, secure framework of a single platform. Standardising procedures and policies in writing, systematising records and planning for disaster recovery are best suited to a technology that allows convenient storage and rapid global access, anytime, anywhere. Globalising and perpetuating the use of these procedures and policies in a comprehensive framework is the key to sound operational performance. **AST**

Simon Shepherd
CEO
MYRIAD Group Technologies

The new breed

Network and relationship managers have to change with the times, says Ulf Norén of SEB

We are entering new times. The changes that we are witnessing now are of a nature that there will be no such thing as a return to normality. In this piece, I will take a look at two essential roles in our business—the relationship manager and the network manager—and provide some basic comments on how I believe they will have to evolve in context of some of the mega indicators for change.

The political and regulatory objectives and sentiment in the Western hemisphere have changed significantly over the past four years. Where as the previous overall objective was a part of the European alignment agenda in order to break down barriers and improve the competitive position, the agenda for the foreseeable future will change the trade- and post-trade scene, and is driven by four main features:

- Risk taking in the financial sector needs to be mitigated to a minimum.
- Risk can be mitigated to a large extent by central clearing and use of collateral.
- The consumer and taxpayer will be protected against the financial sector. Some of the underlying reasons for this are noble, good and needed. Some are not.
- The idea to tax the financial sector has gained massive public (and thereby political) support. I see this as a very dangerous route, and in many cases, where it has been tried before, it has failed.

There are still opportunities for some adjustments by having an intense dialogue with regulators, mainly through industry groups, but a return to more of a self regulating environment will not be the case, in my opinion.

The various dimensions of the crisis have had multiple effects on the business environment and I will mention a few for the sake of illustration:

- The interest levels are going south, and in some cases are not only close to zero but they are also dipping into negative territory
- Consolidation among providers is happening, but not fast enough
- Fee pressure is very, very high
- There are demands for increased service levels and product addition/integration
- Credit availability and appetite globally in many instances are lower than pre-crisis
- Risk assumption is higher, and so is risk awareness, but willingness to take on risk is lower
- Collateral management and transformation are climbing the agenda and are not necessarily the strongest points with either of the two roles, network manager and relationship manager
- As a result of changed market basics and very much as an effect of T2S, key infrastructure partners, such as central securities depositories, will have to replace lost revenues by adjusting fees and beginning to compete in key value areas
- Most importantly, to finish off: liability and compliance issues as a result of all regulations and tougher requirements from local financial services authorities will have tremendous effects on the business.

New future

This is the new reality where network managers and relationship managers will interact. As follows, the demands on both roles have increased manifold. The successful network manager will most likely have the most interesting job in the industry and become the prime 'to-go-to' source for any international activity. But the role will carry a lot of responsibilities and liabilities, and it is not difficult to see how it could easily become a target to account for any problems occurring in the cross-border activity.

In addition to being on top of processing and quality issues, balancing mutual revenue flows and assuring correct attention level, a network manager now needs to be fully on top of the consequences, opportunities and threats of at least 20 regulatory issues that will affect the legal and liability situation for the network manager's firm. In addition to this, a network manager must deal with positioning alternatives when it comes to single market providers versus regional providers. When doing so, the network manager must determine what the recommendation should be in terms of how many providers are needed or whether provider risks should be mitigated by recommending a cluster of several providers servicing parts of Europe.

As we believe that any given organisation is not ready to implement one solution, the chosen model will be a hybrid and the network manager will necessarily have to be involved in a lot of evaluations and have to stand up for why one solution is preferable for Switzerland and the UK while another is the solution of choice for the Nordic/Baltic region. This is to a large extent driven by T2S, but naturally also by cost and efficiency gains, worries that one or more providers will stop doing or selling business, and stability concerns in general.

The end result, we assume, is that the account operator model will be chosen in a number of markets. This is a model that will require studies containing shift of missions, liabilities, and readiness analyses of many infrastructures too. For most buy-side organisations, this is unexplored territory and will require significant resources internally in addition to a drastic change of the operative model involving processing units across the world.

I did say that the network manager role is interesting, right?

The relationship game

Turning to the relationship manager, a network manager will expect a relationship manager to mirror the qualities of the network manager. Just with a deeper knowledge about the local colour of things and with the safety and efficiency of the clients' businesses as priority number one. A network manager will most likely also require much more focus from the relationship manager—there will be no more standard one-hour meetings with general overall picturing. Instead, they will have more frequent and longer sessions, going through efficiency, model restructuring, risk exposure and risk mitigation, local legal and regulatory changes and their effects, lobbying efforts, and endless fee and revenue discussions on how the compensation model can be structured to best serve the interests of both parties. A relationship manager model at a regional provider must be very conversant on the various business models that are offered, finding the balance between short-term gains and long-term optimisation, where in the long term, a recommendation for a model with degrees of self-servicing in settlements, for example, might lead to even more functions being insourced by the client and more business subsequently being awarded to infrastructure providers.

Another element that the relationship manager will have to confront is the broadening of the service offering and that will inevitably involve many areas of the relationship manager's bank. Already at current stage and no matter how any organisation chart looks, I claim that the overwhelming number of sub-custodians have many 'owners' of the business relationship. Now, a number of new features will come into play and the challenges of the relationship manager will not only be external versus a demanding and well prepared network manager, but it will also to an increasing degree involve internal factors. To win this war, a relationship manager must be equipped with a recognition of the business lines strategy and long-term prosperity chances to start with. If not, the borderline issues internally will become too challenging. From there, the relationship manager must be able to fulfill a whole set of criteria in order to be able to deliver successfully:

- New needs in execution, derivatives clearing and collateral management.

- Find ways of securing revenue streams in the above areas where the general opinion is that they are not really core sub-custody core products.
- Uphold the neutrality view and avoid conflicts of interest on the one hand and at the same time present business opportunities for other business areas.
- Defend increasing cost/income by a growth in volume and revenue that as an absolute number is bigger than in previous periods. I have for at least two decades said that I agree that sub-custody is in many ways is a scale business, but that there is always room for the niche player. Now is the time to realise that this is indeed is a scale game. Not attracting additional volume in new products and by beating competition will be detrimental.

Can an individual achieve all of this? The obvious answer is no, but the realistic answer is probably that the individual will have to. You can argue back and forth about whether the responsibilities should be spread locally or remain centrally placed, but at the end of the day, a network manager will want to deal with one individual that will be conversant on all geographies where the network manager has exposure.

Logistically, it will also be very difficult to appear with a team in most meetings, besides being very hard to arrange in a financially viable way. The machinery behind this must be strengthened by dedicated lawyers, compliance staff, credit and risk back up, product managers, and local seniors. It would be very naive to think that the presence of highly qualified, locally placed managers is not necessary in a business that is striving for consistency, but in reality is becoming increasingly complex. It is not clear how local teams will best interact with clients. It has to be done on an operational management level, on a product level, and, maybe most importantly, on a kind of network support level.

