Managing Liquidity & Other Risks Through Changing Times

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Corporate Finance Dynamics in 2011: Recovery

The global corporate sector enters 2011 in a position of strength. The overarching corporate finance challenge will be deciding when and where to deploy this spending power – on organic growth opportunities, on M&A, on further balance sheet strengthening or increased capital distribution.

**Strategic Trends**

- Focus on delivering sustained earnings growth
- Investment in high-growth & emerging markets
- Increase in M&A – buy and sell side
- Advanced trading and treasury models
- Diversification as a risk mitigant

**Balance Sheet Trends**

- High cash buffers remain, but much of it offshore or trapped in regulated environments
- Tapping into attractive EM capital and debt markets
- Continued de-leveraging and capital building
- Surge in shareholder distributions

**Corporate Recovery**

- Pre-crisis operating margins
- Surging cash levels
- Decline in leverage
Recent events confirm continued inter-connectivity of risk triggers...

Risk Assessment processes typically address direct risks and often neglect tangential or indirect risks.

Liquidity Lessons Learned

- Risk triggers are always present, with varying degrees of prominence - regulatory, political, supply chain, commodity prices currently in the forefront
- Increasing importance of due diligence – know your counterparties and suppliers
- Diversify sources of funding and other critical business drivers
- Maintain flexibility
- Develop contingency plans
- Right size buffers to insure against unforeseen and stress events; balance against cost
- Optimize internal utilization of resources
- Monitor risk triggers through enterprise risk management process e.g. regulatory, fiscal, market, geopolitical, environmental
- Leverage local expertise
- Optimize internal utilization and release trapped cash
Evolving Economic & Business Landscape…

The economic environment remains challenging as a result of slower growth across developed markets, concerns with European sovereign debt and impacts from changing market structures…

…As enterprises expand across markets adding complexity, and risk, to business processes

- **Foreign Exchange**
  - Increased in cross-border transactions
- **Custody**
- **Payments**
  - Evolving regulatory landscape adds complexity
- **Collections**
- **Supply Chain**
  - Oversight and control to address heightened risk profile
…Driving Evolution of Business Models

Treasury functions and operating models re-engineered to address increased complexity and risk.

External Environment / Factors

Trading Model

Legal and Tax Structure
- Supply Chain Models
- Manufacturing Models
- Sales / Distribution Models

Corporate Objectives

Liquidity Structure & Forecasting

Risk Management

Process Execution

AP / AR Processes
- SSC
- Netting Centre
- Payments Factory
- “…on Behalf of..”

Working Capital Management Model

Treasury Model

Regulatory, statutory/compliance

Treasury / Risk Management Processes
- Regional Treasury Centre
- In House Bank
- Legal entity

Banks, equity stakeholders and providers of capital

Customers, suppliers and partners

Customers, suppliers and partners
Challenges of Operating Cross-border

Dynamic Risk Environment

- Rise in social unrest linked to political & economic climate
- Localized and pan-regional regulatory and payment infrastructures
- Increasing state intervention
- Trapped flows
- Liberalization of capital constraints in some markets
- Commodity risk and price volatility

Country Rules and Regulations Keep Changing

- When sending Kazakhstan Tenge, the beneficiary's 12-digit Tax ID Number is required for every payment
- All Tunisian Dinar wires under 10,000,000/TND must include the beneficiary's 20-digit account number
- Payments (>USD1,000) in KRW must include beneficiary phone number; bank must contact the beneficiary to receive acceptance of the flows
- Cross-border invoicing and settlement in RMB now feasible

The Challenge

- Keeping current with changing rules, regulations and practices – in some cases creating opportunity
- Understanding local clearing systems (payments/securities)
- Mitigating market and supply chain exposures
- Management of foreign currency accounts and exposures
- Transparency into transaction fees and spreads; FX rates; lifting fees

Hidden Costs & High Fees

Complex Country Rules & Regulations

Overseas Payments

Dynamic Risk Environment
Case Study: Global Electronics Co. RMB Re-invoicing Center

In 2011, the company established a re-invoicing entity in Hong Kong to actively manage settlement of cross border trade flows between their China operations and other entities. Citi has been selected as the trade settlement bank for their China related supply chain flows.

Issues

- China factories have cost inputs mostly in RMB, while sales (mostly intercompany) were USD
- Significant costs due to fragmented foreign exchange exposure management, trapped liquidity
- RMB deregulation appeared to offer potential to address inefficiencies – the challenge was of establishing a viable solution, given the new regulatory frontier, with few precedents

Solution

- Established an innovative Re-invoicing Center in Hong Kong – consolidating trading flows through the Re-invoicing center, with RMB cross-border trade settlement.
- Benefits:
  - Reduces payments costs/fees; allows coordinated timing for better liquidity management
  - Centralizes and improves FX exposure management
  - Reduces trapped liquidity, with transparent costing throughout the supply chain with the use of local currency

Citi’s Role

- Helping in defining and implementing the solution, from concept to execution
- Delivering an integrated approach covering China, Hong Kong and HQ through Citi’s solution and relationship teams
- Negotiations with Chinese regulators to ensure transparency and buy-in from regulators
- Banking partner for all China-related flows
## Changing Regulatory Landscape

Regulatory evolution reshaping the Financial Services industry and consequently bank interaction with clients.

