Harnessing change

MAJOR FINANCIAL INFRASTUCTURE AND PAYMENTS-RELATED CHANGES ARE TAKING PLACE ACROSS THE MIDDLE EAST. IF THEY ARE EMBRACED, CORPORATE TREASURERS WILL HAVE AN UNPRECEDENTED OPPORTUNITY TO IMPROVE EFFICIENCY IN THEIR TREASURY OPERATIONS, ACCORDING TO **SANJAY SETHI**, **K JAGADESHWARAN** AND **KUNAL BIST**.

The Middle East and North Africa region has undergone the most remarkable change in the past year. The Arab Spring has resulted in change in regimes that few dared believe could be replaced. Its impact continues to be felt across many countries in the region, and just as importantly is having positive impact even in countries not directly affected by political turmoil.

Governments in the Middle East recognise the pressing need for change. Most countries in the region have demographically young populations that are underemployed, and there is an acute awareness in those countries that opportunities and jobs must be created for this burgeoning young population, either through more job opportunities or by encouraging and supporting entrepreneurial activity. Consequently, many governments in the region have promised to embark on unprecedented investment in infrastructure. Much of this investment is aimed at bridging the long-standing gap in physical infrastructure, such as roads and utilities, that impact the daily lives of citizens. However, there is also recognition by governments that if their domestic economies are to prosper and create desperately needed jobs, then financial infrastructure must also be improved.

ENHANCING PRODUCTIVITY With the global growth outlook uncertain and concerns that recession may return, both local financial institutions and government institutions such as central banks view improvements to financial infrastructure as a route to enhanced productivity and improved economic growth. Moreover, there is an expectation that such changes could also help to improve convenience and quality of life for citizens.

Chief among the improvements sought by financial institutions and being delivered by central banks across the Middle East in their bid to improve efficiency and productivity of national economies are better payments and clearing infrastructure. Specifically, many countries are aiming to eliminate systemic risk through their settlement systems and are trying to improve efficiency and lower costs in relation to payments.

Finance managers in the Middle East are eager to harness the benefits of these changes. Moreover, many companies, especially in the oil and gas sector, have excess liquidity as a result of high oil prices: indeed, in many cases liquidity is at historically unprecedented levels. However, interest rates remain close to record lows,

presenting a challenge for investment. Meanwhile, finance managers' ambition to promote operational efficiency remains undimmed.

As economic and financial market uncertainty has increased, many industries outside the oil and gas sector are experiencing higher borrowing costs. Consequently, many companies are looking internally to find capital and are seeking to release locked up working capital and reduce liquidity in countries that have exchange restrictions, for example. Measures to enhance financial infrastructure could also yield benefits in relation to trapped capital.

IMPROVING FINANCIAL INFRASTRUCTURE In their bid to eliminate systemic risk and reduce settlement risk and to improve the efficiency of payments, reform efforts by central banks are principally focused on the introduction of real-time gross settlement (RTGS) systems and the international bank account number (IBAN) system.

A payment made to a counterparty using RTGS is advantageous for all parties. From the perspective of a central bank, RTGS is attractive because there is a clear finality to a payment that consequently reduces systemic risk and improves confidence in the clearing system. For banks, as settlement occurs payment by payment, the risk of counterparty default is reduced. In addition, RTGS makes it easier for companies to manage their working capital while end-users can access their funds sooner.

The adoption of RTGS across the Middle East has gathered pace in recent years. The State Bank of Pakistan has worked with the World Bank to develop an RTGS infrastructure and the Pakistan real-time interbank settlement mechanism (PRISM) was inaugurated by the prime minister of Pakistan in July 2008. Meanwhile, the Central Bank of Egypt (CBE) has introduced important payment system improvements in recent years, which culminated in the introduction of an RTGS system in March 2007.

Work to introduce an RTGS-like system for funds transfer is well established in the UAE and the new system is expected to go live in November. Similarly, efforts are under way in Lebanon to create RTGS systems.

INTRODUCTION OF IBAN The use of IBAN to facilitate automatic processing of money transfers offers multiple benefits for all market participants. As a global standard for account numbers, it makes making payments internationally more straightforward and efficient by improving payment times, lowering costs, minimising manual intervention and reducing input errors. Moreover, the risk of rejection or delay in the processing of payments is effectively eliminated because IBAN offers the ability to validate beneficiary account numbers regardless of where that account is held in advance of the payment being made.

IBAN is rapidly gaining ground across the region as the preferred format for account information. It was introduced in Saudi Arabia in July 2008, in Lebanon in January 2010 and in Kuwait in January this year. IBAN is scheduled to be introduced in the UAE on 19 November and in Bahrain in February 2012.

The introduction of IBAN presents a challenge for corporate treasurers, who must obtain IBAN details for all their suppliers, distributors, affiliates and other counterparties. Moreover, this information needs to be integrated into their accounts payable and other systems. Banks have a crucial role to play in communicating how corporates should prepare for IBAN through media campaigns and direct communication with clients: all companies must undertake an impact analysis and devise a plan accordingly.

WORKING WITH CLIENTS Corporates needing services beyond local banking should look to develop relationships with leading international banks with a strong transaction services presence, which may also work with central bank operating committees undertaking financial infrastructure change. Citi works closely with regulators, central banks and governments to help define formats and standards such as turnaround times and service level agreements.

Corporates should also expect their banks to undertake process change on behalf of clients. For example, clients in countries that have recently switched to a real-time system can often continue to provide instructions in the same format as in the past.

