Insights to Treasury Management

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The evolving regulatory environment is becoming more burdensome and the increasing cost of capital and liquidity are creating new strains.

Consolidation of relationships is expected to continue as providers recalibrate their client base.

Banks continue to look for providers who demonstrate commitment to the business, who offer additional products and services, and who offer thought leadership / training programs.

- Control and Transparency
- Payment Execution
- System Resilience and Centralization
- Payment Prioritization
Maximizing Returns

- Low Rate environment
- Operational cost savings
- Rationalize account structures

Managing Risk

- Adequate funding and liquidity by legal entity
- Counterparty Risk
- Settlement Risk
- FX Exposure
- Manual processes with operational risk impact

Addressing Regulations

- Basel III: LCR & NSFR
  - Requirement for higher quality assets
  - Increased appetite for operational deposits
- Intraday Liquidity Management
- Local regulation
How do banks look at all these treasury considerations in a holistic fashion?
Polling Question #1

*Has your approach to payment routing and balance management changed in recent times, or is it likely to change in the near future?*

A. A review has been completed and changes being implemented

B. A review is currently underway

C. A review is expected in the near future

D. No review undertaken to date or expected in the future
Operational Considerations

Robust infrastructure and support model covering the full payment lifecycle is necessary to facilitate more efficient payment flows and through this, increase the bottom line by lowering expenses and lowering settlement risk.

- Transaction Prioritization
- Payment Flow Optimization
- Regulatory Compliance Support
- Sanctions Screening
- Systems Resilience
- Operational Support
- Strategic Intraday Liquidity Management by Legal Entity
- Payment Tracking and Payment Prioritization tools
- Re-thinking the traditional FIFO approach
- System Dependability
- SWIFT Resilience
- High STP rates
- Global Platform
- Operational Support
- Intraday Liquidity transparency and Reporting capabilities
- Reconciliation Reporting
Case Study: Payment Process Optimization and Transparency

Case Example: Asia-based bank seeking faster and enhanced payments service to facilitate early morning payments.

**Client Requirements**

- Same day delivery during Asia business day
- Reduce settlement risk and improve STP efficiency
- Early access to balances and SWEEP

**Solution**

- Gain full access to prior day EOD balances + incoming funds earlier in the day
- Process as split (direct & cover)
- Expedited repair service for early morning instructions
- Local service center access to expedite delivery
Polling Question #2

What is the most important factor in determining how to route your high value payments?

A. STP rates and service quality
B. Payments visibility – monitoring and reporting capabilities
C. Provision of intraday credit
D. Pricing
E. Reciprocity
With increased provider consolidation and more efficient structures, banks stand to gain greater visibility over their balances and through this can reduce their need for liquidity amongst other benefits.

**Current State (without rationalization)**

- Low / Negative Interest rate environment
- Complex account structures
- Focus on Collateral Costs
- Regulations (i.e. BASEL III)

**Proposed**

Treasury centralization improves the ability of banks to identify risks and to manage balances more efficiently.

- By centralizing accounts – banks stand to increase liquidity efficiency, decrease operational expense and improve investment options

**Benefits**

- Increased Visibility
- Increased Liquidity Efficiency
- Netting Opportunities
- Easier Data Collation
- Simplification
Case Study: Intraday Liquidity Management

Below are two client cases to showcase liquidity usage over a given day. Client A uses liquidity efficiently while Client B uses liquidity in an inefficient manner.

**Client A**
Utilization Alignment: Minimal Exposure

- Payment flows are consistent and closely aligned throughout most of the day – minimal exposure
- Account balance is large enough to cover spikes in the day
- Client ends the day with a positive account balance on par with the start of day balance
- Flow alignment supported through liquidity analytics

**Client B**
Utilization Mismatch: High Exposure

- Payment flows are inconsistent and misaligned over the day
- Early inflows provide a positive balance but subsequent outflows and spikes require liquidity utilization
- Client ends the day with a zero or positive balance
- Additional collateral pledging required by Citi at the RTGS system due to large peak usage

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**($800MM) Net Account Balance**

$L2B$ Peak

Inflows
Outflows
Net Balance

$750MM$ starting balance
Closely aligned payment flows
EOD balance on par with SOD

($800MM) Net Account Balance
Liquidity required for outgoing payments
Polling Question #3

In your view, a tool that provides transparency to the payments process and looks to optimize liquidity usage should include most importantly...

