Citi PERSPECTIVES

Emerging Markets

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Swati Mitra

Global Sales Leader, Emerging Market Corporate Clients, Treasury and Trade Solutions, Citi

WELCOME

The international economic outlook remains uncertain. Global growth is projected to remain modest at slightly above 3% in 2013, the same as in 2012.[1] Moreover, key risks persist in developed markets, which remain focused on reducing leverage, while addressing new regulatory requirements. In the US, relatively high unemployment and fiscal uncertainties remain a drag on growth while in the euro area, political uncertainty has heightened structural vulnerabilities.

In developing markets, while there are concerns about a slowdown in some key economies – most notably China – the story overall is more upbeat with 70% of world growth in the coming years expected to come from the emerging markets. China's medium-term growth outlook is positive but systemic risks and vulnerabilities stem from the shadow banking sector. A rising middle class in Asia, strong foreign direct investment flows and trade flows between the growth markets will help underpin medium-term growth in emerging markets.

In these growth markets, managing the transition to a global operating model i.e., establishing sales operations, treasury support structures, risk management, governance policies and configuring supply chains can be challenging. It can be difficult for companies at different stages of development to design and implement effective treasury policies and practices that can be compared to best-in-class multinationals.

Structural shifts in the global economy, increasing financial regulation and uneven economic growth requires treasurers to re-evaluate their organizational structures, goals and priorities against best-in-class peers. The most effective way to do this is by partnering with a financial institution that combines global capabilities and technology-led innovation with on-the-ground expertise in countries worldwide.

With a presence in over 100 countries and strong technological leadership, Citi has the capabilities to help emerging market companies grow internationally in an effective and sustainable way by leveraging our network and platforms. Citi Treasury and Trade Solutions has created an Emerging Markets Resource Center (http://emergingmarkets.transactionservices.citi.com/users/login) which is an online, single source of information for clients to access country profiles, market guides, case studies and trends relating to emerging market countries.

In addition, Citi's Treasury Diagnostics service (http://citibank.com/transactionservices/home/tts/corp/liquidity/treasury_das.jsp) is a comprehensive, online benchmarking service that tabulates core treasury practices, policies and procedures against peer data to help identify gaps and opportunities. It measures company performance relative to peers around the six key pillars of treasury operations: governance and controls, liquidity management, cash and working capital management, entity funding and repatriation, risk management, and systems and technology. It is a web-based, easy-to-use tool that collects secure responses across fundamental treasury disciplines through a 30-minute survey. By including best-in-class comparisons in every report, Citi Treasury Diagnostics service is a proven way for fast-growing emerging market companies to undertake detailed analysis of their existing processes and identify areas of improvement. More than 450 multinational clients have participated globally in the diagnostic and have found the results impactful in shaping treasury's strategic priorities. We look forward to working with you in your journey towards treasury management excellence.

[1] IMF, World Economic Outlook Update, July 9, 2013.

Inés Vargas Barrera

Latin America Industrials Sector Head, Treasury and Trade Solutions Sales, Citi

Jorg Paasche Junco

Latin America Public Sector Head, Treasury and Trade Solutions Sales, Citi

BRIDGING LATIN AMERICA'S INFRASTRUCTURE GAP

Urbanization is a defining 21st-century feature: 59% of the world's population will live in urban areas by 2030.[1] In Latin America, the most urbanized of emerging market regions, 80% of the population is already in cities.[2] Economically, cities drive global growth and prosperity, the world's top 600 accounting for over half of global GDP. And this is expected to rise to nearly 65% by 2025.[3] In Latin America, the 10 largest cities generate around 30% of the region's GDP.[4]

As the number of people living in cities rises – and people's growing affluence continues to raise their expectations – infrastructures are coming under increasing pressure. In particular, transport and roads, power, water and other utilities need urgent new capacity in Latin America. The difference between existing and needed infrastructure investment in Latin America is USD170 billion a year to 2020.[5] In Brazil, the need for investment has been further boosted by its future hosting of the 2014 World Cup and 2016 Olympics.

In addition to the inability of existing infrastructure to meet current and future needs, failure to invest in infrastructure acts as a drag on economic growth. Middle-income nations in Latin America could add two percentage points to annual growth rates if their infrastructures were comparable with that of middle-income nations such as Turkey or Bulgaria.[6] Moreover, an increase in infrastructure investment equivalent to 1% of GDP could add an additional 1.3 million jobs in Brazil.[7]

A new model for investment

Historically, investment in infrastructure in Latin America has been funded primarily by national governments. However, the scale of investment required to meet existing and future demands means that a new approach is needed. The broad focus on fiscal restraint across the region further reinforces the need for alternative – private sector – funding to bridge the gap between public funds and necessary infrastructure investment.

In response, many governments across the region have – through political support and improvements to regulatory frameworks – created an environment increasingly favorable to leveraging private capital for public investments. According to the EIU's 2012 Infrascope study, 14 of 19 countries have improved their investment climates for public-private infrastructure partnerships (PPPs) since 2010. The study attributes much of the improvement to the creation of specialized agencies to promote and implement PPP investment models.

One recent high-profile PPP in Latin America is the awarding of three concessions for three airports – Aeroporto Internacional de Guarulhos, Aeroporto de Viracopos and Aeroporto de Brasília – that account for 30% of the air traffic in Brazil. While the concessions are an indication of the increasing prominence of PPP in many Latin American countries, they are also a reminder that PPP often serves to supplement other forms of financing: Brazil's development bank BNDES will provide up to 80% of the total investment for each airport project.

Meanwhile, developments in the financial sector are changing the mix of non-government organizations that fund infrastructure investment. The eurozone debt crisis has reduced the capacity of some European banks previously active in project finance in Latin America. Global regulatory changes, such as Basel III, which significantly increases the amount of capital banks must hold, effectively penalizes banks that lend beyond seven years, further restricting the involvement of banks in infrastructure investment.

Despite these challenges, it seems certain that external sources of funding that include private companies, Export Credit Agencies (ECAs), pensions, insurance companies and sovereign wealth funds will become increasingly significant in infrastructure financing.

Once a project commences operations, cash and liquidity management, supplier financing and trade services may be required. Finding the right financial provider is crucial.

Citi's unique global capabilities, local knowledge and joined-up approach to servicing the infrastructure investment lifecycle make it an ideal partner for governments, private companies and other organizations seeking to participate in Latin America's infrastructure future.

As a result, there is a need to connect governments in Latin America with financial institutions around the world. Moreover, there is a requirement for greater support for all infrastructure market participants across every stage of a project lifecycle, from development to construction to operation.

Services across the project lifecycle

The increasing involvement of non-government institutions in infrastructure investment shines a spotlight on the various requirements of different types of organizations during different stages of a project. The need to optimize efficiency and returns makes it imperative that these requirements be considered in a holistic fashion. Governments and private companies should choose to work with a bank familiar with project lifecycles and with the interlinked nature of the many organizations involved in them – they are inevitably linked by payments, liquidity or trade flows.

Before a specific project begins, governments may require assistance in establishing a financial and legal framework that can support project finance. It is important that a framework encourages investor confidence. Many projects in Latin America fail to go ahead because of a lack of convergence between a government's demands and the private sector's expected returns based on the underlying risks. At the same time, a framework must be transparent and methodical to ensure efficiency and value for money: Chile's national Public Investment System uses standard forms, procedures and metrics, and rejects as many as 35% of proposed projects.[8]

During the development phase of a project, private participants in infrastructure projects need access to services such as bid bonds, export letters of credit (LCs), receivables financing, escrow accounts (during the front-end engineering and design phase or to facilitate sponsor equity participation) and investment options for cash.

