

Global Payments Practices - Navigating the Changing Landscape By Monika Buechel & Vivek Anand January 2010

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Debbie: Hello, and thank you for joining us today. You're listening to a J.P. Morgan podcast discussing global liquidity and payment practices. My name is Debbie Hartley, and I'll be serving as moderator. I'm joined today by Monika Buechel, Vice President and Product Sales Specialist for J.P. Morgan Global Clearing Services; and Vivek Anand, Executive Director for J.P. Morgan Treasury Services, and Specialist in International Treasury Sales and Market Management Activities. Welcome Monika and Vivek.

Let's start with you, Monika. Globally, what are the challenges and opportunities for a corporate treasurer in terms of cross-border payments and regulations?

Monika: I talk to many clients sorting through the challenges from time zone differences that affect delivery times, charge options, and certainly different practices and required formats for certain country destinations. The expectations are often that the beneficiary will receive the funds same day, or next day at the latest. Understanding how payments settle, all the players in a particular payment chain, and certainly the payment currencies, are all of the things that might highlight where we find some delays in the delivery cycle.

Questions on charge deductions are really asked most frequently. The fact is that every bank in the payment chain wants to get paid for their services in each side of the transaction, both the debit and the credit side is being charged. Clients should have access to knowledgeable bank contacts to help explain and advise of the possible options to control these deductions. In the end, I would say, that some deductions are par for the course, when it comes to cross-border payments. Although we understand that some payments must be delivered with full value, and there's certainly solutions to ensure that.

Secondly, I would say the payment content for cross-border payment needs to be complete as to the payment parties and bank identifiers, such as Swift BICs, to assist with timely and accurate payment execution. There are, however, some countries where this information is not enough to ensure speedy execution. For instance, Canada and India are just a couple of examples where additional routing and beneficiary bank information is required to deliver the payment. I think that is one opportunity for clients to avoid any delays. If we take a step back and look at some of the bigger picture opportunities for cross-border payments, we've certainly seen a lot of environmental changes in Europe, given the SEPA, the Single Euro Payments Area, and also the PSD, the Payment Services Directive.

These new schemes or solutions or market developments will improve payment delivery for clients. With SEPA, you are able to make high and low value payments out of a European based account that presents many benefits. Streamlined bank and account arrangements as one account can be used for activity across Europe. You also have benefits in terms of no delays in crediting the beneficiary, and elimination of bank charges and/or deductions as some of the key benefits with these new arrangements.

Another new possible opportunity are solutions that have emerged to settle U.S. dollars in the region, versus the traditional settlement in the U.S. with then a potentially long delivery to the final beneficiary bank in Asia. Delivery directly into Asia or within Asia is now a workable solution to accelerate the delivery cycle and ability to pay your trading partner or exporter within that region much faster by sometimes taking off a couple of days in the cycle.

Debbie: What are some of the drivers and trends for managing operational risk? Can you share some best practices?

Monika: Basically, the quality of your payment is key to ensuring no breakdown or delay at either stop in the payment chain. That is really looking at it in simple terms, but it is critical. And banks are helping clients improve the quality as it is in everyone's interest to execute it timely and accurately.

Another topic that we hear more about from a client perspective is contingency. Where's my payment data stored? How can I execute when I have a back-office problem? What is my backup plan? So banks can help clients to ensure that the payment information is available and that there is a plan to maybe call in, or send a file, or whatever backup plan to ensure that your operation is not impacted. Because your obligations are still your obligations to pay your counterparties at a certain time. Information continues to be key, not only regarding transaction execution, but account activity and balances. If the accounts are on the books of different banks, reporting tools to consolidate the information is most important. Certainly an inter-day view into the account is preferred, and clients are seeking out solutions to support this view from a payment execution perspective and assurance that every payment was initiated and delivered. But certainly there are also reasons that my colleagues from a liquidity perspective will cover, because the balances are not intended to sit idly, but clients are looking to make investments overnight, or consolidate balances. But I will let my colleagues from the liquidity team address that.

Debbie: Vivek, in these financial times, how has the banking landscape changed?