The more I think about it, the more I realise that it would be unreasonable to expect a network manager to deal with all nine markets that we supply and even less realistic to deal with banks with a larger network than that. So, local teams will have to do a lot of the interaction with the local infrastructure, understand and translate the local reality into business reality, and keep the relationship manager up-to-date in addition to feeding details to a receiving organisation on the client side. In the old world, all local custody, including operations, static data, and so on was done locally. Now, we see most regional custodians of size, including SEB, re-structuring the operational model and creating various types of centres of excellence. This is done to achieve greater operational quality, take the opportunity of scale efficiencies and reduce the operational-cost factor. The challenge here is to make sure that objectives are aligned, that key performance indicators on operations staff are not only related to efficiency but also to flexibility, and a sound business understanding.

How can then this be dealt with? Looking at the requirements of a relationship manager, it has to be a cross-bank effort involving many areas, but the actual profile is best met by a network manager. **AST**

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Life inspires us

top rated by GC between 2004-2009

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Fight for your right to harmonise

A lack of issuer standards across the globe is the main talking point in corporate actions. Industry experts discuss what can, and must, be done

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Senior vice president of business strategy
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Product manager
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Malene McMahon
Senior business manager for securities Americas
SWIFT

Michael Brady
Commercial manager
Asset Servicing Times

Looking forward to seeing you at the Sibos conference in Japan

What are the major operational risks around corporate action information?

Malene McMahon: There are three main areas that we see as major risks around corporate actions. Interpretation of the data from issuers: turning the text of announcements into data by multiple parties guarantees no authoritative source for the data—all of this requires validation. Timing: manual interpretation means inconsistency, which means scrubbing is required. It also includes a manual process, so delays that impact informed decisions by investors. Accuracy: multiple parties extracting, rekeying, and disseminating data from the exact same paper-based information dramatically increases the incidence of errors.

Marty Kruse: There are many operational risks during the lifecycle of a corporate action, from event initiation to allocation of payment. Managing information flow throughout that lifecycle presents different risks, depending on the sourcing of the event and communication protocols that are used by participants. One of the biggest risks arises from the initiation of an event. While many issuers, depositories and vendors have improved consistency levels with basic corporate action information, risks still exist because of how all parties interpret an initial notification of an event. As issuers have focused on new or expanded means for raising or changing capital levels, more events have significantly more options from which investors can choose. As each party in the information lifecycle (depository, vendors, custodians and clients) interpret the event, there's an increased risk of misinterpreting information or understanding what options require vis-à-vis eligibility, participation, documentation, and so on.

Another major operational risk is the technical capabilities and mechanisms each participant utilises to communicate the information. Even with highly structured SWIFT messages, there is still a significant element of interpretation and miscellaneous information that constituents must review, understand and disseminate. Unfortunately, many clients or their investment managers still communicate via facsimile, adding manual effort and therefore risk.

Gerard Bermingham: Operational risk has often been referred to as 'the risk without reward'. In the case of corporate actions data, in the absence of a globally accepted standard, these risks can range from simple non-transactional narrative miscues to huge financial losses and liabilities. Beyond the risk that is inherent in receiving incorrect information, a missed corporate actions event could result in not only a financial risk, but legal risks as well, ie, the liability of the asset servicer's requirement to make the client 'whole'. Even if an event has been identified, a firm could also be put at risk if the deadline to participate has been missed. In the case of voluntary corporate actions, portfolio managers and clients need sufficient time to make decisions. Therefore, there is an urgent need to get the correct information to them as quickly and as efficiently as possible.

Another financial risk is in tracking and reconciling open client and custodian positions. If left to manual devices, this could present a large exposure. The timeliness of position updates is key: time gaps due to the reliance on manual updates, or even periodic batch processes, could result in incorrect eligibility and entitlement calculations, and in poor investment decisions being made.

Gary Wright: Risks in corporate actions information are many but mainly centred around accuracy, completeness, and timeliness. Even then there are risks with how the information is communicated to those involved in corporate actions settlement. Internationally, the problems can also be amplified with domestic market rules and non-standards.

Alan Jones: Risk can be broken down into four parts:

Continued lack of unified standards/messaging/formats

Information is received from a variety of sources, delivered via SWIFT or fax and then printed, sorted, distributed and reviewed by individual processors. This process is time consuming and exposes an organisation to operational risk due to the sheer volume of work and the repetitive nature of the task.

Increasingly complex event types and high volumes

The complexity of corporate actions processing requires a specific knowledge base and established members of staff are often overburdened with a large number of complex events—thus exposing institutions to the risk of manual error.

Documentation of event data not centralised in one application or back up

Critical documentation and information is often kept in a physical or electronic diary and stored locally exposing organisations to tremendous risk in the event of a disaster recovery situation.

Complex processing of elective events

Elective events present the most risk to manual organisations as analysts regularly converse with clients by telephone, often after stipulated deadlines. Instructions are then collated manually before delivery to the depository or custodian to action.

How far has the industry gone to eliminate costly, risky, resource-intensive manual processing of corporate actions and what else can be done?

Jones: Some progress has been made in the automation of the simpler and more standardised event processes. Data capture, reconciliation and messaging are the three most advanced areas, aided by developments such as ISO 15022 messaging standards. The largest firms—especially asset servicers—have made the most headway.

However, many areas such as entitlement confirmations, instruction processing and client communication still need attention and question marks remain over the next steps in the automation process. Automation continues to depend heavily on developments in infrastructure, standards and technology and it will depend on the industry and vendors working together to make improvements.

SWIFT, the Securities Market Practice Group (SMPG) and the National Market Practice Groups have made great headway since 2010 on enhancing ISO 15022 messaging into what we can now truly call a standard messaging format for corporate actions. Messages have become true templates with dedicated placeholders for most details of an event, although there is still room for different interpretations to be applied to the way that these standard messages are constructed.

The use of technology to do much of the heavy lifting that is associated to processing corporate action event notifications, for example, a core element to any corporate action processing solution, allows this function to be transformed into an exception management process where end users only have to review issues and updates, rather than each and every notification that is received.

Wright: The industry made great strides when ISO 15022 was introduced, but since then progress has been slow. ISO 20022 has the possibility to generate further development, but the main issue is still to get standards in processing and corporate action construction introduced into the international markets and an electronic connection between the buy and sell side. Many firms talk about STP in their own firms where the real issue is market-wide STP that can only come from increased use of technology and an electronic communication standard.

Bermingham: Over the years, and working with the ISO 15022 standard (and even 7775 before that), solution providers have developed applications that normalise sources of corporate action information into a single, cleansed record. Others have automated the entitlement, notification, election, and allocation stages of the corporate actions processing lifecycle. Information Mosaic has done both.

I think that the next steps are actually up to the industry. In addressing a global standard, SWIFT has developed the XML-based ISO 20022 standard that addresses the need for individual corporate action message types for all events and the associated processing requirements. Global adoption of this standard is required to further the effort to eliminate the vagueness of corporate actions messaging and reduce the risk (and overhead) that are inherent in manual interpretation. Direct electronic notification capabilities are already available to the security issuer or issuer agents. The use of such notifications via XBRL would significantly reduce the overall interpretational risk that is associated with corporate actions. This electronic data can easily be passed on through other data sources such as central securitie depositories (CSDs) or data vendors in the standard ISO 15022 or 20022 format. The use of detailed legalese-based prospectuses that must be trawled through to extract the relevant data causes a significant amount of unnecessary risk. This could be easily eliminated with the mandated introduction of XBRL messaging for corporate actions from the issuer.

