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flow

Powering the exchange of capital, goods and ideas

WELCOME
Partnership and collaboration – prerequisites for today’s business world

Without an effective flow of goods, services and capital, global business would come to a standstill – that’s widely accepted. Financial institutions, issuers and investors demand that their partnering banks can deliver all of these elements, while also inspiring confidence in the form of insights that help them navigate the current complex economic landscape.

It’s our role to showcase trends and opportunities, explore possibilities and address some of the hurdles facing financial institutions. Flow, our new magazine, will play its part in that process.

We are living in turbulent times where you should expect the unexpected. Seven years after the peak of the financial crisis, we are faced with regulatory challenges, changing undercurrents across markets and intensifying competition. We’re not only competing with our peers, but also with new market entrants eyeing potential growth. It’s an uncertain and occasionally crowded setting, which means that partnerships inevitably come to the fore in helping financial institutions traverse markets through complexity, disruption and evolution.

Collaboration and client-centricity are at the heart of our ethos, and that’s why we’re bringing Flow to you. At the same time, the world has become more interconnected, so as well as providing food for thought for financial institutions, we also offer insight on some of the trends affecting corporate clients.

We hope you enjoy this inaugural issue of Flow and welcome your feedback.

Satvinder Singh, Head of Institutional Cash & Securities Services, Deutsche Bank

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Digested the trends affecting institutions and corporates in the global transaction banking sphere

T2S streamlines settlement framework
TARGET2-Securities (T2S), the European Central Bank’s new platform for the cross-border settlement of securities transactions, went live in June and Deutsche Bank is now offering direct and indirect access to the system. The system removes existing national barriers and enables a smoother and quicker transfer of assets, thereby reducing transaction costs.

Deutsche Bank will provide clients in the financial industry with direct access to the T2S platform, but they will also be able to access it indirectly via existing national markets in Europe have opted for Twenty-three national CSDs from 21 central securities depositories (CSDs).

Twenty-three national CSDs from 21 national markets in Europe have opted for T2S and are migrating successively to the new system.

Deutsche Bank to open tech labs
In step with rapidly increasing digitisation, Deutsche Bank is opening three innovation labs in Europe and the US. The aim: to evaluate potential technology solutions for the bank and its clients, while simultaneously nurturing the wider start-up community.

Located in Berlin, London and Silicon Valley, the labs are in partnership with three technology giants: Microsoft, HCL and IBM. The labs are due to be fully operational by the end of 2015 and will enable the bank to assess an impressive 500 start-up ideas each year. They form part of Deutsche Bank’s “Strategy 2020”, which includes a pledge to spend up to EUR 1 billion on digital initiatives over the next five years.

Clearing houses join forces
Six European automated clearing houses (ACHs) have joined forces to deliver a centralised service for Single Euro Payments Area (SEPA) transactions.

The European Clearing Cooperative (ECC) is the result of combined efforts from DIAS, Equens, Iberpay, ICBI, KIR and TRANSFOND, and will be accessible to all ACHs active in Europe.

This is not only set to greatly improve efficiency and reliability across the European payments market; it will also open up possibilities to develop more innovative services such as real-time clearing and settlement. The ECC is expected to be fully operational by the end of this year.

Five-second payments
Dutch banks have announced plans to implement instant payments by 2019, following talks between members of the National Forum on the Payment System (Maatschappelijk Overleg Betalingswervier – MOB) in May.

The MOB saw banks and other stakeholders commit to working together to ensure customers’ payments will be credited to payees’ accounts within five seconds. To meet this target, current payment systems will be overhauled and brought in line with SEPA, under the direction of the Dutch Payments Association.

The move is further evidence of changing customer needs for instant payments.

What treasurers are saying: Deutsche Bank and EIU unveil new report
Seven years after the financial crisis, many companies are still challenged by the current financial environment. That’s according to a new study commissioned by Deutsche Bank and conducted through the Economist Intelligence Unit (EIU).

The resulting report, Financing the Fragile Economic Recovery, looks at how global corporate treasurers are navigating new risks and opportunities. The findings are based on the feedback from 100 treasurers, 100 CFOs and 100 heads of department from around the world.

The report confirms that the role of corporate treasurer is moving up the boardroom agenda, becoming more visible and highly strategic. At the same time, it highlights many treasury departments need additional resources to achieve the extra key performance indicators these wider responsibilities bring. The study reveals that finance executives remain worried about sluggish growth and risks around counterparties, currencies and regulation. Companies continue to hoard cash as they wait for future investment opportunities and amid fears that financial institutions may not provide adequate credit in the future. Treasurers are responding to change by strengthening their bank relationships.

Shahrokh Moinian, Deutsche Bank’s Head of Trade Finance/Cash Management Corporates Global Solutions, said of the report: “Treasurers and CFOs are operating in a marketplace that is constantly changing. The report underlines to us the importance of strong relationships with our clients in order to develop the solutions that meet the challenges of today and position them for growth.”

For more Global Transaction Banking news, go to gtb.db.com
Deutsche Bank’s Global Transaction Banking (GTB) underlined its commitment to working in partnership with the fintech sector by signing a Memorandum of Understanding with Basware – a global leader in the provision of purchase-to-pay and e-invoicing – and MasterCard.

The triumvirate is piloting an integrated solution that incorporates electronic invoice approval and a supply chain feature that speeds up payments.

The early supplier payment solution (ESPS) aims to address some of the inefficiencies around supply chains at a time when CFOs are looking for greater visibility around supplier payments.

Rick Striano, Head of Platforms & Investments in GTB’s TF-CMC Global Solutions, said: “Corporates are facing a number of challenges around working capital, profit and loss and with their processes and controls. They need to improve their working capital ratios, such as liquidity ratios, while improving their reporting regimes.”

The ESPS will also reduce infrastructure costs, said Striano. “We are developing something that is fully automated, completely digital and secure. There are multiple benefits ranging from streamlined payment processes, better visibility and control over invoice status and cash flow.” By adopting a new cost-efficient supplier onboarding methodology, the bank is able to provide a much broader cross-section of its clients’ suppliers with competitively priced access to liquidity.

Striano believes the solution illustrates how cross-sector collaboration can yield impressive results: “We recognise the importance of bringing innovative payment and supply chain solutions to our clients – in that context, strategic partnerships will become an increasingly important component in how we deliver certain solutions, and our growth.”

SWIFT extends KYC remit

Financial messaging services provider SWIFT has extended its Know Your Customer (KYC) registry’s reach, increasing the number of financial institutions that can access and execute KYC’s approach to due diligence and compliance.

Like banks, fund distributors and custodians will now be able to access and contribute to a standardised set of qualified data and documentation required for KYC compliance. Paul Taylor, Director of Compliance Services at SWIFT, sees the move as a natural extension of KYC’s offering, which will help to tackle the ongoing challenge that financial crime compliance presents.

Introducing the early supplier payment solution

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On the threshold of change

Sibos 2015 comes at a time when the financial industry is on the brink of change. Technological advances driving greater digitalisation, new competitors, question marks against traditional business models and security concerns are all shifting banks’ focus. Neil Fredrik Jensen looks at some of the issues likely to dominate the dialogue.

Not for the first time in recent years, Asia Pacific is very much in the news. China’s growth and contribution to the global economy has made headlines since 2008 and the slowing of this dynamic market has commanded attention in the second half of 2015. So, it seems appropriate that this year’s Sibos conference is being held in the Asian financial powerhouse that is Singapore. It’s also a fitting location given the city is celebrating its 50th anniversary of independence.

Living by the rule book

The financial services industry still faces a market backdrop dominated by regulation, new technology and constantly changing client demands.

Regulation, in particular, remains one of the most labour-intensive aspects of business today. From a regulatory perspective, TARGET2: Securities (T2S) has been the big event in the securities services landscape. While T2S creates a more harmonised securities settlement landscape, this far-reaching market change has implications for many different pockets of the industry (see page 14 for an in-depth discussion).

Furthermore, in the fund services arena in Europe, parts of the European Securities and Markets Authority’s (ESMA) Alternative Investment Fund Managers’ Directive (AIFMD) are still under negotiation, notably the so-called Passport Extension.

Under AIFMD, there are two methods for marketing to professional investors, the EU Marketing Passport and the Member States’ private placement regimes.

ESMA has extended the range of the passport to include, on a provisional basis, non-EU member Switzerland, but has so far rejected Cayman, Hong Kong, Singapore and the US. The directive had envisaged that the passport would be extended to cover both EU Alternative Investment Fund Managers (AIFMs) and non-EU AIFMs in respect to funds inside and outside the EU.

Also within AIFMD, which is chiefly concerned with investor protection, the guidelines around asset segregation are very much at the top of ESMA’s agenda. Debate continues on the level of segregation actually required and for what benefit. One pertinent issue here is that segregation to central securities depository (CSD) level entails additional costs and new operational concerns.