Increasingly important sources of funding for infrastructure projects – both during the development and during the construction phases – are ECAs and multilateral agencies. ECA and multilateral involvement helps to minimize political risk for longer tenors and can be advantageous for banks because they have to hold less capital for ECA and multilateral-backed debt than regular debt. However, building relationships with ECAs and multilaterals takes time, and governments need to ensure they work with a bank familiar with these agencies' requirements.

In June 2012, Citi executed USD250 million financing in support of the construction of Line 1 of the Panama Metro, which runs for approximately 13.7 km along highly populated sectors of the city and which will have an initial transport capacity of 16,000 passengers an hour – significantly easing congestion in this rapidly growing city. The financing was guaranteed by the Multilateral Investment Guarantee Agency, which is part of the World Bank, and was the first of its kind in Latin America.

Pension funds are also becoming increasingly important in funding infrastructure in Latin America. Some countries there have managed to establish large pension fund industries, in both absolute terms and in relation to the size of their economies. In December 2010, Chile's pension funds had accumulated assets equivalent to 63% of its GDP while Peru and Brazil have asset-to-GDP ratios close to 20%.[9] Latin American pension funds also have among the highest allocations to infrastructure projects – around 3% of total assets in countries such as Peru and Mexico.[10] The increasing investment flexibility of the Specialized Retirement Funds (Siefore) in Mexico is also opening up the possibility of channeling resources to infrastructure projects, especially through structured instruments.

As projects lead into the construction phase, there are additional services that may be required that include performance bonds, escrow accounts, and note trustee and paying agents for bond issuances. To enhance cash flow during this construction phase, engineering, procurement and construction (EPC) contractors are often seeking to monetize these receivables to reduce their costs of capital and channel funds back into the projects. Once a project reaches operation, services such as cash and liquidity management, supplier financing and trade services may be required.

Finding the right provider

In summary, it is important to choose a banking provider that has the visibility of the cash flows of the different participants during the development, construction and operation phases of an infrastructure project.

Citi's unique global capabilities, local knowledge and joined-up approach to servicing the infrastructure investment lifecycle make it an ideal partner for governments, private companies and other organizations seeking to participate in Latin America's infrastructure future.

[1] United Nations Global Report on Human Settlements 2011.

[2] McKinsey Global Institute, Building Globally Competitive Cities: The Key to Latin American Growth, August 2011.

[3] McKinsey Global Institute, Urban World: Cities and the Rise of the Consuming Class, June 2012.

[4] McKinsey Global Institute, Building Globally Competitive Cities: The Key to Latin American Growth, August 2011.

[5] United Nations Economic Commission for Latin America and the Caribbean.

[6] Justin Yifu Lin, Bridges to Somewhere, Foreign Policy, 1 September 2011, as quoted in McKinsey Global Institute, Infrastructure Productivity: How to Save $1 Trillion a Year, January 2013.

[7] McKinsey Global Institute, Infrastructure Productivity: How to Save $1 Trillion a Year, January 2013.

[8] Ibid.

[9] OECD Working Papers on Finance, Insurance and Private Pensions No. 26.

[10] Ibid.

Yuri Avramenko

Sales Head
Corporate and Public Sector, Russia and CIS, Central and Eastern Europe, Treasury and Trade Solutions, Citi

Emre Karter

Russia, Central and Eastern Europe Head, Treasury and Trade Solutions, Citi

TRANSFORMING TREASURY TAKES ON NEW URGENCY IN RUSSIA AND CIS

Understanding the forces driving change in the way treasury works in Russia and in the Commonwealth of Independent States (CIS) offers opportunities. Leading companies there want to adopt new ways of working in order to lower costs, improve visibility and control, enhance risk management and achieve gains in efficiency.

In recent years, corporates that operate in Russia and the Commonwealth of Independent States (CIS) have increasingly sought to reshape their organizational structures and change the way their treasuries work. Leading companies from the region, which have long taken a different view than their international peers in terms of efficiency, want to adopt new ways of working in order to lower costs, improve visibility and control, enhance risk management and achieve gains in both efficiency and effectiveness.

As a result, Citi has received numerous requests from clients in Russia and CIS seeking advice, education and assistance in streamlining and restructuring their treasury functions. For example, Citi responded to a request from one leading natural resources company in Russia – a global leader in its industry – by hosting a Treasury Advisory Workshop in order to evaluate the current treasury operations of the group of companies and to jointly define the high-level, end-state vision and provide recommendations about how it could be achieved.

Having been awarded a mandate to conduct a thorough analysis, Citi used its proprietary research program (Citi Treasury Diagnostics℠) and interviews with treasury staff to identify key challenges and create a roadmap to reach the end goal. The company's goals are ambitious – at the initial workshop, the corporate treasury team stated their intention to build the best global treasury in the world within five years. By carefully analyzing areas that cause problems for the company's treasury processes and adopting and agreeing on a transformation plan, the global natural resources company is on course to achieve its aims. A key focus has been on coming up with new ways to perform the working capital management functions that formerly comprised as much as 90% of the treasury's workload.

Why now?

Companies in Russia and CIS are embarking on radical treasury transformation projects for a number of different reasons that may be specific to the company's circumstances. However, for many corporates, there is a common history that explains the need for reform at the current time.

Russia has only had private companies since the early 1990s following the end of communism. During the 1990s, the country experienced a series of crises that occupied many companies' attention. Moreover, growth occurred at an explosive pace so there was little time — and often little immediate need given strong profitability — to seek the best and most efficient ways of managing treasury.

Now, many companies in Russia and CIS have reached a sufficient size and stage of their development that makes it no longer feasible to continue to operate in the same way as in the past two decades. They recognize that they need to centralize not only cash, but information as well if they are to be able to effectively manage their operations as they grow within the region and worldwide.

Furthermore, the financial and economic crisis that has engulfed the world since 2008 has put strong pressure on containing costs and moved the need to improve efficiency further up many companies' agendas. Liquidity is more scarce and costly than before the crisis, prompting many companies to seek to improve how they manage their working capital so they can become less reliant on external sources of funds.

Identifying new models

In many examples, as much as 90% of treasury work is related to working capital management. To improve efficiency, such tasks should ideally be separated from other treasury functions. The most efficient way to achieve this is to create a payment factory and centralize working capital management along with other functions like accounting, human resources and IT within a shared service center (SSC).

Using standardized processes, a single platform and a single center for execution and processing of all payments and collections is an international best practice. Currently, few companies in Russia and the CIS have achieved this goal, although many have made it a priority and have established special task forces to advance their ambitions.

There are a number of challenges in convincing stakeholders within companies in Russia and the CIS of the benefits of a SSC model. There can be a disconnect between those at the top of an organization (who determine strategy) and mid-level managers in various participating departments whose buy-in is essential for any successful

> To improve efficiency, tasks related to working capital management should ideally be separated from other treasury functions, preferably centralized within an SCC.

restructuring. To overcome this, companies need to establish processes that actively push change downward in the organization.

However, there are a few regulatory barriers to the adoption of SSCs that create challenges (other than netting). For example, on-behalf-of payments, where one or more entities are authorized to pay on behalf of other entities within the group, designators are not specifically authorized in Russian legislation. However, by appointing employees in the SSC as representatives of different areas of the group, the same functionality and efficiencies offered by on behalf-of payments can be achieved.

To date, efforts to restructure corporate treasuries to improve efficiency have been led by the largest companies in Russia and CIS. Mid-sized companies are not yet ready for such sophisticated solutions. Most frequently, SSCs are established in Russia's regional cities, where costs tend to be lower. Many international companies that operate in the region have also sought to reorganize their treasuries in recent years, with some choosing Ukraine as a center for their SSC given its geographical proximity to Europe.

