

## SCRIP POOLING

A Stock Exchange based centralized transfer processing service

By A.T. Freemantle — Consultant to  
The Sydney Stock Exchange Limited

*(The opinions expressed in this paper are those of the author and do not necessarily reflect the official view of The Sydney Stock Exchange Limited.)*

There is a manifest need for change in the cumbersome traditional office procedures used by stockbrokers to effect the transfer of ownership of shares, and it is becoming more and more imperative to adopt an effective and economic scrip handling system.

The securities industry recognises this need and has for almost a decade been considering ways of changing present scrip processing methods, but to date none of the proposals put forward have been accepted or acted upon.

### *The Mining Boom:*

The mining boom of 1970 caused chaos in brokers' offices and highlighted alarming deficiencies in control and client protection. It would probably be fair to say that in this paper war, the paper was the only winner. Since those hectic days the securities industry has been buffeted by adverse publicity and an unfavourable economic climate.

Trading volumes today are considerably lower than those experienced during the halcyon days of the boom and brokers' back offices are coping quite adequately with the flow of paper. Unfortunately, history has a habit of repeating itself, and when trading does increase, as it surely will, we will find that the problems that beset the stockbroking industry seven years ago have not only not been solved, but if anything the situation will have deteriorated. This is partly due to the fact that the securities industry is coming under increasing Government scrutiny, and Stock Exchanges are expected to play a wider role in regulating transfer processing practices, in order to provide greater protection for the investing public.

In addition, transfer processing is highly labour intensive and stockbrokers are feeling the impact of the substantial increase in labour costs over the past few years. Accord-

ing to a survey carried out in 1976, clerical wages, together with supervision and occupancy costs, account for about 78% of the total cost involved in processing a transfer. Brokers have as a result, pared their staff to a minimum and are now less able to cope efficiently with fluctuations in trading levels.

### *What the Future Holds:*

Every time a piece of paper is handled, the cost to all parties rises. Imagine a situation where the paperwork is largely eliminated, where buying and selling clients receive prompt delivery of their scrip and cash respectively, and where stockbrokers' resources are mainly devoted to advising and assisting clients in managing their finances.

These automated scrip processing systems are not new. Every major overseas exchange is working towards this end, either alone or in conjunction with banks and transfer agents.

The Sydney Stock Exchange is aware of these trends and has been quietly endeavouring to follow the example of the overseas exchanges, and in spite of a long succession of false starts it now appears that there is a very real prospect of achieving a break through.

### *Scrip Pooling:*

During 1976 the Sydney Stock Exchange initiated a study to ascertain the feasibility of developing a centralized scrip handling system based on the Stock Exchange's computerised Broker/Client Accounting system which handles about 90% of Sydney's trades. This proposal, called appropriately 'Scrip Pooling', is at present receiving detailed consideration by brokers and share registries.

With the establishment of the Joint Exchange, future development of scrip

handling systems, whether based on Pooling or not, will proceed under the auspices of this body. It may therefore be anticipated that much wider consideration will now be afforded the proposal as its ultimate success depends very largely upon acceptance Australia-wide.

#### *Benefits of Pooling:*

The effects of Pooling will not be confined to the back offices of Sydney brokers. Pooling will also have a very real impact on client protection and employment security within the industry. Some of the most obvious benefits of Pooling are listed below:

- A 50% reduction in brokers' scrip processing costs will be achieved when the system is fully operational.
- The duplication of effort presently inherent in checking and recording documents at each point where they pass from one authority to another will be eliminated.
- Pooling will afford equal protection for buying and selling clients.
- Government demands for greater control within the industry will be satisfied as the monitoring of Stock Exchange member firms will be improved.
- Transfer processing will be streamlined and hence buyers will receive their share certificates more quickly.
- This centralization will dampen the effect of major changes in brokers' workloads arising from fluctuations in market activity, and thereby encourage stable employment and development of experienced clerical staff.
- While Pooling will certainly not eliminate all errors in documents received by share registries, the number of errors will be reduced through thorough training of clerical staff and subsequent quality control of their work.

I would like to emphasise that at no stage would full participation in Pooling be compulsory.

Brokers will be able to choose freely the degree of control they wish to exercise over routine allocations and lodgements of

transfers, and therefore by implication the amount of benefit they would receive from the system.

#### *HOW SCRIP POOLING WORKS:*

##### *Delivery of Scrip and Cash:*

Instead of brokers passing documents to each other, all scrip and transfers and any other associated documents will be delivered to the central authority, either directly by selling clients or via their brokers, depending on each brokers' instructions to his clients.

Where a client delivers more shares than were actually sold the central authority will hold the balance of shares for up to three months. At the end of this period, the share registry will be directed to issue the balance in the name of the registered holder.

Buying clients would still deliver their cheques to their brokers who would then advise the central authority of the receipt of the payment.

Every document will be microfilmed immediately on receipt by the central authority, primarily in order to create a secure record of all deliveries of scrip, transfers and advices. During the micro-filming process a unique marking number will be stamped on all transfers.

Under this system all transfers are effectively being split and this marking number will be the prime source of reference to any transfer in the event of a query.

##### *Verification of Scrip and Transfers:*

All documents relating to scrip delivery will pass to experienced scrip clerks for verification. The central authority will require the delegated right to affix both the selling and buying brokers' certification stamp or an equivalent guarantee. This is the certification as to the validity of documents and to the effect that duty has been or will be paid.