The future of CSDs in the T2S world is very much open to debate. At Sibos, there is a session devoted to that very topic. A combination of regulation and market dynamics is putting pressure on CSDs and forcing them to re-evaluate and reinvent their business models at a time when their role is arguably more important than ever, due to the regulatory push for activity to move towards market infrastructures.

For banks, digitalisation is not only a challenge but an opportunity

Like Deutsche Bank, many financial institutions have investigated the possibility of innovation labs that deal exclusively with the technology involved in the blockchain. They are also assessing whether blockchain represents a threat to their existence or an opportunity to implement new proprietary technologies that are likely to raise the digital profile of traditional transaction banking.

Financial institutions could defend their own business models by embedding certain parts of the blockchain technology in their own IT environment for their own purposes. It is possible that banks could, for example, establish a new digital booking and clearing system among themselves that enables them to offer client transactions that include the benefits of the blockchain – speed, efficiency, cost savings – and creates a new, modern clearing system that is cheaper and more efficient.

Yet blockchain is in its infancy, so banks and other intermediaries can still analyse the new technological challenges. In any case, the technology solution is only part of the challenge; there will remain significant legal and regulatory barriers to overcome in adopting new technology market solutions.

Digitalise or be damned

It is a similar story for the whole concept of digitalisation. Technology of the digital kind has spawned a trend that is gathering
momentum by the day. This will go far deeper than the cost-saving potential of IT or the sourcing of new revenue streams. There are mixed views on how the world will be influenced, and indeed, transformed by what has become known as ‘the internet of things’. But it is likely to have a seismic effect on business.

As much as anything, digitalisation will be about taking control of the customer experience by managing business from the client’s perspective and rethinking existing models. Banks have the chance to calibrate data in various formats and meet customer demands through greater customisation. To benefit from digitalisation, however, companies will need to develop a clear strategy that optimises processes and costs, something which has always sat at the very heart of banking.

To some extent, this has provided the kick-start to the banking industry in changing from a traditional ‘search and development’ model to one that is driven by scanning the market and then securing knowledge, skills-sets and expertise. This can help banks understand what they successfully bring to a client relationship and make that offering more substantial and multifaceted.

Although the role of banks will evolve, it is very possible that corporates will further consolidate their bank relationships. The rise of in-house banks and payment factories should contribute to that trend. If the future of banks relies on the way they coexist with new market entrants, and use that fresh impetus to identify where they can add value, partnerships with third-party technology providers will be at the centre of the new battleground. We have already seen some good examples of how fintech companies have collaborated with banks to meet today’s demands. This should gather momentum over the coming years.

Crime watch

While there is a positive tempo and client connectivity to develop products that meet the sea change of business sentiment, warningly, cybercrime is also accelerating. The number of sessions devoted to this sensitive subject is an indicator of how seriously banks are taking the threat of their systems being attacked by criminals.

Banks are spending increasing amounts of money on protecting themselves, but still data breaches happen. Experts believe that banks are falling prey to four main avenues of cybercrime: nation states using espionage to steal intellectual capital; cyberterrorists seeking to destabilise the system; so-called hacktivists that opportunistically try to break into banks’ IT systems; and finally, organised crime focusing on telephone and card fraud.

Regulators are increasingly focusing on cybersecurity standards that are likely to become ever more important in the new digitalised world. Sibos will discuss myriad topics, many of which focus on opportunities and best practice. The global economy needs commercial banks offering transaction banking services that process and fuel the flow of trade and money. By embracing change and maintaining the spirit of innovation and collaboration, an altered model can ensure banks continue to influence tomorrow’s financial landscape.

That’s why, each year, Sibos provides the ideal forum for the exchange of ideas and for market cooperation to germinate.

Monday October 12 (09:00)
Global trends in regulated securities markets: how to return to a path of growth
Savinder Singh, Head of Institutional Cash & Securities Services, Global Transaction Banking, will be speaking about the rapidly changing regulatory landscape that is forcing the industry to refocus on the basics of the profitability quest.

Monday October 12 (10:15)
Why standards should be a boardroom topic
Isabel Schmidt, Head of Institutional Cash Americas & Global Head of IC Market Management, joins a panel that asks what are the key topics occupying boards and senior managers in the industry. Standards have a role to play in addressing all concerns, from reducing the cost of regulatory compliance to improving the efficiency of systems and operations, and providing key building blocks for new interoperable industry solutions.

Monday October 12 (10:15)
ICC community briefing
Daniel Schmidann, Head of Trade Finance and Cash Management Corporates EMEA, and other International Chamber of Commerce (ICC) representatives will discuss topics including the industry adoption of the new trade settlement instrument (Bank Payment Obligation), the Supply Chain Finance service definitions, the ICC Academy and the Trade Register.

Monday October 12 (15:30)
A future for CSDs?
Angus Fletcher, Head of Market Advocacy, moderates a panel that discusses how the battle for business between CSDs and global/regional custodians will shape the future.

Tuesday October 13 (09:00)
A guide to resilience and true 24/7 availability
Many Campbell, Co-Head of Global Technology & Operations for Global Transaction Banking, takes part in a session that outlines the dos and don’ts when developing operational resilience and availability.

Tuesday October 13 (09:00)
Cross-border challenges of intermediated securities: legal transparency versus operational efficiency
Stephen Lomas, Head of Global Transaction Banking Market Policy, joins a panel session on the challenges linked to the current differentiation between direct and indirect holding models.

Tuesday October 13 (15:30)
A future for CSDs?
Angus Fletcher, Head of Market Advocacy, moderates a panel that discusses how the battle for business between CSDs and global/regional custodians will shape the future.

Tuesday October 13 (10:15)
Intraday liquidity reporting: how has the industry progressed?
Christian Goerlach, Head of Financial Institutions, Balance Sheet Liquidity, moderates a session that looks at the impact of regulation on intraday liquidity monitoring and highlights the issues that need to be addressed.

Thursday October 15 (14:00)
ASEAN Securities and Exchanges Workshop
Ying-Ying Tan, Co-Head Client Products & Solutions and Head of Product Management for Asia Pacific, takes part in a panel on regional market infrastructure linkages. This session is built around current priorities and progress in the region.
The BCBS recommendations are not formal regulations but proposals for regulations that would have to be translated into local laws by national regulators. Up to now, only a handful – such as those of Hong Kong, India, Australia and Switzerland – have made that move.

The need for recognition is widely acknowledged. The global financial crisis highlighted the requirement to improve liquidity management, and addressing intraday liquidity management neatly complements Basel III regulations over liquidity coverage ratios. And there is broad acceptance within the financial community that better management of intraday liquidity is essential.

The Basel monitoring tools are generally useful in drawing attention to the various aspects of intraday liquidity management, although there are some data management issues around visibility on the intraday cash positions, mainly due to a plethora of intraday cash reporting practices. "As an industry, we are now increasing our intraday liquidity risk profile, so it makes sense to address this," says Christian Goerlach, Head of Financial Institutions, Balance Sheet & Liquidity at Deutsche Bank. "In the post-Lehman Brothers era, there’s been a tendency to go into clearing to mitigate counterparty credit risk, thereby introducing intraday liquidity risk, because in central clearing, the cash settlement now takes place at defined times during the day." In the past, a transaction could usually be made at any time of day. Now, it must be made at a specified time.

Goerlach adds that the industry and the regulators are finalising the first steps around liquidity tools, and an overall roadmap is still to be determined.

"There is a great deal of collaboration among banks, market participants and regulators on this issue, and we are all eager to see what the overall framework will look like," he says. "But until the detail is in place, people can only anticipate what will be done with the data they have provided. It’s important that dialogue remains intense at this stage to ensure we do not have unintended detrimental consequences. The signs are encouraging."

Banks do know that they will have to report their intraday profiles, but they await clarity of what will emerge when the regulations become ‘live’. Whichever way market participants deal with the outcome, and there are many possibilities, maintaining the stability of the system has to be a priority for everyone.

"Nobody is questioning the desire to enhance security, but what is implemented will surely be to the benefit of the entire financial system," says Goerlach.

Building a common awareness of what needs to be achieved to get there is also a prerequisite. There is a lot of activity across the industry to do just that, and two working groups are now focusing on intraday liquidity risk.

Goerlach concludes that the data collection exercise has to evolve to become a true risk management function. "Basically, it’s going much further than collecting data," he says. "We need to work together to establish what it means for banks and for the users of these products – mainly banks but also non-bank financial institutions and large corporates – to develop a greater understanding of the bigger impact and, of course, the opportunities that may develop.”

Industry works together

The Society for Worldwide Interbank Financial Telecommunication (SWIFT) is trying to work at a collaborative level and help the industry resolve some of the issues related to the implementation of BCBS 248. "We understand that the more different the requirements on banks are, the more difficult it may be to find a flexible solution. But as a standards body, we’re trying to build common definitions working within the industry," says Catherine Banneux, Senior Market Manager of the Banking Market at SWIFT.

