

# THE ASSOCIATION OF GLOBAL CUSTODIANS

## STATEMENT ON THE NEED FOR UNIVERSAL, STANDARDIZED MESSAGING IN CORPORATE ACTIONS



JUNE, 2007

## ASSOCIATION OF GLOBAL CUSTODIANS

### Statement on the Need for Universal, Standardized Messaging in Corporate Actions

#### Introduction and Objectives.

Corporate action events involve substantial wealth transfers, yet various parties involved in the underlying message stream for those events do not use uniform protocols or automated messaging facilities. In this era of electronic communications, reliance on non-uniform or paper-based methods for communicating transactional details concerning corporate actions imposes unnecessary and substantial direct and indirect costs on intermediaries and investors and produces often-unrecognized, negative economic consequences for issuers. The Association of Global Custodians (the "Association") believes that progressive change at every stage of the communications stream is urgently necessary, and in order to promote change and identify priorities the Association has prepared this high-level White Paper aimed at all parties involved in corporate action messaging.

Previous securities industry papers that have described the need for change in corporate action processing have included recommendations to improve and streamline corporate actions, though many of those papers have focused on particular, isolated problems or issues and only some of the recommendations have been implemented. Similarly, various organizations have undertaken initiatives to improve messaging while others have publicized the importance of efficient electronic communications. Unfortunately, the International Organization for Standards ("ISO") protocol ISO 15022 still is not universally employed across the communications chain. This shortcoming is most evident at the beginning stage of an event, where issuers and servicing agents typically initiate the process using non-standard, often paper-based communications. In turn, these non-standard messages are then subject to non-uniform interpretation as downstream processors attempt to leverage standard communication protocols.

Given that history, this White Paper attempts to set out in one place a general summary of key problems that exist in the messaging of corporate actions and a set of recommendations for specific steps that need to be taken by various constituencies to unify messaging protocols and automate communications. In particular, as developed more fully below, the Association –

- encourages each of its member banks to demonstrate clear leadership by using ISO 15022 messaging for all aspects of the bank's communications on corporate action matters, including communications involving the issuers' agent unit(s) within the bank;

- supports immediate actions by other organizations – notably issuers and servicing agents -- that would lead to universal use of electronic facilities and universal messaging protocols;
- supports common solutions globally; and
- encourages active dialogue and cooperation among industry participants to resolve challenges and overcome obstacles.

### **Achieving Progressive Change.**

A. The Association encourages its member banks to play a leadership role in improving and unifying practices in a number of ways.

- Use the Global SMPG Corporate Actions Market Practice and Event Interpretation Grid (the “Grid Guidelines”) for all Global Custodian to Custodian traffic, wherever ISO15022 messaging is used.<sup>1</sup> Where individual jurisdictions or markets require variations based on local practice, reinforce the importance of continued movement toward uniformity and harmonization, e.g., on record dates.
- Use the Grid Guidelines for all outbound Global Custodian to Institutional Investor/Investment Management traffic where ISO15022 messaging is used.
- Use ISO15022 messaging and the Grid Guidelines in lieu of proprietary messaging formats whenever feasible.

B. The Association encourages its member banks and other organizations to work to extend the foregoing messaging principles and objectives beyond traditional communications between global custodians/sub-custodians and between global custodians/customers to include routine use by issuers, infrastructure organizations, and servicing agents. Certain complementary technology, including XRBL templates used by issuers for certain purposes (such as company reporting), may provide a workable foundation for transition to or interfacing with ISO15022 formats. The Association supports further study and consideration of ways to adapt such complementary technologies so as to optimize electronic efficiency in messaging.

C. The Association supports active dialogue among all industry participants to resolve common challenges and obstacles and to achieve uniform and streamlined communications practices. To this end, the Association, together with other organizations, intends to organize discussion forums periodically that are designed to promote dialogue and explore solutions.

---

<sup>1</sup> The SMPG Event Interpretation Grid can be found at [www.smpg.webexone.com](http://www.smpg.webexone.com) in the Corporate Actions/Market Practices segment of the site.

D. The Association supports efforts to achieve common solutions globally. We believe that, e.g., the solutions pursued in United States markets should harmonize with solutions pursuant to Giovannini recommendations for European markets.

E. The Association supports efforts to satisfy recommendations and proposals made in prior notable industry documents. We recognize the significant steps others have taken and seek to reinforce and complement that work.