Kruse: The industry as a whole has made good incremental improvements in recent years. SMPG updated its corporate actions guidelines last year and many national market practice groups have made some strides in better defining standards for data and communication via SWIFT. In the US, the Despository Trust & Clearing Corporation's (DTCC's) efforts to move away from its legacy platform towards ISO 20022 will have a significant and positive impact on the timing and dissemination of corporate action information to its participants and clients, which is one of the primary reasons BNY Mellon has partnered with DTCC to be a part of the pilot implementation. As the initiative between DTCC, SWIFT and XBRL gains momentum in the market, improved tagging and standards at the initiation of an event by issuers/agents will improve the consistency and reliability of corporate actions information at inception.

Continuing to progress standards at the national and regional levels, combined with larger scale infrastructure improvements, will contribute more and more towards less manual processing throughout a corporate action event.

McMahon: The industry continues to invest in tools that can improve the corporate actions process. These are best explained on two levels—automation of message flows and internal applications supporting data cleansing, scrubbing and validation engines. On the automation side, corporate actions has certainly seen a tremendous growth in automation during the last five years with the continued growth of ISO 15022 messaging globally. However, much still remains to be done, especially in the US market. Hence, DTCC's re-engineering project of

its corporate actions platform and its adoption of the new global ISO 20022 corporate actions messages. This transformational change will see some leaps in automation levels at some of the largest corporate action service providers as they implement the full suite of new messages with DTCC over the course of the next few years.

In other parts of the world, we see a continued growth of ISO 15022 (more than 11 percent growth in Europe, the Middle East and Africa and close to 20 percent in Asia) but also the emergence of ISO 20022 automation projects, with a stock exchange in China as well as the Japanese CSDs. Some Eastern European countries are contemplating or even working towards ISO 20022 adoption in the years to come. On the application side, we're seeing many financial institutions and vendors invest in internal applications to better manage corporate actions data to ensure that customers are receiving good quality and accurate data.

Will adopting STP help to reduce this risk?

Jones: Near complete automation, or STP, remains a utopian ideal in corporate actions processing, but even partial automation can reap significant rewards in terms of risk reduction and efficiency gains. There have been strenuous efforts to achieve this over the past decade with some success.

Standardised processes with fewer manual touch points provide clarity and predictability across the entire event management process and exceptions can be identified much earlier in the event process and well ahead of critical milestones. The ability to track corporate actions throughout their lifecycle and set up monitoring processes at critical stages provides another opportunity to identify and correct potential errors—thus reducing risk within the process. However, as corporate actions processing is very much a lifecycle-based process, it will only ever be as strong as its weakest link.

The use of technology to automate the event lifecycle and achieve STP, where it can be achieved, certainly reduces the risk that is associated with processing corporate actions. Releasing staff from repetitive processing and allowing them to focus their attention on the complex events is just once element of this.

Business processing engines are able to constantly review each component of the event lifecycle and instantly generate alerts and escalations to ensure that exceptions and deadline dates are dealt with in good time. Building control points into the processing of events that meet set criteria, such as high value positions, ensures that the events with the highest risk associated to them always receive close attention. Financial and reputational losses are still prevalent in manual corporate action processing environments, which can be countered by striving for STP in this complex area. This can also reduce the capital adequacy burdens of financial institutions.

Kruse: Adoption of STP capabilities can always help to reduce risk and many processing and scrubbing engines have good levels of STP once the data is in the relevant system. However, it is unlikely that there can ever be complete end-to-end STP for all event types. With a constantly changing economic and regulatory environment, legacy platforms and infrastructure and market practice differences, there will always be the need for human intervention, and therefore, skilled and experienced people to handle corporate actions. The key will be to maintain momentum on adoption of standards and infrastructure improvements so that the need for human interpretation continues to decline over time.

McMahon: STP adoption is one part of the corporate actions puzzle. Whenever you can simplify and streamline a complicated flow of information across many different parties, the risks will significantly be reduced. Corporate actions is no different. If issuers were to fully digitise corporate actions announcements and the intermediaries that are servicing the investors seamlessly and electronically disseminate all of the data from the issuers, without interpretation or delay, then you have STP from the issuer to the investor. This approach should eliminate much of the risk that is associated with corporate actions processing.

Wright: Adopting STP will only reduce risk if the market itself is STP. Any firm is only as good as its weakest link. Anyone that works in the corporate actions department will know that it's impossible to have an STP environment, but it is possible to automate some of the processes and highlight problems early to resolve them before they become costly.

Bermingham: Implementing automation solutions to achieve STP would certainly address risk. However, due to the complexity of events, the use of proprietary data formats, and the various integration points within the corporate action process, the levels of STP differ widely throughout the industry. Mandatory corporate actions events have the characteristics to be fully automated via STP. Complex, voluntary corporate actions that require election decisions could be automated to the point in which instantaneous evaluations could be made by portfolio managers and clients. This may be the closest that voluntary corporate actions processing comes to STP. This requires, though, solutions that offer sophisticated modelling of 'what if' election decision scenarios, including 'in/out of the money' indicators.

We provide these capabilities in our application as they are essential in enabling decision makers to perform immediate evaluations of the corporate action terms. The functionality also caters for items such as the prevailing market price of the affected security, helping to support the best investment decision.

To what extent are you seeing increased levels of complexity within your industry?

Bermingham: Additional legislation and the scrutiny of securities and cash movement to lower tax avoidance continues to add to the complexity of calculating corporate action entitlement and final distribution. Foreign Account Tax Compliance Act (FATCA) legislation, to be introduced by the US in 2013, will add further complexity to the correct calculation of income tax liability and the necessity to correctly track and monitor beneficiary data to calculate even the simplest of cash dividend events.

Corporate financiers and capital markets themselves are continuing to add complexity to the terms of a corporate action. This is becoming a significant issue as more and more investors look outside of their own markets when investing. These investors continue to encounter restrictions on or exclusion from corporate actions and their entitlement. Take the recent rights issue on Peugeot Citroen—the legal restrictions regarding shareholders outside of France added a significant amount of complexity when determining eligibility both within the EU and outside.

McMahon: Corporate actions have always been a complex issue. It is one of the last bastions of risk in financial services. Corporate actions events are complex. They are different from one country to another, from one region to another and are definitely not getting any simpler. In many ways, managing the complexity is the challenge is more of an issue rather than corporate actions becoming more complex.

Jones: Processing corporate actions has always been a complex task. A single event may involve hundreds of different market participants (including custodians, fund managers, broker-

dealers and depositories), ultimately cascading down to tens of thousands of investors. Each of these participants faces high risk because corporate action processing is complicated, deadline-driven, not standardised and, to a large extent, still manual.