With this in mind, the Liquidity Implementation Task Force (LITF), an industry group formed by 25 large clearing banks, custodian banks and global brokers, has developed, with support from SWIFT, an intraday liquidity reporting rulebook. This aims to establish a common set of global best practices in the nostro and custodian space regarding the use of SWIFT intraday liquidity reporting messages, which will help alleviate the four most common issues:

- Too few transactions reported on a real-time basis, especially in the nostro space
- Lack of timeliness of reporting
- A dearth of granularity of information provided and, more specifically, the lack of ‘time stamped’ information
- The absence of a common definition and business practice of the current message types regularly used by the industry (FIN Cat9 messages)

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As more settlement is carried out, there will be fewer calls for mismatches and difficulties

SECURITIES SERVICES

T2S and beyond

The TARGET2-Securities (T2S) scheme has taken its first step toward being fully operational in Europe. While T2S is still a work in progress, Richard Willsher finds that other world regions will be observing its approach and processes for post-trade securities settlement.

T2S has been long awaited. Ever since the euro itself was launched in 1999, and TARGET2, the euro cash payment system, came into operation in 2007, there has been a need for an integrated cross-border settlement infrastructure to service capital markets across Europe. The need was described by Yves Mersch, member of the Executive Board of the European Central Bank, in a speech on June 16, 2015, six days before T2S’s first-wave launch.

“Until now, the securities landscape in Europe has been characterised by numerous securities settlement systems, divergent laws governing securities depositories and different rules for post-trade processes,” Mersch said. “This is highly inefficient, increases risks and leads to a significant waste of resources. T2S has started a process that will change this completely.”

A key aspect of T2S is the use of central bank money to facilitate cash settlement, while national securities depositories are able to maintain their asset servicing and other functions.

Increased economies of scale to the settlement process, while securities depositories are able to maintain their asset servicing and other functions.

Allowing for collateral management across borders and thereby helping institutions meet their regulatory capital and collateral requirements.

For more Flow content, go to db.com/flow

As more settlement is carried out, there will be fewer calls for mismatches and difficulties

T2S in a nutshell

TARGET2-Securities is the new securities settlement system in Europe. TARGET2, the cash payment engine, began operations in 2007 and is now one of the largest payment systems. In 2014, it settled more than 80 million payments and turnover was EUR 492 trillion. T2S adds a securities settlement dimension to this.

Benefits of T2S include:
• reduced processing costs for cross-border securities transactions
• greater safety and financial stability, as transactions are settled with central bank money
• increased economies of scale to the settlement process, while securities depositories are able to maintain their asset servicing and other functions
• allowing for collateral management across borders and thereby helping institutions meet their regulatory capital and collateral requirements.

T2S has been a decade in the making and is not yet the finished article. What is certain is the growing need among an increasing range of institutions with funds to invest will become accustomed to the greater efficiencies and cost-effectiveness that working in the T2S environment will bring and will expect similar international interoperativity wherever the securities are issued.

Moreover, part of this expectation will arise from regulatory pressures for the T2S environment to bring and will expect similar international interoperativity wherever the securities are issued.
The value of partnerships

In 2014, Northern Trust mandated Deutsche Bank and Euroclear to support its TARGET2 Securities (T2S) strategy. The solution that was developed positions the US bank for future growth and underlines the importance of collaboration in a complex environment. Neil Fredrik Jensen talks to Justin Chapman, Global Head of Market Advocacy & Research at Northern Trust, about the journey.

In the build-up to T2S, many people spoke of the challenges and opportunities that securities infrastructure consolidation would bring. The organisations that focused on its potential, rather than the obstacles, swiftly seized the moment to take a deep look at their business and use T2S to make some modifications.

Northern Trust, one of the largest global custodians in the world, was among the banks that identified the chance to challenge the status quo. As its T2S strategy took shape, it started to develop a fresh, strategic view on its custody model for the post-T2S world.

“Given that T2S takes us a big step forward in creating greater efficiency and integration across Europe’s financial markets, while also reducing counterparty and settlement agent risk, we met this headlong and set out to consolidate our banking relationships,” says Justin Chapman, Global Head of Market Advocacy & Research.

Northern Trust established that 90% of its T2S flows will be concentrated in six markets in Europe: Germany, France, the Netherlands, Belgium, Spain and Italy. As harmonisation started to take place, Northern Trust reduced its bank providers to two custody providers who could work with the bank on a new strategic operating model.

A landmark mandate

As Northern Trust formulated its strategy, it was looking for partners who could support the new centralised delivery-versus-payment settlement regime in central bank funds across European securities markets on behalf of its clients. The mandate was secured by Deutsche Bank, along with Euroclear France, an investor central securities depositary. It is something of a landmark for the industry in that it underlines how a compelling combination of expertise can be harnessed for the benefit of clients. “Across the teams, the high degree of flexibility and open engagement was instrumental in getting the scope of the project agreed, the objectives in place and, as we moved through the process, the most workable solution,” recalls Chapman.

The journey hasn’t been without hurdles, but Northern Trust, Deutsche Bank and Euroclear all have the commitment, from the very top of their organisations, to make the project a template for successful cooperation. “I hope this does prove to be the first of many such collaborative efforts in the industry,” says Chapman. “All three parties in this transaction bring different strengths to the table. It’s a win-win-win scenario.”

Chapman adds that the commitment of all parties to make the collaboration a success clinched the appointment of Deutsche Bank and Euroclear. “There was a strong underlying feeling from everyone involved that, from a strategic perspective, there were mutual benefits to be derived from the partnership. It was a very pragmatic arrangement,” he says.

Pragmatism is, in many ways, a substantial characteristic of Northern Trust. Historically known as a stable organisation, it started planning for T2S in 2012. “It is a huge investment for us, and our due diligence around T2S included looking at providers who could partner with us in the long term. For example, for this important mandate, the selection process was rigorous, involving many of the pre-eminent names in the field.”

Justin Chapman
Over his 26 years in the securities industry, Chapman has taken on a plethora of diverse roles and has worked for organisations in the investment banking, asset management and consultancy space, among other fields. At Northern Trust, Global Head has been a recurring title on his CV and he has worked in a range of areas covering Change Management, Tax and Income Operations, Product Development and Asset Servicing. Chapman is now a member of Northern Trust’s COO’s executive management team and is responsible for developing the bank’s strategy and implementation for industry engagement across operations and technology globally.
During the height of the crisis, we saw a huge influx of cash as people looked for stability and reassurance. It was an intensive process, working through strategic objectives and, ultimately, developing an innovative structure. Northern Trust was quick to unveil its strategy, mainly because it was not hampered in any way by legacy infrastructure issues.

Following the sun
Northern Trust's own legacy is a 125-year history that has seen the bank come through the Great Crash of the 1920s and the most recent global economic crisis relatively unscathed. Its reputation as a conservative institution served the bank well in 1933, when the banks reopened after President Franklin D Roosevelt closed them at the peak of the crisis. People were queuing up outside, to deposit money with Northern Trust.

The sentiment was similar in 2008. “During the height of the crisis, we saw a huge influx of cash as people looked for stability and reassurance,” says Chapman. “Our performance during the crisis has reinforced our position as a safe, strong organisation to work with.”

This perhaps also explains why 20% of the wealthiest families in the US are Northern Trust clients. And according to Fortune Magazine, Northern Trust is among the World’s Most Admired Companies, an accolade it has picked up for nine years in a row.

Although its heritage is firmly in the US – the bank was founded in Chicago, Illinois – Northern Trust works on a global basis and applies the same ethos to its business in every part of the world. “We take a holistic view of the market and acknowledge that the world is interconnected. Many of our clients are global in their outlook, so we operate on the basis that there are no borders around our business,” insists Chapman. “It’s one model, one service.”

The bank proudly states that it continues to pursue a ‘follow the sun’ approach. The crisis taught financial services that ‘strong banks’ should no longer be taken for granted, but the evolving regulatory environment in its aftermath is designed to protect banks, investors and, equally important, markets.

When surveying the current climate, Chapman sees regulation continuing to dominate the landscape for some years to come. Northern Trust, like all major banks, works closely with regulators to ensure its clients can “get closer to the market”. Indeed, after announcing its T2S strategy, Northern Trust was successful in attracting T2S-related business, a sure sign that clients acknowledged that the bank was meeting the market’s needs.

Chapman is an advocate of regulation as the catalyst for bringing greater transparency to the markets. “Naturally, asset safety and enhanced liquidity have to be prerequisites for the shape and integrity of our industry in the years to come, but the need to demonstrate transparency around transaction reporting, positions and where assets are held is of paramount importance.”

Getting to the starting line
The full benefits of Northern Trust’s T2S strategy will take time to realise, but the implementation of the Deutsche Bank-Euroclear solution means Northern Trust is well placed. Chapman believes this is partly attributable to the success of a relationship that has strengthened as time has passed.

