



Fulfilling a New Year's Investment Resolution

For Corporate Clients

INDUSTRY INSIGHT



"The use of high quality, diversified funds in a variety of currencies that offer same-day access to liquidity has considerable potential for all companies with surplus cash."

The past year has once again illustrated that Asia is a remarkable global phenomenon with unique opportunities for growth and expansion. One of the outcomes of Asia's continued meteoric rise is that companies in all industries and of all sizes are seeing significant increases in the amount of cash they are holding. In many ways, of course, this is a nice problem to have! However, it creates a growing dilemma for treasurers and finance managers who need to find ways to invest cash that are secure and enable access to liquidity. In the United States and Europe, the use of money market funds (MMFs) or liquidity funds is well-established, with many companies increasingly recognizing the benefits of a diversified, highly rated and liquid pooled investment. Investment in triple-A rated international (non-U.S.-domiciled) MMFs total about EUR460 billion, up from less than EUR300 billion three years ago, with even greater penetration in the United States.

These products are not new in Asia, particularly for Asian subsidiaries of North American or European companies, whose parent company investment policy already enables investment in MMFs. Indeed, we are seeing considerable interest and rapidly increasing takeup of these instruments. However, as this article outlines, the use of high quality, diversified funds in a variety of currencies that offer same-day access to liquidity has considerable potential for all companies with surplus cash.

Addressing Investment Challenges

Treasury and finance departments globally are faced with the dual challenge of finding secure repositories for their cash, while dealing with a lack of internal resourcing to conduct the necessary credit research. Corporates of all sizes have tightened their attitudes to risk since the financial crisis; furthermore, as these companies have often reduced their counterparty credit limits due to credit rating downgrades, existing deposit limits are often fully utilized. Consequently, treasurers and finance managers are seeking alternative investments that combine the necessary credit quality, diversification and access to liquidity without the need for significant internal resourcing.

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MMFs are structured to provide safety, diversity, daily liquidity and preservation of capital and fulfill these criteria in a variety of ways:

- Inherently diversified due to the variety of assets that make up the portfolio, with typically no more than 5% of total holdings invested in one asset (due to regulations and ratings criteria).
- Highly rated, typically only investing in money market securities of the highest credit quality (A1/P1 or higher), and excluding commodities, equities or derivatives.
- Offer same-day access to liquidity.
- Subject to a high quality investment process with considerable resources dedicated to credit research.
- Constant net asset value (NAV) (although variable NAV funds will also be permitted.) **See Figure 1**

While yield is no longer of the same importance as security and liquidity, particularly in a low interest rate environment, treasurers and finance managers are still seeking a reasonable return on their cash, and MMFs typically offer a yield equivalent to other investment types, such as bank deposits, whilst benefitting from diversification.

Transacting MMFs in Practice

Despite the variety of advantages of using MMFs, there are two potential difficulties for treasurers and finance managers seeking to leverage these products. Firstly, with an increasing range of funds available in the market, treasurers need to be able to identify the funds that are most appropriate for their company's needs and subject to the most robust investment processes. Secondly, they need an efficient and convenient means of transacting MMFs that enables them to access multiple funds through a single channel, adhere to internal control requirements and integrate with internal treasury and cash management systems to avoid risk of error. To address the latter point in particular, there is now increasing recognition of the value of online dealing platforms, which are becoming ubiquitous in North America and Europe, and are now increasingly available in Asia. These enable treasurers to transact multiple funds through a single channel, with deals then passed automatically to back office systems.

There are some omissions in the approach promoted by several of these platforms, however. For example:

- As any regulated MMF can be included on a platform, the onus is entirely on the investor for assessing fund suitability and investment process.
- The transaction process is not integrated with the settlement process, creating additional tasks and introducing the risk of error or delay.
- Documentation still needs to be completed for each fund manager, reducing flexibility should a treasurer wish to change or introduce new funds quickly.
- In most cases, only MMFs are included on these platforms, with other investment types such as deposits and repos transacted through other online channels, therefore reducing convenience for a treasurer with a broad and diverse approach to investment.

Treasurers are therefore seeking an enhanced means of investing online that covers the spectrum of authorized investment products using a single channel, with access to a carefully-chosen, complementary selection of funds from large, established providers that are covered by a single set of documentation. The processes for transaction and settlement need to be integrated in order to create an efficient workflow with a “one step” approach and reduced settlement risk, as opposed to having to conduct and settle transactions separately. This is the approach that Citi has taken in making its online investment platform available to its clients, not only for MMFs but across the suite of investment products. By leveraging this approach, treasurers and finance managers derive the maximum advantage of Citi's considerable research resources in identifying the most appropriate funds available, and gain the greatest possible investment flexibility and operational efficiency.

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Regulation for Reliability

MMFs are highly regulated products which have proved highly resilient during the market fluctuations of recent years. However, the industry recognizes that further improvements can be made to give investors full confidence in the funds in which they are investing, as well as transparency over their holdings. Consequently, recent updates to the Securities and Exchange Commission (SEC) Rule 2a-7 of the U.S. Investment Company Act of 1940 (for U.S. domiciled) MMFs and the Institutional Money Market Fund Association (IMMFA) Code of Practice (for European domiciled triple-A rated MMFs) adopted similar changes to strengthen their existing standards. These revisions were designed to further mitigate investors’ risk by increasing the resilience of money market funds in changing economic environments and financial market turmoil. Improved liquidity requirements, higher credit quality standards and tighter maturity limits have been implemented to ensure funds can protect principal stability and meet the liquidity needs of their investors.

