



**GLOBETAX**

# SWIFT Service Bureaux A Route to STP in Corporate Actions

A White Paper

## **Enabling STP in Corporate Actions**

by

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## Introduction

*On February 16<sup>th</sup> 2005, SWIFT's board approved the establishment of a Service Bureau operating on the SWIFT network dedicated to providing the opportunity for SWIFT users to automate the corporate actions function of withholding tax processing.*

*In this white paper, Ross McGill, Director of marketing of the service bureau provider, GlobeTax, explains the new bureau and examines the degree to which such service bureaux offerings provide a route for funds and custodians to successfully create STP processes in the back office.*

*Ross McGill co-chaired SWIFT's Market Practice Group on US Section 1441 NRA withholding tax regulations (QI) and is the author of "International Withholding Tax – A Practical Guide to Best Practice & Benchmarking" and "Relief at Source – An Investor's Guide to Minimising Internationally Withheld Tax", both published by Euromoney Books.*

## Preface

As custodians, we are all focused on the continuing challenge to improve quality and scope of service to our clients while at the same time controlling and driving down unit transaction costs in the face of increasing regulatory and compliance pressures. SWIFT is a key element in this equation because it provides the *opportunity* to combine industry standards and network infrastructure to create new and more efficient ways for us to do our jobs and serve our clients. But *opportunity* is all it is. To be productive, we must all grasp these opportunities and create the solutions we need for custody in the twenty-first century. The service bureau described in this white paper is an excellent example of innovative thought and delivers a solution that many custodians will adopt and benefit from. As a paradigm for STP, Service Bureaux which can demonstrate significant cost reductions at the same time as delivering improvements in quality that we can pass on to our clients will undoubtedly be the way forward for our industry.

*John Griffin, State Street Bank*

Most custodians and funds have been embarked for several years on a strategy to leverage efficiencies and cost savings through Straight Through Processing (STP). SWIFT has been a pivotal force and platform for most institutions to achieve this due to our dual role as guardians of industry message standards (e.g. ISO15022) and providers of network infrastructures (e.g. FIN & SWIFTNet). However, many of the functions occurring in back office environments are either manually processed, have a significant proportion of manual processing and/or require hardcopy documentation to support them. To that extent, until the financial services community finds a way to automate these processes, the full benefits of STP will not be enjoyed. This service bureau brings ISO15022 standards into the corporate actions arena with great added value.

*Bob Davies, Regional Director, Pan Americas*

Most corporate actions software platforms have only limited tax processing functionality, often restricted to tax research tables and some receivables posting features. As with many industry utilities, a centralised value added function in the form of a service bureau on the SWIFT network provides a great opportunity to enhance functionality at the user interface with all the benefits and without any of the costs of development or implementation of a full service tax processing system. The underlying business provider of this service bureau already processes more than a million withholding tax events a year. All that has been necessary is to add the SWIFT based "pipe" between corporate actions platform and service bureau.

*John Byrne, CEO Information Mosaic Ltd*



## Executive Summary

The principle of this service bureau is to provide custodians on the SWIFT network with an added value service offering that removes the need for a full service internal withholding tax processing function.

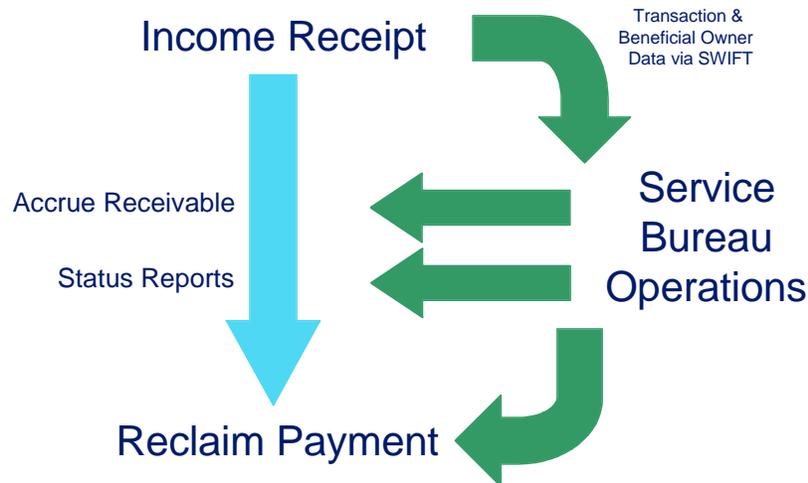
Key attributes:

- Leverage SWIFT investment
- Convert the entire withholding tax processing function or parts of it into an STP environment
- Save up to 65% on costs
- Improve delivered service quality and scope to clients
- Maintain service branding

Exhibit 1 shows the subscriber process model using the SWIFT based withholding tax Service Bureau which contrasts with the complexity (aka cost and risk) of Exhibit 2 representing the current process template used by most custodians. Such bureaux are increasing in number and are providing an increasingly cost effective way to manage complex custodial operations.

