



Chapter 4 - Other Investor Services

10 Questions

Safeguarding

Safeguarding is when firms hold and protect the client's assets in their care and ensure that they have effective arrangements to meet the responsibility.

Failure to do so may lead to:

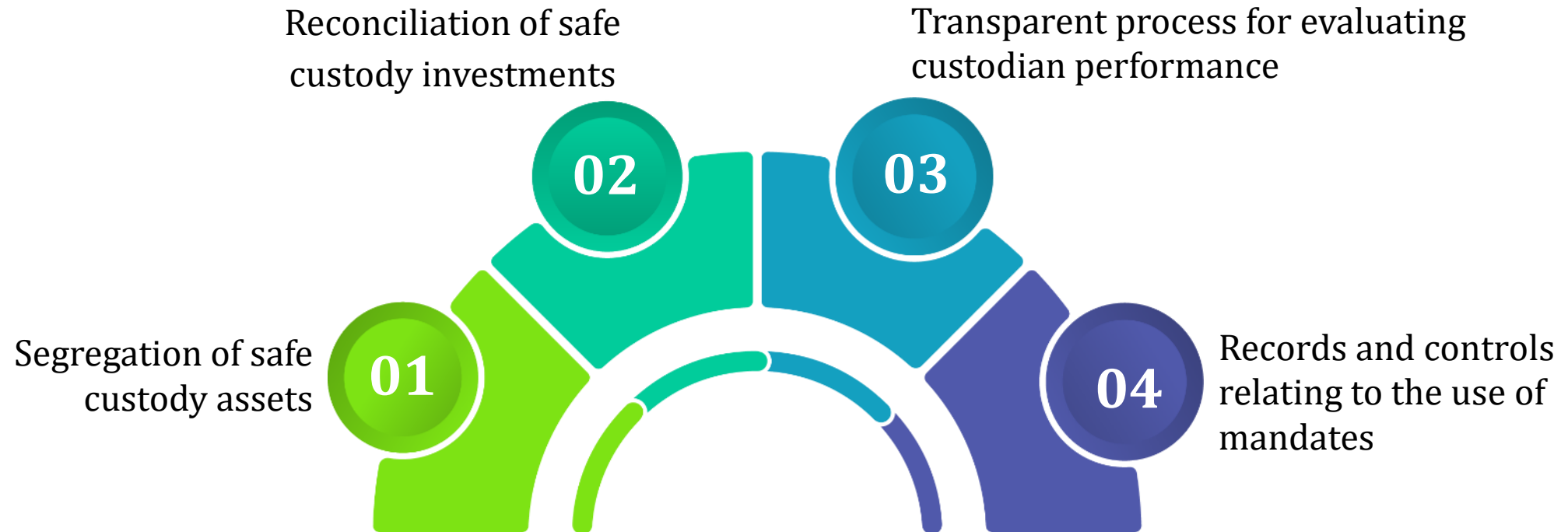


Assets used by the firm
without the client's
agreement



Assets treated as the
firm's assets in the
event of liquidation

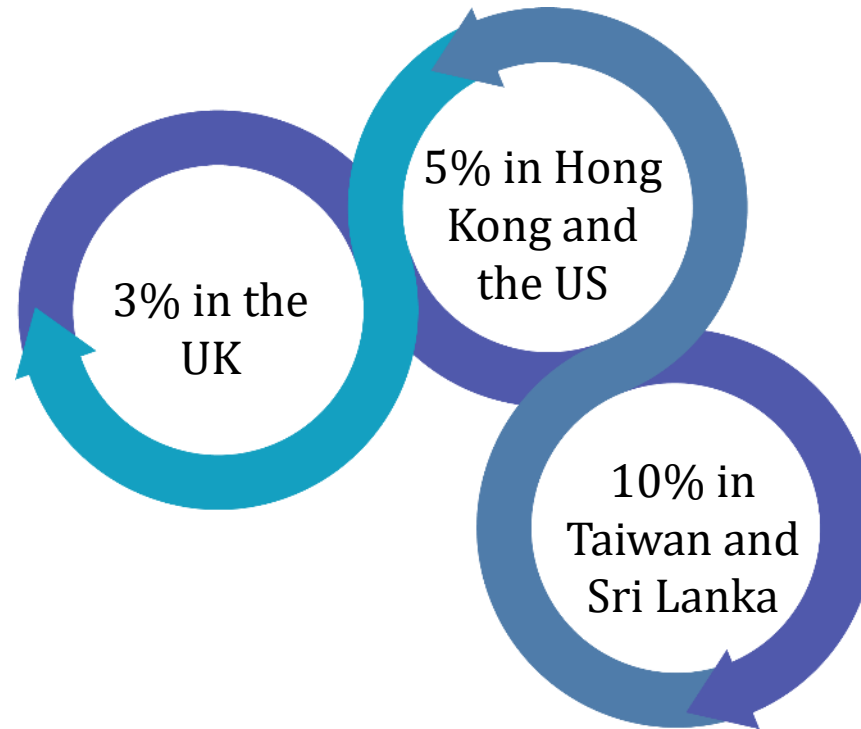
Main controls that a provider of custody services should undertake include:



Substantial Shareholder Reporting

Substantial Shareholder Reporting requires shareholders to notify a company when their ownership crosses specified percentage thresholds of the company's capital.

Thresholds vary by country. Examples include:



The Nominee Concept

Nominee Concept is where investors register overseas assets under a custodian or nominee for convenience.

Nominee holds legal title, while beneficial ownership stays with the investor



Custodians handle transactions and safekeeping via nominee companies



Nominee receives and processes shareholder communications based on investor instructions

The Nominee Concept can be classified into 3 areas:

- 1 Pooled Nominee Holdings (Omnibus Account)
- 2 Designated Nominee Holdings
- 3 Sole Nominee Holdings

Pooled Nominee Holdings Benefits

Aggregated Payments

Entitlements are paid directly to the custodian's nominee account, reducing individual payment processing.

Simplified Reconciliation

The custodian reconciles one holding instead of multiple beneficiary accounts.

Anonymity:

Only the nominee's name appears on the registrar, keeping beneficial owners anonymous.

Efficient Transfers:

Securities transfers between clients don't require reregistration, as the legal title remains with the custodian.

The Nominee Concept

The characteristics of Pool and Designated Nominee Holdings can be summarized as shown below:

Pooled	Designated
Company registrar maintains one registration for any particular company	Each beneficial owner's holding is registered separately