##### *Allocation Process:*

Details of valid scrip and transfers of all selling clients will be entered into the computer during the day and accumulated into a "pool". During the same daily input runs, details of cash payment advices from

brokers using the Broker/Client Accounting system will update the appropriate buying client's record and change the client's status from unpaid to paid. No cash payment advices will be received from brokers using only the Broker/Broker Accounting system and all their buying clients will be treated as having paid for the purpose of allocation of shares.

During the allocation run each night, allocations will be made from the pool of scrip to paid buyers in date of payment sequence. Two criteria will govern the application of the allocation formula. The first step is to decide which paid buying clients are eligible for allocation, as determined by the payment date, and having decided that, the second step in the formula is to select scrip from the pool in the same denomination as the buying client's order, if at all possible, so as to reduce the number of split transfers generated by the allocation process.

The system will also include provision for transactions to be designated as blocked, in which case scrip would be set aside from the pool and allocated to the original buyer on a line-for-line basis. This method of processing would normally be applied only to very large lines.

#### *Transfer Documentation:*

The number of intermediaries involved in effecting a transfer will be reduced by combining the roles of the selling broker's scrip department, buying broker's scrip department and the Stock Exchange's Transfer Marking Services Department into one central authority whose control is independent of any one member firm. Present transfer documentation will be modified to the extent that fully completed security transfer forms (pinks) or fully completed security renunciation and transfer forms (yellows) would no longer be used alone as instruments of transfer. The valid instruments of transfer for all transaction originating on the Sydney Stock Exchange and processed by the central authority would be:

- Part I of a security transfer and Parts I and II of a split transfer (fawn).

- Part I of a security renunciation and transfer and Parts I and II of a renunciation and split transfer (grey).

Deliveries into the system from interstate brokers would continue to be made with either security transfers (pinks) or brokers marked transfers (blues) in the case of shares, and security renunciation and transfers (yellow) or brokers marked renunciation and transfers (greens) for rights.

After daily computer processing to allocate scrip to paid buy transactions, split transfer forms and lodgement advices would be printed by the computer.

Share registries would receive all documents relating to the transfer of ownership of shares in the same delivery, for those trades handled by the Broker/Client Accounting system.

#### *Settlement:*

The daily settlement between Sydney brokers and the Clearing House will become a by-product of the scrip delivery and allocation process. As in the present Broker/Broker Accounting system, a broker's settlement account will be credited with amounts due for valid scrip received from his clients, and debited with the value of scrip allocated to his clients. In addition, under the Pooling system, the settlement account will include postings to cover charges for any valid scrip on-hand which cannot be allocated because there are insufficient paid buyers of a security.

To calculate cover funds with respect to a particular security due from each broker in the daily settlement, any excess scrip will be charged in date-of-transaction sequence starting with the "oldest" unpaid buy transaction.

Thus, with respect to cover charges, each day a broker's settlement account will be:

- credited with the total cover paid on the preceding settlement day.
- debited with the aggregate of cover charges due from the broker with respect to each security for the current day.

Thus, the burden of cover will fall squarely on those brokers whose clients fail to pay promptly for purchases.

*Rights, Dividends, Debentures and Contributing Shares:*

As with transfers relating to securities, all renunciation transfers will effectively be split through lodgement with the central authority. The system will handle renunciations in exactly the same way as security transfers.

After allocating rights to paid buyers, the computer will print renunciation and split transfers, and a cheque covering buyers application monies, which will be sent to the share registry concerned. The application money due from the buying client will appear on his broker's settlement statement and will be settled between the broker and the central authority.

Brokers' renunciation and transfer forms will be eliminated with respect to all transactions originating on the Sydney Stock Exchange. They will, however, still be valid delivery from interstate brokers.

The Stock Exchange will provide a central nominee company into which any scrip-on-hand, when a company's books close for a rights issue, will be registered. This will ensure complete protection for the buying client.

Automatic adjustment of dividends is presently handled by the Stock Exchange's current computer systems and this operation will not be altered.

The procedure which will be used to process debentures is analogous to handling scrip and security transfers.

One of the verification steps that will be carried out on contributing shares, if the share certificates are not marked "call paid" will be to check with the registry concerned, to ascertain whether the calls have in fact been paid.

When a company establishes that there

is no longer any scrip outstanding on which calls have not been paid, written permission may be given to the central authority to discontinue this verification.

*Future Developments:*

Scrip Pooling is stage I of an overall concept to provide a centralized scrip and accounting system. Scrip Pooling is seen as the logical first stage development because of the substantial tangible benefits it offers.

Stage II, as conceived, is the extension of the centralized service to provide comprehensive client accounting and trust accounting facilities, potentially replacing many of the present back office client accounting functions. This stage II development may well entail options, whereby brokers could have on-line access to client information held in computer files.

Another possible development in future is the electronic delivery of transfers to share registries thereby realizing very substantial savings in data input and validation.

In conclusion, I must stress that whilst Pooling does address the major problems confronting the industry at this time, it certainly does not purport to be the only solution; or indeed the final solution.

The ultimate aim of the securities industry must be the elimination of the share certificate. Pooling is one way of taking a small but manageable step in this direction, by eliminating duplication of effort and reducing the movement of scrip. The next stage is the immobilization of the share certificate which has already been substantially achieved in the United States. Progress is essential and therefore inevitable and in this article I have simply endeavoured to outline one way in which the first step could be achieved.