



**JUNE 2008**

**ADVANCED GLOBAL SECURITIES OPERATIONS**

**MARK SCHEME**

**Answer ALL questions in this section**

- 1 Under the FSA rules, before conducting designated investment business for a private client firms are required to enter into an agreement with a private customer. Identify THREE designated investment business types. (3 marks)

*(a) Discretionary Management (b) A transaction in contingent liability investment (c) Stock Lending activity (d) Underwriting.*

- 2 In the UK a tax levy known as SDRT is imposed on certain securities transactions. Explain what SDRT is an acronym for and when it is applicable. (3 marks)

*Stamp Duty Reserve Tax.*

*When UK securities are purchased in the UK in a book entry format*

- 3 What is the current Settlement convention of transactions in UK Government debt issues and what name is commonly given to these government debt issues. (3 marks)

*T + 1.*

*Gilts*

- 4 Sub-Custodians form a vital integral part of the business known as *Global Custody*. Identify THREE of the main items that would form the basis of how a Sub-Custodian might typically wish to calculate their fees and on what basis would you expect these fees to be charged. (3 marks)

*Value of Assets Under Administration (AUA), = Ad Valorem, Number of Transactions Settled, = per settlement, Withholding tax duties, = number of claims, Corporate events, = Items actioned, Money movements, = Per Movement, On-Line system, = One off fee, Account set up, = One off fee, Communication charges, = per message, Out-of Poacket charges, Proxy voting, = Per vote, Foreign exchange, = Per transaction, Tailored reports = Per report.*

- 5 Securities Lending is a very popular business activity. However, within this business activity there is something known as Manufactured Dividends. Explain fully what a manufactured dividend is and when it occurs. (3 marks)

*A manufactured dividend is a cash payment that is paid by the borrower of securities to the lender of the securities. It is a payment that represents the dividend income (after deduction of the appropriate withholding tax), given up by the lender of the securities. It is calculated when the securities in question are quoted ex dividend and should be paid by the borrower to the lender as soon as possible after the ex dividend date.*

6 In Custody parlance “*Contractual Settlement*” is commonly used terminology. Briefly describe what you understand contractual settlement to be. (3 marks)

➤ *Contractual Settlement is a product that might be provided by Global Custodians to it’s client base.* (1 mark)

➤ *It provides a client with the certainty of when the movement of the cash that is associated with their activity in the securities markets will occur e.g. the cash will move in or out of their cash accounts on the settlement date that the contract of the securities transaction determines.* (1 mark)

➤ *It is therefore a “cash management” tool, which allows the client (or the agent) to better manage their cash.* (1 mark)

7 Corporate Actions and the associated terminology is a critical part of global securities operations. Explain what you understand the terminology **Voluntary** and **Mandatory** to mean and give examples of the types of issues that relate to each. (3 marks)

*Voluntary = An issue where the investor has a choice as to whether they participate or not e.g Rights issue, Takeover bid, Placing, Offer for Sale* (1.5 marks)

*Mandatory = An issue where the investor has no choice but to accept/receive the result of the issue e.g. Bonus issue, Capitalisation issue, Stock split.* (1.5 marks)

8 Straight Through Processing is becoming an increasingly important part of the Financial Service industry. However it does have both Advantages and Disadvantages. Identify the 2 advantages and 1 disadvantages associated with STP (3 marks)

*Disadvantages: Any three of the following:*

- *Expensive in terms of management and project team costs*
- *Can divert resources from crucially important day-to-day operations*
- *Can create a significant retraining requirement*
- *Loss of skill sets*
- *Change the disaster recovery procedures*
- *Can initially change the risk profile of the operational environment*

*Advantages: Any three of the following;*

- *Reducing errors and process delays*
- *Reducing costs*
- *Reducing operational risk*
- *Improving customer satisfaction*
- *Enabling business growth without increasing costs*

- 9 Transition Management is becoming and increasingly important business function. Firms who are good Transition Managers have to have a range of skills. Briefly describe what you believe three relevant skills to be. (3 marks)

*A knowledge of:*

- *Project Management*
- *Asset Trading*
- *Custody*
- *Trade Settlement*
- *Asset Distribution*
- *Portfolio Management*
- *Cost awareness.*

- 10 There have been several important global markets developments in the last 2 years. Name two of these developments. (3 marks)

*½ mark for identification and 1 mark for explanation for each of the 2 developments*

