SCORPEO

UNTAPPED VALUE IS A FEW TAPS AWAY

The only technology platform to actively capture value in corporate actions.

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SCORPEO provides specialist services to asset owners and asset managers to highlight and capture the intrinsic value embedded in corporate actions.

WHY IS THIS VALUE BEING MISSED?

- There over 1 million corporate actions a year across world markets and over 100 different types.
- Many require voluntary election decisions which need to be transmitted from the fund manager to the issuing agent within strict deadlines.
- It is a huge processing function for Investment Operations and Custodians.
- It's not easy for investment managers to read all the associated documentation, actively manage the election process in the timelines and also capture the optimal value for the fund.
- As a result a common route is often to apply a default election which is often sub-optimal in terms of economic value.

WHY IS IT IMPORTANT?

Pensions Funds, Investment Managers and Custodians are all operating in a challenging environment.

Regulatory compliance, increased transparency and performance demands are all high on the agenda.

- Pensions in the UK are facing significant challenges with aggregate pension deficits at record levels.
- Objective is to reduce costs and improve returns across the investment value chain and a 'policy of marginal gains' to squeeze out additional value.
- Investment Managers and Trustees have a duty to act in the best interests of scheme beneficiaries so any additional value should be a source of focus.
- Increased performance becomes a differentiator adding to fund performance and investor returns.

HOW MUCH VALUE IS BEING MISSED?

- In 2016 over $600 million was missed in UK scrip dividends alone as a result of sub-optimal elections of cash or stock.
- Over $7BN of value has been missed globally on scrip dividends since 2011.
- Significant additional value is being missed on other corporate actions including rights issues, tenders, buy-backs etc.

SOLVING OLD PROBLEMS WITH NEW TECHNOLOGY

Aware of these inefficiencies and challenges, SCORPEO has developed new and innovative products specifically designed for our clients.

- Applying our data and technology, investors have easy to use and scalable solutions to realise the optimum value from corporate actions across their portfolios.

SCORPEO VALUE ANALYSIS™

Calculates the missed value across portfolios as a result of sub-optimal corporate action elections.

SCORPEO VALUE CAPTURE PROGRAMME™

Captures the missed value in corporate action elections.

SCORPEO ANALYTICS™

Specialises in providing analysis on corporate events.

ROUNDTABLE: TECHNOLOGY AND EFFICIENCY

A group of industry experts met in January for a roundtable sponsored by **SCORPEO** to discuss how schemes might improve investments and achieve marginal gains inperformance using new technology, including finding efficiencies and optimizing value in corporate action election decision-making.

Pádraig Floyd covers the conversation.

PARTICIPANTS

- **DAVID FAIRS (CHAIR)**
  DIRECTOR
  ASSOCIATION OF CONSULTING ACTUARIES LIMITED
- **JOHN BELGROVE**
  SENIOR PARTNER
  AON HEWITT (TELEPHONE)
- **ANTHONY STEVENS**
  GLOBAL HEAD OF PRODUCT INNOVATION
  NORTHERN TRUST
- **MATT RUOSS**
  CEO
  SCORPEO UK
- **ELIZABETH FERNANDO**
  HEAD OF EQUITIES
  USS
- **IAIN COWELL**
  INVESTMENT STRATEGY
  THE PEOPLE'S TRUST
- **LUKE HILDYARD**
  POLICY LEAD: STEWARDSHIP AND CORPORATE GOVERNANCE
  PLSA
- **MARK PROFFITT**
  HEAD OF BUSINESS DEVELOPMENT, EMEA
  SCORPEO UK
- **CLAIRE FINN**
  HEAD OF DC BUSINESS
  BLACKROCK
- **CHRIS BARROW**
  HEAD OF BUSINESS DEVELOPMENT
  SCORPEO UK
- **TROY MORTIMER**
  DIRECTOR
  KPMG

WE NEED TO BE COMPARING APPLES WITH APPLES. THE ONUS IS ON ASSET MANAGERS, CONSULTANTS AND TRUSTEES TO HAVE A PROPER DEBATE ABOUT VALUE FOR MONEY

Consolidation came up early in the conversation, and Chair David Fairs asked whether consolidation is a way of achieving lower costs or higher performance?

