

How CLS benefits global corporate treasury

What is CLS?

Continuous Linked Settlement is a real-time gross settlement system for foreign exchange trades that was created by over 60 of the world's leading financial service companies. CLS radically reduces foreign exchange settlement risk by settling both legs of a foreign exchange transaction simultaneously and irrevocably on a payment-versus-payment basis, irrespective of geographies or time zones.

What currencies can be settled in CLS?

Currently, foreign exchange transactions involving Australian dollar, British pound, Canadian dollar, euro, yen, Swiss franc and US dollar can be settled in the CLS system. It is anticipated that the Nordic currencies as well as the Singapore dollar will be added during 2003.

Why should corporations care about CLS?

CLS is rapidly becoming the foreign exchange settlement standard in the industry. Fifty-one banks have settled over \$50 trillion in foreign exchange trades through CLS Bank International since it went live in September 2002. Now that the large banks are adopting CLS, it is important for corporations to understand the benefits they can realise from the CLS process. Corporations experience a wide range of operational benefits that enable them to reduce costs. Global corporate treasuries with medium to high trading volumes – greater than 200 trades per month – can reap significant funding and liquidity benefits from CLS. High volume global treasuries benefit from netting their liquidity position.

How does global corporate treasury benefit from CLS?

Trading with more counterparties

The CLS process encourages trading with additional counterparties and may lead corporations to consider counterparties that they have not traded with previously.

Real-time information on settlement...

fewer fails and fewer funding issues

CLS offers easy intraday access to real-time settlement information that enables corporations to see and fix mistakes ahead of settlement day. With CLS, participants know what has matched and what has not matched, and can proactively initiate investigations, when necessary, resulting in fewer fails and fewer funding issues.

For example, notification of 'alleged trades' that a counterparty enters into CLS lets a corporation know that the counterparty sent a message to CLS and they have to confirm the trade. Alleged

trades outstanding for an extended period of time indicate that an investigation is needed. A much greater transparency in status reporting and the ability to identify and fix mistakes ahead of settlement day enables CLS participants to receive cash in a timely way.

More certainty about intraday and end-of-day cash positions

CLS features predictable, timed (rather than random) pay-ins and payouts. These provide treasurers with more certainty about their intraday and end-of-day cash positions and improve forecasting. Proceeds can more easily be scheduled to facilitate funding of business activities occurring during the day.

Ability to monitor multi-currency activity through a single account and simplify reconciliation

With CLS, corporations can get information for multiple trades in seven different currencies from one place, rather than from multiple accounts/banks. Reconciliation is greatly simplified. Corporations receive one fully reconciled account statement showing all the settlement details for both sides of each transaction.

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Higher straight-through processing rates, greater operational efficiencies, and reduced costs

A fully automated CLS solution that is integrated into a treasury system enables corporations to rationalise back-office processes, streamline funding and account reconciliation, and achieve higher straight-through processing rates. As a result of increased operational efficiencies, the cost of foreign exchange settlement drops.

Reduction of payments

Rather than make multiple gross payments to settle trades, CLS participants manage one net position per currency (a single debit or credit position) in their end-of-day funding process with their

settlement member. In this way corporations benefit from the 'CLS netting effect'.

This means payments for trades, including misdirected and late payments, compensation claims, and the time and cost required to conduct payment investigations are virtually eliminated. Depending on the structure you establish with your CLS provider, overdraft fees can be reduced or eliminated as well.

Reduction of risk credit lines

CLS nearly eliminates settlement risk, and along with it, the need for settlement risk credit lines – which frees up credit that corporations can use for additional trading. Corporations can use their daylight overdraft lines for other activities.

A greater transparency of information enabling better management of balances

In a non-CLS environment, treasurers typically do 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. For example, 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 euros and thereby reduce or eliminate the overdraft in euros and avoid bank charges. In this way, the CLS settlement process drives the trading process and can improve the management of liquidity across borders.

Treasurers can use tomorrow/next day swaps to move idle balances to markets where short-term instruments are available as a liquid investment. Treasurers can also release enough balances using tomorrow/next day swaps for long-term investment and even business acquisition without having to remove necessary working capital from key market operations.

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.

Increased FX trading

Since FX trading is more secure, efficient and cost-effective in CLS, corporations might embrace FX trading for cross-border funds movement on a more frequent – weekly or even daily – basis.

Improved management of capital on a global basis

Corporations may want to consider using FX trading mechanisms in the CLS environment to fund subsidiaries, to manage capital and liquidity on a regional or global basis, or simply to hedge exposure in certain currencies.

Corporations generating operating costs and/or revenues cross-border may find CLS particularly useful. The process of funding subsidiaries in various countries and generating revenue cross-border often leaves corporations with large overdrafts and idle cash balances around the world. Corporations can use the CLS process to reduce these balances. They do so by executing FX trades via CLS in order to fund subsidiaries and receive dividends on a more frequent basis. With a desirable way to fund operations cross-border and/or sweep excess

funds back to the home-office via CLS, corporations may be able to match costs and revenue and manage their capital on a global basis more effectively.

Ability to leverage RTGS networks

In essence, with CLS, corporations can leverage the real-time gross settlement (RTGS) networks set up by banks, which facilitate the movement of funds around the world in real time. These networks have been in place for several years but have not been fully utilised. As a result of the CLS process, banks are using the RTGS networks more, and are more likely to send funds intraday, in real time to their corporate counterparties.

Greater audit control and a streamlined audit process

Without CLS, a corporation's audit responsibilities and costs expand as they audit different processes for different currencies provided by different banks. CLS concentrates funds into one bank, in the CLS operating account, and brings information on all currencies and transactions into one place. CLS is a single transparent process that provides treasury with increased control – complete transparency of real-time information that is easy to audit and approve.

Reaping the full benefits of CLS to gain competitive advantage

CLS virtually eliminates FX settlement risk; it provides operational and cost efficiencies to the corporate back-office. CLS has also created a new cross-border payments paradigm and a promising value proposition for treasurers. The true challenge for treasurers vis-à-vis CLS at this time may be determining how to take full advantage of the opportunities CLS offers.

Corporations should work closely with their bank partners not only to execute the mechanics of settling through CLS, but also to explore innovative ways of managing treasury in the CLS environment. Those corporations that explore the full potential of CLS as a strategic treasury management tool are likely to be the ones that gain the most.

CLS is a trademark of CLS UK Intermediate Holdings Ltd.



Conrad Steinmann (left) 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.

For more information on Citibank® CLS™ settlement services, please visit www.citigroup.com/transactionservices