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| Basel III | • Comprehensive reform of international accord on capital adequacy and liquidity to improve the banking sector’s ability to absorb shock arising from financial and economic stress  
• Measures include:  
  – Consistency & transparency of regulatory capital base  
  – Higher capital standards and capital conservation buffers  
  – Strengthening cross-border bank resolution framework  
  – Internationally harmonized leverage and liquidity ratios | • Significantly higher capital and liquidity requirements  
• Drift toward national ring-fencing and inconsistent regulatory regimes | |
| U.S. Dodd-Frank | • Comprehensive reform involving:  
  – Restrictions on certain business activities, e.g. proprietary trading  
  – Mandatory clearing requirements for OTC derivatives  
  – Amendment of Regulation Q  
  – More stringent prudential regulatory standards; expanded role of FDIC  
  – Enhanced corporate governance and executive compensation requirements  
  – Increased consumer protections | • Expanded set of restricted/priced out activities  
• More stringent regulatory oversight; increased compliance and reporting requirements | |
| Accounting & Tax Reform | • Reform intended to create future accounting standards that are principles-based, internally consistent and internationally converged, e.g. GAAP to IAS  
• FBAR and FATCA | |
# Implications of Regulatory Reform

Regulatory evolution reshaping the Financial Services industry and consequently bank interaction with clients.

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<th><strong>Banks</strong></th>
<th><strong>Clients</strong></th>
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<td>• Increased capital requirements; liquidity and capital buffers; higher provisions for trade finance and contingents</td>
<td>• Bank borrowing and services, e.g. trade, become more expensive as competition for capital market sources increases</td>
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<td>• Regulatory capital mix changes</td>
<td>• Rules on derivative clearing and collateral imply higher cost of hedging</td>
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<td>• Balance sheet valuations shift; preference for term and structural funding with greater reliance on capital markets over wholesale funding</td>
<td>• Balance sheet and operational efficiencies to offset higher capital and banking costs</td>
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<td>• Cost of entry and maintaining infrastructure increases</td>
<td>• Timely information delivery and analytics critical to improving performance</td>
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<td>• ROA/RORC hurdles harder to achieve</td>
<td>• Rationalize bank relationships to ensure support for global expansion &amp; operational efficiency initiatives</td>
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<td>• Refocus on strategic activities; exit non-core businesses</td>
<td>• Re-evaluate investment options in view of new bank valuation models, regulatory and accounting treatment and risk profile.</td>
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<tr>
<td>• Balance sheet efficiencies critical to offset higher capital levels and costs</td>
<td>• Increased reporting requirements and infrastructure</td>
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Dealing with Increasing Complexity

With CEO/CFO priorities shifting from crisis management to “risk aware” sustainable growth, the role of the Treasurer has been re-defined as a strategic partner and “gatekeeper” of the balance sheet.

Strategic Focus – Optimizing capital allocation & funding structure

- Acting as gatekeeper of the balance sheet
- Addressing the treasury and funding implications of internal processes, policies and capital actions
- Identifying appropriate level of liquidity to support operations vs. strategic cash available for investment and expansion
- Extracting value from working capital / supply chain financing options to create in-house liquidity

Maximize Cash Efficiency

- Rationalize account structures, processes and technology
- Cash consolidation
- Centralized treasury operations and services
- Release cash from working capital cycle
- Improve cash forecasting

Improve Risk Management

- Develop firm-wide view of exposures
- Implement policies and governance framework to monitor compliance
- De-risk supply chain
- Centralize decision-making
- Plan ahead

Manage Growth

- Evaluate options to free trapped cash
- Tap into local knowledge and expertise in growth markets
- Extend best practice
- Integrate treasury management as a “functionally centralized/globally distributed” process
- Leverage technology to drive efficiency and de-risk processes

Key Challenges – Increasing Complexity

- High proportion of expansion into EM countries and currencies; increasing importance of managing currency risk
- “Beware of any proclamations of an end to volatility”*
- Restrictive regulatory and operational environments
- Proliferation of systems and data formats; insufficient global visibility into positions
- Aggregating critical information for real-time decision support

*Global Growth Generators, Citi, February 2011
Advanced Treasury Structures

Supporting “risk-aware” business growth and performance with advanced treasury and liquidity management structures, e.g., In-house Banks, global pooling structures, netting and payment factories.

- In-house bank, housed within a Global Treasury Center (may be in a tax-favorable location)
- Global Treasury Center becomes exclusive owner of external credit limits and management of bank relationships
- Intercompany commercial flows are settled from Netting Center through In-house Bank (cashless settlement) and physical payments
- Trading model may use (for example) Limited Risk Distributors and Contract Manufacturing, where feasible
- Global Treasury Center provides Treasury support services to non-IHB participants

▲ Minimizes external transaction volumes, reducing banking fees and processing costs
▲ Aggregates cash for most efficient use by the enterprise, optimizes use of external credit lines with banks
▲ Optimizes FX risk management and reduces external spreads taken
▲ Liquidity structure overseen by Global Treasury Center:
  ▪ Automates liquidity concentration
  ▪ Optimizes Interest earned
Case Study: Global Consumer and Health Care Company

Company (revenue $20bl) with Global Business Strategy aligned Global Treasury organization to support a 5% CAGG revenue growth strategy.