- SMPG, for example, has worked to create common approaches to option numbering and event reference numbering. In so doing, they have highlighted weaknesses in current standards application and usage, including variations in option numbering caused by different interpretations of an event. This shortcoming affects the ability of asset managers to process an event in a homogenous manner -- each variation in option numbering must be individually processed and responded to uniquely. It would improve processing materially if each event was communicated with a single universal overview and all involved in handling the event communications used a uniformly constructed response. In particular, issuers' use of ISO standards would dramatically reduce variations in messaging and would alleviate the need to interpret announcements.
- The European Central Securities Depositories Association ("ECSDA") published a series of discussion papers concerning the Giovannini Barriers and ways to unify securities processing standards in the European Union. ECSDA proposals addressed to Giovannini Barrier 3 -- specifically the proposals to implement Standard 11 (notice to International Central Securities Depositories ("ICSD"s)) and Standard 12 (use of formatted electronic messaging throughout the communications chain)<sup>2</sup> -- constitute imperatives for improved processing.
- Euroclear, in its role as ICSD, has taken up these ECSDA proposals, issuing a request in June 2006 to ISO to create standard messaging protocols for issuers announcing event details to central securities depositories (including ICSDs). The Association supports the creation of ISO standards for these communications and recommends their implementation in Europe and elsewhere. We believe (I)CSDs and other industry participants could make important progress globally by engaging Euroclear and ISO directly in efforts to develop and refine these standards for all markets.
- In views expressed to the European Commission regarding the Giovannini barriers, the Banking Federation of the European Union has echoed the need for issuers to progress away from their traditional methods of announcing events by adopting uniform electronic delivery using ISO standard communications protocols -- thus ensuring use of standardized communications at the source and

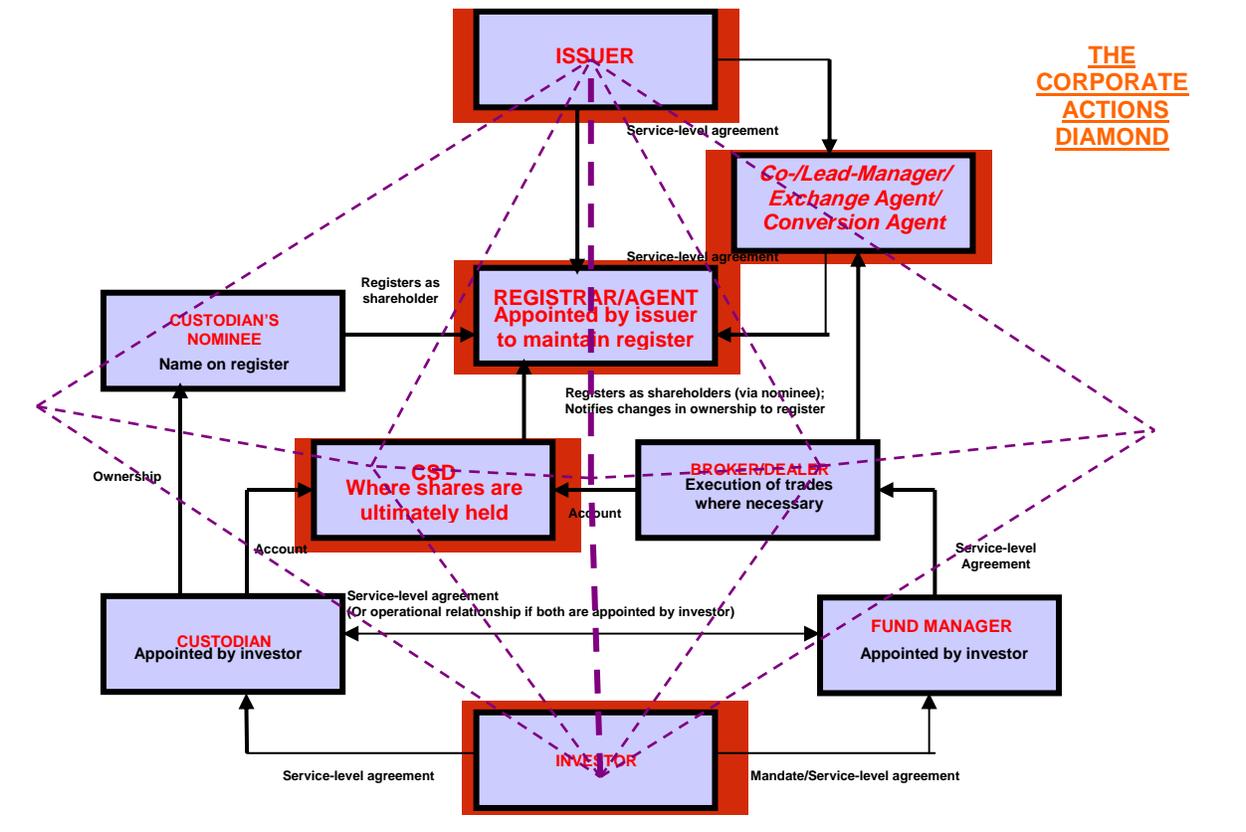
---

<sup>2</sup> The ECSDA Final Report of WG5 on Barrier 3 can be found at [www.ecsda.com](http://www.ecsda.com) within the Publications of Working Groups/Harmonization segment of the site.

enabling (I)CSDs to leverage such messaging as the central, essential links in the communications chain.