Additionally, the Committee of European Securities Regulators (CESR) has taken steps to standardize the definition of an MMF. For example, the new requirements for offshore funds under CESR regulations are outlined in Figure 1, with a compliance date of 1 July 2011 for new funds, and 31 December 2011 for existing funds. For established, respected providers, these requirements will result in very little change due to the quality of the investment process already in place. Under these terms, the existing triple A-rated MMFs fall into the category of Short-Term Money Market Funds, in which most corporate investors typically invest. In the future, a wider range of MMFs are likely to be made available by fund managers to give greater flexibility for different profiles of investor.

These changes, that are being introduced by the Committee for European Securities Regulators (CESR) will apply to all offshore funds in European domiciles, but in efforts to standardize the industry internationally, in order to provide transparency and confidence to investors, these changes are being widely observed in Asia.

Leveraging New Investment Opportunities

With MMFs becoming increasingly familiar and accepted by treasurers and finance managers in Asia, new regulations offer even greater reassurance to corporate investors seeking confidence in the security and liquidity of their cash. With the growing availability of efficient and convenient online platforms, 2011 presents new opportunities for treasurers and finance managers seeking to invest the company’s cash in a secure, liquid and diversified product, without creating an additional resourcing burden. Citi’s continued focus on increasing the accessibility of MMFs and other investment types is yet another illustration of our continued commitment to providing the tools and capabilities that our clients require, fulfilling the need for companies with surplus cash to find new, high quality investment opportunities.

Figure 1 Committee of European Securities Regulators (CESR) Money Market Fund Definitions

	Short-Term Money Market Fund (ST-MMF)	Money Market Fund (MMF)
Primary Investment Objective	To maintain the fund's principal and provide a return in line with money market rates	
Investment Criteria	Invest in high-quality (top two available ratings by each recognized credit rating agency, or equivalent), compliant (Directive 2009/65/EC) money market instruments or deposits	In addition, may also hold government securities of investment grade quality
Investment Maturity	Less than 397 days	Less than 2 years, with the time to the next interest rate reset date less than or equal to 397 days
Disclosure	Provide daily net asset value (NAV ¹) and price calculations and information on redemptions	Provide daily NAV and price calculations and information on redemptions
Weighted Average Maturity¹	Less than 60 days	Less than 6 months
Weighted Average Life²	Less than 120 days (based on legal redemption date except if an instrument has a freely-exercisable embedded put option, with a strong likelihood that it will be exercised, in which case the exercise date applies)	Less than 12 months
Market Exposure	Avoid exposure to equities or commodities market, and limit use of derivatives to those that support the fund's investment strategy. Any currency exposure must be fully hedged	Avoid exposure to equities or commodities market, and limit use of derivatives to those that support the fund's investment strategy. Any currency exposure must be fully hedged
Investment in other Funds	Limited to funds that satisfy the conditions of the Short-Term Money Market Fund	Limited to funds that satisfy the conditions of either the Short-Term Money Market Fund or a Money Market Fund
Net Asset Value (NAV)³	Constant or Variable	Variable

1 WAM = Weighted Average Maturity Average time to maturity of all of the assets in a fund, weighted to reflect the relative holdings in each instrument (or next interest rate date in the case of floating rate instruments). WAM is used to measure the sensitivity of a money market fund to changing interest rates.

2 WAL = Weighted Average Life Weighted average of the remaining life (maturity) of each security until the repayment of principal (i.e. not interest reset date). WAL is used to measure credit risk, as the longer the period until the repayment of principal, the higher the credit risk. WAL is also used to limit liquidity risk.

3 Net Asset Value Constant Net Asset Value (CNAV) A constant or stable NAV money market fund seeks to maintain an unchanging face value NAV (for example \$1/EUR1 per unit/share). Income in the fund is accrued daily and can either be paid out to the investor or used to purchase more units in the fund. Assets are generally valued on an amortized cost basis which takes the acquisition cost of the security and adjusts this value for amortization of premiums (or discounts) until maturity.

The constant NAV is not guaranteed and where a discrepancy between the market value and the amortized cost value of the portfolio becomes material, the money market fund can no longer issue and redeem units at the stable NAV of USD1/EUR1 per unit (this is often known as 'breaking the buck'). This may occur, for example, where there is a default by the issuer of an instrument in the portfolio. (source: CESR). Amortized cost accounting values the asset at par at maturity, and discounts the premium on a linear basis through the life of the asset back to the purchase price.

VNAV = Variable Net Asset Value These funds use mark-to-market accounting to value some of their assets. As the value of assets will change slightly, the value of each share will vary a little. These funds may distribute or accumulate income. Mark to market accounting values the asset at the price that could be obtained in the market by selling the asset.

CNAV & VNAV From an investor's perspective, the primary difference between CNAV and VNAV funds is the tax and accounting rules that apply, which may differ by domicile. The investment process and guidelines may be the same, and their risk exposure comparable.

Source: Asymmetric Solutions Limited

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Philippe Jaccard is a Managing Director and the regional head of Liquidity and Investment, part of Citi's Global Transaction Services business, based in Hong Kong. In this role, Philippe is responsible for structuring end-to-end liquidity management solutions for Citi's institutional clients, including corporates and financial institutions, as they seek to optimize their working capital management. Philippe joined Citi Singapore in 2000 in a business development role. In 2002, he led Citi's Treasury Services business before relocating to his current role in 2006.

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For more information about Citi's Global Transaction Services, please visit www.transactionservices.citi.com.

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