



ONGOING REGULATORY CHALLENGES CONTINUE TO RESHAPE THE TREASURY HORIZON



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NEW REGULATORY, COMPLIANCE AND RISK DYNAMICS REQUIRE VIGILANCE/ACTION FOR TODAY'S INDUSTRY PRACTITIONERS

The ongoing regulatory focus around transaction banking continues to be one of strengthening liquidity and transaction oversight. The resulting – and evolving – regulatory mandates and compliance directives are culminating to create a risk environment that is altering many fundamental aspects of doing business around the globe. For corporate and institutional treasurers to stay on top of the changes, vigilance remains key. Keeping abreast of the developments to ensure internal policies meet new and impending requirements is one part of the equation. Just as importantly, understanding how the changes are set to impact financial providers can help businesses adjust and develop strategies as needed to achieve their goals for growth.

Regulatory Challenges and Considerations

The increased regulatory focus highlights both quantitative and qualitative liquidity standards, both for the U.S. domestic market and globally, and by varying measures in response to the 2008 financial crisis. A sampling of some of the potentially most impactful of these currently set to affect aspects of the treasury marketplace are highlighted below.

- **Basel III** – The Basel Committee on Banking Supervision (BCBS), a global group of bank supervisors, strengthened capital requirements in 2010 in response to concerns that insufficient capital contributed to and worsened the 2008 financial crisis. Basel III increased the minimum amount of capital required, limited the types of instruments that qualify for regulatory capital, and introduced new capital measures, including a leverage ratio requirement and a common equity tier 1 requirement. Basel III builds on Basel II, which primarily revised the risk weightings and calculations for exposures in the capital calculation.



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Developed to strengthen the regulation, supervision and risk management of the banking sector, the Basel III measures aim to help:

- improve the banking sector's ability to absorb shocks arising from financial and economic stress;
- enhance risk management and governance; and
- strengthen banks' transparency and disclosures.

In the U.S., banks must manage compliance with new Dodd-Frank, Basel II, and Basel III capital requirements, which are combined in the July 2013 revised capital rules.

To prepare for Basel III's more stringent capital adequacy requirements, European banks are cutting costs and investments to preserve capital. Liquidity could also become an issue in the future. The ECB is providing low-cost liquidity to banks but, with the redefinition of assets that can be given a 100 percent weighting as being liquid assets, European banks could ultimately find themselves competing aggressively for increased retail deposits to meet the new liquidity ratios.

- **Liquidity Coverage Ratio (LCR)** – The first minimum, quantitative, regulatory liquidity requirement applied to banking organizations, the BCBS developed the LCR as part of the Basel III package in response to concerns that a lack of liquidity contributed to and worsened the 2008 financial crisis.

The LCR is intended to promote the short-term resilience of banking organizations, absorb shocks from financial and economic stress, and improve the measurement and management of liquidity risk. To achieve these goals, the LCR requires a company to hold enough “high quality liquid assets” (HQLA) to meet net cash outflows over a stressed 30-day period. The LCR rules specify which types of assets count as HQLA (e.g., cash and U.S. Treasuries) and how to calculate cash outflows (e.g., deposit run-offs) and inflows (e.g., receipt of loan payments).

In the U.S., the final LCR applies to the largest banking organizations with \$250 billion or more in total assets, or \$10 billion or more in on-balance sheet foreign exposure, and to insured depository institutions with \$10 billion or more in total assets that are subsidiaries of such companies. A less stringent, “modified” LCR applies to banking organizations with less than \$250 billion but \$50 billion or more in total assets. Banking organizations covered by the final LCR rule (for the U.S. phase-in period) must meet 80 percent of the standard beginning in 2015, 90 percent in 2016, and 100 percent in 2017.

The final U.S. LCR rule mitigates many of the LCR concerns for custody and trust banks. The proposed U.S. LCR rule did not appropriately recognize stable and low risk sources of deposit funding from custody and other servicing relationships. The final rule allows a wider range of client deposits, such as cash from mutual funds and certain correspondent banking relationships, to receive LCR credit. As a result, banks may hold less HQLA against these deposits and place them into higher yielding assets. Other types of client deposits, such as cash from hedge funds and private equity funds, continue to be expensive from an LCR perspective.

