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THE INSIDE TRACK

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Brexit and Corporate Actions Risk Management

On Thursday 23 June 2016, the UK voted to leave the EU.

There will be many consequences of this referendum outcome, but most remain unknown. Some will be good and some will be bad, and I really don't want to go into personal views here. My focus is on the implications for the Financial Services industry and Corporate Actions processing in particular.

So far, the overwhelming consensus among those with experience of the financial markets is that the uncertainty will create considerable market volatility. As a consequence, firms will need to come up with new and inventive ways to raise finances/restructure their organisations.

How could Brexit impact Corporate Actions processing?

Based on the evidence of the last six weeks, stock prices and FX rates have been directly impacted by the result of the referendum, and both have seen significant daily fluctuations. Stock prices and FX rates are key factors when determining the value of any Corporate Actions event, as well as in determining the associated risk.

So the question we must ask ourselves as an industry is:

How do you measure and manage the risk associated with Corporate Actions processing in such volatile market conditions?

Clearly, the traditional red/amber/green or high/medium/low models – based purely on event type – become even less meaningful in a volatile market, as they are too simplistic to fully capture the real levels of risk involved.

At present the more complex risk calculation models are usually collated manually. In a volatile market, the output will take longer to calculate and will most probably be dangerously out of date by the time the process is completed. Bad data is often worse than no data.

Clearly the industry needs to develop and deploy more structured, digital, automated tools for calculating risk generally - and Corporate Actions risk is no different, but it is often overlooked. Such tools must help us ensure the risk values produced reflect the true risk in a highly volatile market, otherwise the data is useless and any effort in collating it will be wasted. Pressure will increase on the limited resources we have at our disposal, so having digital tools as part of a redefined servicing model will be essential and will allow the industry to make the required operational changes.

The commentators agree that the markets will be in a state of flux. For how long is harder to predict, but it could be years, irrespective of any other disruption that may occur in the European member state model alongside that caused by the invocation and negotiation of Article 50.

Over the past 15 years, we have become more attuned to a less certain, riskier world. But our capability to evolve our assessment of that risk profile in our industry at the same pace of change is questionable. One thing is for certain – measuring Corporate Actions risk isn’t going to get any easier in the foreseeable future and we need to catch up.

However, without accurate risk measurement in Corporate Actions, it becomes almost impossible to properly manage the risk and use the limited resources available as efficiently as possible, when the objective should be to reduce the overall risk we are carrying in our organisations.

As an industry, we need to get ahead of the curve in terms of risk measurement, in order to be fully prepared for the impact of future uncertainty and volatility. Only then can we effectively and efficiently manage the inherent risk associated with Corporate Actions processing.

Given the current climate and future uncertainty, the crucial questions in relation to Corporate Actions risk must be:

Are you confident enough to rely on your current model, measurement and management methods to cope with a highly volatile market?

Do you have the future capacity to continue to support a manual risk measurement/management model?

Do you have the right resources available to improve and automate your current model?