

# CLS for fund managers

Continuous Linked Settlement, better known as CLS, went live in September of 2002, and now settles on average 80,000 instructions or approximately USD 1 trillion per day. CLS is rapidly becoming the foreign exchange settlement standard in the industry for banks, broker dealers, and multinational corporations, and all sectors have reported front and back-office benefits that extend far beyond settlement risk reduction. CLS can settle FX trades for both treasury and securities clearing and the next wave of CLS participants will be fund managers including pension funds and asset management divisions of banks and insurance companies, as well as investment managers. Fund managers will benefit significantly from CLS, and their volumes are expected to be second only to CLS shareholder volumes by 2007. This article describes some of the basic benefits and implications for fund managers.

Conrad Steinmann\*

## Why participate in CLS?

Fund managers should participate in CLS because they are required to conduct business in the safest manner possible as part of their charter. However, the reduction of settlement risk is only one of the many benefits fund managers will reap from CLS.

Today, securities settlement is characterized by a high degree of operational and credit risk. One typically does not learn that funds did not arrive and one's account is overdrawn until the day after settlement date. With CLS, fund managers experience far greater predictability, more certain settlement and a host of other benefits.

Fund managers are third party participants who submit their CLS-eligible FX transactions to CLS through their CLS settlement member<sup>1</sup>.

## Reduce payments and investigations

Rather than make multiple gross payments for 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. This netting down of foreign exchange payments results in greater liquidity. Perhaps more importantly for fund managers, it also means payments for trades, including misdirected/late payments, compensation claims, and the time and cost required to conduct payment investigations are virtually eliminated. CLS will radically reduce the time fund managers spend on investigating misrouted or lost payments.

## Monitor the entire settlement life cycle in real time

CLS offers easy intraday access to real-time information that enables fund managers 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, ensuring far fewer fails and the timely receipt of cash.

## Streamline funding, settlement and reconciliation

CLS increases automation of the entire settlement process end-to-end and provides integrated matching, settlement, and reconciliation services.

A quality CLS provider will provide end-of-day statements and online information detailing individual settlements in each currency to facilitate real-time reconciliation.

A fully automated CLS solution that is integrated into the back-office enables fund managers to streamline funding, settlement and account reconciliation, and achieve higher STP rates. As a result of increased operational efficiencies, the cost of foreign exchange settlement drops.

## Monitor all activity via one operating account

With CLS, fund managers can get information for multiple trades in multiple currencies from one place, rather than from multiple accounts/banks. Fund managers receive one fully reconciled account statement showing all the settlement details for both sides of each transaction.

## Certainty about intraday and end-of-day cash positions

Depending on the CLS provider, CLS can facilitate predictable, timed pay-ins and payouts. These timed pay-ins

<sup>1</sup> CLS Bank only permits its shareholders to participate directly in its settlement system. Most direct participants are settlement members, while a few are user members who outsource payment responsibility. Indirect participants of CLS rely on a direct participant to submit trades and execute payments. Indirect participants include third parties, who are the clients of settlement members and user members, and fourth parties, who are the customers of third parties.

and payouts provide fund managers 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 during the day. Citibank facilitates timed pay-ins by offering pre-authorized direct debits which add tremendous predictability in terms of treasury and custody management.

### **Increase trading**

CLS significantly reduces settlement risk, and along with it, the need for settlement risk credit lines – freeing up credit. In addition, the need for daylight overdraft lines to make payments may be reduced because of the netting effect. And finally, since CLS protects against settlement risk, fund managers who participate in CLS may be able to consider trading with an expanded group of counterparties.

### **Greater audit control**

Without CLS, a fund manager'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 fund managers with increased control – complete transparency of real-time information that is easy to audit and approve.

### **Implications for fund managers**

Fund managers have unique needs as CLS participants that may or may not be properly addressed by the various CLS providers. For example, fund

managers have a fiduciary responsibility to their clients to provide timely, accurate reporting. Fund managers will also need a CLS provider who can provide intraday timed payment services, and enough liquidity to handle the high value payments the fund manager and their clients will require.

Fund managers should first choose a CLS provider based on the excellence of the provider's CLS capabilities and their experience in the marketplace. Next, they should consider if they can gain efficiencies by using existing custody/FX providers for CLS settlement – in order to leverage existing interfaces and instructions on the custody side and benefit from a lower

cost of settlement (and book transfers) on the FX side.

When properly implemented and integrated into the back-office, CLS not only mitigates FX settlement risk, but also creates significant efficiencies. For fund managers, CLS can be a catalyst for achieving higher levels of automation and straight-through processing and radically reduce time and cost spent investigating misdirected and lost payments. Fund managers who embrace CLS will not only keep pace operationally with other financial institutions, they are likely to gain competitive advantage by streamlining processes and costs.

## **CLS Basics**

### **What is CLS?**

Continuous Linked Settlement, or CLS, which was created by over 60 of the world's leading financial institutions to mitigate foreign exchange settlement risk, links multiple real-time gross settlement systems in real-time for a five hour window, through CLS Bank International. CLS radically reduces foreign exchange (FX) settlement risk by settling both legs of an FX transaction simultaneously and irrevocably on a payment versus payment basis, irrespective of geographies or time zones.

### **What currencies can be settled in CLS?**

CLS settles FX transactions in the following currencies: Australian Dollar, British pound, Canadian Dollar, euro, Japanese yen, Swiss franc and US Dollar and, as of September, 2003, the Singapore Dollar, Norwegian Kroner, Danish Krone, and Swedish Krona.

### **When can fund managers start participating in CLS?**

With live trialing of investment manager FX transactions beginning in October, it is expected that fund managers will be able to start participating in CLS in the fourth quarter of this year.

### **What process will fund managers use to settle trades in CLS?**

Fund managers must be sponsored by a CLS settlement member to participate in CLS and can leverage their existing SWIFT MT304 process to settle trades in CLS, using the MT304 as a payment instruction to their CLS provider. CLS Bank will match custody FX trades using the fund identifier (which is the account number at the custodian bank). Fund managers and FX counterparties will populate field 83J/ACCT/ on SWIFT MT300s and 304s with the fund identifier to identify the fund and enable matching in CLS.

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