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Billions Lost Highlight Corporate Actions Tech Failures

Processing corporate actions is usually the last workflow to be automated, mainly due to the complexities involved and the weakness of underlying data. Wei-Shen Wong explains how this has changed over the last few years and what challenges remain.

Corporate-actions processing is rarely viewed as a high priority within trading firms. Like most operational processes, however, they are ignored at their peril, and if neglected, can cause enormous problems for any firm—in fact, they caused $1.65 billion of them last year.

That's the dollar value placed on lost revenue for untimely, inaccurate, or just plain bad processing of scrip dividends alone, a payment that gives shareholders the choice of receiving a cash dividend, or the equivalent in additional shares of the company.

This stunning amount was calculated by Greenberg Taurig in a whitepaper, published in December, which attributed it primarily to asset managers failing to optimize their decision-making on corporate actions. As such, the paper said, these money managers either lost money through their faulty processes or missed opportunities entirely.

The industry is leaving piles of money on the table each year—and for many firms, particularly in an increasingly challenging trading environment for buy-side outfits, this could mean the difference between securing a mandate or a redemption.

“Corporate actions are a binary decision. It’s ‘do you want X or do you want Y?’ and you would know how much X and Y are worth at the point of making that decision,” says Jonny Ruck, CEO of software vendor Scorpeo, which commissioned the whitepaper. “It’s fairly simple and easy. But it’s not quite as straightforward and easy as that when you put the mechanisms of what you really have to do together.”

Scorpeo’s edge in this game is apparent—the vendor sells software designed specifically to process corporate actions relating to scrip dividends—but the findings point to a wider issue in the industry, in that the automation of corporate-actions processing has, to put it simply, failed to keep up with modern trading.

The impacts don’t fall solely on firms, either—it’s the end investor that ultimately suffers.

Ruck says one of the conclusions from the data it has on corporate actions decisions, which goes back to 2010, is that the majority of big asset managers are not making these decisions in the most economical way. Instead, they are defaulting to the easiest choice possible.

This could mean that they are stripping the end-client of the extra value of that event. Ruck says while asset managers are aware of what they have been missing out on, the underlying clients are not aware and this is one of the factors holding asset managers back from making changes.

Automation Equation

Corporate actions—a term used to define an event occurring to a particular publicly listed security—have been viewed for a long time through an archaic lense, untouched for various reasons including the usual “it’s too complex” excuse.

Be it a straightforward dividend, capital reduction, share buyback, rights issue, or a stock split, these corporate actions, which will impact a security’s price or intrinsic value, paint a picture about a company’s financial affairs and how a corporate action could influence its future performance.

Automating this process has not been an easy task, due to the diverse and complex nature of some corporate events. Also, the fact that some events are voluntary—and, thus, difficult to anticipate—hinders the possibility of true automation of corporate actions, given that straight-through processing is the ultimate goal.

As with many other issues surrounding automation, the problem is mainly with the underlying data, which is usually scraped together from fragmented systems before going through a process of cleaning and normalization—if an organization has the ability to do so. Often, not even that much happens.

Vendors have, for years, attempted to market this as a service they can offer. They have the people, the expertise and the technology, so the argument goes. While it’s not mandatory to get a corporate-events datafeed from a data vendor, the information could prove to be beneficial. Lacking a datafeed that alerts to an upcoming event, organizations run the risk of receiving an event notification late in the lifecycle of the security. Alan Jones, business solutions director at SmartStream Technologies, says late notifications could mean standing by for days, if not weeks, for the details of the event as organizations would have to wait for their custodians to receive the event notifications, process them, and only then would the action be broadcast.

As a result, asset managers trading in the affected stock would not have been able to take advantage of previous knowledge of the event.

SmartStream's TLM Corporate Actions platform targets both the buy side and sell side, covering the complete event lifecycle from announcement capture to golden-record management, position management, event broadcasting and communication, election management, entitlement-generation and posting.

SIX Financial Information is one of the data vendors providing corporate action data to organizations. Joanne Chen, data consultant at SIX, said during a panel at the Asia Pacific Financial Information Conference held in Hong Kong in November that having the data in a structured and accurate manner is important for processes that will follow after the corporate action event is first ingested into the organization's banking system.

"A lot of clients are looking to automate non-complex event types, but you also see the clients who wish to but are unable to achieve 100 percent automation. This is primarily for those complex corporate action events that the clients are either reluctant or unable to automate," she said.

Meanwhile, Matthew Pountain, product lead and deputy general manager of international post-trade at Broadridge Financial Solutions, says it is still difficult to find a single "golden source" that can deliver data in a timely manner. He says all organizations should be looking at multiple sources of event data, including market data vendors.

"Of course, having multiple sources puts you in the position of needing to automate the generation of an internal golden-source record if the process isn't going to become very labor-intensive. An efficient 'scrubbing engine' allows you to put the rules in place about which source you want to trust in given circumstances and then only raise exceptions for the real discrepancies across the sources for human investigation," he says.

Pountain explains that, as there is a very complex trading landscape within large organizations, it is essential for all desks to be kept updated with the impact of an active corporate event on their positions.

"This information needs to be accurate and timely to enable traders to optimize their decision-making, whether that relates to tax optimization across geographies, scrip dividend arbitrage opportunities or just managing a currency exposure," he says.

There is also an issue that is becoming particularly pertinent in Asia: dual primary listings. SmartStream's Jones says when there is a dual primary listing, there tends to be different ex-dates. "If you have the data presented to you, and let's say the ex-date is today, and you think you can have an arbitrage opportunity. But in actual fact, you didn't realize that the event has already gone 'ex' in the other market the security is listed in. That leads to missed opportunities," he says.