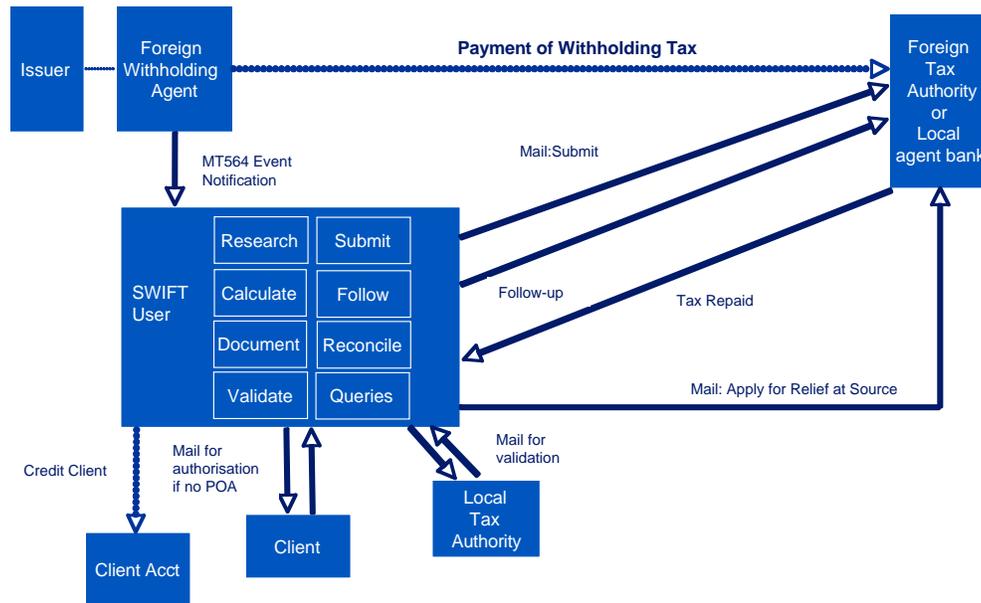
The Service Bureau model effectively outsources all manual processes which would otherwise and currently custodians from enabling STP in corporate actions processing.

The model described leverages SWIFT technology, uses existing messages as well as new SWIFT services such as FileAct, to create an automated, interactive tax processing function that enables custodians to retain their service branding to clients while reducing costs by up to 65% and improving the quality and extent of service significantly.



*Exhibit 1 Complex and Manual processes convert to simple STP processing  
Source: Author's own*

## 1 Background



*Exhibit 2 Tax Processing as it is today*

Source: *International Withholding Tax – A Practical Guide to Best Practice & Benchmarking*. Publ. Euromoney 2003

Exhibit 2 shows the current corporate actions function of withholding tax processing which clearly is not an STP process. Any SWIFT user who provides tax processing services to its clients may well have automatic processes initiated by the receipt, typically, of a SWIFT message MT564, providing notification of a corporate actions event. This of necessity includes calculating the effect of the notification against the clients who have an eligibility to receive a proportion of any income .