A variety of factors have affected both the volume and complexity of corporate actions in recent years. Competitive and regulatory drivers have increased cross-border trading, and derivatives such as swaps have become relatively common portfolio holdings, for investment or hedging. As a result, corporate actions are also growing in volume and complexity.

Globalisation drives security master complexity, and wreaks havoc on systems that are not initially designed to be multi-currency, multi-exchange—and there are lots of these. The ability to provide corporate-action-adjusted pricing across secondary markets is more difficult than, say, a US-only view of the security. This, coupled with the difficulties surrounding reference data governance, is a significant challenge in the corporate actions space.

There is also a growth in cross-border corporate actions. This occurs when a security in one country results in a security in another country. These cross-border corporate actions further increase a corporate action's complexity.

Wright: Corporate action operations have always been complex, and why most financial service firms put their best and most knowledgeable people there. However, the economic crisis and the likely need for refinancing will only cause the investment banks and corporate advisors to come up with more and more creative ways of raising capital or refinancing companies. Although corporate actions can be complex, they can also be simple, in that the emphasis is always on data and communication. If these two pillars of settlement are efficient, any complex action should be within the capability of the department to handle.

Kruse: Complexity of capital events has increased significantly within the last two to three years. This trend will likely continue for the foreseeable future and will remain a big challenge for participants in the corporate action lifecycle. Whether it is a large-scale event such as the recent Greek bond restructure or a cross-border merger, it is increasingly difficult for legacy systems and older standards to be applied to an event with upwards of 30 options, rules for eligibility or local market requirements.

What are the biggest problems around issuer-to-investor communications for corporate action announcements and how can these be addressed?

Wright: This depends if we are talking about UK domestic or international markets. In the UK, the registrar has a pivotal role communicating between the issuer and the investor. Other international markets might have another type of agency fulfilling this role. In the US, the legislation forcing issuers to standardise communication with the market is the model that I think will be adopted internationally. The use of XBRL with a ISO 20022 message within it would allow the issuers to send a standard electronic message to the market for redistribution without the need for embellishment. Therefore, eliminating the need to data cleanse or the need for the firm to buy multiple lines of data. It would also allow the corporate actions information in a single ISO 20022 to be broadcast over the internet.

Kruse: A lack of issuer standards across the globe remains the biggest challenge for issuer-to-investor communications. The DTCC/SWIFT/XBRL initiative is certainly a positive step towards creating better and more consistent standards and delivery mechanisms, which will lead to better and more consistent downstream application of the information that is contained in those communications.

McMahon: From the SWIFT perspective, we believe that one way to solve this problem is to enable the issuers with technology that would allow them to digitise their corporate actions announcements. Issuers are required to produce documents containing information related to a corporate action, which they all do today. The challenge is getting the issuers to implement that approach, which would be a big change from what they do today. To get issuers to change the current process, the industry needs to create the right incentives to encourage digitisation of corporate action documents at the issuer level or issue mandates, which are aggressive and could place additional burdens on issuers as they already have many mandates to follow, particularly in the US.

With the downstream communications (depositories to custodians and investors) the challenge to digitise seems less of an issue as many depositories and custodians have been using automated technology, either from proprietary systems or messaging formats for a number of years. We continue to see growing interest from that community to adopt new messaging standards for corporate actions (eg, ISO 20022). Again, some great progress is being made in the US with the DTCC re-engineering project for corporate actions.

Jones: Each issuer of a corporate action (the corporate involved) can have a different way of representing the event and a different way of reporting it. It is true that there have been a number of efforts to standardise both, but this still has some way to go even in the developed financial markets, and has yet to get off the ground in any meaningful way in the emerging economies.

This raises a fundamental obstacle to the automation of corporate actions—the lack of standardised reporting of events. This is an essential pre-requisite to the ability to systematise and ultimately automate this process, and progress towards this goal is dependent on these standards being put in place.

In addition to the lack of standardised event reporting is the complete lack of an official event identifier. With the many market participants that receive and subsequently pass on corporate event notifications there is still no official reference or identifier that is associated to the event to enable all parties in the chain to immediately and correctly identify the event that is being reported.

Ultimately, the only way that these issues will be resolved is via enforcement. It is difficult to build a business case for any party to take on the overhead of initiatives in these areas even if the benefits would be considerable.

Bermingham: Issuer to investor communication has already been cited by the industry as one of the stumbling blocks in creating STP for corporate actions processing. The multiple ways and formats that corporate actions information is distributed by the issuer is the basis for many errors and delays in the process. The inefficiencies of this communication process have given birth to a cottage industry in which data vendors, data cleansing application providers, and 'golden record' service firms all vie to offer a suitable answer. Regulators, such as the FDIC in the US, have mandated use of XBRL for balance sheet reporting and have found success with the format. SWIFT, DTCC, and the XBRL US organisation explored this option for corporate actions. While that initiative remains somewhat in the theory stage, DTCC has continued with deploying SWIFT's ISO 20022 standard in the US. After a successful pilot phase, the next planned step is to increase the number of participants (early adopters).

However, the real key is getting adoption in other markets besides the US. Regarding XBRL, it is worth mentioning that DTCC also has an initiative in the US market regarding the American depository receipts (ADR) market, which is comprised of a set, limited number of 'issuers' in the form of the banks that issue ADRs. XBRL may be the best approach in such a controlled environment. **AST**

Fasten your seatbelts

The risk of default is always there, but collateral management has evolved and is easing the burden, as AST finds out

MARK DUGDALE REPORTS

The risk of counterparty default became a reality when Lehman Brothers collapsed in 2008. The adage 'too big to fail' was tested and ultimately proven wrong, teaching financial institutions some hard but important lessons about the risks that they take.

The risk of counterparty default is one that has always been there, but it became more pronounced when Lehman Brothers went into bankruptcy. James Tomkinson, who is a specialist in collateral management and OTC derivatives at Rule Financial, says that the failure of Lehman Brothers made other financial institutions realise that they needed to focus more on the solvency of their counterparties.

"When Lehman Brothers went down it all came into focus in one big, painful experience," he says. "Before the collapse the focus was about the return on capital, afterwards it was all about return of capital—as counterparty risk became the number one priority."

"Prior to the financial crisis, the relationships between financial institutions were relatively simple," according to Richard Glen, head of global securities financing sales for the UK, Ireland and the Americas at Clearstream.

He added: "Many financial and non-financial institutions were happy to place their cash directly with each other on an unsecured basis without receiving any collateral in exchange. This type of transaction generally rolled from one day to the next and if the receiving counterparty were to go into default, be placed in administration or go through insolvency, the unsecured cash would be gone with a claim against an administrator being the only hope of compensation."

A close shave

The collapse of Lehman Brothers and the financial crises that ensued underlined collateral management as a means of mitigating counterparty risk, according to Ted Leveroni, executive director of derivatives strategy and external relations at Omgeo. "Collateral management is the most effective process for managing a risk that often changes dramatically day-to-day," he says.

Leveroni likens collateral management to wearing a seatbelt in a car—"they are both 'measures of last resort". He explains: "You can manage collateral incorrectly for a long time and never get burnt by it, much like you can drive and never wear a seatbelt. When there's a problem, you want to be wearing a seatbelt and you want to be managing collateral correctly."