It is important to note that in order to gain the benefits of centralization, it is not necessary for a company to rationalize the number of banks it works with to just one. It is possible to view all accounts (including those with third-party banks) using Citi's Infopool. Similarly, TreasuryVision® enables corporates to view their overall positions and forecasts (including those with third-party banks) and more effectively manage global liquidity and risk across the enterprise. The ability to improve forecasting is a particular priority for companies in Russia and the CIS given their existing challenges in this area.

Enhancing connectivity

One trend closely related to increased interest in SSC models is a growing enthusiasm among large companies in Russia and CIS to use SWIFT to standardize bank-to-corporate connectivity. Indeed, three of Russia's largest companies have formed a working group with SWIFT and leading banks to devise a unified approach to SWIFT connectivity and use of formats. While the use of SWIFT still faces some challenges, such as currency controls in most countries, it is being increasingly considered because of recognition of the benefits of standardized connectivity rather than the use of multiple proprietary channels.

Adolfo Tunon

EMEA Head of Service, Treasury and Trade Solutions, Citi

Femi Rowaiye

EMEA Head of Implementation, Treasury and Trade Solutions, Citi

IMPLEMENTING CASH MANAGEMENT SOLUTIONS FOR EXPANDING EMERGING MARKET CORPORATES

Emerging market corporates (EMCs) continue to expand to countries beyond their home markets, but many EMCs may overlook the obstacles encountered when implementing a global cash management solution. This article examines the potential pitfalls and how these can be addressed through a global banking services provider.

As the so-called BRIC economies of Brazil, Russia, India and China steadily overtake those of the West in their size and influence, a growing number of emerging market corporates (EMCs) are expanding beyond their traditional borders. The number of BRIC companies on the FT Global 500 list more than quadrupled between 2006 to 2008 alone, and in 2012 companies based in emerging markets grew roughly twice as fast as those in developed economies. Having already produced heavyweight multinationals such as Petrobras, Tata, Sinopec and Gazprom, the BRICs have a new wave of EMCs nursing global ambitions. Many are not yet household names outside of their home markets, but this will no longer be the case in the near future.

International expansion brings with it a host of challenges from a treasury and cash management perspective and an EMC may not always appreciate the complexities of operating in the new markets they are entering. These challenges range from the difficulties of dealing with diverse regulatory and tax jurisdictions to simple local language communication barriers. For example, a Chinese or Brazilian corporation accustomed to their home market may regard the Europe, Middle East and Africa (EMEA) area as a single distinct region in the same way they view their local market. That is until they encounter the varying legal frameworks and regulatory regimes in the 50-plus individual EMEA markets. Emerging market corporate treasuries will therefore need to consider adjusting their operating and treasury models to adapt to challenges encountered with multiple banking relationships and market practices outside of their home country. Some of the key challenges that EMCs should consider are outlined below:

Implementation considerations

Culture shock
Most EMCs will generally be accustomed to a personal working relationship with their local bankers, enabling them to fulfil banking services on an informal basis. It is not uncommon for large companies in local markets to simply call their relationship manager and request for an account to be opened with limited or no documentation. Companies may not be able to leverage these familiar relationships to the same degree outside their home markets, as regional and global banks are subject to greater levels of regulatory scrutiny that call for highly disciplined control practices. These processes make the fulfillment of such apparently straightforward banking services seem more formal. For example, being asked for personal documentation such as passport copies or utility bills to prove one's identity when opening an account can come as a shock to a corporate treasurer.

However, this may be a regulatory requirement that cannot be waived by banks in the given countries. In addition, some EMCs prefer to verbally agree to solutions, which can compound risks if solutions and/or even team members change at a later date. Companies are therefore urged to formally document all details of the solution defined, to prevent any ambiguity at some future time.

The devil's in the detail
When entering new regions, EMCs will encounter unfamiliar local banking instruments and market practices. While the broad cash management requirements are usually well understood, it is important not to make assumptions and invest sufficient time prior to implementation in validating all details of the final solution at a very granular market level to ensure treasury requirements are fully met.

As an example, an EMC unfamiliar with the Danish market may mandate their bank to establish 'low value payment capabilities' (ACH) without realizing that Denmark has a variety of low value payment instruments such as: 'Denmark Standard ACH payment', 'Denmark ACH Salary payment', 'Denmark ACH Pension payment' and 'Denmark ACH Supplier payment'. Failure to fully understand and define the correct instrument from the outset could result in the incorrect transaction capability being selected and implemented, potentially resulting in serious consequences such as failed salary, pension or supplier payments.

Be ready to hand over the keys
Delegation of decision-making and authorized signatories is a significant step that EMCs may elect to take. The ability to legally bind the company, such as opening/closing accounts and authorizing transactions, may have to be delegated to local treasury

managers in countries outside the home country via a power of attorney, if having executives in the head office managing and executing overseas banking relationships proves inefficient.

From a practical implementation perspective, the EMC treasury team may be required to manage an unfamiliar documentation completion exercise. Internal constitution documentation relating to each legal entity and subsidiaries may require updating, so that accounts and banking relationships can be independently managed from the home country. Correspondent banking contracts and documents in a local language may also require translation and/or notarization for acceptance in a particular jurisdiction.

'Buy in' is critical

Political challenges arising from a strategic decision to expand beyond traditional borders into new markets via acquisition will inevitably arise, and EMCs should not underestimate the potential impact of internal resistance to change. The decision to move to a global bank, for example, may be perceived by a local subsidiary as a direct threat to their autonomy.

Stakeholders' concerns that are not addressed effectively may translate into overt or covert resistance to the project, which may present significant barriers to successful implementation.

Bringing local stakeholder groups into the implementation process is a means of generating support, as is a proactive communication program outlining the benefits of the move at an enterprise level.

Get the techies on board

The technical infrastructure underpinning an EMC's transition from local to global should be sufficiently scalable to maximize standardization and centralize control, whilst minimizing any local integration or maintenance challenges across diverse geographic markets. This may require the upgrading of accounting platforms and enterprise resource planning (ERP) environments, adoption of bank agnostic file formats such as ISO 20022 XML and the establishment of new bank connectivity. The availability of sufficiently-skilled technical resources within the EMC will be critically important in establishing the technical infrastructure and bank connectivity required to maximize the expected efficiencies of globalization.

Service considerations

Operating models in a day-to-day environment

During an exciting and challenging period of international expansion, the practicalities of conducting transactions across multiple locations in a business-as-usual, day-to-day environment may be the last to be considered. Nevertheless, given the local flavor of many of the products and solutions used by EMCs, service models and expectations related to the most appropriate support structure for both headquarters and subsidiaries must be evaluated early on, to ensure satisfactory handling of inquiries expected once the client initiates transactions. Incorporating these considerations in the decision-making phase, prior to the implementation of banking solutions, ensures not only that the required service model is provided to the client, but also that service representatives are familiar with the EMC's business profile from the outset and are able to work towards establishing long-standing partnerships with clients.

Leveraging the technology at your fingertips

From online banking capabilities to inquiry self-servicing platforms, extensive technology is available to clients to enable smooth daily transaction initiation and account oversight, with maximum automation opportunities. The temptation to revert to manual transactions and minimum self-service, typical for a local-only relationship may, however, transform into long-term business habits and prevent the maximization of the bank's available resources, both human and technical, to support the client.

Making use of training programs materials and resources

Clients' knowledge of both electronic banking (e-banking) systems and extensive industry-related topics via online and on-demand training can be boosted by using the learning portal of a bank such as Citi, which offers live, on-demand, web-based sessions. Content is tailored to local conditions and trends, and regularly updated to bring clients' insights into technical and industry information. Shared service centers (SSCs), or combined local and global needs, makes these resources invaluable for the seamless operation of business, and EMCs – more than any other corporate segment – can benefit as they establish themselves as regional and global companies.