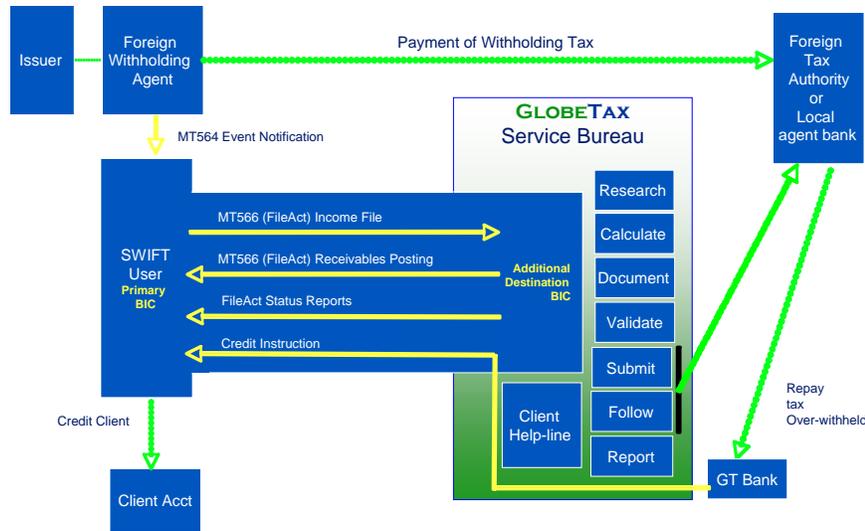
There are a number of processes which require manual interventions. These include account set-up, documentation management and also the processes of creating, filing and following up on applications for exemption, relief at source and remedial reclaims with third parties such as agent banks, local and foreign tax authorities. There are only two ways in which this type of function could be effectively incorporated into an STP strategy resulting in reduced transaction costs and increases in efficiency and quality. Either:

- each element of the process itself must be automated or
- the process must be outsourced using an automated data feed so that, from the user's perspective, the manual elements of the process become transparent.

For over twenty years firms have attempted to address this internal automation issue. Yet, to date, only a small fraction of the tax processing function has been found to be susceptible to internal automation. These are typically the profiling of clients through tax research, document management through imaging software and creation and compilation of tax reclaim forms through in-house or third party software. These solutions do not provide a complete STP offering and they are expensive for any individual firm to deploy and maintain.

The second alternative has been successfully developed into a service bureau which provides fully automated links between user and service bureau removing all internal manual processing.

## 2 Tax Processing Service Bureau



*Exhibit 3 Service Bureau model for STP in tax processing  
Source: Author's own*

Exhibit 3 shows that by the creation of a separately managed BIC address, tax processing can be outsourced to a secure managed center leaving the SWIFT user with a fully automated, full service tax processing function supporting a much simplified vertical relationship between withholding agent, SWIFT user and client.

The service bureau subscription is established in three steps:

1. Apply for an additional destination BIC
2. Apply for membership of the message user group for MT574.
3. Ensure SWIFT FileAct is implemented at the subscriber institution

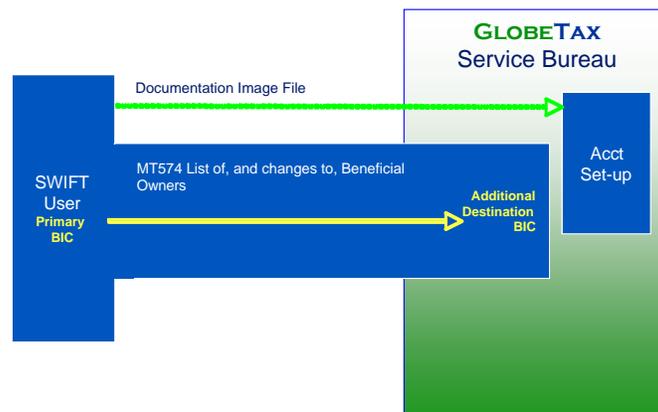
In essence, the additional destination BIC means that subscribers to the service bureau are able to send SWIFT messages and files to, and receive messages and files from, their own BIC addresses. These messages and file transfers can be initiated automatically from the receipt of MT564 notification.

MT574 messages, using repeatable blocks, are used by subscribers to send beneficial owner information to the service bureau where, combined with transactional data sent in either MT566 or FileAct files, it is used to monitor and establish eligibility for relief at source, exemptions or remedial reclaims. MT574(IRSLST) was originally created to automate a single jurisdiction tax processing issue (US S.1441NRA withholding tax regulations). The Corporate Actions Securities Maintenance Working Group has already approved the necessary expansion of the scope of this message subject to ratification by the UK National Member group.

Since all the otherwise manual and semi-automated processes are undertaken by the Service Bureau, the SWIFT User is able to maintain its client facing tax processing service based on the sending and receipt of SWIFT messages and files representing

beneficial owner and transactional data outbound and receivables posting data, status reports and tax refunds inbound.