Issues
- Emerging growth markets identified
- Net borrower with debt concentrated in US; untapped cash of $600mm residing globally.
- Existing centralized treasury function for NA and WE and in-country finance support covering Asia and Latam.
- Significant real and opportunity costs due to localized liquidity and Foreign Exchange processes.

Solution
- Extend treasury structure aligned to further centralize working capital management across all regions.
- Global consolidation through IHB and additional RTC for non-IHB participants.
- Deploy single instance TWS, KPI identification and measurement processes to all newly established RTC’s.
- Design and deploy global liquidity structure to minimize bank relationships and standardize bank communications.
- Establish Global Netting Centre to minimize payments and FX volumes and costs.

Citi’s Role
- Helping in defining and implementing the solution, from concept to execution
- Delivering an integrated approach covering 80 countries of operation for liquidity and payments in both Treasury and SSC.
Supporting Growth: 2011 and Beyond Execution Imperatives

Keep abreast of changing market conditions
- Continued volatile market conditions and evolving regulations require real-time information management and improved monitoring and reporting capabilities
- Maintain financial, process and supply chain flexibility to respond to changing conditions

Implement robust control processes to monitor operational & financial risks that come with growth
- Close coordination with businesses, regions and partners to identify issues and mitigants
- Implement functionally centralized policies and controls
- Establish governance framework, KPI’s and alerts
- Ensure ability to monitor

Think strategically of treasury transformation opportunities
- Company-wide cash and liquidity management programs are a must
- Rethink trading models; legal and tax structures
- “Piggyback” treasury objectives on organization-wide technology/process initiatives to help drive the business case

Reassess banking relationships with a view towards future growth strategies and plans
- Long-term view of requirements across a broader network
- Rationalize providers to improve operating and cost efficiency

Technology and Infrastructure Investment to support global complexity
- Industrialize global reparative processes through deployment of technology to support working capital management
- Increase ability to generate actionable information, risk management and analytics from global business flows
- Streamline connectivity to suppliers, customers and banking partners to minimize cost and maintenance

Continuous Process Improvement
- Implement structures and processes to continuously align business, capital and liquidity requirements
- Mitigate risk through centrally administered processes and policies
- Streamline and standardize; eliminate repetitive and parallel processing
What are others doing?

The centralization paradigm continues to underpin risk-aware operating efficiency. Companies continue to develop and extend organizational structures within which the supply chain operates.

**Working Capital**

- Treasury Involved in Working Capital Management – 60%
- Operate Netting Centre – 61%
- Have Centralized Payments Processing – 60%
- Deploy single or minimal number of ERP systems – 55%

**Treasury**

- Centralized Treasury Policies - 93%
- Centralized Risk Management Processes - 72%
- Cash Concentration to Global or Regional level – 69%
- Utilize TWS – 65%

**Identifying Best In Class: Citi Treasury Diagnostics**

- Identify where you stand relative to peers - Learn what counts as best in class
Information as a Key Enabler: Looking Ahead

In an increasingly complex environment, the aggregation and review of enterprise wide data is critical to effective risk management.

Fundamentals of an operational visibility program

- Integrity – quality and timeliness of data
- Transparency – Easy to understand, standardized data
- Holistic – encompassing all available data points and positions
- Flexible – customize ways of gathering and examining data
- Integrated – within risk and business management processes to quickly evaluate impact and take action

Transforming to actionable data management

- Companies initially focus on utilizing enterprise-wide data aggregation to improve operating efficiency, cut costs and raise returns
- Visibility provides an added measure of control and oversight to ensure regulatory and corporate compliance
- Top-performing companies move up the value chain, adopting data-driven decision making practices
- Transformed companies utilize data to optimize business performance across a broad range of functions.
In January 2007, Citi released a Climate Change Position Statement, the first US financial institution to do so. As a sustainability leader in the financial sector, Citi has taken concrete steps to address this important issue of climate change by: (a) targeting $50 billion over 10 years to address global climate change: includes significant increases in investment and financing of alternative energy, clean technology, and other carbon-emission reduction activities; (b) committing to reduce GHG emissions of all Citi owned and leased properties around the world by 10% by 2011; (c) purchasing more than 52,000 MWh of green (carbon neutral) power for our operations in 2006; (d) creating Sustainable Development Investments (SDI) that makes private equity investments in renewable energy and clean technologies; (e) providing lending and investing services to clients for renewable energy development and projects; (f) producing equity research related to climate issues that helps to inform investors on risks and opportunities associated with the issue; and (g) engaging with a broad range of stakeholders on the issue of climate change to help advance understanding and solutions.

Citi works with its clients in greenhouse gas intensive industries to evaluate emerging risks from climate change and, where appropriate, to mitigate those risks.