For retail, universal, and broker-dealer banking organizations, the final rule improves the treatment of certain retail funding, retail brokered deposits, collateralized deposits (e.g., for public sector and corporate trust deposits), committed facilities to special purpose entities that do not issue securities or commercial paper, and assets held in segregated accounts in accordance with regulatory requirements for the protection of client trading assets.

The Federal Reserve, Financial Stability Board, and other regulators also are increasingly focused on the more general liquidity risks of short-term wholesale funding, asset fire sales, and matched books. The LCR addresses some of these risks by increasing the liquidity charge on committed credit and liquidity facilities and securities financing transactions (SFTs), but the LCR only applies to SFTs that mature within 30 days. As a result, regulators are developing other measures to address the liquidity risks of short-term wholesale funding and SFT financing, including a net stable funding ratio, heightened capital surcharge for firms that rely heavily on short-term wholesale funding and minimum margin and haircut requirements for SFTs. These requirements could increase costs for broker-dealer banking organizations and other banks that fund or service these arrangements.

- **Dodd-Frank Section 1073** – This section of the Dodd-Frank regulation applies to consumer remittances (of US\$15 or more) initiated in the U.S. and sent to locations in foreign countries. Its provisions are designed to protect consumers by making remittance processes and fees more transparent. The rule especially affects open-loop models, for which it is not possible to know at origination how the payment will be routed and, thus, what the total fees will be. The rule could ultimately result in significant changes to payment industry practices – up to and including the opting out by some from certain cross-border funds transfer.

- **U.S. Commodities Futures Trading Commission (CFTC) Regulations on Derivatives Trading** – As part of Dodd-Frank legislation, OTC derivatives (credit default swaps and interest rate swaps initially) are to be settled via CCP Clearing Houses. The new requirements apply to OTC derivatives which have historically been settled bilaterally and not through CCP Clearing Houses requiring their members use Futures Commission Merchants (FCMs) instead. The FCMs' solicitors accept orders for commodity contracts traded on an exchange and hold clients funds to margin. This is designed to limit risk by reducing/eliminating intra-day exposures as a result of exchange settlements, and assist clients in meeting regulatory requirements. Many market participants who previously had no collateral requirements now need to access and manage collateral in order to comply with these exchange regulations.

Compliance Scrutiny

Increased scrutiny around Anti-Money Laundering (AML) measures have created a new operating environment for both financial institutions and large U.S. and multinational corporations across many industry segments, including energy, media/telecom, manufacturing, automotive, transportation and logistics, real estate, insurance, healthcare and more.

Although it has always been standard practice for financial institutions to be aware of who they are doing business with, the U.S. Patriot Act has made these requirements even more essential. Passed in October 2001, this law requires all financial institutions to make sure they have AML programs in place to help prevent potential terrorism financing. Since the law was passed, adherence to KYC has been highly scrutinized by the U.S. government.

Financial institutions are required to perform due diligence with comprehensive background checks designed to help ensure their clients are who they say they are and are not participating in any illegal activity or terrorism. Strict transaction monitoring procedures are also required to uphold KYC directives.

For businesses that access the financial markets, understanding what your financial partners require with respect to KYC will help to facilitate the account opening process, on-boarding new services and aid the effective and efficient movement of transactions through the financial systems. Companies need to be sure they have effective programs in place to comply with increased efforts to monitor these risks – businesses that fail to develop such plans may face severe sanctions for their lack of oversight. The scrutiny pertains not only to financial institutions and corporations managing cash transactions, but also to individual managers within companies who can face penalties for violations of the Bank Secrecy Act, AML and regulatory requirements. Overseas accounts are also highly scrutinized for AML compliance.

Marketplace Response

As these changes aim to impact the marketplace to varying degrees, financial providers and their clients are homing in on three main areas of heightened focus to accommodate the changes, including:

- **Capital reform** – Incorporating a renewed emphasis on quality, consistency and transparency of the capital base to identify and stem potential risks while managing growth. Managing capital requirements to accommodate internal needs for profit making and growth are now intrinsically linked with regulation compliance.
- **Risk management and supervision** – Including accommodating higher capital requirements for systemic derivatives and financial exposure, and ensuring a capital surcharge for systemically important banks.
- **Market discipline** – Addressing securitization exposures, off-balance sheet vehicles and calculation of regulatory capital ratios.