Collateral management has changed as financial institutions—most notably on the buy side—have increased their focus on it. Mark Higgins is managing director for Europe, Middle East and Africa business development at BNY Mellon Global Collateral Services, which was recently established to bring together BNY Mellon's global capabilities in segregating, allocating, financing and transforming collateral for its clients, and encompass the firm's broker-dealer collateral management, securities lending, collateral financing, liquidity and Derivatives360 businesses.

Higgins says that his firm's collateral management services are changing to meet the new demands of clients. "It's evolving. We're taking what we have on the shelf for a traditional problem and reapplying it to a new problem. In the case of a triparty model, which is traditionally there for repo and stock loan, we've now reapplied that as a way of allocating collateral into a clearinghouse from a broker or direct vendors. It's all about optimisation and efficiency, and rather than having a physical delivery of assets, it's about using triparty books and records. That's how we've evolved. We've taken something that we've done for more than 20 years, found a new need for it and twisted it to fit."

On the formation of Global Collateral Services, Higgins explains that the group has been established to give broker-dealers and institutional investors the operational control, comprehensive capabilities and added precision that they need to manage collateral more effectively and efficiently.

He says: "Segregation is a key part of that and can be done in multiple ways, depending on whether it's the buy side or the sell side. This is the same with the other pieces. What you're doing is trying to address the buy and the sell side in a sensible conversation. For example, the buy side could be required to post and receive initial margin for uncleared trades. Normally, I'd be talking to each side separately about themselves, but now I need to be talking to one side about both sides' obligations in the same conversation. It's all about gluing together all parts of the industry."

Collateral management also represents a method of increasing returns in a market that many say is yet to fully recover from challenging financial conditions. Saheed Awan, head of global collateral services at Euroclear, says that if an institution is placing cash into safe instruments, rates are currently negative, "so it makes sense to move to the securities collateral model."

"And there, the price setting of securities lending has shifted more to the borrower. Securities lending volumes are currently depressed and borrowers are looking at how to make a return. This is where collateral management comes in nicely. If you are able to have flexibility in the type of collateral that you can give, for example, equities indices or corporate bonds, and the lender finds it agreeable, you and the lender can generate more loans. The flexibility of eligible collateral is now the name of the game."

He adds: "A good triparty collateral management service provider should give you flexibility as well as safety. For example, as a collateral taker your triparty provider should allow you to take many different types of securities as collateral and diversify the risk of accepted collateral with concentration limits on the different types of assets and names that you will accept. It requires a very sophisticated and automated collateral management service to manage the collateral commitments during the entire life cycle of the loan." **AST**

Back to the 21st century

AST talks to David Little of Calypso Technology about the collateral landscape and the need for innovative technological solutions to address it

MARK DUGDALE REPORTS

In what ways has collateral management changed in the last few years?

There have been a number of infrastructure changes implemented at all levels within custodians, central counterparties (CCPs), central banks, and sell- and buy-side organisations to improve the efficiencies of collateral processes. Operating model changes and re-platforming have influenced projects large and small to advance their collateral capabilities.

We have also seen the arrival of new service providers. Third-party reconciliation and workflow platforms have aimed to improve efficiency, optimising the use of assets, lowering risk by managing haircuts and concentration limits more frequently and accurately.

Is collateral management a profitable business, a risk mitigation strategy, or both?

It is a risk mitigation strategy with some profitable aspects for larger participants. In part, triparty providers have historically provided a profitable and very useful service to the market. In the future, collateral transformation will prove to be a lucrative business to be in as well.

How are firms that act across multiple product lines integrating collateral management into their operations?

Quite simply, it breaks down the silos by having a system that can operate across multiple products. It eliminates segregated inventory pools for the most efficient processing by providing a holistic view of the firm's holdings. Frequently, this is done under a collateral optimisation initiative that may or may not include changes to collateral processes and systems.

How should the need for high quality collateral in large quantities be balanced?

Going forward, the two principal mechanisms for dealing with larger amounts of collateral that will be needed are a broadening of collateral eligibility and use of collateral transformation services. Both are important and have a role to play in maintaining this equilibrium. Much has been said and written about CCPs broadening the eligibility of the collateral that they will receive, including scare stories about a 'race for the bottom'. In our experience, clearinghouses are highly responsible risk management organisations and their consideration of broader collateral eligibility is an appropriate and much needed improvement to the collateral landscape. When considering broader collateral, taking haircuts into account is an appropriate measure counteracting the simple notion that broader eligibility means increased risk. At appropriate haircut levels, corporate bonds and other lower grades of collateral can represent a very secure risk mitigation service in a scarce high-grade environment.

How is technological innovation shaping collateral management?

You'd expect supermarkets and delivery firms to use sophisticated algorithms to optimise supply chains and process efficientcy. Yet most large banks are still managing their collateral manually. A large bank would have thousands of counterparties, each with different eligibility and haircut definitions. As a result, it is beyond the power of any human mind to optimise the allocation of available inventory against those obligations. Collateral optimisation is a new category and Calypso is the first solution provider to bring sophisticated algorithms to take on this challenge. It provides practical, quantifiable optimisation benefits that bring collateral into the 21st century.

What is having more of an effect on collateral management—regulatory change or market demand

The cause and effect is much aligned: the market was increasing its use of collateral before the regulators intervened. The regulators have reinforced that trend strongly for a very good reason, because collateral works and is a highly effective mitigator of credit risk. In all previous crises, collateral has successfully limited the effect of defaults, which is why both markets and regulators have increasingly sought to eliminate unsecured exposures and why collateral has become so important and pervasive.

What are your thoughts on CCPs and clearinghouses?

They are increasingly becoming very important hubs in the collateral world. For this reason, the efficiency of CCPs in managing cash and securities collateral is becoming more important than ever. We're seeing all major CCPs investing in their collateral systems to be able to improve their capabilities. These improvements are much needed in the market and should result in streamlined operations as they are rolled out.

How many CCPs today could accept 10,000 lines of securities collateral and manage 1000 substitutions tomorrow? CCPs need to and are scaling up; they are scaling up their systems to meet this challenge and will become major collateral players. To demonstrate this trend, three major CCPs have selected Calypso in 2012 alone. The need for a sophisticated, single-platform solution is now more apparent and we are pleased to be able to address market needs.

If these aren't the way forward, what are the alternatives?

Many organisations are queuing up to offer collateral services, including clearing member firms, prime brokers, triparty agents, international central securities depositories and other custodians. Each have their strengths and their part to play in a connected world. AST

Call to action

Hervé Valentin of SWIFT outlines why issuers and investors need to put their heads together to solve the corporate actions processing problem

Corporate actions processing remains one of the last bastions of risk in financial services. It is a horror show of paper and the related misinterpretation about what is on the paper, accompanied by manual processing and near-zero STP rates. Why? The current approach inserts risk deep into the system at a mammoth operational cost, which is driven by the need to multi-source, scrub, reconcile, and often manually re-enter data.