What should you expect from your banking partner?

A well-prepared and qualified team is paramount

All of these considerations mean that an EMC facing such challenges will require a banking partner able to meet its cash management implementation and service requirements in several areas. Top of the list is the ability to provide clear direction and a significant degree of hand-holding, through a professionally certified project management team with a single point of contact to oversee and co-ordinate the entire project, as well as efficient business-as-usual capabilities to serve the corporation at both local and global levels.

During an exciting and challenging period of international expansion, the practicalities of conducting transactions across multiple locations . . . may be the last to be considered.

The bank's implementation and service teams should ideally have local language capabilities and a proven track record of implementing and supporting global treasury solutions for large corporates. They can assist in defining the optimum global solution down to a specific country level. This can be achieved via 'solutioning workshops' between the corporate and its banking provider, an efficient means of getting to the detail quickly, ensuring that the correct solution is implemented at the outset and mapping out the end-to-end country requirements.

An efficient banking partner should also offer a structured implementation framework based on best-in-class governance techniques, with the flexibility to adapt to an EMC's unique requirements where needed. It will also provide a seamless end-to-end on-boarding experience and transition, from the solutioning phase through implementation to on-going customer service. Getting the solution right from the outset, knowing exactly what is being implemented and what is the business-as-usual customer service landscape are vital. If this understanding is lacking, then even the best in-class project management team, top-notch technical specialists and comprehensive documentation will not be able to compensate. From the outset, all of the low-level detail must be established, so that everyone throughout the organization knows what will happen, why it will happen and exactly how it will happen.

As noted above, internal 'buy-in' for the global solution within the EMC is important to ensure project success. The bank should be ready to assist the EMC's head office in 're-selling' the benefits of the global solution and implementation methodology to internal EMC subsidiaries, to ensure the buy-in of all stakeholders is attained upfront and confidence in the execution model established.

Clear file integration guidelines are key. These should cover the full range of transaction types across all countries, as well as comprehensive

testing programs to ensure a seamless integration experience. In addition, experience of managing bank agnostic file formats, including ISO 20022 (pain 2 and pain 3) as well as other well-established payment file formats, will be essential as the EMC endeavours to maximize the benefits of scale.

Finally, a well-defined legal and documentation support model that can centrally guide the documentation strategy and co-ordinate/support the documentation execution globally, including any legal negotiations between the EMC and the bank's legal teams, will be essential in ensuring a seamless documentation experience.

Banks with a major global footprint can assist EMCs in their transition from local player to global contender in managing their working capital, preparing them for any challenges that they can expect to encounter, and by maximizing continuity across diverse markets.

Manish Kohli

Global Head of Citi Commercial Cards, Treasury and Trade Solutions, Citi

COMMERCIAL CARDS COME OF AGE IN THE MIDDLE EAST

In many countries in the Middle East, corporates and their business travellers can now access the full benefits of commercial cards.

The Middle East

The Middle East (ME) is becoming more interconnected and more integrated into the global economy. As a result, business travel in the region is growing rapidly: Qatar and Saudi Arabia should record double-digit growth in 2013 while other regional markets will grow by more than 5%.[1] Consequently, travel and entertainment (T&E) spend is increasing and companies need to control costs and improve efficiency.

Organizing and paying for business travel in the ME is often seen as challenging compared to mature markets in Europe or the US. Some countries, such as Pakistan and Egypt, still use significant volumes of cash and, to a lesser extent, checks for travel expenses. Other countries, most notably the United Arab Emirates (UAE) and Kuwait, have adopted cards but are less fully integrated than the most developed international markets.

However, global best practice is increasingly being adopted across the ME and commercial cards made available. "Commercial cards deliver improved efficiency, accountability and convenience," says Steve Donovan, Regional Executive at Citi Transaction Services. Citi's issuing network spans over 100 countries and offers local currency cards in Pakistan, Egypt, Kuwait and the UAE and international currency cards in Qatar.

Commercial cards offer a compelling alternative to cash, checks, personal credit cards or so-called hybrid cards (which are personal credit cards repurposed for business) in the ME. As a replacement for cash and checks, commercial cards improve security and reduce fraud. Similarly, they offer improved accountability compared to use of employees' cards. Compared to hybrid cards they offer MIS data, improved reporting, greater transparency and enhanced control for corporates.

Commercial cards encompass more than just T&E: purchasing cards improve efficiency and accountability and can lengthen companies' working capital cycle while virtual cards, which generate unique card numbers, deliver complete control and seamless reconciliation.

Global consistency and best practice

As regional and global companies expand across the ME, they want standardized processes to improve efficiency. Commercial cards deliver consistency, which is important for regional and global firms. More generally, standardization can enable automation (of expenses processes, for example) and deliver reporting, compliance, control and security benefits.

Commercial cards make it possible to achieve process standardization, either within the ME or multiregionally. "By working with a global provider such as Citi for the rollout of our EMEA cards program to UAE, we have brought global best practices to markets in the Middle East for the first time," notes Wook-Joong Yoon, CFO for Samsung Gulf Electronics based in Dubai.

To achieve these benefits, corporates must differentiate between banks' card products. While hybrid cards are issued to employees, they offer few benefits to corporates. Equally, many genuine commercial cards have no local currency offering, making the card redundant for much of a company's spend (and generating incremental FX costs).

Companies must also consider card providers' additional functionality, support and integration. "Citi's Global Card Management System was a fundamental differentiator when choosing a provider for corporate credit and purchase cards," says Toby Shore, Corporate Treasurer and Chief Risk Officer at Dubai Aluminium. "It delivers the flexibility, control and visibility we require to effectively manage our card program."

In addition to the Global Card Management System, which enables account level online management, Citi offers Citibank Custom Reporting System (CCRS), which captures and manages expense information related to card transactions. The solution facilitates reconciliation by including detailed travel booking information alongside financial information.

Complete flexibility

For organizations considering commercial cards, the range of products can seem daunting. However, commercial cards can be tailored to clients' specific needs, minimizing complexity while delivering the same efficiency, visibility and control benefits.

For example, Monsanto, which had commercial cards for travelling employees in many EMEA countries, wanted local currency cards in Pakistan but had tried and rejected several card products. "The Citi commercial card out-shone the others because of its uncomplicated mechanics, its complete integration with our IT systems, its sharing of controls with our management and its provision of round-the-clock comprehensive administrative support," explains Javed Murtaza, Country Finance Lead at Monsanto in Pakistan. "Citi commercial cards offer a reliable, dedicated, hassle-free and tailor-made service that matches our working philosophy."

By working with a global provider such as Citi for the rollout of our EMEA cards program to UAE, we have been able to bring global best practices to markets in the Middle East for the first time.

Virtual card accounts

While the use of T&E and procurement commercial cards is increasing in the ME, virtual card accounts are also generating interest, especially in the travel supply chain. Virtual cards generate unique virtual credit card numbers. These allow client administrators to set spending and controls on each virtual card based on specific requirements. When a supplier uses a virtual number, the transaction flows through the authorization process like any other credit card payment. Transactions include robust reference data: each is tied to a unique virtual card number and there are 30 customizable data fields to ensure seamless reconciliation.

One major B2B ME travel industry wholesaler has used virtual card payments since 2011 to enable it to meet hotel chains' demand for a credit card to immediately secure discounted booking rates. Without this ability, suppliers are reliant on post-stay invoicing, which is expensive and inefficient. Now the travel wholesaler can generate single use credit cards to secure bookings on clients' behalf for specific values, validity dates and suppliers.