Nominee retains records of each client's holdings	Still in the nominee company's name
	With an additional identifying code

What is the primary risk of poor Safeguarding practices by a firm?



- A. Client assets may be used by the firm without their agreement
- B. Client assets may lose considerable value overtime
- C. Firm may be at risk of missing its yearly ROI targets
- D. Firm may show preferential treatment of certain clients over others

Custodian Fee Schedules

Custodian fees depend on business volume, relationship strength, client reputation, and other factors.

May negotiate better terms due to their size and reputational value.

Fee Types include:

Ad Valorem Fee:

A basis point fee on the value of assets held, often with a minimum fee



Transaction Fee:

Charged based on the number of settlement transactions processed



Custodians must inform clients of corporate events and process instructions accurately and promptly. Failure to do so may require compensating clients for any resulting financial losses.

The size of the loss may be uncertain until the custodian addresses the error (e.g., buying or selling shares).

Market fluctuations can increase potential financial losses for the custodian.

Risks for the Custodian (Voluntary Actions)

For voluntary actions, custodians must submit client instructions to the registrar before deadlines.

Custodians set a cutoff time to receive client instructions to meet event deadlines



If custodians fail to act on instructions received before the cutoff, they may be liable for losses.



Instructions received after the cutoff are processed on a best-efforts basis, with no liability for missed deadlines.

Mandatory Corporate Events – Dividends

Global custodians must provide timely and accurate information about the event and ensure clients' instructions are properly recorded

01

Dividend payments are a company's distribution of profits to shareholders, usually paid in cash but sometimes as shares.