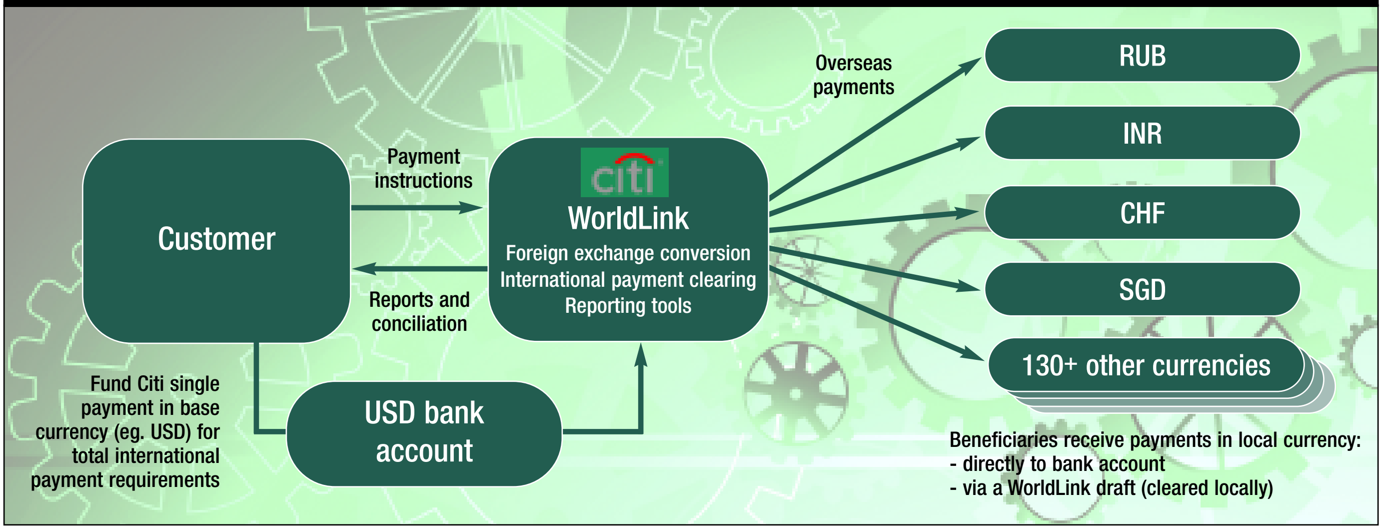
Corporate treasurers of different types of companies necessarily react differently to changes in financial infrastructure. For example, treasurers of multinational companies will be familiar with international standards such as RTGS and IBAN and are often relieved when they are introduced in a country where they are active: often their company will have a global team that can be rapidly deployed to roll out existing models and process engines to that new country.

Box 1: Citi leads the way

- Citi's established local presence means it can fully support clients' business transactions in the region, whether in a single country or across the Middle East. It is an active member of committees in the region charged with reforming financial systems and a member of clearing systems in key markets in the Middle East. Worldwide, Citi has direct membership network of almost 200 clearing systems.
- As the Middle East is a trading hub, customers need to settle payments in various currencies. With WorldLink, Citi's multicurrency payment platform, customers can make payments in more than 130 currencies either on an account or non-account basis (see Figure 1). WorldLink is a much sought after solution by corporate clients as well as financial institutions as they can now settle an invoice in their own currency.
- With bank harmonisation a central theme for corporate clients, Citi has focused on building an extensive network of partner bank relationships across the Middle East both for domestic and cross-border capabilities. Citi is able to offer the best possible solution to its customers including a combination of partner bank and Citi's capabilities through a single window.

ALL COMPANIES MUST UNDERTAKE AN IMPACT ANALYSIS AND DEVISE A PLAN ACCORDINGLY.

Figure 1: Settling payments with WorldLink



BROADER IMPROVEMENTS IN TREASURY EFFICIENCY While Citi always works to make sure that it absorbs as much of the impact of financial infrastructure change as possible, the bank also recognises that some corporates view infrastructure change as a catalyst for broader improvements in treasury efficiency. Forums such as client academies make it possible to communicate the potential opportunities available as a result of infrastructure change.

For example, some treasurers in the Middle East have taken advantage of infrastructure change such as the introduction of RTGS and IBAN to embark on a review of their banking relationships. The aim is to rationalise the number of banks they work with, thereby improving efficiency, visibility and control, and lowering costs. Necessarily, those banks that have established processes in place to support clients through periods of change and are proactive in communicating potential benefits – such as Citi – stand to benefit from such reviews.

In the current financial climate, with many banks' credit ratings in flux, an important part of any review of banking relationships and share of wallet is understanding bank risk. Increasingly, clients decide which banks get what business – and how much they get overall – based on their understanding of the credit risk of that institution and their ratings. Before the financial crisis such behaviour was unheard of.

An important issue related to bank rationalisation, and increased selectivity in terms of the banks that a company will work with, is connectivity. Historically, banks have used proprietary systems. Now there is an inexorable trend towards the standardisation of connectivity for larger corporates through host-to-host integration and SWIFTNet, for example. This kind of sophisticated integration is usually part of a broader programme of process change and greater automation.

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An associated change is the greater demand from corporates for banks to share knowledge. Companies clearly need access to information about changes to financial infrastructure that will impact how they do business. However, increasingly they also want insights into their current treasury practice and how they can become more efficient by adopting best practice.

Similarly, governments are increasingly open-minded about the benefits of new technology. For example, historically pensions have been paid in cash in many countries in the Middle East, resulting in high costs for government and significant risks and inconvenience for retirees. Now, new tools such as prepaid cards or electronic payments are being used to lower costs and improve convenience.


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