

Clearance and Collateral Management (CCM)

(An Introduction)

Custody - An Introduction

Topic 1: Business overview & key players

Custody in modern markets

↓
Safeguarding / warehousing
of investors assets

→ temporary holding and
mgmt of financial
assets / securities

These are mostly

① financial assets

② Securities

→ Eg

① Stocks

② Bonds

③ Mutual
Funds

④ Exchange-Traded
Funds (ETF's)

⑤ CD → Certificate
of Deposits

⑥ Real Estate Investment
Trusts → REIT's

Past
↓

These custodians
exist in physical form
as

① certificates

(to the custodians
who held them in
vaults)

statements which are considered
to be in physical form in the
past

to assignment

They are not issued as physical certificates

(but they exist in electronic form)

details of
ownership
are recorded
in Book Entries

electronic

records (or) databases
by financial institutions

Instead of having
a paper certificate
to record the ownership
(it is recorded digitally)

These are

① immobilized

② Dematerialized

Stock certificate

physical document

(represents ownership of a
certain number of shares in
a company)

includes details like

① Shareholder's name

② No. of shares owned

③ Company's name

(serves as a proof that
you are part of the company)

(eg → Stock certificate)



you are buying

50 shares
(company)



called
"Tech Innovators
Inc"

stock certificate

This certifies that John Doe is the owner of 50
shares of Tech Innovators Inc.

Certificate No.: 12345

Date: January 1, 2023

Signed by: [Company's Officers Signature]

Immobilized

Dematerialized

Some of them do exist in mixed form nowadays

Mixed form (depending on situation)

↓
Can be either digital / paper

(depending on what you (or) the issuer prefers)

Eg → Savings bond

↳ type of loan you give to the govt.

(buy a bond after a certain period govt
pays you back with interest)

buy → \$100 (Savings bond) → after a few years → you can cash it for \$120

\$100 → \$120

(because of the interest)

↳ extra money you

you (buy a Savings bond) → govt. agrees to pay you back the extra amount (interest) → earn for lending your money to someone it is the government

you buy a Savings bond (\$100) → govt. promises to pay you interest over time → after 5 yrs the same bond can cost \$120
4% per year

how 120\$

year

$$\begin{array}{r} 1.04 \\ \times 4 \\ \hline 4.16 \end{array}$$

1 $\rightarrow \$100 + 4\% \rightarrow 104\$$

2 $\rightarrow \$104 + 4\% \rightarrow 108.16\$$

3 $\rightarrow \$108.16 + 4\% \rightarrow 112.49\$$

4 $\rightarrow 112.49 + 4\% \rightarrow 116.99\$$

5 $\rightarrow 116.99 + 4\% \rightarrow \boxed{121.67\$}$ worth of 100\$
(after 5 years)

bond

\hookrightarrow it's like an

you \rightarrow I owe you

\rightarrow way for organisations

(like govt / companies) to borrow

money from people

bond \rightarrow loan you give to an
organisation

interest \rightarrow Extra money you earn for lending
your money

Maturity \rightarrow

\hookrightarrow when the bond's time is up (you get your money
back with the interest)

Property Deed

\hookrightarrow A property deed

(legal document that shows
who owns a piece of property
like a house / land)

when you buy a property

the deed is transferred

\rightarrow to your name

(proving you are the
owner)

Ex
↳ you buy a house → you get a property deed that has your name on it → proof that you own the house

Immobilized

↳ (means to make something unable to move (or) to keep it in a fixed position)

Concept

① Physical certificates

(stored in a central location and not moved when ownership changes)

Ownership changes

→ (recorded electronically)

physical certificates } remain in the central depository

initial ownership

A buys 100 shares of Company XYZ

Issued to investor A
(in physical certificate also it is recorded)

Shows investor A as the owner

Ownership change

A sells 100 shares to investor B

e-records are updated
physical → still shows

A as the owner

Dematerialized → ownership updated electronically
↳ Converting physical certificates to electronic records

Central Security Depositories (CSD)

- ① Safekeep the securities (stocks and bonds) → in e-form
- ② facilitates the transfer of securities b/w buyers and sellers
- ③ Maintains accurate records of ownership and transactions