A. Counterparty payments analysis
B. Historical information including ability to download data
C. Peak intraday liquidity information
D. Ability to prioritize payments
E. Real time liquidity usage data presented by legal entity and underlying accounts
Increasing regulatory pressures are becoming ever more burdensome and the increasing cost of capital and liquidity are creating new strains on bank balance sheets. Banks will have to re-think their treasury structures.

### BASEL III

- Redefining how balances are classified and deposits are managed
  - Challenging the traditional correspondent banking model
  - Banks re-assessing value of client operating and lending activity
- Banks will have to manage their balances more efficiently to maximize return on balances
  - Adapt Institutional Cash Management Practices
  - Operating vs non-operating/ excess

### Resolution

- New requirements are being implemented to have contingency arrangements for key nostro relationships

### Intraday Liquidity Usage and Reporting

- Value of intraday liquidity is now being realized across the industry
- Implementation complexity caused by data collation across multiple providers and jurisdictions
  - Currently no standard for reporting
A number of regulatory changes are reshaping bank balance sheets, leading to an impact on client liquidity management.

**Liquidity**
- Liquidity Coverage Ratio
- Net Stable Funding Ratio
- Intraday

**Leverage**
- Leverage Ratio
- Statutory Liquidity Ratio

**Risk Based Capital**
- Tier 1 Capital
- Total Capital
- G-SIB Buffer
- Capital Conservation & Countercyclical Buffer

**Other**
- Total Loss-Absorbent Capacity
- Brokered Deposits
- Money Market Reform

**Final Rule**
- Prescribes high quality liquid asset level necessary to fund stress outflows over 30 days
- Defines HQLA level required to fund stress outflows over a one-year period
- Enhances monitoring and control process
- Establishes tier 1 capital threshold based upon total asset levels, without regard to riskiness
- Sets capital threshold based upon total asset and off balance sheet commitments & derivatives
- Establishes minimum equity and other tier 1 capital necessary for a level of risk weighted assets
- Sets minimum tier 1 and tier 2 capital necessary for a level of risk weighted assets
- Systemically important FIs hold additional capital to offset risk transmission to/from the market
- Increases capital requirements in lieu of limiting capital and discretionary compensation payouts
- Reserves capital & debt to absorb losses and recapitalize G-SIBs as part of resolution planning
- Classifies most third party placement or facilitation of deposit gathering as brokered deposit activity
- Institutional prime funds subject to floating NAV as well as redemption gates/fees from 2016
Deposits – Operational or Not?

Deposits are deemed to be operational only if they are necessary to complete operational services. If a client can redirect funds without reducing operational services, that portion of the deposits must be re-classified as non-operational.

Operational Services:

<table>
<thead>
<tr>
<th>Cash Management</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Remittances</td>
</tr>
<tr>
<td>• Payroll administration</td>
</tr>
<tr>
<td>• Collection and aggregation of funds</td>
</tr>
<tr>
<td>• Payment orders</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Clearing</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Daylight overdraft</td>
</tr>
<tr>
<td>• Intra-day and final settlement positions</td>
</tr>
<tr>
<td>• Customer subscriptions/redemptions</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Custody</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Settlement of securities transactions</td>
</tr>
<tr>
<td>• Cashflow related to safekeeping assets</td>
</tr>
<tr>
<td>• Escrow, stock transfer, taxes, etc.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Attributes</th>
<th>Final U.S. LCR Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operational Account Designation</td>
<td>• Deposit account linked to operational accounts</td>
</tr>
<tr>
<td></td>
<td>• Held for primary purpose of obtaining operational services</td>
</tr>
<tr>
<td>Termination of Service</td>
<td>• Contractually required 30 day termination notice or</td>
</tr>
<tr>
<td></td>
<td>• Significant cost to move to new provider or</td>
</tr>
<tr>
<td></td>
<td>• Material termination costs</td>
</tr>
<tr>
<td>Excess Operating Deposits</td>
<td>• Bank must demonstrate methodology for calculating excess</td>
</tr>
<tr>
<td>Economic Incentive to Maintain Excess Funds</td>
<td>• Balances necessary for operations can be competitively priced</td>
</tr>
<tr>
<td></td>
<td>• Incentives related to operational services are acceptable</td>
</tr>
<tr>
<td>Institutional Investor Treatment</td>
<td>• Excludes deposits provided in connection with specific prime brokerage services</td>
</tr>
<tr>
<td></td>
<td>• Deposits from non-regulated funds are not eligible as operating</td>
</tr>
</tbody>
</table>
Polling Question #4

What impact has Basel III’s interpretation of Wholesale Banking Deposits had on your day to day operations?