Understanding the problem

Worldwide, there are close to one million complex corporate actions announced every year, coupled with another 10 million corporate actions announcements, with approximately $1 billion lost to error and inefficiency during the processing of these actions. This is because the lack of a standardised way to generate corporate actions 'data' immediately at the time of an issuer/offeror's announcement effectively delays the communication of this information to investors, burdens their intermediaries and maximises the possibility for erroneous or inaccurate communication of the necessary details. In a global interconnected world, the problem is especially acute, as remedies are hindered due to the constraints of time zones, language barriers and jurisdictional differences.

Despite the large costs that are associated with errors in corporate actions processing, up to now the process by which corporate actions are filed and processed has been largely manual and lacking a global standard for communication. This is surprising. We live and work in an age of asset-class automation. STP initiatives have taken hold in other asset classes and operations, but corporate actions processing seems almost consigned to a life in the shadows of the arcane, lurking in a system of paper-based regulatory filings and newspaper-to-custodian notifications.

Good news

Financial messaging standards—created as a way to standardise communications between counterparties, both ISO 15022 and the newer ISO 20022, have set the industry in the right direction in terms of moving the automation of corporate actions forward. ISO 15022 was great and moved us part of the way there, but ISO 20022, with its flexibility and ability to link messages to business processes, will help to get our heads around the corporate actions problem. SWIFT remains committed to working with the industry to roll out ISO 20022 on a global basis and intends to build onto the efficiencies that have been gained through the adoption of ISO 15022 (ISO 20022 messages for core corporate actions have been developed in such a way to make them backward compatible with the ISO 15022 messages, which means for those not ready to move to ISO 20022, those messages will continue to be supported by SWIFT).

Market practice guidelines—industry collaboration to agree and define different interpretations of standards usage rules and market practices. Market practice guidelines for corporate actions were updated by the Securities Market Practice Group in 2011.

Market practice assessment tools—central applications that enable industry participants to test the compliance and efficiency of IT systems with published standards and market practice are being used more regularly by market participants across the corporate actions lifecycle.

Industry collaboration—no single organisation is going to solve the corporate actions problem alone. Market infrastructures have an important role to play in helping to solve the issues with corporate actions. Many of the market infrastructures will drive the implementation of ISO 20022 and we're already seeing this with a number of key players across the globe. The Depository Trust & Clearing Trust Corporation in the US market has taken a leadership position by announcing its plans to migrate from its proprietary formats to the ISO 20022 standard for corporate actions. We're also seeing more interest in key geographies, such as Asia, where some market infrastructures are also looking at ISO 20022 adoption, including Japan and China.

Tomorrow's good news

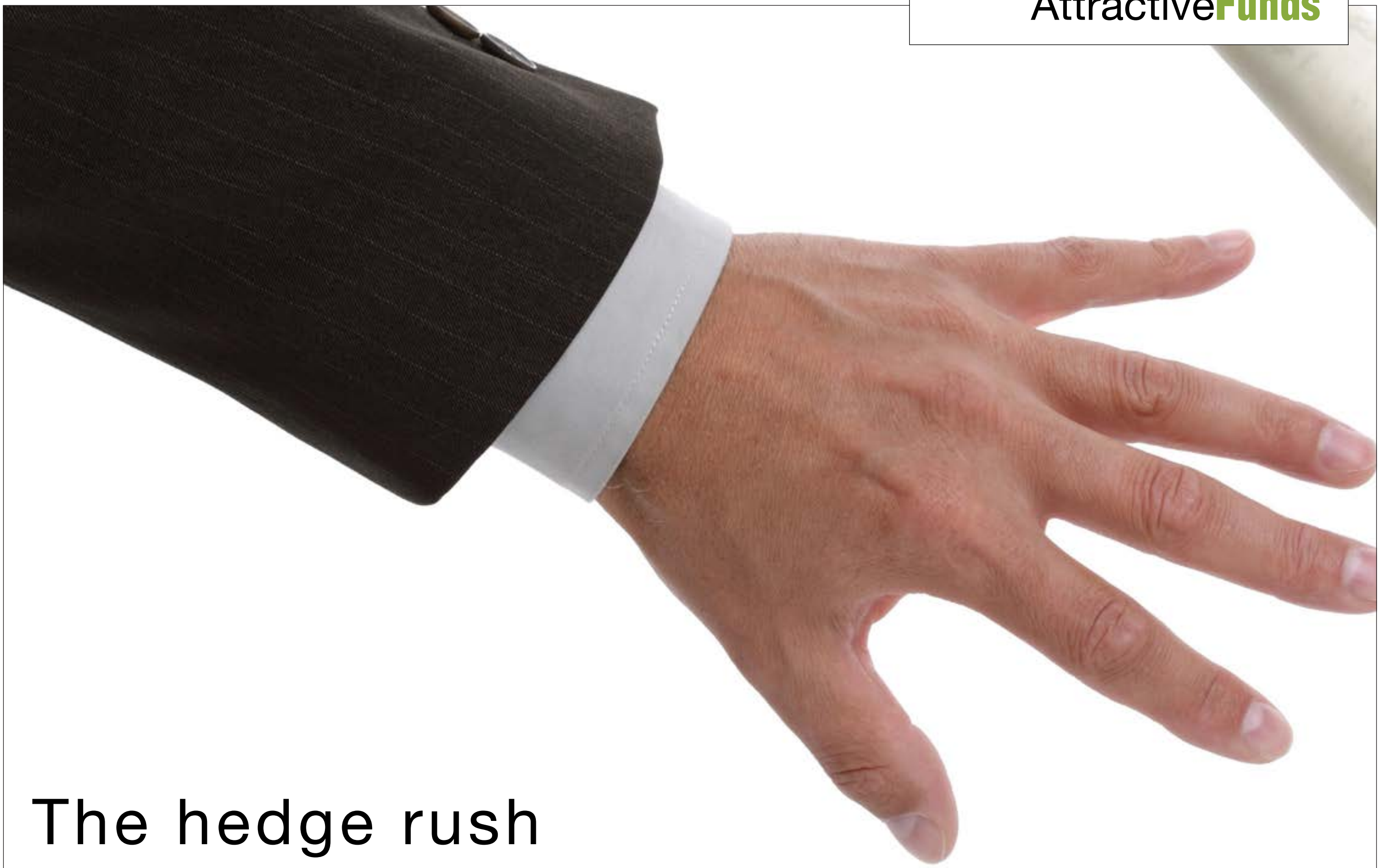
Educating the investors—investors are not to be forgotten and as shareholders they are in a great position to help educate issuers. Investors can help their investor relations people to better understand how the many manual steps have created an error-prone process with the potential for heavy losses at all levels.

Capturing data at the source—for years, we've believed that the only way to completely solve this problem is by capturing information directly from the source of the corporate actions announcement—the issuer. We have said the only way to do that is to turn free form text—as the corporate actions announcements are issued today—into computer readable and easily consumed information. By standardising the information at the source, it is believed that the industry can realise reduced errors, cost and risk as well as increased transparency. While we stand by these statements and believe this concept to be true, are we asking too much of issuers? Is there another way?

What should we do now?