Exhibit 4 shows the simplicity and value add incurred at set-up. Data transfers are made via SWIFT MT574. The Service bureau uses a sophisticated document imaging and management system to acquire and manage supporting documentation. Where subscribers also have imaging, the transfer of supporting documentation is fully electronic. Where subscribers do not have document imaging, a conversion process is provided which allows the service bureau to leverage its imaging systems in the tax process as well as give access for the subscriber under secure conditions to the benefits of a document imaging system without having to pay for it.



*Exhibit 4 Set-up of Data required by Service Bureau  
Source: Author's own*

### 3 Features

#### 3.1 Branding

The service bureau concept is not intended to compete with custodians. Its essence is to provide a more efficient service model allowing custodians to retain their own service branding whilst reducing costs and improving service quality and scope. This service bureau already has extensive experience as the back-office.

#### 3.2 Fit & Liability

There are always two issues raised when considering outsourcing – fit and liability. The former enables the subscriber to marry its internal processes to those outsourced so that there is no cost or quality impact. In this case, since the SWIFT network is being used and both BICs are proprietary to the subscriber, fit can easily be 100%.

As can be seen in Exhibit 2, tax processing services involve a number of third parties whose action or lack thereof, can impact the ultimate success of the process. No custodian currently offers blanket liability to its clients for tax processing because no custodian is in full control of every aspect of the process. The Service Bureau, like custodians, offers liability only for problems caused by its own failure. In this instance, the service bureau provider, due to its data scrubbing and security techniques, has a zero failure rate for thirteen years and zero backlog on tax reclaim processing – a benchmarking record that many custodians would envy.



### 3.3 Reducing Costs

Research in pre-sales indicates that the use of this service bureau for tax processing will reduce costs by as much as 65%, representing several million dollars a year for the average custodian. Clearly each SWIFT user is different and has addressed tax processing in a different way. Hence the actual degree of cost saving will depend on a number of factors.

On a general level however, custodians typically invest in tax processing infrastructure in a different way than a service bureau - they have a number of different cross functional activities and priorities to satisfy that affect costs - upwards. Service Bureaux, on the other hand, focus their entire cost on improving just one process. So, as long as the links to the SWIFT user are well defined and allow the user to manage their other activities, a service bureau should always be a lower cost alternative to internal processing, all other things being equal. The concomitant benefit is that the specialization of the service bureau and resultant higher volumes of transactions processed makes it more likely that the service bureaux will develop and use more efficient procedures and tools to do their job.

The cost structure for this service bureau is:

- One-off Subscription Fee
- Transactional Fee - fixed fee, volume based with retrospective rebates based on volume growth.

### 3.4 Improving Quality

For most custodians, even those who profess an all-encompassing service, there are aspects of tax processing that are often not provided to clients. Some of these are market driven, others structural or cost related. The Service Bureau model can successfully improve service quality by leveraging its processing volumes to provide tax processing benefits that would otherwise be excluded from a service offering. Four examples are given below:

1. *Omnibus Account Processing.* One of the most common self-imposed limitations of tax operations is based on client structure where no service is offered if the client has an omnibus or multi-level structure. This is sometimes imposed due to the perceived complexities or cost of processing and sometimes due to the absence of underlying beneficial owner information. The Service Bureau offers the potential for custodians to extend their service offering (and therefore competitiveness) into such areas as omnibus processing at no incremental cost
2. *Tax interpretation* is, as most custodians know, both expensive and theoretical. In several areas, theory and interpretation are limited by risk or compliance concerns that can be specifically voided based on direct consultation with tax authorities. Again, the service bureau model leverages significant processing volumes to enable either reduction at source or remedial reclaims in areas where theory otherwise indicates such activity is not possible. So, clients for whom it has historically been thought impossible to leverage tax benefits can be brought into receipt of such benefits as a service extension with no incremental cost.
3. *Contractual Tax.* Performance is also a key attribute of any tax operations function. It's a fact that there is a link between volumes of reclaims and applications for relief at source and the quality and frequency of relationships with tax authorities. This allows the service bureau to initiate proprietary procedures that facilitate the return of funds faster than market expectations and on a statistically more consistent basis. Thus service extensions such as contractual tax can be offered on a competitive basis by custodians whose



volumes would not otherwise give them enough basis to create a commercially viable contractual tax model.

4. *Account Opening & Documentation.* While existing accounts are, as noted in Exhibit 1.2, updated via SWIFT message, the service bureau also offers the option of branded new account opening functionality via secure web site. Subscribers can thus meet their regulatory requirements whilst minimising their workflow and making the process far more beneficial-owner friendly.

End

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