02

03

Errors in recording client preferences, such as paying cash instead of shares, can lead to significant losses for custodians if the market moves unfavorably

→ Custodians are responsible for compensating clients if they fail to inform them of a corporate event, resulting in a loss of entitlement

Interest payments are a cash entitlement paid to holders of debt securities

They are predictable, with the payment amount (coupon rate) and timing (coupon payment date) announced at the issuance of the debt security

An exception is floating rate bonds, where the coupon rate varies with the benchmark interest rate and is not predetermined.

Capitalization (or bonus) issues are the distribution of new shares to existing shareholders at no cost, from the company's capital reserves



It is an alternative to paying dividends from accumulated reserves.



The total market value of the shares (existing and bonus) remains unchanged, leading to a reduction in share price.

Mandatory Corporate Events – Splits

01

Stock splits or subdivision involves converting one share into multiple shares, as decided by the company's directors.

They occur to make shares more affordable and attractive to investors by reducing the share price.

02

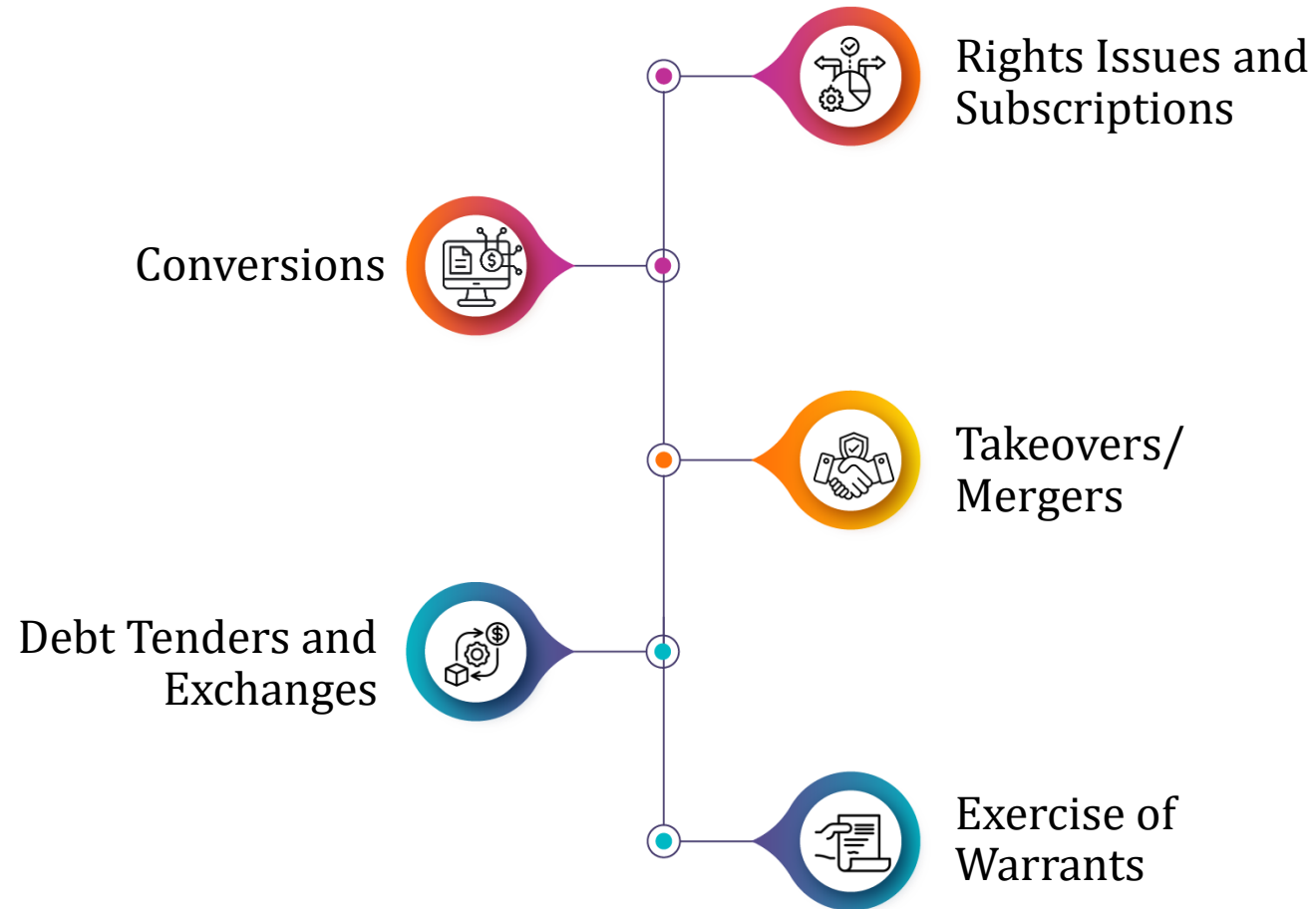
03

Other mandatory events include Consolidation, Capital Repayments, and Redemptions.

→ Let's go through a worked example...

Voluntary Corporate Events