Creating a seamless process for corporate actions that goes untouched by human hands and passes directly from the issuer to an investor looking to make timely and well-informed investment decisions should be a top priority. We need to look at the data and not just talk about what this means and the effect at a theoretical level. By looking beyond the qualitative measurements of harmonisation guidelines and quantifying the progress of STP in corporate actions, we can benchmark best practices and identify the true pain points across the process. If the few things holding us back are education and finding a way to standardise corporate actions information from issuers, now is the time to put our heads together and move this forward one way or another. **AST**

Hervé Valentin
Head of asset servicing, securities markets
SWIFT



The hedge rush

Keith Hale of Multifonds looks at the institutional investors who are flocking to hedge funds

As the saying goes, there are only two guarantees in life: taxes and death. In today's age of austerity and poor public opinion of financial services, hedge fund managers and their administrators must deal with the former, particularly from an institutional investor perspective.

Taking a step back for the moment, hedge fund managers and their typical high net worth 'sophisticated' investors, often favour limited partnership structures particularly in US (eg, Delaware) or offshore (eg, the Cayman Islands), enabling the tax implication to be passed down to the partners rather than applied at partnership or fund level. Limited partnership structures also give the manager other benefits such as investor specific incentives fees. Hedge funds can take different approaches, such as unitising the structure, and equalising performance fees across investors or creating a series for every dealing period, which are more common approaches in the Europe. Then tax may need to be considered at the investor or the fund level dependent on the domicile of either.

Growth of institutional investors into hedge funds

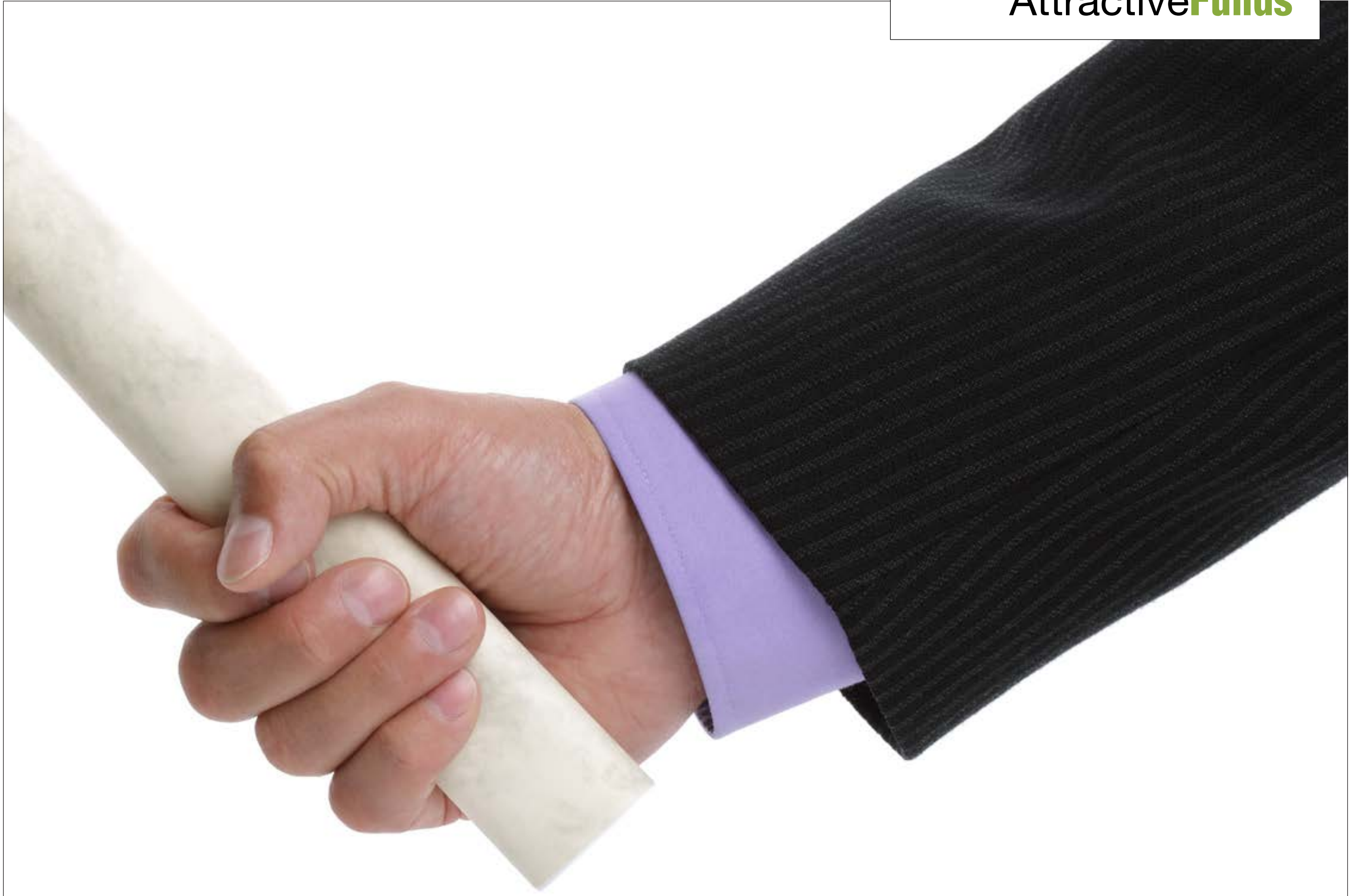
There are numerous surveys and predictions indicating an ever-increasing growth of institutional investors into hedge funds. This continued growth is not surprising, given the perfect storm of low interest rates and high market volatility, combined with traditional underfunded pension schemes looking for better returns to make up the deficit. Hedge funds generating alpha, at the same time as reducing the impact of market volatility, as well as diversifying risk, all make sense to the institutional investor assuming that it can be delivered by a hedge fund.

However, institutional money comes with additional challenges for the manager and its service providers. The traditionally cautious institutional investors' expectation in terms of risk management, transparency, liquidity, as well as fees is likely to have a significant impact on how funds are structured, where they are domiciled and how they are administered, including how tax is treated at the fund or investor level. In other words, hedge funds are being driven to become more long only in their characteristics due to the inflows of institutional money.

The AIFMD catalyst

The Alternative Investment Fund Managers Directive (AIFMD) in Europe is a further catalyst for this potential seismic shift to the hedge fund industry. For example, to meet AIFMD obligations to market the hedge funds to European investors, such as third party depository, independent valuation and more transparency to portfolio holdings, to get the EU passport for hedge funds, it is becoming likely that the funds may well re-domicile or co-domicile the fund in Europe in order to further increase its attractiveness to the European institutional investors. Particularly given that by 2018 the private placements regime in Europe may be required to end. This begs the question, which structures and domiciles do hedge funds in Europe adopt to continue to make them attractive to institutional investors as well as their high-net worth investor base? This is at the same time as correctly dealing with the tax implication of the domicile of the fund and indeed the end investor.