Vivek: The credit markets are now slowly making a comeback, and liquidity is vastly improved. Short-term credit spreads are returning to normal levels, compared to what we faced late last year. The given equity markets have recovered somewhat, but it's still well below the pre-crisis level. With the worst of the crisis apparently behind us, we are probably moving towards a new paradigm in the world of banking and banking relationships. I would say that the financial institutions specifically, which faced a great difficulty and a challenging environment, are forcing new models. They are obviously regulation redefined. Let me highlight areas where things have changed since the crisis and what I see as the environment today. The first one is credit availability, which has become very tight. I think what happened is tighter credit has actually forced the credit and lending cost to rise. Banks' margins are lower, because the regulations made them do huge amounts of monitoring, which obviously raised the cost. The banks and non-banking financial institutions, have tried to adapt their operation with a higher-risk cost, low margin, and low volume of transactions on the credit side. The second is the efficiency factor. I'm sure the capital market eventually will stabilize. And maybe the interbank credit market will also come back to the pre-crisis level. Banks such as J.P. Morgan are doing significant programs on [inaudible 6:37] management and balance sheet management. We are also grading our focus on risk management, and focusing on maintaining and increasing our customer relationships. In a capital-constrained environment such as this, banks will become more transparent and maybe have stricter governance. Almost all of the banking models would probably become simpler, less risky, and more cost-conscious with greater focus moving toward transaction processing and fee-based activities with clients.

Debbie: Okay, thanks, Vivek. Are you seeing changes in liquidity management practices, and what would be the top liquidity management priorities in this environment?

Vivek: That is a really good question. You should never put liquidity at risk, but what has happened during and immediately after the crisis, the investment guidelines and liquidity management practice have moved from an aggressive into more of a conservative position with a lot of corporates worldwide. Principal protection has become the paramount goal at all times, not just during the difficult times. What should be the top liquidity priorities in this environment, I would say that the global corporations must first establish clear guidelines about their liquidity structure. And the [inaudible 8:50] strategies, such as are the counterparties worthy banks, if they're the right banks to be in, what kind of investment type itself, and obviously the terms of investment along with the currency. I would pick four or five that should be priorities. Forecasting is still the biggest area. There has to be improved forecasting on liquidity needs. You need to determine appropriately, or liquidate acquisitions. If you know those trouble spots, you will be better prepared. There are quite a few things which have happened in the last 12 or 18 months, so you have to factor in an unexpected demand situation when you start doing your forecasting. I would also suggest, that you do the stress test as often as possible and build some worst-case scenarios; if something happens, what we should do and what we should be prepared with. The second point is "go back to the textbook". You have to segment your cash and identify from operating versus residual cash, or what we call strategic and restricted cash. You need to establish appropriate guidelines for each type of those cash balances. To make sure of the availability and safety of that cash. Select investment types within the guidelines that are appropriate for each of these segments and identify the institutions which are your counterparties for those investments, so that you monitor them very clearly. The third point would be to establish and diversify the funding sources. The fourth point would be to make your liquidity as transparent as possible, and asset-efficient across all geographies and all legal entities. I've seen people who are not able to bring in cash, when

they really want it in one geography from the other geography, because they never prepared for such a situation. The last one should be investment diversity itself, enhancing the returns without increasing investment risk.

Debbie: In summary, what should treasurers be focusing on today?

Vivek: The crisis taught us that cash is king. keep reviewing your bank counterparties. When you evaluate and approve the counterparties, make sure that they give you names for removal, or adding new counterparties with equal vigor. ensure that you have complete visibility and accuracy of the account information, which provides you with the cash position across the globe. If it is not there, you need to start working on it. Reset your investment guidelines. You need to make sure that it fits into your risk profile. Ensure the efficient recycling of cash within the system. Look at your operating tables, or receivables process. I would say that if you're managing suppliers, how you manage your invoice-to-payment cycle. If it is clients or your customers, how are they doing from billing to collection? Look into those processes, and ask yourself whether the crisis might have played out differently. Make sure that you regionalize or centralize all your foreign exchange management and settlement activities. You have to continuously examine your contingency bank model. You need to increase the frequency of reviewing the strength of your banking relationships globally, not necessarily only in the biggest region that makes sense for you. There are a lot of plans internationally that I would say are the payment systems which allow you to process payments from one geography to manage the other geographies. I'm sure there are people who already know the three-part arrangement which have come in Europe for Euro clearing, and the CHATS clearing in Hong Kong, which is basically helping those U.S. dollar transactions to happen outside the U.S., within Hong Kong to take care of the cross-border transactions which are happening heavily between China, Japan, Korea, and the U.S. I think that there is an opportunity to rationalize your account structure and the payment process behind these trans-national payment systems. Finally, you have to keep asking your banking partners — I think this is something that corporations normally miss, but banks pretty much have the capability to provide the best advice, which is suitable for the industry that you operate in. As them to come and share with you what's really happening across the globe, and to help you out. We have gone past the real crisis, and we now have time to ask the companies to do some repair work if it is required. I think that the ideas which I've shared can give some amount of background to go forward. Thank you.

Debbie: Thank you Monika and Vivek. This concludes our J.P. Morgan podcast.

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