A bright future

The potential for commercial cards in the ME is remarkable. The region is growing rapidly while the uncertain financial environment since 2008 has prompted companies to reassess cash flows and spending and improve efficiency, visibility and control. Meanwhile, central banks and regulators want to reduce cash use to improve national competitiveness and efficiency.

"Citi estimates that the potential cardable spend for government and corporates in the UAE alone is around $53 billion, of which just $3 billion is currently spent on cards," says Donovan[2]. "The size of the figure is less important than the enormous business travel and other spend benefits that ME organizations can achieve. There is a huge opportunity for companies to improve efficiency, lower costs and take charge of their business travel and other spend in a way that has never been possible before in the ME."

Citi estimates that the potential card-able spend for government and corporates in the UAE alone is around $53 billion, of which just $3 billion is currently spent on cards.

[1] Source: Kaiser Analysis using data from OECD (2005), OECD (2009), National Statistics, IMF World Economic Outlook Database, Bank of International Settlements (2011), MasterCard Research and Analysis.

[2] Sources: National Tourism Agencies, World Travel and Tourism Council, IMF/Intl Financial Statistics and National Tourism Boards.

THE SECRET TO EM SUCCESS

Mark Tweedie

Head of Sales EMEA, Corporates, Treasury and Trade Solutions, Citi

Joakim Lidbark

Global Head CitiFX, Corporate Solutions, Foreign Exchange, Citi

In a recent 'Finger on the Pulse' poll on Treasury Today, the majority (61%) of respondents chose foreign exchange (FX) as their biggest cash and risk management concern when operating in emerging markets (EM), followed by cash flow forecasting and visibility and then regulatory complexity. Mark Tweedie, Head of Sales EMEA, Corporates, Treasury and Trade Solutions and Joakim Lidbark, Global Head CitiFX Corporate Solutions, Foreign Exchange, outline Citi's strategy for helping clients navigate liquidity management challenges in the EM.

Around 70% of world growth over the next few years will come from emerging markets (EM), with China and India accounting for 40% of that growth. In 2005, less than 10% of the global Fortune 500 was headquartered in the emerging markets; last year, that proportion had grown to over 25%. Today multinational corporations (MNCs) are eagerly looking to enter or expand their business operations in these dynamic markets. As the EM increases in importance within a corporate's overall growth strategy, treasurers are being called upon to improve visibility and control over the company's cash within these countries, which in turn is driving the desire for increased treasury centralization.
In order to use liquidity efficiently and rely less on external funding, a treasurer needs to know where the company's cash is, how much is in each locality and whether there are restrictions on its flows. However, this level of oversight can prove to be quite challenging. Given this importance, Citi has created an EM resource center which is a single source of information on regulations required and its transactional services.

In addition, as corporates move from a distributor-led G3 currency (US dollar (USD), euro (EUR) and Japanese yen (JPY)) model to a full-fledged permanent local presence, they need to develop a strategy for modifying their working capital practices. Many of these companies are now looking to invoice in local currencies, as a result of becoming more responsive to the end customers' buying behaviour, funding currency and need to reduce FX volatility.

FX risk management

FX risk management in the EM is a hot topic, as shown by Treasury Today's 'Finger on the Pulse' poll. As a result many treasurers are looking to evolve their policies around currency hedging and the management of local currency positions. In doing so, a common realization is that existing G10 currency[1] hedging policies, which may be more than ten years old and written at a time when the corporate was G10-specific only, is not fit for purpose in the EM.

Depending on the sector, a typical corporate would use a hedging tenor of one to two years for its G10 FX exposures. However, as sales and revenue streams alike shift to

EM, simply applying a G10-centric hedging policy may not suffice. This is mainly because of the cost of hedging EM currencies, but also in some circumstances due to liquidity and regulatory constraints. As a consequence, we believe that corporates with a global foot print should consider benefits of applying two separate approaches: one pursuing a long-term hedging policy in the G10 currencies; and the other with a much shorter hedging tenor, e.g., less than one year in the EM.

Before setting up a hedging policy, or rewriting one, corporates should first understand why they are hedging. For those corporates predominately managing G10 currencies, a common objective is to smooth out the peaks and troughs of year-on-year volatility. To achieve this goal, a corporate will need relatively long-term hedges in place such as provided by a layered hedging framework, where hedge ratios are built up gradually over time. However, in the EM, smoothing volatility is not as straight forward due to factors such as the absence of mean-reversion, jump-risk and hedging cost; instead many use hedging as a means to lock in margins or achieve a budget rate over a specific period.

Citi helps corporates quantify risk, and then determines which types of derivatives can be used to mitigate the exposure. This advice is not limited to the type of derivative, but also to implementation method. Once a hedging policy is defined it's important to effectively track exposures and make sure it's accurately followed. For example, Citi's FX Pulse product allows subsidiaries to enter their exposures which feed up to central treasury in real time. Treasury can readily access a breakdown of cash flow and balance sheet exposures alongside their existing hedges, and in turn receive a clear instruction on how much more or less to hedge at any time to stay on target.

A netted risk view allows users to see total risk in a given currency pair, or indeed single currency, across all subsidiaries, exposures and value dates so that risk on aggregating positions across opposite functional and exposure currencies are quickly highlighted.

Cash management and cross-currency payments

As large multinational corporates (MNCs) move a greater proportion of their business and density of sales into the EM, they are looking at ways to repatriate surplus cash from financing and debt redemption. Corporates are increasingly using inter-company control, netting and sweeping (to the extent that currencies are fungible, or without capital or currency control restrictions).

Corporates need to stay abreast of new developments in global liquidity management, as the EM economies evolve. The most prominent example is the People's Bank of China (PBoC) and State Administration of Foreign Exchange's (SAFE) recent relaxation of RMB currency controls. Citi is participating in a pilot program that includes just a handful of banks and corporates. In January, the bank completed its first cross-border lending transaction in RMB, conducted on behalf of a European consumer company. The money was lent to the company's regional treasury center (RTC) in Singapore, in order to leverage its China operation's surplus cash and achieve greater efficiency in its global fund usage and allocation.

As they expand deeper into the EM, corporates are switching from foreign currency to local currency invoicing and searching for a single solution for cross-border payments. Citi's WorldLink product has continued to evolve for the past 30 years and now supports 2700 clients, processing 36 million payments per year. WorldLink is a multicurrency cross-border payments solution enabling clients to have a single funding currency while making payments in over 130 currencies.

Corporates, in particular those setting up joint ventures (JVs) to support their growth in EM, are using WorldLink as part of a 'banking lite' operating model and payment architecture. Common in the oil and gas industry, JVs are usually set up for finite timescales, such as for production and exploration projects. These JVs don't necessarily have the natural offset between accounts receivable (AR) and payable (AP), as crude oil is denominated in USD and shipped through commodity traders, whereas payments to tax authorities, suppliers, insurers, employees, etc., are in local currency. In this situation, often companies don't want to put a lot of expensive plumbing in place, or go down the laborious road of joint signing authorities, account openings and complex liquidity structures, with a new JV partner. Instead they want to fund the JV on an as-needed basis and make their proportionate share of disbursement from a treasury account.

As part of managing end-to-end financial flows, Citi supports corporates' employee expense management and business-to-business (B2B) purchase cards programs. Companies usually want to drive more spend through cards to increase their control and leverage (from a procurement standpoint). Citi issues local currency commercial cards in over 65 countries, which means that the cardholder doesn't suffer from the local currency fluctuations and the corporate gets the benefit of the entire global spend, not just in the US and Western Europe where most issuers have acceptance capabilities. This holistic coverage means that procurement can negotiate with its suppliers based on the company's global spend and that card holders have a common experience irrespective of territory. To this end, Citi has become the only international bank offering this service in China.