“T2S is a solution for the market, so we felt that we had to move quickly to send a message to our clients and to the wider market,” he says. “Getting to the starting line was an achievement in itself within the timeframe, but by introducing a set of complementary skill sets and expertise, and a code of collaboration, we have worked together to show how we can meet the challenges of market change and give our clients what they need to navigate a more harmonised market for Europe.”

He concludes: “It bodes well for the future, not just for the success of Northern Trust and its clients, but also for the way we can effectively partner with our bank providers.”

To find out more about Northern Trust, visit northerntrust.com

Image: Getty
Regulatory update: The rate of change

Regulatory measures vary in speed and delivery across the globe. As James Gavin finds, this is introducing new complexities for transaction banks.

Regulation, rather like death and taxes, is unavoidable for institutions and corporates active in the transaction banking space. The main financial regulatory agenda is not principally focused on transaction banking: a relatively low-risk, low-margin business. Still, the sheer weight of legislation and the pace of regulatory change has an enormous impact. From capital-related legislation such as intraday liquidity reporting measures, Basel Committee liquidity coverage ratios (LCRs) and the Capital Requirements Directive IV (CRD IV), to cash management-related regulations, like funds transfer regulation, the panoply of regulation is showing no sign of petering out.

The LCR has a particularly significant effect on the correspondent banking market, because it does not acknowledge corresponding banking deposits as operational. If therefore penalises them from a liquidity point of view, explains Matthew L Elberg, Vice President, International Policy at the Bankers Association for Finance and Trade. If expectations around intraday liquidity monitoring aren’t clear or haven’t been fully discussed from a national regulatory perspective, it creates a great deal of pressure on the transaction banking space in particular.

Preferential treatment

The diversity of businesses that make up transaction banking adds to the complexity of regulation. Among the recent regulation, of notable importance is the EU’s CRD IV, covering prudential rules, as well as the LCR guidelines.

“We are still looking for more preferential and harmonised treatment for the way in which certain trade finance products are treated under Basel on a global basis, and then applied on a regional or local basis,” says Angus Fletcher, Head of Market Advocacy, Global Transaction Banking, Deutsche Bank. “That’s because any differences create problems in terms of how you deal with cross-border business.”

The CRD IV and its associated Capital Requirements Regulation (CRR), which is directly applicable to firms across the EU, are to be reviewed. Discussions will need to be resolved by October 2015. This is a key opportunity to raise such concerns again.

Out of the fire

The broader backdrop is the continued rollout of the post-crisis G20 objectives of systemic risk reduction, the introduction of ‘too big to fail’ measures and new investor protection procedures. These objectives were mooted in the immediate aftermath of the financial crisis but are now in full blown implementation stage.

This brings its own challenges, says Fletcher, because different regulators across the globe are bringing such measures in at different paces; they are interpreting the principles agreed at G20 level and then fed down by the likes of the Financial Stability Board and the International Organisation of Securities Commissions.

“They are interpreting those guidelines in slightly different ways and bringing them in at different timings, so some are ahead of the curve and some are behind. For an international business, that becomes relatively challenging,” he says.

The sheer geographic diversity of transaction banking makes for an additional challenge: ensuring that local and international regulations are being met, particularly when there are different speeds of implementation involved.

Full implementation of the current regulatory agenda is likely to take a minimum of three to five years, but there is still more in the pipeline, given that questions over shadow banking – a system whereby intermediaries that are not subject to regulatory oversight facilitate the creation of credit throughout the global economy – have yet to be fully fleshed out.

New agenda

However, a new agenda is slowly beginning to emerge that reflects the change in the rhetoric in Europe amid talk of the Capital Markets Union, the building blocks for which are due to be laid in 2018, and a resultant single digital market. Piling more restrictions on the banking world is not necessarily going to achieve the EU’s goal of strengthening the European economy, and the new agenda appears to reflect this understanding.

The challenge is to bring the new growth agenda in line with what is already being done on the regulatory front.

“We have got CRR and CRD IV on which consultations are coming out now, in light of this growth agenda, and then you have this whole new cyber security aspect emerging as part of the recognition of the digital era,” says Fletcher. “There’s discussion around fintech, which is a potential game changer – blockchain technology and new currencies that could change the industry in a similar way to how streaming has revolutionised the music industry.” (See page 32 for an in-depth discussion of fintech.)

He adds: “Regulation now drives more than 50% of strategy both in terms of what we require and what our clients are looking for in terms of services.”

Thinking ahead

There remains a sizeable grey area as to what institutions must deliver from a regulatory perspective. Banks are still waiting for clarity around much of the detail. In reality, however, they will have to start implementing the changes well before they are aware of the intricacies of the regulation in question. Banks will need to listen to their clients’ regulatory needs, which should provide opportunities to enhance their services. Ultimately, this should lead to a win-win scenario for those banks willing and able to invest in the changes required for their own and their customers’ businesses.
LANDMARKS

Cautious beginnings

On June 15, 2015, Saudi Arabia opened its stock exchange to foreign investors for the first time. The Tadawul is well diversified, with 169 listed companies across 15 sectors. The value of these companies combined is about USD 570 billion, which puts the exchange in the range of those of Russia, Malaysia, Mexico and Indonesia. Investors can only enter the market if they have USD 5 billion in assets and more than five years’ investment experience. What’s more, investors who are approved are not allowed to own more than 49% of a traded company. Despite 2015’s sharp oil price drops and Middle Eastern geopolitical uncertainty, the stock exchange’s opening was a landmark for the region. The future of this fledgling yet financially robust market will be interesting to watch.
There are certain things that should be entirely predictable: the quality of tap water, the performance of a car’s brakes, the service in banking. In the run-up to the financial crisis, however, ‘innovation’ in finance led to some questionable practices and, later, to worse outcomes. Where does that leave banks that want to ensure their customers do not face unpleasant surprises?

It leaves them doing what they have always done: assessing and pricing risk. This is one of the reasons why a very traditional product – trade finance – had a ‘good crisis’ and continues to prosper now. “A bit of a crisis is good for trade finance,” says Daniel Schmand, Head of Trade Finance & Cash Management, Corporates, at Deutsche Bank, who was recently appointed Chairman of the Banking Commission of the International Chamber of Commerce (ICC).

The ICC supports cross-border business through its work on self-regulation, dispute resolution and policy advocacy for member companies from over 120 countries. “During the upheavals in the European peripherals, for example, we just went back to the tried-and-tested ways of securing trade, letters of credit, guarantees and, particularly, export credit financing,” he says.

This mattered. Trade finance provides working capital to support international trade and allows exporters to reduce payment risk. Companies can, of course, trade without the intermediation of banks – sending goods on ‘open account’, in other words, before they get the money and without a guarantee of payment – but that is not always advisable with unfamiliar business partners in far-flung parts of the world. Quite apart from that, around 90% of trade is oiled by credit, payment insurance or a payment guarantee of some form. The global flow of bank-intermediated trade finance per year is estimated at up to USD 8 trillion. Money really does make the world go round.

Trading standards

“Trade finance overall is of critical importance to the economy and something that banks should, and always will, do,” says Schmand. “We need collectively to make sure it is safe and not vulnerable to fraudulent activity.”
The importance, and stability, of trade finance can mean it is taken for granted. It has long underpinned much of global corporate trade. Schmand points out that Deutsche Bank itself evolved out of an institution founded in 1870 by Georg von Siemens to support German industry outside Germany. What may turn out to be a positive outcome of the financial crisis is that it gave politicians and markets the chance to see what happens when the wheels of trade finance stop turning. It should be stressed that trade finance banks did, as the Bank for International Settlements (BIS) points out, rebound “quickly”. Still, what the regulators saw was sobering: in periods of crisis, bank-intermediated trade finance has, BIS says, “a statistically and economically significant role” – particularly when it comes to exports.

Trade finance also brings more than money to the companies it supports. “If we tried to impose a German model elsewhere, we would fail,” says Schmand. “What we can do is share best practice and the experience we have gathered while valuing local nuances and differences.” He points to the Sharia-compliant trade financing that know who the underlying beneficiaries are.”

During 2008-09, when trade finance banks were still picking themselves up after the financial crisis, some of the slack in export financing was taken up by export credit agencies (ECAs). As government entities, ECAs have often been accused of skimming what should be otherwise “fair” markets. Schmand says this concern is exaggerated. “Their purpose is to promote prosperity, create jobs and support trade. They are paid for by taxpayers to help their own economy, which is quite fair.”

The other arm of governments that regularly comes in for flak – with or without crises – is financial regulation. Is post-crisis regulation strangling the ability of banks to support trade, as some would suggest? “We need to tighten and foster regulation and, overall, regulators are doing a very good job,” says Schmand.

Fine-tuning the regulation

“Basel III intends to make banking better and safer. Trade finance got treated fairly – as a set of instruments used to support the so-called real economy. There will be fine-tuning of the rules and that is a work in progress.” That begs the question as to which parts of the regulatory machine are misfiring. Schmand points to the treatment of letters of credit – and the degree to which contingent credit risk must be backed by equity under Basel III – as one area of concern. It is not that regulators are unwilling to cooperate.