## **SECTION B**

**TOTAL 30 MARKS**

- 11 You are the manager of a Global Custody firm's Trade Settlement area. Your senior management have asked you to prepare a presentation for a prospective new customer who is particularly interested in knowing how your firm manage the *Cradle-to-grave Settlement* process. Your presentation must outline;

(a) The primary tasks undertaken by your firm in pre Trade Settlement (5 marks)

(b) The primary tasks undertaken by your firm in post Trade Settlement (5 marks)

*(a) Tasks should include:*

- *Effective Trade Capture*
- *Effective trade matching (broker-to-fund manager) and problem resolution*
- *Effective communication to the settlement agent (use of Swift / other secure electronic mechanism)*
- *Effective pre settlement routines with the settlement agent to ensure local market acknowledge the transaction*
- *Effective routines to cater for NAKS from the local market*

*(b) Task should include:*

- *Effective capture of settlement messages (Swift / other) from the local agent*
- *Effective management of non-settlement*
- *Processes to ensure Certainty of Settlement (should include settlement advice and reconciliation processes of stock and cash positions)*
- *Measurement of the firms settlement performance*

12 A junior member of your staff has asked you for an explanation of what a “BONUS ISSUE” is. How you would answer this question so that the junior member of staff is fully aware of;

(A) What a “Bonus issue” is (5 marks)

(B) The benefits a “Bonus Issue” could bring and to whom (5 marks)

(a) *A Bonus Issue is an issue of free shares by an issuer of securities to their existing shareholders. The issuer allots the eligible shareholders new shares based on a ratio determined by the issuer.*

(b) *The Bonus Issue has benefits for both the issuer and for the shareholder. The issuer benefits by conversion of cash reserves into shares thus converting reserves into capital. The market price of the shares of the issuer is reduced, thereby making the issuers shares potentially more attractive to would be investors. The shareholder benefits by having additional shares at no additional cost and therefore the potential to increase the capital value of their holding in the issuer by receiving additional shares.*

13 The fulfilment of regulatory requirements is of paramount importance to any institution conducting business in the investment industry. The opening of client accounts is a critical juncture in the scheme of things.

(a) Identify the overriding principle that must be adhered to before accepting a client and how that principle might be adhered to. (5 marks)

- *Know Your Client (KYC).*
- *Review Passport*
- *Review Articles of Association of A Company*
- *Proof of address*
- *Specimen signatures*
- *Attestation to authenticity of documentation and assertions made*

(b) What are the key standardised regulatory elements that should be applied when opening a client account. (5 marks)

- *Client Classification*
- *Client Agreements*
- *Client Asset Protection*
- *Anti-Money Laundering laws*
- *Data Protection*

**Answer ONE question in this section**

- 14 You are the manager of your firm's Client Transition Team. Your team consists of several operatives. A situation has arisen, and has been brought to your attention by a member of your team about another team member. It has been reported to you by (Bob) that a client has complained to them about the manner in which a particular transition is being handled by (John). It is reported that John is said to be unhelpful when reporting certain issues to the client and in some cases abusive when items are queried by the client.
- Describe the actions you would take to clarify this situation
  - Explain the key drivers that will influence the action you will take
  - Itemise the action you would take to remedy the situation.
  - Outline the actions you would take to prevent this from recurring.

*(20 marks)*

*This question examines the candidates on several fronts e.g. their ability to deal with anecdotal issues, their ability to defuse potential client issues and their resolve to manage the situation to an equitable outcome.*

*The anticipated answers are as follows:*

*(A)*

- *Identify the client contact involved*
- *Request (Bob) to invite their client contact to formerly write to you or phone you in confidence, to outline any inappropriate behaviour by (John).*
- *Request (Bob) to also have his contact inform their own management of their intentions*
- *Await response to this*
- *Diarise and follow up*

*This will flush out if the situation is of importance at this stage and if it is factual. It will show (Bob) that you are taking things seriously. It will also put a stop to any maliciousness being perpetrated by (Bob) on (John). In the event it is factual you can ascertain the facts first hand.*

*No Response:*

*Inform (Bob) that nothing has been heard and therefore you will be taking no further action.*

*Response:*

- *Talk to the management counterparty at the client site to inform them that a formal complaint has been received and that you wish to ascertain if any feed back about the situation has been given to them*

- *Inform my management counterpart of my wish to ascertain the facts by talking directly to their staff, seek approval*
- *Review any documented service visits that have been made*
- *Review any taped phone calls to ascertain recorded evidence of conversations between your team and the client.*
- *Ask my counterpart at the client site to review any tape recording facilities they have to help determine facts.*
- *Talk to any other client sites that (John) has contact with to ascertain the level of service being received from (John).*

