Demand on the rise

Against a backdrop of volatility, corporate actions are becoming riskier and higher in demand

Maddie Saghir reports

All over the globe, people are dealing with the disruption caused by the ongoing COVID-19 pandemic.

In the financial services industry, the pandemic has led to high levels of unprecedented volatility and uncertainty. Corporate actions is just one area of the financial services industry that has been greatly affected by the pandemic but it is an important one. While shareholders meetings and dividends are being cancelled and changed, the demand for corporate actions has increased. This is because companies that were due to pay a dividend that had already been announced are now cancelling those dividends. Amid all this, industry participants are seeing an increase in buybacks and delayed mergers.

For example, Philip Taliaferro, general manager, asset servicing, Broadridge, says banks in the UK were asked to defer their scheduled dividend payments. However, COVID-19 has increased the degree to which investors are concerned about the two key issues of corporate actions: governance and capital.

"Firstly, investors want to ensure that matters they deem critical; proper stewardship, responsible management, growth/investment discipline and of course environmental, social and governance, are being adhered to by management," Taliaferro explains.

He notes that the governance side of this equation, often referred to as proxy voting, is becoming ever more critical in the eyes of investors, particularly during a period of great economic uncertainty.

Elsewhere, on the capital side, Taliaferro expects that issuers will be faced with complex decisions about how to restructure debt, convert debt to equity and adjust dividend pay-outs.

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"Investors will be keenly interested in these issues and institutional investors, in particular, will be seeking to maximise investment return and arbitrage opportunities resulting from changes in capital return," Taliaferro notes.

Additionally, while the number of events may have decreased, for those events going ahead the recent market volatility has increased changes in ownership which are exacerbating underlying operational or technical issues, particularly as ownership changes over the course of ex date, record date and payment date, according to Taliaferro.

Adam Brill, vice president, product management, master data services, FIS, explains that COVID-19 has increased the volume of corporate actions.

Brill says: "Companies that were due to pay a dividend that had already been announced are now cancelling those dividends. Some companies pay dividends every quarter, and they may now start sending out dividend notifications saying that the June dividends are not going to ahead, for example, which is happening increasingly as a result of COVID-19. Unfortunately, over the next few months I think we will see a lot more bankruptcies coming across but that's the nature of the beast. COVID-19 has played a major part in corporate actions and it will continue to do so over the next few months."

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Challenging times

Looking at further challenges in the corporate actions space, specifically for custodians, Ankush Zutshi, head of product management, securities processing and corporate actions, IHS Markit, affirms that the biggest challenges for custodians in the corporate actions space emanate from the fact that even with continuous margin compression for both custodians and their clients, the costs and risks in the corporate actions space are increasing due to volumes increases, new regulations and market infrastructure changes.

According to Zutshi, these factors coupled with the lack of standardisation and manual processes built around legacy technology architectures further exacerbate the risk of errors and financial losses.

Discussing the increase in volumes, as noted earlier, Zutshi explains that there has been a significant increase in the volumes and complexity of corporate events as capital markets find new and innovative ways to raise investment, and governments and local tax authorities seek to recover taxation from investments via the introduction of new tax legislation.

In addition to these challenges, Zutshi highlights that there has also been the introduction of several new regulations as regulators look to protect investors and maintain confidence in market integrity.

He comments: "We are seeing newer regulations such as the second Shareholder Rights Directive (SRD II) increasing transparency around corporate governance and setting performance parameters by which intermediaries must pass on corporate event notifications to clients."

Meanwhile, Gerard Bermingham, managing director sales/business development, financial markets, IHS Markit, cites: "Market infrastructures around the world are also evolving. DTCC in the US is completing the reengineering of corporate actions processing to move to the latest

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ISO20022 standard. Various European market infrastructures, driven by T2S harmonisation efforts are following suit and the ones in Asia Pacific are not far behind."

Indeed, weighing in on this, DTCC said they believe that automation – use of application programming interfaces (APIs) and real-time messaging – can have a positive impact on the entire industry, from central security depository to custodian/broker-dealer, to asset manager to beneficial holder and even to the various agents that aid in facilitating processing.

A standardised approach

In terms of tackling these challenges, industry experts decipher that increased standardisation can help pave the way for a more accurate and efficient corporate actions process.

Bermingham highlights that changes to the corporate actions process require continuous product and technology change investments. He says: "With the growing demand from clients to provide accurate data and information on a real-time basis through modern open platforms and APIs, helping them optimise the investment decision process comes at a much higher cost to the custodians, especially the ones which are still using legacy technology architectures and that too at a time when margins in the industry have continued to be compressed."

"Whilst progress has been achieved by custodians in tackling these challenges through adoption of technology, the ability to fully optimise this investment is restrained due to other weaknesses in the investment chain who do not or cannot comply with industry reporting standards," Bermingham stipulates.

Fabian Nelissen, head of global asset services at Clearstream, also agrees that the biggest challenges probably remain: lack of standardisation, constant tendency towards more complex offers, issuer's persistence in reaching back to paper forms and tight deadlines.

"Corporate actions processing is an area of significant risk and one of the most manual, complex and challenging parts of back-office operations. Clarifying incomplete, conflicting or confusing information puts pressure on the timely delivery of corporate action events down the custody chain," Nelissen says.

Nelissen continues: "The volume of events depends on major factors in the financial markets which makes it volatile and difficult to predict, hence turning the allocation of the right level of resources a challenge. An increasing number of deals are customised to the needs of the issuer, which eliminates scalability within the corporate actions processing to a great extent. The necessary skills and expertise needed to effectively handle the events require a significant and growing investment both in staff and system."

DTCC concludes that the use of standardised, modernised, real-time technology can provide the industry with accuracy and efficiencies that will allow firms and individuals to make sound investment decisions and maximize their investment returns.

To discover more on corporate actions, please see issue 240 for more insights.

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