Liquidity and trade finance

Operating in the EM raises corporate risk levels and many are looking to mitigate risk with early settlement of their pending receivables. Citi has focused its activity in the trade finance space to help clients with their payment terms to free up liquidity early on in the process. Citi also has a Global Concentration Engine providing treasurers with seamless end of day cash mobilization for an unlimited number of accounts in 25 countries (the bank is currently expanding this), thereby minimizing idle cash and consolidating cash in treasury hub locations.

Citi is active in the letters of credit (LC) space, which effectively swaps corporate risk for bank risk. LCs continue to be a common approach when companies enter into agreements with new trading counterparties. They are looking for a single counterparty to help them with their export LCs – not just issuing LCs but also discounting where possible to accelerate the cash conversion cycle.

Therefore, as clients go into new markets, trade services are a highly valued area of the corporate and bank partnership. Citi understands that having teams on the ground, illustratively, in Lagos, Nairobi, Algiers and Dubai is of critical importance especially when aligned to the largest correspondent bank network in the business. Citi has further invested in expanding and mobilizing its electronic bank platforms to handle LC issuance and confirmations. Furthermore, the trade processing hubs at Citi are essential tools for the treasurer when navigating new markets.

In addition, and especially common in manufacturing and energy/refining industries, corporates are also looking for import loans and financing to buy equipment, which are most often large

Citi is effectively configured as an "early warning system" for its clients, with the aim of de-risking, demystifying and simplifying the EM.

dollar-denominated purchases. By linking the asset to a trade transaction, banks are able to reduce the risk capital intensity given the low loss given default rates and therefore price such loans attractively for corporates. Citi has further seen a significant expansion of interest in extending its successful supply chain finance programs for clients to cover EM suppliers. Fundamentally, corporates need banking partners to help them navigate environments successfully and de-risk it. Citi, for example, was one of the first banks to set up LC re-issuances for the Trade Bank of Iraq (TBI), effectively swapping out exposure on Iraq for risk on Citi in UAE.

De-risk, demystify and simplify

Citi's investment and commitment to the EM is absolutely core to its business strategy. Mike Corbat, Citigroup CEO, outlined the bank's orientation in his 1Q13 speech on 5th March: "For Citi, global doesn't mean packing up a suitcase and travelling to where a client needs to do a transaction. Global means we're established in the countries where our clients need us to do business, both in developed and emerging markets. They can make payroll in Tanzania. They can purchase raw materials in Indonesia. They can hedge currency risk in Korea. And they can do so knowing that they're dealing with a strong, well-regulated firm."

Citi has deep knowledge and experience in the EM and is well-positioned to comment on evolving trends, such as cash management practices during the impact of the Arab Spring. Citi also enables corporates with centralized treasuries to be guided by the bank's relationship, sales and product teams as to what is happening from a regulatory change standpoint, whether that is Hungary's financial transaction tax (FTT) or new depositor insurance regulation in Kenya or Nigeria or the relaxation of RMB currency controls. The bank is effectively configured as an "early warning system" for its clients, with the aim of de-risking, demystifying and simplifying the EM.

MNCs are engaging in a significant amount of capital raising activity in the EM, as indeed are EM companies, given the attractiveness and the low spreads on the high yield debt and some of the EM debt. Clearly what the companies do with that cash once they have raised it and how they manage that cash is of principle concern for the group treasurer, who will be working hand-in-glove with the M&A department and the business development function. In addition, Citi is investing in banking evolution – CitiDirect BE – and has launched a mobile version of its CitiDirect platform, CitiDirect BE Mobile, with an upgraded user experience and new functionality, such as access to Trade Advisor. This enhancement, along with other channel extensions that Citi currently has in the works, is geared towards giving treasurers control and oversight of transactional activity across their business.

[1] G3 plus Canadian dollar (CAD), Australian dollar (AUD), New Zealand dollar (NZD), British pound (GBP), Swiss franc (CHF), Swedish krona (SEK) and Norwegian krone (NOK).

Luxottica Group S.p.A

Luxottica Group is a premium, luxury and sports eyewear company with manufacturing, retail and wholesale operations that span 130 countries worldwide. The company has adopted a regionalized treasury structure with each treasury center responsible for cash and FX risk management in its own region.

In China, Luxottica has two manufacturing facilities plus retail and wholesale operations. The Chinese subsidiaries import and export raw materials and finished products to and from various group entities, the invoice currency primarily in USD, EUR and AUD. In addition, various group entities have trade flows with third-party suppliers in China where the invoice currency is in EUR or USD.

In 2010, the treasury team reviewed its FX flows worldwide with the objective of simplifying the invoicing process to minimize the FX risk in particular regions and concentrate it in Europe, where the company's main manufacturing facility and HQ are based, and its exports worldwide account for a significant percentage of the groups' FX exposure.

The internationalization of the RMB was gaining momentum at the time so Luxottica assessed this in relation to flows with Chinese entities and decided that all inter-company flows with China would be re-invoiced in renminbi (RMB). As part of the review and transition to the new invoicing process, Luxottica mapped out all the relevant flows that would be affected by this change and worked with Citi on solutions to support the initiatives.

This involved its fiscal and tax departments, with a particular emphasis on transfer pricing; the IT department, charged with amending accounting systems and billing/logistics systems; and the treasury team, which co-ordinated with all relevant departments, including local finance teams. In the process, the treasury team in Europe opened a number of offshore RMB accounts with Citi to collect and pay RMB, and manage the FX risk using spot and forward deliverable RMB contracts. The whole project was completed in just six months.

Adopting the RMB has brought significant efficiencies to Luxottica: simplified invoicing for China and reduced currency pairs managed from AUD, EUR and USD to RMB; simplified hedging process, removing FX risk from China and concentrating FX risk in Europe; a greater natural hedge than it had before; lower transactional and operating costs.

With the increased liberalization of the RMB, Luxottica is considering integrating the RMB into a global cash-pooling solution (such as multi-currency notional pooling) to concentrate its cash.

Wipro India

Wipro, a global IT company, has over 130,000 employees, with clients located in 54 countries. The company has established a shared service center (SSC) in Bangalore, India, and embarked on a project to automate payments processing, migrating from the use of checks to electronic payments (e-payments) for payments both in India and in Europe from its enterprise resource planning (ERP) system. This project proved highly successful, with a significant number of payments made electronically within the first year, leveraging uniform standards.

Since then, Wipro has extended the reach of its SSC across nearly 35 countries, and continued to pursue an active acquisition program, further increasing the scale and complexity of the SSC's operations. Consequently, the company has worked closely with Citi to expand and enhance its activities to meet its changing business needs in 22 countries.

Wipro's SSC now makes payments on behalf of branches and subsidiaries in nearly 35 countries using a full range of payment methods to support the company's activities across eight countries in Central and Eastern Europe (CEE), Latin America and North America. When first establishing the SSC, Wipro used CitiDirect Online Banking for payments and account statements. More recently, the company has been working with Citi to migrate to a host-to-host connection with Wipro's ERP, enabling full straight through processing within a secure environment.

Wipro had already implemented Citi's Worldlink solution for making foreign currency payments from a single account. Most recently the company expanded its business in the U.S., leveraging Wordlink's capabilities by automating the production of checks, and testing is in progress for the Canadian region. In India, foreign currency payments can be complex because of the documentation requirements, which can make the process slow and labor-intensive. Wipro implemented Intralinks, which exchanges foreign currency payment information electronically with the bank, streamlining the process considerably, and ensuring that Wipro's team has to deal only with exceptions.