Voluntary corporate events demand that the shareholder communicate whether it wishes to accept or reject the terms of the corporate action. These include:



Rights Issues and Subscriptions

Rights issues give existing shareholders the right to subscribe to an issue of new shares, usually at a discount to the market price.

Main stages include:

01

Distribution of the rights entitlement by the issuer to the existing shareholders

02

Shareholders elect or decline to subscribe to the offer of new common shares

03

Non-subscribed rights will expire at the subscription deadline

Voting

Shareholders have the right to vote on resolutions at company meetings.

Examples include:

Election of directors

Directors' remuneration

Issuance of new equity capital

Stock repurchase plans

Takeover bids

Appointment of a new auditor

Resolutions proposed by shareholders

Approval of dividends

Ex-Benefit and Cum-Benefit

When a company announces a dividend, it specifies the following:

01

Type of dividend

02

Amount per share

03

Record date

04

Payable date

Shareholders must own the stock before the Ex-Dividend Date to receive the dividend

Cum-Benefit

Security has been purchased **before** the ex-date / the **purchaser** is entitled to the dividend.

Ex-Benefit

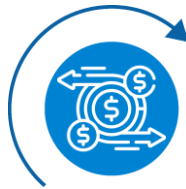
Security has been purchased **on or after** the ex-date / the **seller** is entitled to the dividend

Cash Management

Cash management refers to strategic policies to optimize an organization's cash resources.

Key responsibilities for a custodian in this space include:

Knowing when and where cash is needed to meet obligations



Detailed understanding of cash flows



Predicting short and medium-term cash flows efficiently

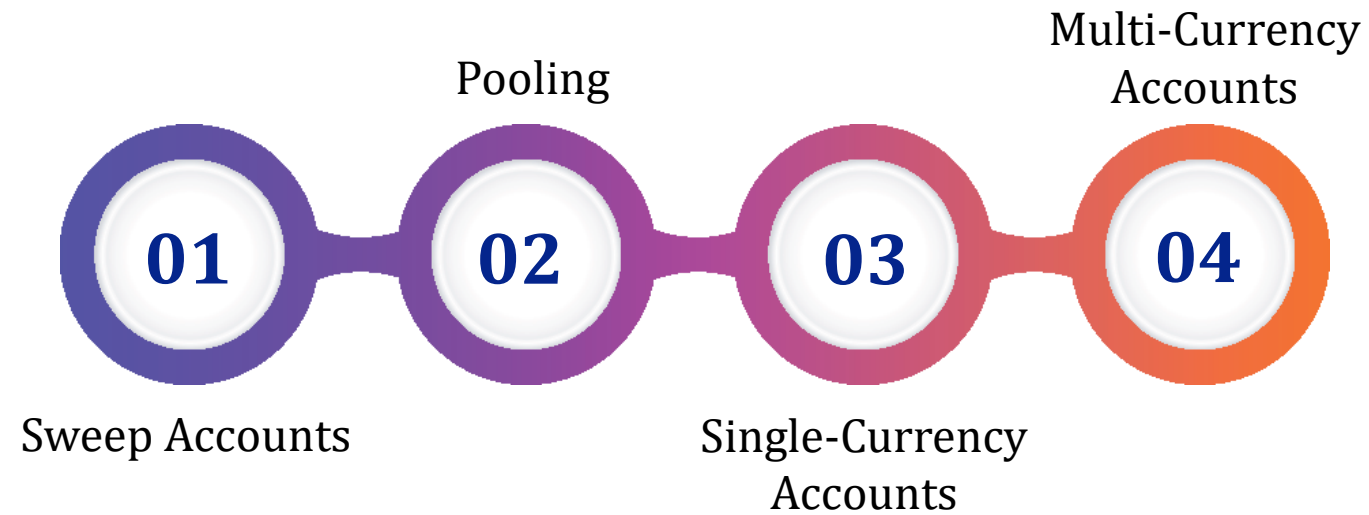


Safeguarding client cash with designated bank accounts in case of custodian insolvency



Cash Management

Custodians may administer the following accounts/techniques:



Why is SLB Employed?

Securities lending and borrowing (SLB) is a process where institutional investors lend out securities to generate additional income.

Lenders earn income from lending their securities, boosting portfolio returns

Borrowers may need securities to cover failed settlements, fulfill short-selling needs, or maintain liquidity for market makers

Risks Involved and Precautionary Measures

SLB presents the risk of the securities on loan, or the collateral, not being returned on the agreed date. Those securities will then need to be acquired in the market, potentially at high cost.

Risk mitigation measures include:



Detailed credit evaluations on the borrower



Collateralising loan exposures



Employ master legal agreements



Set limits on the lender's credit exposure

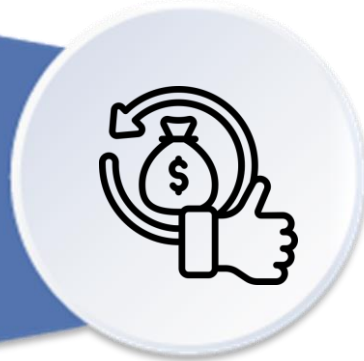


Mark exposures/ collateral to market daily & make margin calls

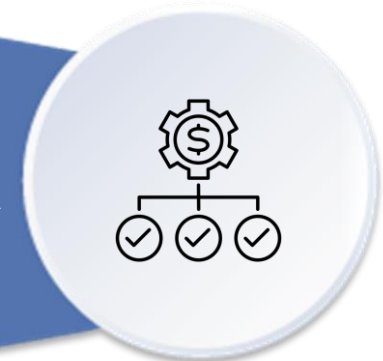
Repurchase Agreements

Repurchase Agreement (Repo) is a secured lending method involving selling securities for cash with an agreement to repurchase them later.

For the borrower, it offers a cheaper alternative to unsecured funding



For the lender, it provides an avenue through which it can generate income on its cash balance



Cash lender receives securities as collateral throughout the loan period.

Repurchase Agreements

The types of securities acceptable as collateral will depend on the risk appetite of the cash lender.

Some cash lenders may opt for lower quality collateral due to:



Better returns



Top-grade collateral is in short supply and expensive to borrow

Environmental, Social, and Governance (ESG) is a set of standards for companies that helps socially conscious investors screen investments before trading.

Environmental	Social	Governance
<ul style="list-style-type: none">• Energy usage• Waste and pollution management• Treatment of animals• Conservation of natural resources	<p><i>Relationships with:</i></p> <ul style="list-style-type: none">○ Employees○ Suppliers○ Customers○ Community	<ul style="list-style-type: none">• Executive remuneration• Shareholder's rights• Internal controls• Audit

What is the difference between the Ex-Benefit and Cum-Benefit periods for dividend payments?



- A. The seller receives entitlement in the Cum-Benefit period
- B. The entitlement is paid to the buyer in the Ex-Benefit period
- C. The entitlement is paid to the buyer in both periods
- D. None of the choices