The crisis gave them a clear view of the benefits of trade finance and the downside of its absence. However, there is no such thing as a global regulator, which can be problematic for an asset class like trade finance that is, by its very nature, a global undertaking. “Contrary to regulatory requirements just make global business ever more complex,” Schmand says.

Until regulators can move forward together on the rules that they would like to see for trade finance, which may not be easy given the “creeping protectionism” that the World Trade Organization (WTO) has identified post-2008, banks clearly need to work within the regulations that they have now.

Given that equity is not cheap and that concepts like contingent credit risk could cover a multitude of sins, trade finance providers are looking at ways of moving trade finance exposures off the balance sheet. Again, this is no reinvention of the wheel. Standard Chartered was the first bank to securitise trade finance assets, with a USD 1 billion collateralised loan obligation (CLO) in 2007. Unfortunately, the letters “CLO” can remind investors of the acronym soup brewed up, pre-crisis, around asset-backed securities. It sounds similar to MBs, CMOs and CLDs – and the bitter aftertaste they left.

The right prescription

Investors – even in a low-interest-rate environment that encourages a hunt for yields – might, that given the positives, still be worried that a CLO is a bit like a cheap sausage, with some very unattracting elements that could cause indigestion later. Are they worried? “It comes down to how securitisation is used,” says Schmand. “It’s like a shot of morphine. Correctly administered, it is helpful. We see an ever-increasing interest in trade finance securitisation as an asset class.”

If the figures are anything to go by, trade finance itself is one of the least risky asset classes around. The ICC’s 2013 Global Risks Trade Finance Report gives an average loss rate of 0.02% for traditional, short-term trade finance products in 2008-11, which it compares (applying some methodological caveats) with an observed default rate of 2.41% across all of the companies that Moody’s rated during the same time period. This is a world away from the mortgage-backed securities in the US that gave securitisation such a bad name. Schmand says that the ICC is making sure that investors can understand the difference.

Investors in the securitisation can have detailed insight into the underlying assets if they want it. Schmand of the three trade finance deals that Deutsche Bank has structured so far. “They can know, for example, what type of financing is involved, or the geography. However, unless the trade finance client wishes it, they do not know who the counterparty is.” (Aspects of trade finance can benefit from the reputational clout of borrowers, or of their network.) What might surprise more about the CLOs is that some of the deals contain an “unfunded element” – that is, supply chain financing can be part of the mix. “Investors are given a lot of comfort and are quite happy with that,” says Schmand.

One of the reasons why investors may not be losing sleep over their holdings in trade finance CLOs – apart from the returns, which Schmand describes as “attractive” – is that international banks like Deutsche Bank focus on providing trade finance to larger players. Such companies tend to have strong relationships with equally strong suppliers. Smaller companies, with perhaps shaky credit profiles, are dealt with by regional and local banks. However, these banks are, in turn, backed by larger financial institutions. This, Schmand points out, is one of the challenges of trade finance: “Knowing both your clients and your client’s clients.”

So-called South-South trade grew as a share of world trade from 8% in 1980 to 27% in 2010, according to the OECD. Many of these countries may not yet be able to afford to give the full support of bank-intermediated trade finance, certainly without the backing of their ECA, but their growth boosts trade overall. While it may be difficult for smaller trade finance banks to remain profitable amid low interest rates, that only provides more opportunity for those banks that can invest in a strong and long-term trade finance presence.
The demands of supply

New supply chain financing techniques offer sophisticated platforms and opportunities for growth, writes Dominic Dudley. But in order to benefit, companies will need to communicate clearly and effectively.

Most business-to-business transactions involve the use of credit in some form, with suppliers typically delivering their goods or services first and then invoicing their client and waiting for the payment to come through at a later date.

It is a system that has stood the test of time, but it is also one that continues to throw up new opportunities for the finance industry to explore.

The major spur for the adoption of supply chain finance in recent years was the 2008 global financial crisis. That led large companies to seek new ways to raise liquidity at a time when traditional sources had dried up. Extending payment terms was a simple way for a business to raise the working capital it needed, but this risked putting suppliers in a difficult position.

The answer was to use supply chain finance platforms that would mean suppliers weren’t unduly harmed by having to cope with later payments.

Supply chain finance can cover a multitude of tools (see box, page 31), but the most popular form by far is reverse factoring. The Association of Chartered Certified Accountants (ACCA) estimates that the global market for reverse factoring is worth between USD 255 billion and USD 280 billion. The telecommunications sector has proven the keenest at adopting the practice, accounting for between USD 39 billion and USD 55 billion of the total. Other prominent sectors include aerospace, chemicals, pharmaceuticals and retail.

Now a second wave of supply chain finance is under way with the development of more sophisticated platforms. These tend to use a wider range of tools to expand what companies can do with their supply chains, allowing them to reach out to more partners further along the chain. Analysts say it should lead to increased growth in the sector.

“Supply chain finance is becoming more popular because there are new entrants that make it possible to reach out to smaller companies, the so-called long tail of suppliers,” says Enrico Camerinelli, a Milan-based senior analyst at Aite Group, an international research and consulting firm. “These new platform providers are making it possible to move into what I call supply chain finance 2.0.”

As the use of financing tools spreads further along the supply chain, there are challenges to overcome. Buyers need to optimise their processes for accounts payable and receivable and to
The aim is to limit risk, enhance liquidity and reduce supply chain costs across the network.

Traditionally, supply chain finance has used approved invoices to trigger payments from banks or other financial providers to the suppliers. Under a typical reverse factoring system, for example, a supplier will quickly receive its payment from a bank once an invoice has been approved. When the invoice reaches its settlement date, the buyer pays the bank.

The latest generation of platforms, developed by the likes of GT Nexus and Trade River Finance, use sophisticated algorithms that allow them to build up a history of the relationship between a buyer and its supplier. The platform can then use events earlier in the process to trigger a payment, such as a purchase order or an unapproved invoice. There are many potential advantages to this. As with traditional supply chain finance, the supplier receives payment more quickly and the process can help to ensure the financial health of those suppliers a buyer relies on. At the same time, a buyer can gain more substantial discounts for the earlier payments.

There can also be other, intangible benefits. Suppliers can potentially gain from financial health of those suppliers a buyer stands to benefit cash flow predictability, fewer disputes and the potential for banks and other finance providers. The techniques that are now being used to assess the credit risk and quality of the corporates being financed through supply chain finance platforms are the sort of instruments that could also be used to reduce the rate of non-performing loans in other areas. Overall, ACCA estimates that on average, 80% of the value from an effective supply chain finance programme is shared between the suppliers and the buyer. It is the buyer that typically benefits most, capturing between 35% and 50% of the savings, while the supplier takes between 25% and 45%. The amount will vary depending on factors such as how much financial support the buyer wants to offer to its key suppliers.

Financial providers also benefit from between 15% and 18% of the savings. The final cog in the machine is the platform provider. Firms such as Primelend, Taulia and Orbian take a cut of between 2% and 5% of the savings.

What will it take for all the potential benefits to be realised? With the financial crisis now largely dissipated in most parts of the world, there is no longer the same pressing need among large corporates to find ways to raise working capital through accounts payable. The potential benefits for everyone in a supply chain mean that it is still an opportunity worth pursuing.

It is easier to set up supply chain finance programmes if there is already a culture of electronic invoicing, as is the case in places like South America and, to a lesser extent, in the Asia Pacific region. That helps to explain why adoption of supply chain finance techniques is more advanced in those places than in many other parts of the world. It is also popular in the US, although that is likely more to do with the openness of the market to using alternative sources of finance.

For the finance industry to make the most of the opportunity, banks and others will need to ensure that they are able to provide the credit capital required by their customers. They could also help with the education and marketing that will be required, particularly in terms of explaining to small and medium-sized businesses (SMEs) the opportunities that are available and the benefits they could accrue.

With SME access to finance a perennial problem around the world, the greater use of supply chain finance offers one way to address the shortfall.

What is supply chain finance?

Supply chain finance is the use of financial tools to optimise the management of working capital and liquidity in a company’s supply chain. As a process, it has been made far easier by the development of advanced technologies that allow a business to track and control events in its physical supply chain. In turn, this allows financial tools to be used in an automated way.

There is little consensus on the precise definition of supply chain finance, and lots of different tools can fall under the umbrella. On the accounts receivable side, there are tools such as receivables purchasing, invoice discounting, factoring and forfaiting. On the accounts payable side, the tools include reverse factoring and dynamic discounting.

Other types of supply chain finance include pre-shipment or purchase order-based finance and inventory financing. In addition, there are a number of other closely related tools, such as documentary trade finance, bank payment obligations and asset-based lending.

Of all these, by far the most popular is reverse factoring, which is also known as approved payables financing. This allows a supplier to receive payment for an invoice earlier than usual from a bank or other financial provider, but at a discount. At a later point the buyer pays the invoice as normal, with the financial provider earning a profit on the difference between the two amounts.