As a company with an ambitious growth strategy, Wipro has made frequent acquisitions in recent years. In order to achieve full visibility and control over cash, both for accounts held with Citi and third-party banks, Wipro chose Citi'sTreasuryVision program, in order to give visibility over accounts globally. Around 60% of accounts are now accessible through TreasuryVision, which is also increasing rapidly, so Wipro will have full visibility over its cash balances globally, which can be extended to new accounts as the company structure continues to change and expand.

Panalpina Latin America

The Panalpina Group, a multi-modal transportation company, has global operations in more than 80 countries. In Colombia, the company faced unique challenges in its efforts to maximize cost efficiency and improve supplier relationships. Because ground transportation is particularly costly in the region with shippers demanding that all costs be paid up front, Panalpina Latin America focused on improving cash flow and meeting working capital goals.

In order to improve the company's working capital, it needed to renegotiate terms and conditions with ground transportation suppliers. With help from Citi the company implemented a supply chain finance (SCF) solution. After securing buy-in from the procurement team, treasury worked closely with the bank to put a customized Citi Supplier Finance program in place. The program offers suppliers the opportunity to turn their AR into immediate cash.

This innovative solution provides an electronic disbursement service with Citi acting as Panalpina Latin America's paying agent, allowing the bank to pay suppliers on their respective due dates. At the same time, Citi offers suppliers the option of accelerating AR payments, either through a true sale or a discount structure.

To initiate a payment, Panalpina Latin America informs Citi via electronic straight through processing (STP). Citi Supplier Finance presents these payments, along with underlying remittance information such as invoices or purchase orders, to the suppliers, who gain critical visibility into future payments. Suppliers may choose to elect early payment on all or some of these payments, or simply be paid at normal maturity. On the AR due date, Citi takes the collection directly from Panalpina Latin America through its debit authority.

The technology put in place by Panalpina Latin America and Citi has delivered a highly efficient host-to-host payment system that achieves low operative costs and reduced manpower requirements. While initially only implemented in Colombia, the corporate treasury team has to come to recognize the value of this structure for the entire organization and has rolled it out across Latin America.

Further benefits of the SCF program include supporting suppliers' working capital needs, which ensures continuity across supply chain sourcing. Suppliers' AR can be converted into cash more rapidly; and they gain better access to alternative financing options and highly competitive funding rates which reduce their financing costs. By unifying supplier payments through Citi, Panalpina Latin America is also able to achieve greater negotiation control.

For the company, working capital ratios have increased through improved days payable outstanding (DPO), days sales outstanding (DSO), and days inventory outstanding (DIO). By increasing the efficiency of its working capital flows, Panalpina Latin America was able to improve its financial indicators by more than 100% in less than one year, becoming one of the first divisions in the region to achieve this milestone.

Sameer Sehgal

EMEA Head of Trade, Treasury and Trade Solutions, Citi

FOUR GLOBAL TRENDS CHANGING THE FACE OF TRADE FINANCE

The trade finance industry is changing rapidly. While leading banks have benefited in recent years from client demand for risk mitigation in their trading relationships – and enjoyed a substantial rise in funded assets as a result – the business faces four distinct challenges: geopolitical uncertainty, new banking sector regulation and its impact on trade finance, drive towards digitization in the trade business, and the emergence of new models of origination and distribution of trade paper.

Increased uncertainty in a globalized world

Five years on from the post-2008 financial crisis, the world is still suffering the after effects of the financial crisis: it could be another five years before the global economy – which is expected to grow at a just over 3% for 2013 overall (the same as in 2012) – is fully recovered.

Partly because recovery has taken longer than previous economic cycles, there has been political upheaval in many countries and across a broad spectrum of society. Austerity policies, high commodity prices and weak economic growth have resulted in protests and a call for regime change in countries across the globe.

Periods of uncertainty could lead to scarcity, which in turn could bring about inflationary forces – especially when it is coupled with expansionary policies driven by governments trying to turbo charge their respective economies out of the downturn. More generally, for companies that operate around the world – with diverse global supply chains and a myriad of distribution outlets – such uncertainty requires careful analysis and close management.

Another side effect of the uncertainty in global markets, is the consequent pressure on the cost of financing and transacting, as banks must reflect the higher risks they face. In addition, disruption to the physical supply chain adds delays and costs to the value chain, directly increasing the price of goods. Government actions to fix foreign exchange rates to boost exports indirectly raise the cost of imported goods.

However, there are also forces driving costs down. Some governments are introducing protectionist measures, such as restrictions on cross-border labor movement, to improve opportunities for nationals. This is often coupled with ceilings on lending rates and prices of essential goods. These measures can work in the short term, albeit at the cost of quality of goods available. The most popular response by governments and central banks to weak economic conditions is record low interest rates, which are designed to stimulate borrowing and trigger a multiplier effect in the economy.

This complex environment has held back world trade in the past few years: world trade growth fell to 2.0% in 2012 – down from 5.2% in 2011 – and is expected to remain sluggish in 2013 at around 3.3%. Looking ahead, this period of uncertainty may continue for another two to three years before reaching a possible inflection point on the growth curve.

The challenges of increased regulation

The recklessness of some banks in the lead-up to the financial crisis – and consequent cost to taxpayers and damage to the global economy – has rightly spurred governments and central banks to introduce new regulations designed to prevent similar problems in the future. However, given the dynamism of the global economy it is challenging for many, including regulators, to keep up with the pace of change. Over regulation can lead to the inability of banks to extend financing for trade and thereby contributing to a slower turnaround of the trade markets.

For example, trade is universally regarded as a low risk product, given its short term, self-liquidating characteristics and alignment with companies' working capital cycle (which mean it is needs based). Documents evidencing trade are required as a condition for finance. Both banks and, in many countries, regulators require proof of trade to monitor foreign exchange. The average default rate on short-term international trade credit is just 0.2%, of which 60% is recovered , making it one of the safest forms of lending. Moreover, trade serves a critical role for global companies, government (which need it to facilitate infrastructure) and individuals, who rely on it to supply their daily needs.

However, Basel III could adversely affect trade because it does not discriminate between general purpose lending and trade. Specifically, the conversion factors for import letters of credit (LCs) and guarantees, which in the past reflected the unfunded contingent nature of these instruments, have been removed. Consequently, the amount of capital that banks are required to hold for such instruments will be many times that of the past. Banks are likely to limit availability or increase their pricing to account for the increase in capital: reduced credit or higher prices could damage world trade.

The plethora of regulatory changes could also harm innovation by forcing banks to deploy much of their technology budget to compliance-related investment – a problem made worse by staggered reforms and different rules in different jurisdictions. This limits the budget for innovation that could benefit businesses. Moreover, it results in a focus by banks on costly customized solutions rather than broader solutions that might benefit a sector or industry.

The plethora of regulatory changes could harm innovation by forcing banks to deploy much of their technology budget to compliance-related investment.

Other regulations also have potentially detrimental consequences. Labor restrictions, such as limitations in the number of work permits, eventually result in a dip in the quality of available talent. That can potentially reduce the quality of solutions generated or implemented in a market, and make it more difficult for global companies to operate seamlessly across markets.

Similarly, restrictions on cross-border lending reduce companies' financing flexibility and potentially weaken centralized control. Moreover, such restrictions could negatively affect trade by reducing the amount of funding available and increasing the cost of borrowing as global and regional banks currently use their ability to pool and lend cross-border to fund trade.

While the need for regulation is understood, when coupled with protectionist and populist measures in various countries, it could make for a very closed, inward looking and restrictive economic environment, running contrary to forces of globalization.

Digitization

The trade business remains largely paper based, partly because it involves so many parties, such as insurance companies, government agencies, chambers of commerce, freight and forwarding agents and banks. Moreover, digitization has failed to occur because while it might be desirable it is not essential: the primary objective of trade is to cover risks and finance working capital and a paper-based system achieves these goals.