With AIFMD looming and European investors considering their options, it isn't surprising that the two main European domiciles for alternative funds, namely Ireland and to a lesser extent Luxembourg, are both in the process of passing legislation by the end of 2012 enabling limited partnerships, and therefore tax transparency to be dealt with in a similar vein down to the investor level. The other option for a European domiciled fund will be to structure the fund using more typical European vehicles such as qualified investor funds, or possibly even a UCITS structure. Given the interest in absolute return



funds by retail investors, this has lead to significant growth in alternative UCITS funds, in other words, long only funds with hedge fund characteristics. This can then lead to dealing with another set of fund level tax treatments such as the European Saving Directive and/or the complexities of German tax.

Continued growth in Asia

With the Dodd-Frank Act in the US affecting the US investors and indeed any/all hedge funds with US-taxable investors, it will be interesting to see what the Asian markets adopt from a regulatory and investor standpoint. One simplistic view is that the new regulation in the West, combined with a tightening of tax legislation in Europe, might be lead to a wholesale move of the alternative fund industry to Asia, because it is easier and cheaper to manage and administer the fund in a region with lower tax rates than the West.

However, that would have significant implications for migrating one of the key centers of gravity for the brain trust of the industry, not to mention the consideration for investors' requirements in terms of fund domiciles and indeed structures used, in part to deal with local tax requirements. Although there will likely be continued growth in Asia, it is more likely that Western hedge fund managers and their service providers will adapt to the new regulation in the US and Europe, and indeed use it as an opportunity to grow their asset base by attracting more European institutional investors, and leveraging the AIFMD passport, for example.

The net result is that managers will create an increasing array of structures across a wider array of fund domiciles to attract institutional and even retail inflows, as well as high net worth. They will require their service providers to deal with their structures and domiciles with the associated and increasingly onerous and complicated tax requirements. On top of all of this, the investor and fund managers will expect this complexity to be dealt with by their service providers on the cost basis that they are used to.

Convergence of the fund industry

Simply put, the clear distinction between hedge or alternative fund manager and the traditional long-only manager will likely cease to exist. So from a service provider perspective, having completely high touch and therefore high cost hedge processing centres with extensive use of spreadsheets will be increasingly uneconomic. The need will be for operating models and supporting systems that can deal with the complexity of alternative funds, but at the same time cater for the tax requirements and automated processes typically associated with traditional long only funds. This convergence of the fund industry and the associated requirements is the basis for Multifonds's software product strategies.

The other option for hedge fund managers and their service providers is to ignore the changing of the guard in the industry, but that may well lead to the other guarantee in life. **AST**

Keith Hale
Executive vice president of client and business development
Multifonds

Deirdre Jennings

AST talks to Deirdre Jennings, Information Mosaic's business development director for Asia Pacific

What career path have you taken?

I have worked in the financial software industry since 1999 and have been with Information Mosaic for more than 10 years. Originally joining as a senior business consultant, I worked on the initial go-live project of our corporate actions solution, IMActions, and from there I ended up specialising in corporate actions.

I am the type of person who continually seeks new challenges, and after two years I moved into pre-sales consultancy where I was responsible for the bid management process in the UK and Europe.

In 2008, I accepted the role of business development director for Asia-Pacific and was asked to start up Information Mosaic's new Asian headquarters in Singapore.

After four fantastically challenging and busy years in Singapore, I was presented with the opportunity to open up Information Mosaic's Australian office in Melbourne. I am currently charged with growing the team and building on the business that Information Mosaic has already established in Australia.

How did you get into your industry?

I have a degree in chemistry and originally worked as a process research chemist for two years in the US before heading back to Ireland to do a PhD. I finished my PhD in Monte Carlo Simulation of Chemical Systems, but after four years of research, I decided that I didn't want to do academic research or computer programming. I talked to a few people and since I could research, analyse, document and communicate (ie, translate between completely disparate groups such as chemists, computer scientists and students), I decided to look for a job as a business analyst, or in management consulting.

Nineteen ninety-nine was the beginning of the economic boom in Ireland. I attended an open interview with a start-up financial software company called DreTec, which offered me a job as a business analyst. I was told afterwards by the HR officer that it was the direct manner in which I argued how the skills I'd learned during my PhD were applicable to the role of business analyst that actually secured the job, as they realised that I wouldn't be intimidated by the clients. I worked with DreTec for two years, and then followed the chief technology officer to Intrade, and then on to Information Mosaic.

To what extent did the industry meet your expectations?

I didn't know what to expect when I started as a business analyst but I absolutely loved the job. I enjoyed the interaction with the clients, the developers and translating between the two. I loved the adrenaline rush of researching a topic before a client meeting and the creative thrill of working with the developers on a solution to meet the client's requirements. My role is now in business development rather than business analysis, but I still think of myself as a consultant who helps clients to transform their businesses.

What would you change about your industry?

I work in the financial industry and yet when it comes to my pension, or trying to invest, I am mystified by the fees that the fund/pension industries are trying to charge. In the good times, when everyone was getting returns of 15 percent, these types of obtuse fee structures were okay. Nowadays, it's just not acceptable.

Advances such as mobile smart 'apps', 'big data' analytic tools and social media are enabling consumer education and empowerment like never before. At the same time, as a result of the global financial crisis, regulation is pushing the financial industry to more openness and transparency.

Though these two trends may seem like a threat, I believe that it's a huge opportunity for banks to win back the trust of their customers and to use IT to provide better services and increased transparency at reduced cost.

Do you have any role models in the industry who have helped or inspired you?

Grace O'Donnell, Information Mosaic's deputy CEO, has always been a wonderful role model for me. Her own business development talents opened up markets for Information Mosaic in the Nordic region as well as in Southern Europe. She has a technical background like mine, but has run sales, marketing, client relationship teams, product management, human resources and operations. She has risen to become the second highest executive for a firm that services the largest custodians and some of the largest financial firms in the world. She also gives back through volunteering for various industry organisations and women-in-business groups. She is also a very warm and genuine person who, for me, dispels the old myth of 'good guys finishing last'.

What are your ambitions?

To rule the world—not really! I would like to be able to educate, inspire and mentor the next generation of female executives in this industry. That in itself would be a worthwhile legacy.

What about your regrets?

I don't believe in regrets. Everything in life is a learning experience. From the PhD, I learned fortitude and perseverance, even if pure research wasn't for me. In my current career in financial services, I have learned a whole new industry, worked with amazing people, and it also afforded me the opportunity to travel around the world and live in some fantastic countries.

If you weren't in your current industry, what would you be doing?

I think you should aim to have at least four to five distinct careers in your life. My first was chemistry, my second finance, and my third is yet to materialise. I can start to see the outline, though, and I think that it will have something to do with management consulting. My last career may have something to do with teaching yoga and dance in an exotic location.

What are your interests and hobbies?

I suppose my top three would be travel, bargain shopping and dancing. One of the great things about living in Asia is that you can hop on a plane and be in all of these amazing countries in a few hours. I love experiencing the different cultures and also finding those quirky little shops and picking up that unusual top or amazing vase. To relax and keep fit, I dance—Salsa, Tango, Bollywood or plain old disco. Once you start dancing, you forget all of your worries and just live in the moment. **AST**