**Identifying the current messaging/processing problems, the challenges presented, and the benefits associated with change**

The following diagram, developed by the International Securities Association for Institutional Trade Communications, portrays the full lifecycle of corporate actions.



The corporate action “diamond” diagram above illustrates the level of complexity and risk inherent in the lifecycle of a corporate action event. This complexity and risk are compounded today because not all participants in the communications chain use industry standard messaging. As highlighted in the Introduction to this paper, to reduce risk and achieve automated Straight Through Processing it is imperative that all participants use industry-standard message protocols for the communication of corporate action notifications and instructions.

Looking at the current flows of information and focusing on event notification -- from issuer to investor -- through, variously, the relevant stock exchange, CSD, local custodian, ICSD, global custodian, fund manager, and broker/dealer, it is clear that the

core communications problems are **non-use** of, and **non-adherence** to, industry standard messaging.

**Non-adherence** to the existing standards is a generalized problem summarized in the Introduction to this paper. The “diamond” diagram notes in *red* where **non-usage** of industry standard messaging occurs. The table below documents the key issues and impact associated with **non-usage**.

**Impact Table.**

<b>Participant</b>	<b>Issue/Impact</b>
<b>Issuer</b>	<p><b><u>Issue</u></b></p> <p>Current notifications are published in varying formats on behalf of the issuer based on local market rules and conventions, usually based on delivery to medium that has reach across a required circulation. The issuer’s agent does not publish these notifications in an industry-standard message-based format. There is minimal regulatory guidance on content and timing; and this guidance, and the resulting practices, differ from market to market.</p> <p><b><u>Impact</u></b></p> <ol style="list-style-type: none"> <li>1. Potential for Investors to miss events</li> <li>2. High cost of issuance due to inefficient process</li> <li>3. Un-regulated output</li> <li>4. Poor take-up on event opportunities</li> <li>5. Disadvantaged Investors</li> <li>6. Poor reporting of event take-up and post event analysis</li> </ol>
<b>Co/Lead Manager or Agent</b>	<p>The issuer co/lead agent -- usually the advising broker -- is employed to manufacture the terms of the corporate action to maximize the goals of the event.</p> <p><b><u>Issue</u></b></p> <p>The complexities of events are increasing as companies use corporate actions to support more sophisticated</p>

	<p>corporate finance strategies. When creating events, the leads are under no obligation to conform to consistent terms or even common structures that would enable downstream automation of outputs. There is no mapping of event terms or components of event terms to underlying industry messaging.</p> <p><b><u>Impact</u></b></p> <ol style="list-style-type: none"> <li>1. Inconsistent articulation of similar events, which leads to subjective, interpretive categorization and the potential for the same event to be processed in the market by different processors in different ways. The consequences of this include but are not limited to -- <ol style="list-style-type: none"> <li>a. Disadvantaged investors</li> <li>b. Poor take-up</li> <li>c. Increased industry processing cost</li> <li>d. Increased risk for intermediaries</li> <li>e. Unpredictable impact on Share Price</li> </ol> </li> <li>2. Unstructured terms inhibit the progressive use of automation</li> </ol>
<p><b>Registrar/Local Agent</b></p>	<p>The Registrar or Local agent for the issuer (not to be confused with Sub-custody agent for the investor) is responsible for executing the corporate action in the local market on behalf of Issuers and is guided by the terms laid out by the lead/co manager/agent.</p> <p><b><u>Issue</u></b></p> <p>The execution of a corporate action in the market follows that market's local rules and conventions. There are currently no global market standards or protocols for the publication of a corporate action notification; and the publication, distribution and timeliness of the announcement varies dramatically by market.</p> <p><b><u>Impact</u></b></p> <ol style="list-style-type: none"> <li>1 Increased Cost to the industry in capturing and processing the event due to manual capture and</li> </ol>

	<p>need for research</p> <ol style="list-style-type: none"> <li>2 Increased cost in processing the event at the agent, which in one way or the other is passed on to the issuer</li> <li>3 Limited automation opportunity</li> <li>4 Increased risk to all in the chain</li> <li>5 Multiple interpretations of the event by collection agents, which causes inconsistency in down stream processing.</li> </ol>
<p><b>CSD</b></p>	<p><b><u>Issue</u></b></p> <p>The CSD's and ICSD's take on a role that encompasses some local agent and sub-custodian functions. This allows them to play an aggregator/consolidator role as the focal point for event distribution in their sphere of influence. Their position in the event lifecycle should lead to positive effects in terms of streamlined interpretation of events executed via the CSD. That is, the CSD as consolidator should be the prime source of the event information, although in the current context CSDs do not accept liability for the event information they distribute. In a context in which Issuers use standard communications, liability risk is likely reduced as the CSD/ICSD becomes a pass through of information published by the issuer in standard form, thus requiring less subjective (and less variable or inaccurate) interpretation.</p> <p>Some CSD's/ICSD's have moved toward distributing corporate actions via the industry standard ISO message set but this is not consistent across all markets, and is often a 'for profit' exercise, as opposed to a function of marketplace efficiency and/or risk mitigation.</p> <p><b><u>Impact</u></b></p> <ol style="list-style-type: none"> <li>1 A degree of automation is possible either via ISO or proprietary message formats, but the result is not uniform across markets.</li> <li>2 The CSD/ICSD's may require enhancements to the existing ISO messages to facilitate STP within</li> </ol>