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With SME access to finance a perennial problem around the world, the greater use of supply chain finance offers one way to address the shortfall.

In the UK, the government has estimated that the finance gap for SMEs will be between GBP 84 billion and GBP 191 billion in the five years to 2017. It is something that industry bodies are keenly aware of. The Society of Motor Manufacturers & Traders, for example, has been pressing for greater use of supply chain finance among companies in the UK’s automotive sector.

In a recent study, it said that improving the flow of money across the automotive supply chain is not ensuring that payment terms and conditions cascaded down the supply chain was one of the main financial barriers that the industry needed to overcome, "including the relatively underdeveloped use of supply chain finance in the sector".

However, the increasing sophistication of supply chain finance will present problems for the unprepared or unwary. More than anything else, the difficulties boil down to a lack of communication. This can occur between different departments within a company, as well as between a buyer and its supplier. If the process is to be a success, it is vital to ensure it involves everyone with a role to play.

“Things go wrong when there is a lack of alignment between different departments in the company that wants to launch the programme, which is typically the buyer,” says Camerini. “When you start talking with your suppliers, you need to get your procurement people involved. And when you have to implement the platform, you need to speak to your IT people. If all the different parties are not aligned, that’s where the problems come in. The biggest mistake that can be made is if the only things that are considered are the technology platform and implementing the software.”

It is also important to tailor supply chain finance solutions to the specific circumstances of the organisations involved, according to Dr Templar. Among the findings of postgraduate students at Cranfield is that the organisations involved need to understand their physical, information and financial flows. If it is done correctly, all this can help to build up collaboration, enhance trust and improve the relationships from one end of a supply chain to another.

The potential for supply chain finance to grow in the years ahead is certainly there, but making it happen will be more challenging for some businesses than others. Success will depend on ensuring that a company communicates clearly with not only its suppliers and finance providers, but its own people too.
A lot has been said about fintech in the past year, but not a lot has been agreed. As Joanna Lewin writes, one certainty is that banks are beginning to ride the wave.

Crowdfunding. Peer-to-peer lending. Robo-advisors. Cryptocurrencies. The now infamous Bitcoin. These words, among many others, are becoming common parlance in bank boardrooms as non-bank players – or ‘fintech’ start-ups – become increasingly present within traditional banking arenas. These enterprises have been broadly tilted ‘disruptors’ and, perhaps understandably, some leading banks have approached them with caution.

Collectively, they have the potential to overhaul the way in which banks and clients liaise, as well as banks’ internal processes. In some segments, fintech has been considered a byword for ‘replacement’, born out of concerns over how automation has rendered defunct many branches of retail banks. Other banking professionals fear that a ‘let’s automate everything’ approach could reduce the quality of service that banks provide to their clients.

These are genuine concerns. Yet, with global investment in fintech trebling in one year to a staggering USD 12.2 billion and growing at more than three times the rate of venture capital investment overall, it is an industry that banks should be getting on board with, and sooner rather than later.

In this low-interest-rate environment, the pressure on banks to maintain profitability has been heightened at the same time that clients are looking for ever more innovative ways to provide for their customers. If banks fail to keep up with this demand from clients, the risk that they might bypass traditional institutions, where possible, suddenly becomes a very real one. Still, the operative phrase remains ‘where possible’. Gaining access to the reams of consumer data that would be required to meaningfully rival banks is a distinct shortcoming of these young ventures.

Nevertheless, there is a genuine need for traditional banks to adapt. Marrying established banking architecture with still-new technologies while placating shareholders, all under the intensifying gaze of regulators such as the European Securities and Markets Authority (ESMA) and the Financial Conduct Authority, will certainly prove challenging. But for those institutions that are willing to take the plunge and collaborate effectively, the rewards could be highly worthwhile.

Friend or foe?

With startling statistics like those from Accenture, which posits that 30% of banks’ revenues could be lost to innovative new players by 2020, it might seem prudent for banks to see fintech start-ups as a threat, just another risk to add to the pile. After all, there is plenty of evidence that fintech start-ups are moving into arenas that were once exclusive to banking.

Funding Circle and Lending Club are just two examples of peer-to-peer lending fintech firms that have, for some users, removed the need for a traditional intermediary: a bank. In the first half of 2014, Lending Club could boast loan originations of USD 1.8 billion after five years of doubling growth. To be wary of fintech firms seems reasonable. To see them as an outright threat, though, is likely misguided.

Sir Mark Walport, Chief Scientific Adviser to the UK government, hailed fintech as a tool with which financial services could “re-establish trust … while opening up financial services to a vast number of unserved or underserved consumers”.

Moreover, Lisa Myole, Head of the Financial Services and Payments programme at techUK, explains: “While some start-ups wish to compete with the banks directly, such as those involved in peer-to-peer lending, remittances, currency exchange and mobile payments, many are looking to sell their innovative technologies into the banks. In fact, that is where we see most of them wanting to play. There are vast opportunities to improve the bank rather than compete directly.”

Indeed, Rhomaios Ram, Head of Product Management, Global Transaction Banking at Deutsche Bank, looks at the sector as delivering opportunities for banks and their clients. “These companies can be our clients and our collaborators, as well as our competitors,” he says. “Advances in technology have always played their part in the development of markets and business. The emergence of specialist companies from the fintech sector is another stage in that evolution. So, it is natural that we want to work with them and to find the right technology-oriented partners for our clients.”

The amount that global investment in fintech rose to in one year: USD 12.2 billion
Keeping fintech at arm’s length is, in fact, likely to be more damaging than helpful, says Matteo Rizzi, Partner at SBT Venture Capital, who was recently named among the 40 most influential fintech executives in Europe by Financial News. “I think the rhetoric of fintech start-ups being a threat is last-century thinking already,” he says. With end-clients’ customers demanding increasingly sophisticated technological solutions, it would be ignorant to try to halt the tide of the fintech revolution by suggesting the sector is ruinous for banks. But Rizzi concedes that it’s not likely to be an easy move for institutions. “The biggest challenge at the moment,” he says, “is that these fintech initiatives are rather isolated from the bank itself.”

Bringing competition into the fold

The potential remunerations for banks that fully immerse themselves in the fintech explosion are bountiful. Jordan Lampé lauded the potential gains of collaboration in a recent blog, and they are certainly lauded the potential gains of collaboration in a recent blog, and they are certainly attractive. “Collaboration will enable financial institutions to spread risk, address regulatory burdens, and drive down research and development costs and overall time to market. “On top of this, by hand-selecting partners and placing many small bets on technology, banks access fresh minds and bring a new perspective to the table. Cynics might argue that he would conclude this, given that he is Director of Communications and Policy at Dwolla, a real-time interoperability and communication platform for financial institutions. But again, to argue that way is probably missing the point.

Regardless of whether fintech is welcomed or feared, the message to banks is clear. “They need to deal with their legacy IT infrastructure and fully digitise, enabling them to better and more cost-effectively meet the changing needs and demands of their customers, the regulator, cybersecurity and fraud in what is a more challenging macroeconomic and regulatory environment,” explains Moyle.

Delicate alliances

Inevitably, there will be hurdles along the way in the banking sector’s transition to a fully digitised operating machine. Aside from the more obvious and logistical puzzles in its transition, like how banks will find cost-effective ways to develop proprietary technology for each client’s specific needs, there is the cultural disparity in the room shared by ‘digital natives’ from tech start-ups and banking execs. The former can afford to be risk-tolerant and are at greater liberty to take an ‘if at first you don’t succeed’ stance; the latter are obliged to be far more risk-averse and conservative in their methodology and operations. The former are met with the relatively firm regulatory regulation that’s currently in place for the tech start-up sector; the latter are governed by an intricate web of rules, compliance and regulations, and face high barriers due to, at the least, bank licensing. These factors may make for delicate alliances.

An appreciation by banks that fintech firms come in various shapes and sizes and need to be treated with as such will be critical,” says Mohit Mehrotra, Partner at Deloitte Consulting. “Likewise, a culture at the bank that is supportive of fintechs is key to making start-ups work for them.”

Another vital element for happy collaboration, will be stakeholder involvement. “Clear identification of key unaddressed and underserved needs is important to drive a consensus across the business around development of internal solutions versus external solutions. This is to ensure business, operations, technology and regulatory teams are clearly aligned on the trade-offs.”

Andree Velitch, Director at digital advisory firm Amphibus Group, said recently that “the greatest opportunity in the industry lies at the meeting point of large financial institutions and young, ambitious start-ups” – and that something that several major banks have started to capitalise on. By the end of this year, Deutsche Bank will have launched three new innovation hubs in Europe and the US – one in Berlin, another in Silicon Valley and a third in London. The hubs will allow different parts of the bank to assess hundreds of innovative tech start-up ideas and incubate those that could aid the development of products for clients, as well as internal processes. While fintech will disrupt the funding space and could derail banks that do not adapt, Deutsche Bank and the many others establishing innovation hubs, the phenomenon will offer a new business model for investing and borrowing.