Eg → ① you buy 100 shares of a company

② CSD records that you own these shares electronically

③ if you sell the shares

CSD updates the shares of the new owner

Post

Transportation
of physical
certificates

All that is required
now

change in the
Book-Entry
Adjustment

(All the securities of single bond/equity issue can stay at one place)



Securities of single bond

all the physical certificates
for a particular bond / stock
issue can be kept together at
the same place

Company → issues 1000
shares of
stock

1000 phy stock certificate
stored in a central
depository

depository → stores the
electronic records

Converting them into e-book

↳ Eliminate

① shipping costs

② storage headaches

So that

production

(↑)

overall

cost

(↓)

Economies of Scale

↳ refers to the cost advantages
that a business can achieve
by (↑)ing the scale of production

(production ↑ → cost per unit
o/p (↓))

Small Scale

1000 widgets

10000\$

$$\frac{10,000}{1,000} = \$10$$

Large Scale

10,000

10,000

$$\frac{10,000}{10,000} = \$1$$

Company produces

more product

it can spend its cost

in fixed costs like

rent and machinery

thereby (↓) in the
cost per unit

rent
machinery

varies

raw

materials

De-materialized
financial
assets

X need to move
anywhere

(investors
don't have the
time and
resource to
co-ordinate
these e-assets
themselves)

One type of
Service

① Asset Servicing

Ⓐ keeping accurate records
of ownership

Ⓑ managing events like
stock splits

mergers
acquisitions

③ you own 100 shares
dividend 1\$ per share
you receive 100\$

but they require
a lot of

① Maintenance → keeping the

② Admin records
up-to-date

ensuring
Security

They rely on

Custodians

Specialized financial
institution
(store and safeguard
investors assets)

Ensuring investors receive

any dividends / interest
payments

payment made by a
company to its
shareholders
(usually from its profits)

① Comp XYZ makes a profit
② Company decides to distribute
part of its profit to shareholders
as dividends

Acquisition
↳ when one company
buys another company

CA $\xrightarrow{\text{buys}}$ CB
(big tech comp) \rightarrow (small Soft comp)

Other Services

① Securities lending

↳ Letting someone borrow
your stocks / bonds

→ you lend your
stocks / bond

→ give you something
valuable (like money)
as a guarantee

and then you pay

a fee

you earn a fee
for lending your
shares
(\$100)

you hold the collateral
until your shares are
returned

① you have
100 stocks of company XYZ

② investor wants to borrow
your shares

③ investor gives you

10,000\$

so shares

of company

} collateral

mediator

④ bank guarantees the
return of your shares

fund Services

- ① keeping records of all transactions
- ② Giving updates to investors on how the fund is doing

because of the below custody business is highly specialized requiring

- ① Specially trained staff → advanced/refined
- ② Sophisticated Systems

So, there are more type of financial assets → complex financial assets that people can invest in
eg → Derivatives
structured Products

Processing Trade

Steps to complete buying cos) selling a stock

includes → ① Placing the order

② confirming it

③ transferring the stocks and money

① Eg decide to buy

Shares of a company

② Place an order to buy

③ trade confirmed

④ Shares go to your account

money → goes to the Seller

These are

more complicated than stocks and bonds

innovations overtime has changed custody business

↳ its importance overtime has no way diminished

Custody business in values managing and safeguarding assets

causes of the new type of business
custodians have more responsibility and challenges

Derivatives

you place a future price
in order to overcome
price drops

Scenario

① you are a farmer
growing wheat

② Problem

you worry that the
price of wheat might
drop by the time you
harvest

Solution

enter into a future
contract with a
buyer

Agreement

you agree to sell your
wheat at \$10 per bushel
in 3 months

Outcome

No matter what the market
price is in 3 months you
sell for \$10

Stock index

① Measurement
(or) performance
of a specific
stock

Structured Products

↓
investor buys a
product that guarantees
initial investment
back (and some returns
based on stock market
performance)

(principal-protected
note)
↓

invest 1000\$ in principal
protected note

→ linked to the performance
of a stock index

(eg:- S & P 500)

note guarantees that you
will get your \$1000 back
at the end of investment
period regardless of how
the stock grows
↳ stock index performs

Stock index } you get
grows } additional returns

down → you get back your
\$1000