A. No impact yet

B. Non-operating balances are becoming increasingly difficult to place

C. Non-operating balances are being invested out the maturity curve
LCR Impact on Institutional Deposits & Loans

LCR requires an amount of high quality liquid assets (HQLA) that equals net cash outflows over a prospective 30 day period which is reflective of regulatory stress assumptions.

\[
\text{LCR} = \frac{\text{Stock of High Quality Liquid Assets}}{\text{Total net cash outflows over the next 30 calendar days}} \geq 100\%
\]

**Outflows**
- **Deposits (Non-Maturity)**
  - Stable
  - Less Stable
  - Operating
  - Corp Non-Operating
  - FI Non-Operating
- **Commitments (Undrawn)**

**Inflows**
- **Loans Contractually Due in 30 days**
  - FI
  - Corp/Other

**Contractual Maturity**
- Time Deposits
  - TDs < 30 days are treated as Non-Operating
- Unsecured debt
- Secured wholesale funding
- Derivative exposures and other collateral requirements
- Other contractual and contingent funding obligations

**Credit Facility**
- Corporate
- NonBank FI
- Bank

**Liquidity Facility**
- Corporate
- Bank
- Non Bank FI
**LCR Value By Account Type**

<table>
<thead>
<tr>
<th>Account Types</th>
<th>LCR Value of Deposit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corp/Public Sector Operating</td>
<td>75%</td>
</tr>
<tr>
<td>FI Operating</td>
<td>75%</td>
</tr>
<tr>
<td>Corp/Public Sector Non-Operating &amp; Corp/PS Excess</td>
<td>60%</td>
</tr>
<tr>
<td>FI Non-Operating &amp; FI Excess</td>
<td>0%</td>
</tr>
<tr>
<td>Insured Unaffiliated Retail Broker Sweeps &amp; Escrow</td>
<td>75%</td>
</tr>
<tr>
<td>TDs &gt; 30days</td>
<td>100%</td>
</tr>
</tbody>
</table>

**Key Consideration**
LCR value of transaction accounts is comprised of sub-components with different LCR values - each account balance may consist of operating and excess components.

**Institutional Deposits Methodology**
1. Classify Accounts Based on LCR Criteria
2. Identify and Re-class Excess Operational Deposits

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*Note: Fed considers broker sweeps as a separate category outside of operational and non-operational. Listed here as operational since the run-off factors are more aligned with operational.*
Polling Question #5

*How important is your correspondents ability to support your end of day liquidity in the decision to allocate payment flows?*

A. Not important

B. End of day liquidity management is managed independently within our bank and has no impact on payment flow allocation

C. Important as we rely upon our primary correspondent to support our end of day liquidity
Considerations for an End-to-End Treasury Strategy

As the Banking industry evolves toward greater visibility, technological innovation and in adapting to the regulatory landscape, treasury optimization will require a broader strategy encompassing multiple considerations.

**Operational**
- Move away from FIFO and towards upfront payment prioritization
- Improve STP rates

**Structural**
- Provider consolidation for visibility and operational efficiency
- Explore netting opportunities to reduce Intraday need

**Regulatory**
- Increased collateral requirements
- Contingency alternatives
Preparing for Basel III requires an understanding of impacts from LCR:
- Set firm-wide objectives
- Align regulatory and treasury objectives with business actions
- Implement business initiatives

Banks need to revisit the allocation of payment activity and work with their providers to better align their payment and liquidity management to drive efficiency and value
- Holistic assessment to maximize intraday and end of day liquidity value
- Liquidity mismatches could prove costly from an intraday liquidity perspective

New regulatory deposit valuations are impacting the balance sheet value of deposits for correspondents
- Implications and relationship discussions on balance sheet capacity and wallet allocation
- Focus now is on sophisticated wallet allocation: regulatory value of deposits, deposit value by currency, bank fees, reciprocity

Banks have to right size their correspondent banking networks
- Move towards centralizing liquidity
Thank you