Come together

A good example of how banks and fintech can come together can be found in crowdfunding, one of the most notable fintech breakthroughs, and as such has been well documented. What other major ‘fin-technologies’ will dominate the global transaction sphere? Rizzi believes “real-time payment technology that is faster, cheaper and more ubiquitous” will be one. He points out that many banks are already partnering with companies in this area, such as Earthport, which provides a service for low-value cross-border payments and promises to bring increased efficiency to banks.

What else? “Authentication technologies and fraud identifiers, “ says Rizzi. “And assets distribution technology, with ever more alternatives to banking to manage retail and corporate assets.” Moyle thinks blockchain has yet to meet its full potential in global transaction banking and beyond. “These technologies, the uses of which are currently being explored within both established banks and challengers, have the potential to transform aspects of banking,” she says. “Beyond payments and transfers, blockchain could, for example, be used in the settlement process for derivatives.”

Distributed ledger technology (like blockchain but with an added layer of security) and smart contracts will also have the potential to transform aspects of banking, says Rizzi. “Beyond payments and transfers, blockchain could, for example, be used in the settlement process for derivatives.”

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Distributed ledgers – like blockchain but with added security

Distributed ledgers are currently being explored within both banks and fintech start-ups and banking execs. The former are met with the relatively flimsy regulatory regulation that’s currently in place for the tech start-up sector; the latter are governed by an intricate web of rules, compliance and regulations, and face high barriers due to, at the least, bank licensing. These factors may make for delicate alliances.

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Meeting in the middle

However banks may have first viewed the young technology ventures ruffling feathers in the banking world, it is no longer possible to ignore or repel the changes. On the other hand, tech start-ups are realising that it’s also no longer possible to imagine that the complex regulation, entrenched systems and high capital requirements fundamental to banks can be thrown out with the Windows 98 packages and clunky PCs.

Can they meet in the middle? Mehrotra says yes: “In the right circumstances, banks and start-ups can be good partners. That is, in areas where a fintech firm can complement or enhance the existing capability of a transaction bank.”

Rizzi says they’ll have to: “They need each other, with very few exceptions.”
Hacked off

Corporates and institutions are facing increasingly sophisticated cyberattacks. Lawrence Cohen explores some of the risks

5 facts about the cybersecurity threat

1. More than half (56%) of organisations are unlikely to detect a sophisticated cyberattack, found EY’s latest annual Global Information Security Survey.
2. Nearly one-third of respondents from US businesses and law enforcement agencies in PwC’s 2015 US State of Cybercrime survey said they were hit by a phishing attack in 2014.
3. More than 70% of banking and capital market CEOs identified cyber-insecurity as a threat to their growth prospects, according to a PwC study.
4. The financial industry is the most frequent target of cybercriminals, facing three times as many attacks as any other sector, according to Websense.
5. Each year, the banking industry spends more than GBP 700 million fighting cybercriminals, according to a recent Department for Business, Innovation and Skills paper.

How are corporates and financial institutions protecting themselves?

A large European bank recently hired three hackers to visit one of its boardrooms and demonstrate how they could steal executives’ identities, take control of their mobile phones, eavesdrop on their conversations and even spy on them through the phones’ inbuilt cameras. The exercise reflects a concerted effort by businesses both inside and outside financial services to ‘know their enemy’. Many firms are adopting a ‘poacher-turned-gamekeeper’ recruitment strategy, hiring former hackers to help them understand the threats they face and identify and plug any gaps in their cybersecurity defences.

What methods do cybercriminals use?

The hacking attack on a major Japanese conglomerate involved sophisticated malware that fired off a round of code in search of vulnerabilities in the network. One bank’s technology team simulated the type of attack that the firm suffered and found that when it successfully patched one potential weakness, the malware triggered another round and searched for a different vulnerability. This went on for several rounds.

Cybercriminals are also exploiting organisations’ increasing reliance on third-party systems in their provision of digital services. Vendors and suppliers are key components of a successful business but are often the weakest link in the security chain.

How is cybercrime evolving and how is it different from traditional crime?

‘Hacktivists’ and criminal gangs are increasingly targeting the banking industry, usually with the aim of stealing funds or valuable customer data through security breaches or stopping systems from working through, for example, denial-of-service incidents.

With an increased need for transaction banking to be efficient – think instant payments – innovative new banking platforms are introducing new kinds of cyber risk. Mobile devices and applications have inadvertently let in mobile malware (malicious strands of computer code), for example. Other common threats include botnets or ‘zombie armies’ and phishing.

What are the immediate risks to the global transaction banking arena?

Cyberattacks can target multiple systems and processes simultaneously, causing widespread harm.

Digital attacks can target multiple systems in an organisation’s increasing reliance on third-party systems in their provision of digital services. Vendors and suppliers are key components of a successful business but are often the weakest link in the security chain.

The cost of cyberattacks can extend far beyond the loss of financial assets or intellectual property.

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Can companies benefit from working with each other to combat cybercrime?

Yes, absolutely. Companies need to consider the wider system in which they operate and share intelligence on the cyberthreats they face.

This requirement has already been recognised in the UK. Initiatives such as the Financial Crime Alerts Service, launched by the British Banking Association and BAE Systems Applied Intelligence, are proving to be valuable channels for managing evolving and emerging cyber risks.

The Bank of England, meanwhile, has run a number of ‘Waking Shark’ exercises to help it understand what a major attack might look like. These exercises have involved participants from investment banks, financial market infrastructure, the financial authorities and relevant government agencies. They tested communication between firms and the authorities with the aim of improving understanding of the impact of a cyberattack on the participants and wider financial sector.

These initiatives underline that by putting rivalries aside and joining forces to combat common foes, banks and other corporates can take vital steps towards keeping cybercriminals at bay.
Are you renminbi ready?

Evan Goldstein, Head of Renminbi Solutions at Deutsche Bank, speaks to Alastair O’Dell about navigating the internationalisation of the Chinese currency

The Chinese government is committed to transforming the renminbi into a leading global currency. But while the goal is clear, the rate of progress depends on a delicate balancing act between simultaneous reforms of the capital account, the mechanisms for allocating capital and the severity of market volatility.

There has been a procession of measures to internationalise the currency that benefit both multinational corporations and asset managers.

“The moves China is committed to are all really positive. It’s just a question of which of them happens first,” says Evan Goldstein, Head of Renminbi Solutions at Deutsche Bank. “You have to be careful about which reform to go after and what the pace of reform will be, when you are most concerned about domestic employment, growth in GDP and the need to shift from an investment-based to a consumption-based economy.”

With high hopes for this dynamic currency, what factors will form the shape of things to come?

Multinationals

In China, multinationals have only recently been able to access sweep accounts, starting in the Shanghai Free Trade Zone in February 2014 and nationwide since November 2014. This has allowed corporates to free up trapped cash and consolidate overnight onshore renminbi positions into a single-entity, two-way, cross-border sweep account offshore for integration into a firm’s liquidity pool.

“There is a real uptake for the sweeping mechanism,” says Goldstein. “The growth in the consumer market, in particular, means subsidiaries can now let money flow through to the parent corporation. It is a big change.”

Sweep accounts are part of a multipronged policy that also includes changes to funding and lending and establishing the ability to use offshore parent company guarantees onshore. “It means corporates can optimise and get the best overall funding they need, whether internally or through the market,” Goldstein explains.

Stock Connect

Launched in November 2014, the Shanghai-Hong Kong Stock Connect opened up Chinese equity investment offshore (southbound) and foreign investment onshore (northbound). With Shenzhen and bond components in the pipeline, it can be viewed as a template for direct access.

Stock Connect has facilitated quota-free access to new investors, including offshore hedge funds, and it has highlighted beneficial ownership issues. European UCITS funds and US ‘40 Act funds were concerned with the Hong Kong Stock Exchange’s (HKSE) nominee structure, as the investor is not shown as the asset owner.

“US ‘40 Act funds and UCITS funds would not invest under these conditions,” says Goldstein. “They want a beneficial ownership structure. They want to show who the end investor is, so if there is ever a claim or issue the end investor is truly represented.”

The HKSE, China Securities Regulatory Commission (CSRC) and the Shanghai Stock Exchange are working together and have since made an announcement that clarifies beneficial ownership.

“Everything is moving forward in a much more realistic way,” says Goldstein. “The degree of interaction between offshore and onshore is increasing, so China has to increase its engagement with industry groups and governments when tweaking its reforms.”

Historically, Chinese reforms have been internally focused, without significant consideration of foreign markets. But they are moving away from this narrowly focused approach.

“That is definitely not the case today. There has been a big conceptual leap forward,” Goldstein asserts. “Stock Connect, the Shanghai Free Trade Zone and the incremental loosening up of restrictions on sources and uses of funds show that China is committed to reform, which will either be a continuing drip-feed of liberalisation or China will surprise us with how fast it comes to the market.”
Despite its staggering pace of development, China remains an emerging market that still has some challenges. Many underlying markets are not yet exposed to market forces; municipal debt is substantial and opaque, state-owned enterprises take a dominant share of bank lending and onshore interest rates can be politically driven. But the government is cognisant of such issues and has plans for gradual liberalisation.

