

IBM Algo FIRST for investment firms



*Qualitative and quantitative database
of external risk loss events*

Highlights

- Helps users understand, identify and manage operational risk
- Recognized by analysts and practitioners alike for its industry-leading coverage
- Provides thousands of real-life case studies based on external risk loss events

IBM® Algo FIRST® highlights operational risk events, control breakdowns and management responses to help investment firms prevent losses before they occur. Subscribers can proactively apply lessons learned from almost 15,000 real-life case studies to help minimize their risk exposure and enhance internal controls.

The Algo FIRST database is constantly expanding, and recent additions encompass several buy-side industry events, including directed brokerage payments, hedge fund blow-ups, pension fund settlements related to corporate accounting, fraud, market timing and mutual fund sales practices.

One of the industry's most respected external risk loss databases

Investment firms are complex entities that are ultimately responsible for managing the financial resources of others. As a result, they are at risk of losing their franchise if they are unable to preserve their good name. A worst possible scenario for an investment firm is when its reputation is linked to lawsuits, news stories involving breach of fiduciary trust, or accusations involving the failure to deliver promised returns. History has shown that the failure to understand and manage these potential risks can lead to a catastrophic loss in franchise value.



One important strategy for proactively managing risk is to learn from the experience of others. The Algo FIRST database contains distinct, real-life case studies that provide the buy-side community with qualitative and quantitative analysis of large loss events. This content, which includes insight into key triggers, contributory factors, management responses, and associated control breakdowns, can help buy-side organizations prevent similar mishaps in their own firms.

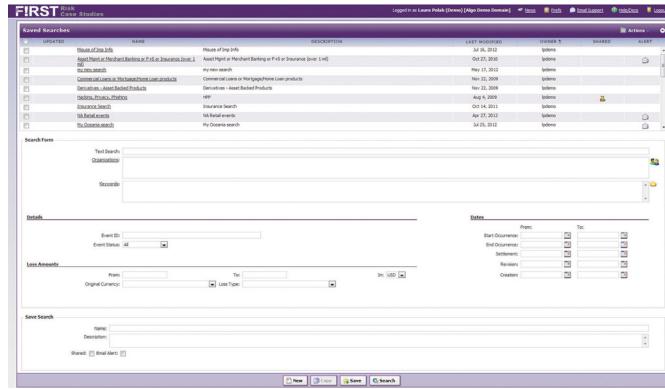


Figure 1: Screen capture of the Algo FIRST home page

One of the industry's only research tools that puts real-life case studies in an operational risk framework, Algo FIRST is an ideal supplement to internal data for self-assessment and scenario modeling. Charts and graphs, free-text search, in-depth case studies, and essential content for self-assessment programs help ensure that Algo FIRST is an invaluable resource for hedge fund managers, asset managers and pension fund managers. Offered on a subscription basis, the Algo FIRST database is accessed by using the internet, and does not require installed software.

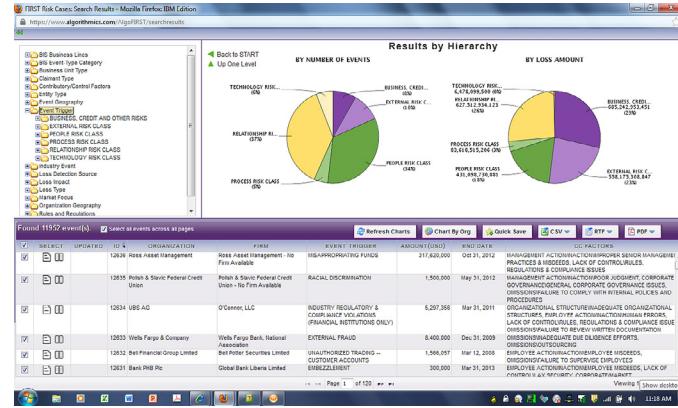


Figure 2: Screen capture of Algo FIRST query results

Algo FIRST database sample case study

T. Rowe Price (excerpt from Event# 15472)

In this example, failure to check a third party, proxy-voting system caused a significant liability to one of America's largest mutual-fund companies. T. Rowe Price Group Inc. agreed on June 6, 2016 to pay USD 194 million to clients as compensation for a proxy-voting blunder connected to Dell Inc.'s USD 24 billion management buyout in 2013.