*(B)*

- *To minimise the impact on my firm and the potential loss of goodwill.*
- *To have a fair resolution to all parties based on the evidence presented.*
- *To ensure service levels are of a high standard*

*(C)*

- *Assuming that the original anecdotal evidence has some substance in fact (John) has to be made aware of the situation.*
- *Depending upon the evidence from all parties, the remedial action would need to range from a cautionary interview with (John) about training or their future conduct and service delivery, to a full disciplinary including dismissal*
- *Inform the client of the action taken.*

*(D)*

- *Request each team members to have a regular monthly feed back session with their clients and have this feed back signed off by the client site*
- *Review this feed back each month with the team and use as a personal KPI for the team.*

15 You are the manager of your firm's Offshore Funds Settlement section. Your firm offers a service to its clients whereby they will accept Buy and Sell orders of Offshore Unit Trusts from its clients. It has been brought to your attention that a request to sell units in a fund registered in the Cayman Islands has missed the fund's stated quarterly Redemption deadline.

- (a) Discuss the potential impacts that this could have on your firm.
- (b) Outline the actions you would immediately take in such a circumstance.
- (c) Outline the potential remedial actions you will likely have to take in such a circumstance.
- (d) Outline what you would do to prevent this from happening again. (20 marks)

(a) Impacts

- *Potential for serious capital loss to the firm*
- *Potential Reputation costs*
- *Cost of remedial action*
- *Potential issues with Regulators*

(b) Immediate Actions

- Identify client.
- Identify the Redemption unit value missed.
- Identify current unit value, evaluate potential loss..
- Identify why the Redemption date was missed e.g. did the client fulfil all of the product requirements, did the staff adhere to the correct processes, did the transfer agent do what they should have done.
- Inform Senior Management of circumstance and your proposed action.

(c) Potential remedial action

- Inform the client of the circumstances.
- Explain the reasons for the failed Redemption to the client.
- Explain to the client what action you are going to take and why.
- Firm to take the capital loss by making client whole if firm was at fault
- To reinstate “Sale” at the next Redemption date.
- Staff training / disciplinary action.

(d) Outline Prevention

- Ensure that the firm’s procedures are robust.
- Make any necessary changes.
- Retrain staff if required.

**SECTION D**

**TOTAL 20 MARKS**

- 16 You are the Senior Network Operations manager of a Global Custodian institution. You have been tasked with appointing a Sub-custodian in a new market. Your staff has conducted the local searches and completed the RFP process. You now have to make a recommendation to your Directors as to which Sub-custodian you would appoint. (20 marks)

- (a) Discuss how you would approach the task in hand.  
(b) Outline what factors you would take into consideration to help you make a recommendation.

(a) Approach:

- Prepare a selection criterion as to what minimum product requirements are involved including credit rating, regulatory and existing AUA.
- Review any value added services provided
- Draw up a short list based on needs versus abilities.
- Include the Operations sections (Settlements, Corporate Actions, Reporting, Compliance, etc) in the overall review.
- Ask for a preferred selection from the review team.

*(b) Factors:*

- *This may include weighting for own branch.*
- *A cost analysis for each candidate bank.*
- *Review any reciprocity considerations.*
- *Review any supplied references and any market performance measurements.*
- *Due Diligence visits to preferred short list banks.*

- 17 You are the Senior Manager of your firm's Network Management department. Your Board of Directors has decided to review the firm's costs as part of a drive to generate a better profit margin for the whole firm. You have been asked to produce a report which identifies the possibilities for cutting costs in your particular cost centre.

What would be the significant items that you would include in your report to your Board of Directors? (20 marks)

*This is a fairly open question. The only qualifiers given in the question is the fact that the candidate looks after the Network of agent banks and that the board is looking for cost reductions. There are no clues as to the state of automation currently employed or the number of Sub-custodians being retained or the number of Network staff. Therefore I think this will test the candidate's business acumen and their ability to answer the question from a very high level business point of view.*

- *Identify the significant cost areas in the section e.g. Staff Costs, Due Diligence expenses, Industry seminars attended, etc.*
- *Produce a list of products that your staff currently support e.g. Market Profiles, Market changes, etc and determine whether the level of activity devoted to these products could be reduced*
- *Outline the number of fee discussions already undertaken with the Sub-custodian network.*
- *Produce a list of fee discussion yet to commence.*
- *Produce an estimate of the level of Sub-custodial fee reductions that might be accomplished.*
- *Report on the overtime levels currently required.*