For corporations and institutions, these areas of heightened focus may lead to impacts across the operation, such as the following:

- Increasing demand for liquidity may limit supply of overnight product availability, potentially impacting supply chain workflows and end-product manufacturing/operations.
- Differentiated interest rates and/or balance sheet capacity may be offered as banks value certain types of depositors over others.
- Tiering of short-term rate curves may occur, potentially requiring new investment policy guidelines to optimize earnings on cash.
- Adjusting workflows, redirecting resources and considering additional financial service products and services may result from the need to more actively manage liquidity.
- Complying with regulations that require forfeiture of liquidity, stability or yield by investors (corporations, banks and non-bank financial institutions) may cause time- and resource-heavy commitments to work more closely with business partners and regulators (where applicable), and overhauling supply chain processes, as needed.
- Increasing need for investors to more actively manage their cash may expand the corporate treasurer's role beyond traditional cash management responsibilities.
- Identifying short-term investment vehicles as important, profit-making alternatives may necessitate further research into products and services offered by your financial providers.

- Establishing strong banking relationships via enhanced communication with financial institutions may help:
 - manage accounts and processes according to current legislation while accommodating bottom-line improvements;
 - define proper liquidity policies; and
 - understand tools that are available to manage the new requirements.

BNY Mellon Solutions and Strengths

Risk, regulation and cost control continue to be the key drivers among client needs for solutions that are at once flexible and scalable. This is a challenging and ever more complex environment for everyone, and clients continue to look to us to help them transform their business models, notably around risk mitigation, collateral, transparency, compliance and distribution.

BNY Mellon Treasury Services tools available to help organizations handle the new requirements include:

- **Liquidity management solutions** – As ongoing credit constraints, heightened risk profiles and regulatory requirements highlight the use of cash – and liquidity – as collateral and working capital, we offer several solutions to help businesses and institutions gain greater visibility over their cash flows. These solutions are designed to help optimize the use of end-of-day funds for intraday collateral purposes, as well as offer tri-party collateral management and repurchase agreement (“repo”) techniques.

Intraday reporting and analytic tools available on TreasuryEdge[®], our electronic banking portal, include:

- **Intraday Liquidity Analytics Service**, which provides critical trend and transactional data to allow organizations to better manage costs associated with intraday liquidity, reduce intraday overdrafts and handle payment flows more easily and efficiently.
- **Payment Analytics Service**, currently being piloted, provides comprehensive payment trend information on USD wires related to Straight-Through Processing (STP) rates, inquiry reporting and historical trend data to help streamline the liquidity management process.

- **Managing USD and foreign currency account structures** – Our Foreign Exchange solutions allow us to work with clients to manage, build, expand and deepen their foreign currency payment and account capabilities. Our solutions help organizations convert incoming investor subscriptions into the base currency of their individual fund, whether they need to convert outgoing investor redemptions into their home currency or to fund their foreign currency accounts.

BNY Mellon provides options for clients to meet expanding foreign currency service needs, enabling them to:

- Send FX payments in more than 120 currencies.
 - Open accounts in more than 45 currencies, enabling them to manage their payments and receipts of each currency.
 - Access local high value payment clearing in EUR, GBP, and USD.
 - Access enhanced liquidity reporting to simplify calculating the overall net position.
- **Asset Account solutions** – Our Consumer Notes Program offers organizations interested in raising capital by leveraging their brand equity via their own notes program an outsourced service with complete processing capabilities and back-office support to help them manage their program, including investor registration, client service, transaction processing, record keeping, tax reporting, and integration and back-office administration.

The service offers corporations:

- A stable, reliable, predictable source of funding
- Flexibility to meet financing needs
- Increased client loyalty through cross-sell opportunities

The new regulatory market is dissolving the boundaries between businesses and their traditional areas of expertise. To navigate the guidelines for compliance, today businesses want broader, more multi-faceted solutions that comply with the new regulatory mandates and are delivered in a more seamless fashion. As a result, they are asking us to do more for them. Specifically, this translates into helping to develop

strategies to successfully navigate these areas and build successful programs to achieve their specific goals via solutions such as those outlined above.

Contact your BNY Mellon representatives to discuss these industry trends and what you can do to help your organization plan for the opportunities that reside in a transformed marketplace.

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