The Baltimore money manager inadvertently voted its 31 million shares in favor of, rather than against, the buyout, even though it was a vocal opponent of the deal, arguing at the time that the deal undervalued Dell's shares.

On May 11, 2016, the Delaware Court of Chancery ruled that this voting error rendered T. Rowe Price's fund, trust, and client shares ineligible to pursue fair value. On May 31, 2016, the court ruled that Dell's fair value per share was USD 17.62 and not USD 13.75, a difference of more than 28 percent, validating the firm's original investment argument. Based on that ruling, the firm decided to compensate affected clients for the difference in valuation, plus statutory interest, resulting from the denial of appraisal rights.

The firm had been one of the most outspoken critics of the 2013 Dell buyout, led by Michael Dell, the computer manufacturer's founder and chief executive officer. However, T. Rowe Price's default position in merger votes, like many of its peers, is to support management and, in the case of Dell, its computerized voting system gave instructions to vote YES that weren't manually overridden before the final vote.

T. Rowe Price retains State Street as broker for some of its funds, and both firms outsource the voting activities to two different companies. State Street outsourced the task of collecting and implementing voting instructions from its many account holders to Broadridge Financial Solutions, Inc., granting Broadridge power of attorney to execute proxies on its behalf. Broadridge communicated with State Street's account holders and obtained voting instructions by mail, by telephone, and over the internet.

T. Rowe Price also involved proxy advisory firm Institutional Shareholder Services Inc. (ISS), which was hired to notify it of forthcoming votes, provide voting recommendations, collect voting instructions, and convey them to Broadridge. To make the voting process more efficient, T. Rowe Price uses a computerized system that automatically generates default voting instructions and provides them to ISS.

Several T. Rowe Price funds not only vocally opposed the deal, they also demanded appraisal of their shares, under which a Delaware court determines how much the shares were worth and orders the surviving company to pay the difference. The buyout price for Dell ended up being USD 13.88 a share.

T. Rowe Price sued to obtain a higher valuation but lost on technicalities. The Delaware appraisal statute requires that to get appraisal a shareholder must a) demand appraisal in writing before the merger closes and hold shares continuously until the closing, and b) vote against the merger.

However, in 2015, some of the funds' appraisal lawsuits were dismissed because they failed the first test. At some point, shares beneficially owned by some T. Rowe Price funds had their official record ownership transferred from Cede & Co., a nominee of the Depository Trust Company (DTC), to Kane and Co., a nominee of JPMorgan, which was the custody broker for those funds. The T. Rowe Price funds never sold those shares, but their entirely arbitrary legal ownership changed, which was enough to disqualify them from appraisal.

T. Rowe Price's funds held by custodian State Street avoided that problem and remained with Cede & Co. the whole time. They, however, voted in favor of the deal by mistake. The Dell buyout was so controversial that the shareholder meeting for voting on the deal had to be rescheduled several times to get enough votes and to negotiate a higher price.

T. Rowe Price's voting system automatically pre-populated the September Meeting Record with the default voting instructions, that is, instructions to vote "FOR" the merger, "AGAINST" the advisory resolution on golden parachutes, and "FOR" authority to adjourn the meeting.

No one from T. Rowe Price's proxy team logged into the ISS Proxy System to check the status of T. Rowe Price's voting instructions. As part of the routine operation of the two systems, the default instructions in the September Meeting Record were conveyed automatically to ISS.

When the mistake thus disqualified T. Rowe Price from suing for more money, the company decided to review its internal voting procedures.