But timeliness is only one half of the story; data quality is equally important. After all, if the machine is being fed bad data, it's going to spit out bad data in turn. "Why are we looking to enhance automation of corporate actions and reduce the manual touch points if we use bad data? If we're using bad data, we're just increasing the exception management process that staff and operations will have to deal with. I think quality and timeliness of data is equally paramount," adds Jones.

This is something that SmartStream works on with data providers such as SIX. “You can’t use one without the other. Using a data vendor will give the client real insights and notification of events, which leads to the facilitation of arbitrage trading, for example, and also to validating the custodian notification that is also flowing into the institution. The ISO data standard certainly facilitates automation and we’ve done a lot of work over the years making sure that the standardization of those data formats is absolutely facilitating the automation,” he says.

While increased guidance from the Securities Market Practice Group (SMPG)—a group comprising broker-dealers, investment managers, custodian banks, central securities depositories and regulators that seeks to harmonize market practices—is helping organizations to put structured data formats in place, it is another challenge to populate those templates. Those standards are intended more for external communication between parties, says Pountain.

“Large sell-side and buy-side firms will have highly complex internal processing environments and face a huge challenge in ensuring they have captured all trades and positions relevant to an event. In a large organization, you would typically find that in a given security there will be house inventory positions, client custody positions, financing positions with stock borrowed, stock out on loan or held as collateral, as well as a swaps desk with synthetic and hedge positions and then a whole range of exchange-traded options positions that would be impacted by the event,” he says.

This data is often held in disparate systems aligned to business units and further fragmented by geographical boundaries. Pountain says many firms are still not yet at the point where they have defined the internal standards necessary for efficient data communication around their organization to bring all this data together.

Continuous Challenge

According to messaging and standards provider Swift, processing corporate actions is complex because there are more than 70 event types, and a certain event may point to a mandatory action or offer voluntary participation, with multiple options. Events can take months to process, dealing with position changes, settlement and distribution. Any errors in the process can result in significant financial and reputational losses.

For all the existing challenges in automating corporate actions, it is a space that is evolving and improving. Historically, firms have looked at existing internal systems that may provide the ability to calculate the entitlements of a limited number of mandatory event types, and thereafter considered their corporate-actions processing automated, Jones says.

But now, it is possible to automate the entire event lifecycle within a processing platform that delivers instant visibility, real-time processing of events, control check points, alerts, audit and metrics.

Other factors that make automation easier and more effective now include the continuous evolution of data standards. “Standardization facilitates automation, so as the industry as a whole gets to participate and influence the ISO messaging standards to ensure the nuances of each market sector and geographical location are catered for, it will only lead to a reduced number of exceptions being thrown within the event lifecycle. Also, correct adoption and usage of messaging standards by all parties if the event notification and processing chain is key,” Jones says.

If the messaging standards are misinterpreted by one party in the flow of data, this can cause unnecessary breaks in the automation of the event lifecycle, Jones adds. Therefore, it is important for service providers to have open communication channels with their clients so any issues in this area can be addressed.

Adoption of ISO 15022 and ISO 20022, which harmonize messaging standards, along with better recommendations from the SMPG, help increase automation on the market side, says Pountain. This includes advancements in digital-communications delivery, which allow client interaction to become a straight-through process for both advising clients of entitlements and capturing their elections where there are choices.

A key remaining challenge is ensuring all the various systems, especially corporate actions and accounting, talk to each other properly. Andrew Kouloumbrides, CEO at Xceptor, says while straight-through processing is the goal, the reality is streamlining. “A key area of focus here is transforming the data before it is pushed into the systems. With the industry increasingly using more market data, it is important that the quality of that data is validated before pushing into systems as less than 50 percent of inbound data is ready to process without intervention,” he says.

Other key areas that can be streamlined, which are often overlooked or considered too hard to automate, are the tax aspects, he adds. This is currently a highly manual process.

“However, with systems like ours feeding into core corporate-action systems, clients can start automating that part of the process too. This means they can easily identify which clients are subject to which tax treatments, eligibility for relief-at-source, regulatory changes, document management and generation as well as any other checks and balances. These are all added into an automated workflow, including any human validation that is internally required,” he says.

Kouloumbrides adds that this would benefit firms, and human validation as part of the automated workflow also ensures there is a clear end-to-end audit trail.

Although not every single corporate-action process will be suitable to be automated, if organizations are able to automate about 80 percent—comprising, traditionally, standardized actions such as cash dividends, interest payments, higher volume and mandatory type of events—then that will allow financial institutions to have their staff experts and operations teams focus on mitigating or managing the risk associated with the more complex voluntary events.

SmartStream is working with a number of organizations in the region and globally to help them onboard a corporate-actions processing solution, and it sees a trend for cloud or software-as-a-service environments. “We are seeing the trend for organizations to adopt pre-packaged, off-the-shelf corporate actions processing solutions with implementation in the cloud,” says Jones.

Therefore, clients can benefit from a packaged solution that delivers 80 to 90 percent of the business rule and workflow configurations they require out of the box. Also, the speed of implementation allows for fast activation and realization of benefits.

Although automation of corporate actions processes is on the rise, driven by ease and cost-effectiveness, getting the data right can still be an issue. The decision to obtain and monitor a few sources of corporate-actions data is still up to the organization and its priorities, whether it is making the most economical event decisions or taking advantage of potential arbitrage opportunities off corporate actions data.

Ultimately, the question is this: Is the investment required worth the amount of money left on the table, based on the earlier figure of $1.65 billion lost each year in scrip dividends alone, how large are complete losses across the range of corporate actions?