However, the advantages – and simplicity – of digitized processes for trade are now compelling. Internet banking solutions such as CitiDirect deliver not just product information and MIS but also facilitate faster transaction initiation. CitiDirect's global reach meets the needs of global companies for LCs, funding requests, payment instructions or issuance of guarantees seamlessly across borders.

The prospects for the digitization of trade are also being boosted by SWIFT's efforts (on MT798 message standard and the BPO initiative), to - streamline multi-banking for trade finance and secure financing for clients without going through the onerous LC documentation process.

Investments that support faster scanning and processing of trade transactions, coupled with state of the art credit and compliance support systems, could provide a much faster turnaround of trade transactions.

Such technological advancements require investment in time, money and people and are only possible for banks that put trade at the heart of their business and have a significant transaction volume. The need for such high investment and in some cases the lack of it, is driving consolidation: approximately five years ago, the top five providers of trade services had about 12% of the market – today, they have 22%.

New models for trade finance

Trade has historically been an originate to hold business. Its short-term nature made it difficult to sell down because agreeing documentation was time-consuming and transactions had to be almost complete before they could be sold. However, technology for distribution of trade paper has improved significantly: many trade banks now have distribution desks - buying and selling it.

Distribution of trade risk facilitates transactions that are larger than a bank's individual capacity. By working with a single bank, clients do not have to knit together a solution involving multiple banks and benefit from simplified documentation. Distribution can also deliver tighter pricing because it reflects the demand-supply equilibrium. Finally, it allows banks to calibrate their capacities more closely to companies' financing needs, by bringing in peripheral banks that not have direct access to the corporate.

Distribution still faces problems. Many companies' credit ratings mean they cannot gain access to affordable liquidity. Equally, there is a need to educate potential investors to the merits of trade paper, while its modest returns may limit its appeal. There are also structural hurdles in linking origination to investment on a portfolio basis and in portfolio management. However, the potential rewards of distribution mean banks must collaborate to resolve these problems.

Some trade banks are still in the process of deleveraging to achieve and maintain the higher capital stipulations. With that, many Trade banks would need to identify different pockets of investors, including alternate investors such as hedge funds and pension funds. Historically, this has not been an investor class for conventional trade paper but presents an opportunity for the trade business.

Conclusion

The four aforementioned themes represent the most significant trends that Trade bankers will need to manage over the next few years. In many ways trade has been considered a counter cyclical business; the early stages of the financial crisis increased demand for trade products, as other sources of financing slowed. However, over last 12-18 months that has changed. While most banks have strengthened their balance sheets and addressed their core business models, debt markets seem to be coming back. In that light, the challenge for trade banks is to continue to ensure they stay on top of these macroeconomic and geo political challenges. This will ensure they continue to grow despite the eventual upturn, demonstrating that trade is not countercyclical business as it has been historically viewed.

[1] IMF, World Economic Outlook Update, July 9, 2013.

[2] 1World Trade Organisation, Trade to remain subdued in 2013, April 10, 2013.

[3] International Chamber of Commerce's Trade finance loss register, cited in WTO, Trade Finance and the WTO, March 2013.

[4] Citi Equity Research report "Trade Transformed – Oct 2011".

KEEPING INFRASTRUCTURE FINANCIING ON TRACK

Case Study: Panama City Metro Line 1

Citi has executed the first MIGA sovereign non-honoring guarantee in Panama for a vital infrastructure project.

In June 2012, Citi completed a $250 million MIGA guaranteed financing in support of the construction of Line 1 of the Panama Metro. The financing was the first-ever of its kind in Latin America and supports a vital infrastructure project for Panama, easing traffic congestion in the capital, reducing travel times, increasing access from the outskirts, and reducing pollution.

As a solution to its long-standing transportation and urban mobility issues, the Government of Panama has prioritized the construction of a mass transit system for the City of Panama, with the Panama Metro as the centerpiece of its plan. At a cost of approximately $1.9 billion, Line 1 of the Panama Metro will extend some 13.7 kilometers along a path that connects the sector of Los Andes in the north to the transport terminal at Albrook, and crosses most of the main avenues of the City of Panama.

The financing of the project by Citi is innovative in a number of ways, not least by including the first ever sovereign non-honoring guarantee by the Multilateral Investment Guarantee Agency (MIGA) – the political risk insurance arm of the World Bank Group — in the Republic of Panama.

In participating in the financing plan of this ambitious new infrastructure investment, MIGA issued a guarantee of $320 million to cover a $250 million loan arranged by Citi including interest and other financing costs associated with the construction of Line 1 of the metro system. This project represents MIGA's first coverage of non-honoring of sovereign financial obligations (NHSFO) in Latin America and the Caribbean — and one of the largest in the product's history.

"The Panama Metro is one element in a series of investments aimed at cementing Panama's position as a services hub in the Latin American region."

Panama Minister of Economy and Finance, Frank de Lima.

"Citi's support for the construction of the Panama Metro represents a further sign of our continued commitment to the growth and development of the country that dates back to our support for the original canal construction," states Valentino Gallo, Citi's global head of export and agency finance. "Our cooperation with MIGA shows how multilateral organizations can support the private sector as it fulfills the need for important infrastructure projects to move forward globally."

Citi is the joint global coordinator, along with the Bank of Tokyo-Mitsubishi UFJ on the MIGA guaranteed financing, with Mizuho Corporate Bank serving as lead arranger. This is the second transaction that Citi has structured for the Government of Panama to support the Panama Metro, and complements a $362 million ECA-supported financing from February 2012. Citi is the largest arranger of debt to the Panama Metro project at over $600 million.

Citi successfully negotiated several market-setting precedents on the MIGA contract of guarantee, increasing the NHSFO's marketability, and structured the first-ever MIGA premium to be paid on a rolling basis during the life of the deal (rather than up-front). The all-in cost of the MIGA-guaranteed financing contributed to a reduction in the average cost of the country's existing total debt stock.

Despite market turbulence and an extended deal-execution timeframe, the deal team successfully retained competitive pricing for the client, assuring a complete syndication of the transaction. Market reception was so positive that the transaction was oversubscribed.

Future lines of the Panama Metro are planned, with Line 2 expected to be announced before 2014. Panama is also designated as a priority Citi for Cities (C4C) country, and this transaction illustrates Citi's commitment to helping transform and modernize urban infrastructure in Panama while enhancing the firm's broader C4C strategy.

"Our Metro will be very helpful in solving traffic problems in its route, and our team is elated to have MIGA's and Citi's crucial participation in the financing."

Roberto Roy, executive secretary for the Metro's Secretariat

Given the state of transportation and mobility in Panama City's urban center, the Panama Metro will have a positive effect on the livelihoods of the city's residents and commuters. It will reduce travel times, vehicle operating costs, and greenhouse gas emissions, while helping people living in suburban regions access jobs and educational services in the city.

Vinício Fonseca, director of structured finance in Latin America and Angola for the Brazil-based Construtora Norberto Odebrecht — the company that is the majority owner of the engineering, procurement, and construction contractor for the Line 1 metro (the Line One Consortium) — comments: "The development of new capital structures that make long-term finance viable while optimizing funding costs plays a fundamental role in our ability to better serve clients, especially in the current state of global financial markets."

He adds: "We are honored to have contributed, with Citi and MIGA, to this pioneering project in Panama."

The Line One Consortium is a jointly-owned enterprise of Odebrecht and Fomento de Construcciones y Contratas of Spain.

"We're very pleased to support a project that will serve Panama's residents, in an environmentally friendly and sustainable way," says Izumi Kobayashi, MIGA's executive vice president. "Insuring large and complex infrastructure projects such as this one is a key priority for MIGA, and a demonstration of how we can support the strategic development objectives of our member countries."

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