Inadequate technology planning was a contributory factor: despite T. Rowe Price's adamant opposition to the Dell buyout, postponement of the shareholder voting meeting led to the firm's voting system automatically pre-populating the September Meeting Record with the default voting instructions called for by T. Rowe Price's voting policies, which were to vote in favor of the merger. A secondary factor was poor execution. No one from T. Rowe Price's proxy team checked the status of their voting instructions on the ISS Proxy System immediately prior to the vote.

As part of its corrective actions, T. Rowe Price said it would take a charge equivalent to the USD 194 million moved to its funds and investor accounts—the company's largest ever one-time deduction from earnings. The scale of the payment and the circumstances were unusual for a mutual-fund company, according to analysts.

Shareholders will not receive cash but will see a relatively small performance increase for affected portfolios because of the number that held shares and their size. The payments will go to four US mutual funds, one overseas fund, two trusts and about a dozen other institutional client accounts.

Chief Executive William Stromberg observed the fund firm is "rock solid" financially and that it would make the payments from its available cash. "T. Rowe Price has a long history of putting our clients' interests first, and that is what we are doing here," Stromberg said in a press release.

Key benefits and features

Provides a better understanding of potential exposures

Case studies can be shared among departments, providing valuable content for use in management reports, committee or board presentations or discussions, internal newsletters, self-assessment workshops, and scenario-based models. Charts and graphs allow for better understanding of loss breakdowns, while the internet-based subscription helps ensure that users in the organization can have ready access to Algo FIRST without additional infrastructure cost.

Helps minimize risk exposure

Proactively applying lessons learned can help investment firms improve internal controls, reduce investment risk, and create even better understanding around new product research processes before losses or exposures occur.

Enhances trend analysis

Firms gain the ability to examine commonalities among a series of events and to track emerging patterns. By benchmarking internal loss history against the event experience of peers, organizations can use Algo FIRST to improve their competitive insights.

Helps reduce investment risk

Improve new product research processes by identifying potential risk exposure by product type, so the appropriate control measures can be put in place. Management can also reference Fitch ratings or Scaling data, linked to the timing of events, to see if there are contextual references of how events might impact the cost of capital.

Increases access to relevant insights

IBM operational risk research analysts have a background in financial analysis. This experience helps ensure that they understand which loss event details are relevant to investment firms and that these insights are passed along to subscribers.

Allows for easier data export

Users can create customized searches and then download information in CSV, RTF or PDF formats for use in other internal documents or knowledge-based systems. For those who want to integrate Algo FIRST into systems by using automation or filtering routines, Algo FIRST is available in three data add-on formats:

- An XML version that you can use to incorporate Algo FIRST data through direct feed into internal or external operational risk, compliance, enterprise risk or other knowledge-based systems
- A FastMap version that you can use to incorporate Algo FIRST data through direct feed into the IBM OpenPages® Operational Risk Management module
- A Services Directory Integrator (SDI) version that you can use to incorporate Algo FIRST data using the SDI ETL tool into the IBM OpenPages Operational Risk Management module

In-depth case studies

Loss events are detailed with analyses of key factors, including control breakdowns, regulatory rule violation information, management responses to events, graphs and charts, and industry lessons learned. Special coverage is provided for catastrophic (tail) events, which are detailed with timelines to allow for day-by-day or hour-by-hour analysis of breakdowns that led to loss.

Extensive search functions

Free-text and hierarchical searches allows for user identification of events by natural language or keyword node terms. The powerful search engine of Algo FIRST enables users to combine search concepts or search by several factors, including product type, geography, loss type, event trigger and control breakdowns. Basel II categorizations and Boolean search are also supported in the advanced search function of Algo FIRST.

Access to online newsletter

Algo FIRST Database subscribers also receive a monthly newsletter. This monthly online publication is designed to raise awareness of topical issues that can impact daily business operations. This newsletter also provides excerpts from relevant case studies to highlight how Algo FIRST informs your risk program.

About IBM Analytics

IBM Analytics software delivers data-driven insights that help organizations work smarter and outperform their peers. This comprehensive portfolio includes solutions for business intelligence, predictive analytics and decision management, performance management, and risk management.

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