	<p>their own systems</p> <p>3 Not all the CSD's have moved to industry standard ISO messaging.</p>

In summary, the table above underscores two key problem areas -- **Risk** and **Cost**. The industry widely recognizes that processing of corporate actions presents high exposure in both categories for all persons involved. *Particularly in this processing context -- where the output can be only as good as the input -- non-standardized, non-automated input is creating an industry wide block to STP and an obstacle to risk and cost reduction.* The Association believes that refocused attention on improvements at the initial input stage will introduce the key enabler for industry wide automation. In turn, automation and standardization will reduce risk and cost for all parties and will likely increase event participation levels. Those improvements benefit all – from the issuer to the end investor.

a. The Challenges Presented

We believe that the substantial problems noted above can be addressed through cooperative effort. To be sure, a number of serious tactical challenges exist, as the list below illustrates.

1. Gaining commitment from Issuers, Lead- and Co-agents and Regulators to be active participants in progressive efforts;
2. Categorizing events consistently across markets;
3. Securing agreement on a mandatory data set for all events, first by market and then across all markets;
4. Obtaining commitment from issuers and their agents to deliver to the agreed mandatory data requirements set out in point 3;
5. Ensuring consistent presentation of mandatory data set of Terms-to-data-consolidators by Issuer -- first within market and then across markets;
6. Achieving delivery of Terms to mandatory data set in a machine readable format;
7. Agreeing to standards by and across market on distribution points for events;
8. Enabling distribution of mandatory machine readable data by providing cost effective collection methods;
9. Agreeing on standards with regard to timeliness of event distribution by and across markets; and
10. Rationalizing key event dates across markets.

b. Benefits to, and incentives for, issuers to work toward automation and standardization

We believe that progressive change in communications as described in this paper will provide important and concrete benefits to issuers. These benefits have economic and corporate governance consequences that outweigh the short-term costs associated with introducing automation and standardization.

1. Improvements in shareholder servicing and event participation;
2. Providing a level playing field for all investors in each issuer subject to an event and avoiding disadvantages for any individual due to inefficiencies in the process;
3. Providing a more efficient and cost effective corporate action process to all parties in the chain, including issuers, by reducing issuers' costs of communicating via paper and by reducing the number of inquiries received from entities attempting to 'interpret' announcements into ISO formats;
4. Improving the take-up and the financing results on the underlying events;
5. Increasing predictability regarding the impact of corporate action events on the share price;
6. Enabling accurate and cost effective board level reporting on the success of events; and
7. Enabling a cost effective and demonstrable corporate governance model in relation to event distributions.

**Recommended Action Steps**

In consideration of the foregoing summaries, the Association makes the following recommendations that are intended to encourage broad-based efforts to achieve progress.

- ✘ The Association encourages its member banks to continue to participate in national market practice groups and Global SMPG.
- ✘ Association member banks are encouraged to use ISO15022 messaging for their communications incident to corporate actions as universally as feasible.
- ✘ Association member banks are encouraged to interact with their internal Issuer's Agent operations to assist those operations in understanding the recommended solutions and benefits and in providing leadership to achieve the identified solutions.

- ⌘ The Association intends to sponsor and work with others to arrange industry forums for issuers and other relevant industry participants to discuss issues and find ways to facilitate solutions consistent with the above recommendations.
- ⌘ ICSDs and CSDs are encouraged to work together to examine the opportunities and resolve common issues through harmonized approaches globally.
- ⌘ The Association will undertake periodic reviews of progress and will formulate new action items when appropriate.

---

The Association of Global Custodians is an informal group of ten global banking institutions that provide securities custody and related asset-servicing functions to institutional investors world-wide. The member banks of the Association are: The Bank of New York; Brown Brothers Harriman; Citibank, N.A.; HSBC Securities Services; Investors Bank and Trust Company; JPMorgan Chase Bank, N.A.; Mellon Financial Corporation; Northern Trust Company; RBC Dexia Investor Services; and State Street Bank and Trust Company. Information concerning the Association, including views it has expressed in public consultations on custody, market structure, clearance and settlement, and related matters can be found at [www.theagc.com](http://www.theagc.com).