

Preparing the Corporate Back Office for CLS

Continuous Linked Settlement, better known as CLS, drastically reduces foreign exchange (FX) settlement risk by settling both legs of a foreign exchange transaction simultaneously irrespective of geographies or time zones. With 51 banks settling over \$50 trillion through CLS Bank since it went live in September 2002, CLS is rapidly becoming the FX settlement standard in the industry. Pioneer CLS users are enjoying benefits beyond risk reduction including increased straight through processing rates, a reduction in the number of payments made daily, and increases in reconciliation efficiency. With so much to gain, corporations must now look at how to best integrate CLS into their back offices. This article explores the implications of the operational choices corporations can make when preparing their back office for CLS.

CLS Integration Options

In CLS, corporations are typically Third Party participants that identify and route CLS eligible trades to their CLS services provider, known as their Settlement Member. Their Settlement Member then submits the trade to CLS Bank for processing and interfaces with CLS Bank to provide reporting on the transaction to the corporate Third Party.

There are essentially two options for integrating CLS into the corporate back office. A corporation can purchase a CLS module from their treasury system provider to upgrade their existing treasury system. Or, they can manually import and export CLS information using a Settlement Member's browser based electronic banking system.

Full Treasury Integration

The main benefit of integrating a CLS module into an existing treasury system is higher straight through processing. A CLS enabled treasury system provides corporations with a single interface to their Settlement Member, a single application for all information and reporting, and a mechanism for automatically reconciling CLS trades and updating accounting modules.

Most CLS modules are add ons to existing systems and should support a variety of CLS functions. The CLS module should identify CLS eligible trades automatically; route eligible trade information to the Settlement Member via

SWIFT flat file upload and message upload; and provide complete reporting of the trade details and the CLS pay in/pay out schedule.

The cost to upgrade and CLS enable a treasury system may range from \$50,000 to \$100,000 or more, and a fully automated CLS enabled treasury system is likely to be the right choice for corporations that process a high volume of foreign exchange trades and require a high level of straight through processing.

...Vs. the Semi Automated Solution

It may not be cost effective for corporations processing a low volume of trades – 20 trades a day or less – to purchase a CLS module. Instead they can manually upload their instructions via the Settlement Member's browser system. When using the manual approach to upload CLS instructions, corporations must update and monitor accounting information manually. Although no system re-engineering is required, corporations using the manual approach must train staff to upload and download files, which can be time consuming and expensive.

The Benefits of Using a Single Settlement Member and a Single Browser Interface

Corporations should consider whether or not their Settlement Member offers a browser based electronic banking system such as CitiDirect® Online Banking for viewing CLS activity as well as activity for all of their demand deposit accounts (in every currency) at that bank. If so, they can use a single set of procedures when integrating information into their treasury system. Using a provider's browser based workstation as a CLS process management tool may be a good solution – if the provider is able to provide real time information on all banking activity.

A Solution for Corporations Maintaining Multiple Bank Relationships

Corporations that wish to maintain relationships with multiple banks can use another alternative for viewing and handling CLS transaction information. A U.S based corporation using a U.S. bank for U.S. Dollars, a Japanese bank for Yen, and a European bank for Euro, probably

receives three separate file feeds from three different electronic banking systems. Rather than rely on multiple electronic banking systems that do not always contain real time information, the FX operations department of a corporation can use a vendor supported corporate FX matching system to view their CLS trade activity. The corporation can take a file feed from the matching system into their treasury system, calculate accurate balance information, and use that information for payment generation, forecasting and internal reporting.

Payments and Funding

Corporations, as CLS Third Parties, must generate end of day (rather than intraday) payments for CLS eligible trades and can authorize their Settlement Members to generate these end of day payments automatically. For example, with pre-authorization, Citibank can draw funds on a corporation's operating accounts and bring those funds into the corporation's CLS account, to fund their CLS trades. Any long positions - excess balances left over from trading - can be automatically sent back to the corporation's regular operating accounts in the various currency centers.

If a corporation chooses to automate the settlement process with their Settlement Member, they need to designate funding accounts for CLS trades around the world. They must also communicate with their banks to make sure they have adequate Daylight Overdraft Lines assigned to those accounts to handle the peak value days.

As an alternative to automating the funding process through their Settlement Member, corporations can choose to manually sweep balances into their CLS operating account. However, outsourcing the payment generation and drawdown request to the Settlement Member is likely to be a more efficient and more cost effective alternative.

Reconciliation

Regardless of the level of automation selected for CLS settlement, corporations must establish a reconciliation process for both CLS eligible and CLS ineligible trades. For CLS trades, the netted payments and the individual gross trade values in the Settlement Member's system must be reconciled against the list of CLS deals in the corporation's system. The CLS enabled treasury system should offer a reconciliation module that automatically segregates CLS eligible and ineligible trades so they can be reconciled automatically. Low volume players should not underestimate the manual work required in reconciliation and accounting if they choose not to CLS enable their treasury system.

A Greater Transparency of Information and Better Management of Balances

In a non CLS environment, corporations typically may not know precisely what their net balance will be at the end of the day. With CLS, a participant sees the projected balance – one position for each currency – a day in advance. This means that, in CLS, if a company is long in Swiss francs, and short in Euros, they can use a tomorrow/next day swap, to trade Swiss francs against Euro and thereby reduce or eliminate the overdraft in Euro and avoid bank charges.

With a greater transparency of information available through CLS, a corporation's Settlement, Trading and Treasury Units have an opportunity to collectively manage trading and funding in a more optimal way – making adjustments to tomorrow's balances at the end of each business day. In order to do so, all three departments should have access to the same real time information at approximately the same time – via their CLS enabled treasury workstation or their Settlement Member's browser system.

Options and Implications

Ideally corporations will partner closely with their Settlement Member to evaluate how the operational choices they make will impact funding, payments, account reconciliation, as well as how they monitor and manage balances. A fully automated CLS solution will enable the corporation to rationalize back office processes and streamline funding and account reconciliation.

Once the back office is prepared for CLS, corporations should work closely with their bank partners to explore the full potential of CLS as a strategic treasury management tool and use CLS as a catalyst to manage liquidity and working capital more efficiently. By doing so, a corporation not only keeps pace operationally with their bank partners and counterparties, but also gains competitive advantage by embracing the many opportunities available in the CLS environment.

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Conrad Steinmann is a Vice President with Citigroup Global Transaction Services. Having completed the successful launch of CLS services for financial institutions, Conrad is responsible for developing services for corporations and fund managers. Conrad represents Citibank at the North American CLS User Group.

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