“The establishment of a municipal bond market is something that we see happening in the next 12 to 18 months,” says Goldstein. “As is the growth of the asset-backed securities and mortgage-backed securities market, which had stalled.”

MSCI and IMI inclusion China is targeting inclusion in both the MSCI Emerging Market (EM) Index and the IMF special drawing rights (SDR) basket of currencies. Renminbi shares traded and purchased onshore, as well as onshore and offshore stock exchanges are known as A-shares. These are on the MSCI watch list, but inclusion requires “significant” openness to foreign ownership, which runs up against CFI approval quotas. If A-shares were included in the MSCI EM Index they would comprise 40% of the index, which would be unachievable for many.

“If you are a large asset manager tracking the index, and the quota secured is significantly less than you need, you have an issue,” explains Goldstein. The MSCI and the CIRIC have set up a joint working committee to tackle the problem.

IMF SDR designation brings greater benefits than just global reserve currency recognition. On a practical level, central banks could use renminbi reserves for balance of payments investments. Also, where IMF disbursement is made, the recipient country could include renminbi in its desired SDR composition. Inclusion would also mean that the Bank of International Settlements would have a better sense of foreign government investment in China. “You can see that the Chinese government and regulators are doing whatever it takes to address the hurdles that many institutions have put forward as stumbling blocks,” says Goldstein.

Market volatility Perhaps the biggest impediment to the pace of liberalisation is volatility; reforms could be stalled or reversed if they create instability. During the month from June 8, 2015, A-shares experienced a major stumbles, falling nearly a third and prompting a series of emergency measures, including cutting the interest rate and reserve requirement ratio, suspending IPOs, buying exchange traded funds, creating a market stabilisation fund and banning major shareholders/ insiders from selling stakes.

“The draconian measures – particularly for those with a holding larger than 5% having to hold until reaching a certain vacation – do not help the cause for reform,” Goldstein says.

The policy of managed convertability – where certain items are closed or restricted in the capital account – is less about money coming in than going out. The government is wary that a sudden opening of the capital account – making it fully and freely convertible – could cause trillions of dollars to flood out into foreign markets.

“If that happened, China’s financial system would be under tremendous pressure, says Goldstein. “It is an overarching concern.”

Next steps A wide variety of further reforms are planned. The Shenzhen-Hong Kong Stock Connect is progressing, which will expand the number of liquid equities in the Stock Connect model and facilitate hedging instruments, such as for the CSI 300 Index. The proposed reform of IPD listing rules and the registration process will be a big step forward. It was expected imminently, but the recent volatility has inevitably delayed means.

On July 14, restrictions on foreign monetary authorities’ investment in the interbank bond market were relaxed (see box). “There is no quota now, which is a big positive,” says Goldstein. “It is a foundation for further liberalisation and opening, which the private asset management world will benefit from.”

Another big liberalisation concerns the yield curve. The bulk of issuance goes out at three to five years (though some go out at up to seven years) but the growth of the municipal market could multiply the size of the market and push issuance out to 10 years or more.

A further significant development is the creation of the China International Payments System (CIPS), a cross-border interbank payments system equivalent to the Clearing House Interbank Payments System in the US. Phase-one rollout takes place in the fourth quarter of 2015 and will create a bridge between SWIFT instructions from qualified institutions directly through to CNAPS2 (China’s second-generation payment system). It also expands the window of operations to 20:30 Central Standard Time to take European operating hours into consideration.

“It should increase payment efficiency,” says Goldstein. “At the moment, there is a manual, break, as there are fields in CIPS2 that are not in SWIFT instructions. Also, SWIFT is in English and CNAPS2 in Chinese – CIPS bridges that gap.”

Local knowledge The further away you get from an on-the-ground presence in China, the harder it is to understand reforms and benefit from the opportunities they bring.

Deutsche Bank is one of the few foreign financial institutions that is licensed to both be a broker in the interbank bond market and settle transactions. “A lot of what we do concerns keeping our clients informed and educating them about the detail of the rules,” says Goldstein.

There is uncertainty, for example, about the different interest rates used in setting onshore and offshore foreign exchange rates. Corporate treasurers will be particularly concerned about interest rates and how they will be set.

“When you hear that you can earn up to 1.5 times [interest] on your deposits, is that real or not? Should you expect to earn that, or is something else in play?” asks Goldstein.

“When people hear about convergence, they want to know exactly what it means and what mechanisms are used to establish rates.” Local knowledge is also of paramount importance for corporates when they are considering the benefits of the myriad government-led initiatives, such as the free trade zones.

Deutsche Bank research suggests that foreign investors will hold up to 10% of China’s domestic bond market in the next five years.

“Deutsche Bank highlighted three key benefits in a research paper. First, foreign monetary authorities will only need to register (rather than apply for) a quota with the PBC. Second, they will be able to trade all fixed-income products in the interbank without transaction size restriction. Third, they can freely choose any custodian in the interbank bond market or remain with the PBC.

“The report states: “It affirms our view that China remains committed to financial liberalisation reforms, as well as to opening up the domestic capital market to the renminbi is on track towards convertibility.”

Deutsche Bank suggests that the near-term limit will be increased as currently only 60% of the approximately RMB 600 billion of quota granted to foreign monetary authorities is being utilised. However, Deutsche Bank estimates that in the medium to long term, foreign reserve inflows will boost demand for renminbi bonds, especially to onshore and quasi-sovereign bonds. Over the next three years, the bank estimates that up to 5% of China’s domestic bond market will be held by foreign monetary authorities; in the longer term, this will rise to approximately 10%. It expects the market to grow in size, depth and liquidity.

“We expect China to further liberalise foreign investors’ onshore bond market access,” the report concludes. “We forecast foreign investors to hold up to 10% of China’s domestic bond market in the next five years.”

The exchange has announced that it is going to address this in February 2016 and test it for two months. “By April, there will be a true DvP model in place,” says Goldstein.

“However, until that happens, a lot of asset managers and local custodians are trying to understand what opportunities there are for them to start trading today.”

Relaxing restrictions On July 14, 2015, the People’s Bank of China (PBC) confirmed that it is to remove interbank bond market restrictions for foreign central banks, supra-national financial institutions and sovereign wealth funds. Deutsche Bank highlighted three key benefits in a research paper.

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Bored by cryptocurrencies? The wild-eyed bitcoin evangelists from the libertarian fringe can make the whole idea seem like a bad Ayn Rand novel. The ‘bitcoin Jesus’ Roger Ver, PayPal founder Peter Thiel – currently funding the Seasteading Institute to build floating offshore tax havens – and even the politically confused Ashton Kutcher are loving the buccaneer freedom from government and regulation, which makes the whole idea easy to dismiss. This, however, would be a mistake.

Once you step past the evangelists, something genuinely interesting is under way. Every form of payment is stored value. It leaves one ledger and transfers to another. The cryptocurrencies blockchain means all the ledgers are in the same place. It’s a much faster and much safer way to move huge amounts of money. Useful, no?

Indeed, it’s the blockchain that’s worth all the attention – a giant decentralised electronic ledger with duplicate copies on thousands of computers around the world.

The ledger can’t be altered retrospectively, so bitcoin doesn’t need trusted third parties to handle flows of money. It’s a digital payments protocol – a finance version of the SMTP protocol that allowed email to move out from the confines of AOL.

On one level, this is a wake-up call to the banking industry. Buying and selling across the globe with a cryptocurrency requires no identification, no bank account and no credit card. It pays no foreign exchange fees or banking charges, meaning you could be a bitcoin billionaire without ever having spoken to a bank. It could also, of course, be a threat to investments in Uber and Airbnb – and all fintech start-ups that are essentially intermediaries using banking’s payment rails.

But the insurgents go further. Given that the blockchain is an irrefutable ledger that allows ownership of digital assets, it does not logically follow that bitcoin – or other cryptocurrencies – is its only use.

“Capitalism took off in countries like the US, with small business owners borrowing against property equity,” argues Brian Forde, MIT Media Lab Director of Digital Currency. “Where people don’t have a formal property title, like in Egypt, all this capital is tied up. If you have a property title go on the blockchain, even if there is a change of government, it’s proof: the government can’t say you don’t own the property. In Egypt, that unlocks USD 400 million in capital overnight.”

This is an attractive chunk of change by anyone’s measure and, if Forde is correct, it means the next wave of would-be oligarchs might not need a government-backed currency at all. It’s like a nascent version of M-Pesa, Kenya’s mobile money payments system, which is poised to spread across the developing world. Plus, there’s almost no one on the ground floor.

Can you afford to ignore that potential?

Stephen Armstrong acknowledges the monotony of the bitcoin debate, but argues the merits of its potential.