It would certainly address governance, because schemes acquire complex third-party services and they need to be EQUALLY sophisticated buyers, said Iain Cowell.

"Consolidation will allow them to achieve that and will help to enhance governance. That improved governance will spiral, in turn drive better understanding of the products they are buying."

Claire Finn warned that consolidation is neither a magic wand nor a single structure: "From a DC perspective, the vast majority of costs relate to administration, not investment," she said. "We see new form of consolidation in DC with master trusts and I expect more consolidation into master trusts going forward. This in turn gives rise to an opportunity to ensure higher quality investment solutions are made available to more members."

"True consolidation could be much more radical," said John Belgrove, but acknowledged it has proved difficult even for schemes under the same sponsor. "That would be the ultimate level, but it's incredibly hard."

Chris Barrow said "the regulators are currently fixated on costs in the pension fund but investors should also be focusing on opportunity costs and easy marginal gains in the portfolio. The role of SCORPEO's technology is to help clients achieve this in the specific area of corporate actions value."

That is inevitable, said Elizabeth Fernando, as costs are certain, while returns are not. It is important to clients, because it is something they can control.

BIGGER IS BETTER

Building larger funds through consolidation is also a way to promote accountability, said Mortimer.

"Larger schemes bring greater responsibilities and more assets means you have to assess all the asset classes. This drives awareness and education."

INNOVATION OFTEN COMES AT A TIME OF STRESS, AND THIS IN TURN ENABLES NEW TECHNOLOGIES AND BUSINESS MODELS



However, there are practical limitations to the trustee model, said Belgrove.

"I wish people had the time to do everything and to do it brilliantly," he continued, "but the truth is they simply don't have the resources and they must delegate to providers or partners that can do things on their behalf."

Mortimer agreed: "It is all about stewardship, which is why schemes are coming together and ESG is being introduced to smaller schemes."

But things are very different for DC schemes, said Finn: "Commodities, listed infrastructure, smart beta, multi-asset and absolute return can all be had in the liquid space and so we are some years away from having illiquids in DC."

WHO CALLS THE TUNE?

Responsibility is clearly an issue, but should trustees be trying to maximise returns, asked Fairs?

The period of low returns we have experienced is unusual for those in the industry and requires a new mindset, said Cowell.

"The rewards of long-term investing stem from taking risks, rather than short term cost reduction" Cowell explained. "For most portfolio managers, delivering low-cost, engineered returns is considered strange. Blended ETF strategies operate like that, but it is very different from where we've come from."

MANAGERS HAVE A ROLE TO PLAY TO DEVELOP OPTIMAL SCHEME SOLUTIONS. THERE IS A LOT MORE TO DO, BUT THERE IS A ROLE FOR US ALL

Fernando questioned whether the motivation behind the development of diversified growth funds was to allow complex asset allocation decisions to be devolved to someone with greater technical knowledge.

Smarter products must be part of the solution, said Belgrove, and that will inevitably continue to drive down costs. “Smarter products will mean more dynamic asset allocation,” he argued, but this alone will not deliver better outcomes.

“There is still no guarantee of contributions in addition to better products and lower costs, and that is what is needed.”

However, Finn said we should remember that what is important is risk-adjusted investment returns: “Managers have a role to play to develop optimal scheme solutions. There is a lot more to do, but there is a role for us all.”

TELL IT AS IT IS

As we move to a world of even greater disclosure, will this show how hard your investment manager is working for you, and will that increase the focus on how schemes operate, asked Fairs?

“Innovation often comes at a time of stress,” answered Ruoss, “and this in turn enables new technologies and business models such as ours to help drive change and bring better outcomes.

“However, as a member, I would be angry if my scheme was not doing this even in a bull market. It is not just down to the investment manager, but equally the custodians, trustees and consultants all need to be part of the driver to marginal performance improvements.”

“In a lower returns world, fees take up a larger part of the returns, but cost control should always be a key feature,” said Belgrove. “However, there are obvious costs – fund manager and adviser fees, etc – and I expect there will be more pressure to deliver value for money here as well.”

Mortimer agreed: “It is not just about cost minimisation, but efficiencies. That has to be attractive to the asset manager and we must look at how they are incentivised.”

But the managers are still the best placed to understand how to operate their businesses and how efficiencies will work, Mortimer contended. Rather than seeking to punish asset managers and advisers, schemes should be working with them in order to save money.

PUSHING AT AN OPEN DOOR

But there are some easy wins to be had, suggested Barrow, particularly in the area of corporate actions. SCORPEO’s data shows that in UK scrip dividends alone, over $600 million was left on the table in 2016 due to the inefficiencies and complexities for fund managers in making corporate action decisions.

"There are more than one million corporate actions a year and managers not only have to process these but also make choices in many of them, such as when offered cash or stock in a scrip dividend," says Barrow. "That's a lot of work and analysis, and as a result many fund managers tend to have default instructions in place."

However, these default positions are not extracting maximum value from these corporate elections, leaving a lot of money on the table – in fact in European stock scrip dividends alone, well over $1 billion is missed every year and there are many other types of corporate actions where significant value is being missed for the pension fund.

"Technology can be used across the value chain," Barrow said, "and can create better outcomes for schemes and their members."

However, the technology must be right, added Ruoss. It must fit the industry needs, and not make the industry fit the technology – a typical mistake of the past. New and exciting technologies bring solutions to old legacy problems, from processing and payments right through the value chain. The C-suite is recognising this and actively engaging it, with the evidence in the raft of in-house innovation zones that have sprung up over the last couple of years.

This is one of the reasons why Northern Trust uses SCORPEO's product, said Stevens, "Developing these tools for a maximum 4,000 actions a year is neither easy nor cost-effective for a platform that is running $6.5 trillion.

And there is demand for it, he added, as cost controls using new technologies have taken off in the Dutch and Australian markets: "There is a great deal more information required of the investment industry by the DNB, and this is increasing the focus on managing costs more closely."

Though the same reporting is made available to UK clients as Dutch ones, there is little demand for this more granular information in the UK, perhaps because trustees don't have the resources to make use of it.

WHOSE RESPONSIBILITY IS IT, ANYWAY?

But, asked Fernando, what is the market doing in return to service the decision-making process around these elections?

"We often get asked to make an election a week before the date it takes place," she said. "It may appear that money is being left on the table, but the time lag combined with market moves may mean what was optimal a week ago is no longer optimal - if we could have made a choice on the day, I may have made a different decision."

Again, this is where new technology is solving these legacy problems, answered Ruoss. "Small, dynamic companies can offer solutions to the value chain. Technology innovation reduces complexity and risk by reducing manual processing and freeing up capacity in an industry stretched by regulation and looking for ways to add value to investors and beneficiaries, and custodians are well placed to be at the forefront here."

"We are not always the best people to manage the trading process," acknowledged Cowell.

The fact that we don't really know where the responsibility for this lies shows how fragmented we have become, he said.

"Custodians have a real opportunity in the future to take on the responsibility."

THE REGULATORS ARE CURRENTLY FIXATED ON COSTS IN THE PENSION FUND BUT INVESTORS SHOULD ALSO BE FOCUSING ON OPPORTUNITY COSTS AND EASY MARGINAL GAINS IN THE PORTFOLIO

PROFESSIONAL ADVISERS MUST STEP UP

Mortimer agreed that trustees must ask whether they are getting the maximum value out of their trades. However, this will require education as this is a highly technical area for trustees.

But while trustees must understand the costs, there is a danger they could start down the road towards micro-management of the component costs said Belgrove: "The responsibility for this should sit with service providers and professional advisers to demonstrate value, because the trustees' focus is stewardship at the overall level of costs. Transparency and disclosure must improve so they can monitor it more easily.

In some cases there is not enough pressure being placed on advisers, he added, and raised a concern that the bundled total cost measure favoured for the benefit of simplicity will hide some of the costs that many schemes are already ignorant of.

"I am highly supportive of meaningful cost disclosure," said Finn, "but we need to be comparing apples with apples. The onus is on asset managers, consultants and trustees to have a proper debate about value for money as the lowest cost solution is not necessarily going to offer the best value to the member."

The industry has certainly embraced the concept of what we do to help investment returns but the reality of being open to new and innovative technology can be somewhat different, said Barrow.

"People are focused on so many other things – usually regulation or cost base. They need to push for the easy wins."