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Shift from Letters of Credit to Open Account using Electronic Supply Chain Management Tools

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Agenda

- Market Perspective
- SWIFT TSU Perspective
- Corporate / Financial Institution perspectives
 - Corporate Challenges
 - Shift of Risks
 - Bank options

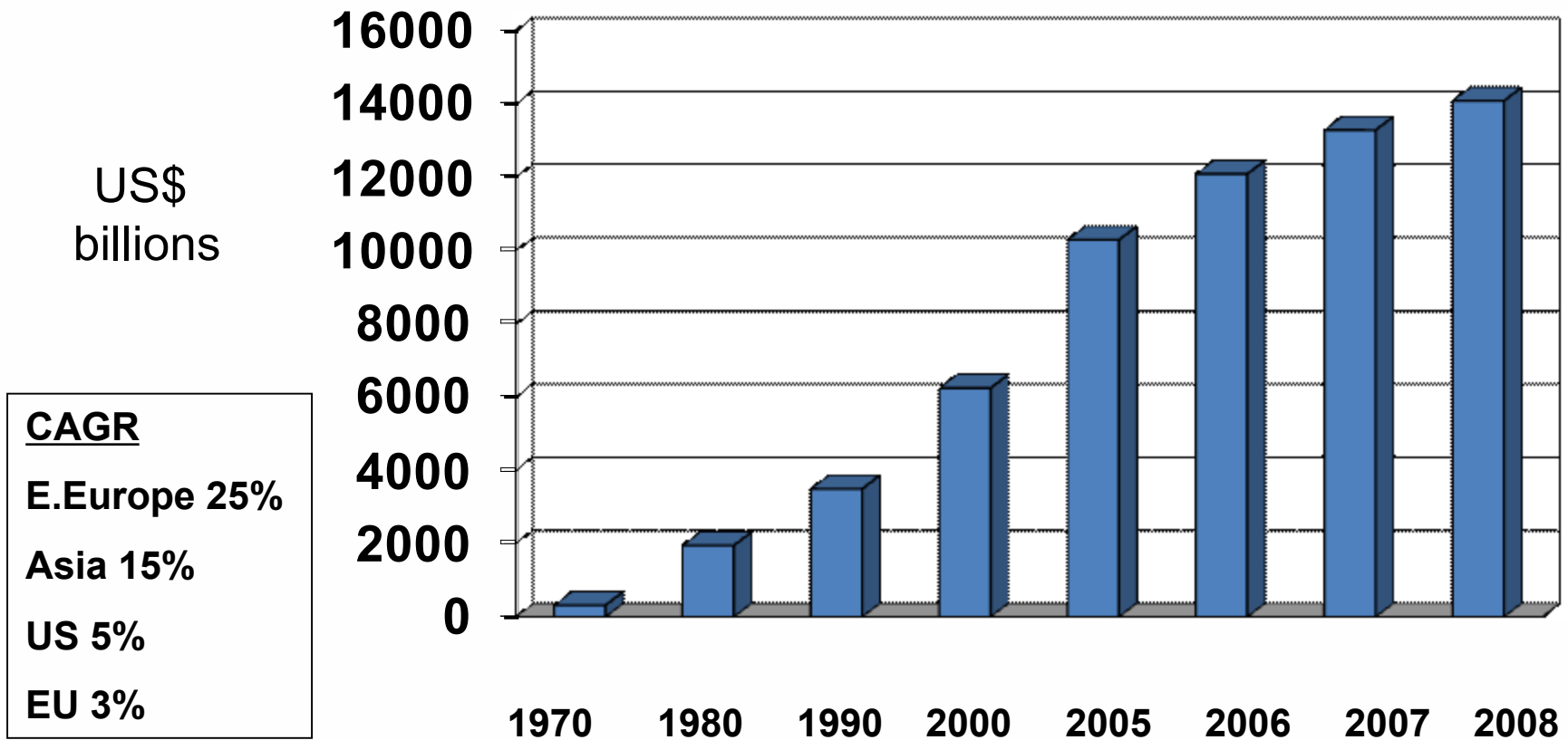


Market Perspective

Global Trade

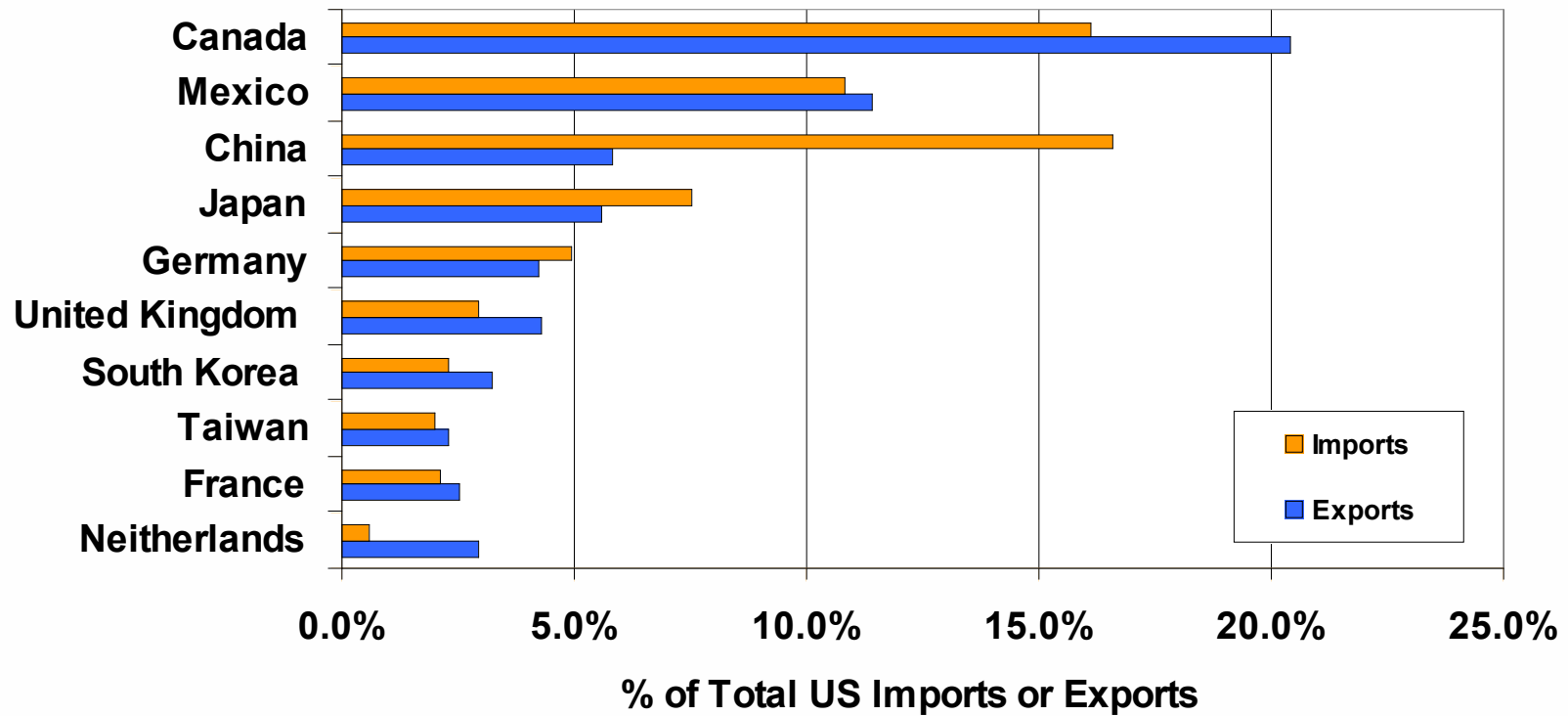
\$14 Trillion

Growth in international trade



Sources: World Trade Organisation

Top 10 US Trading Partners = 65% of Total U.S. Foreign Trade

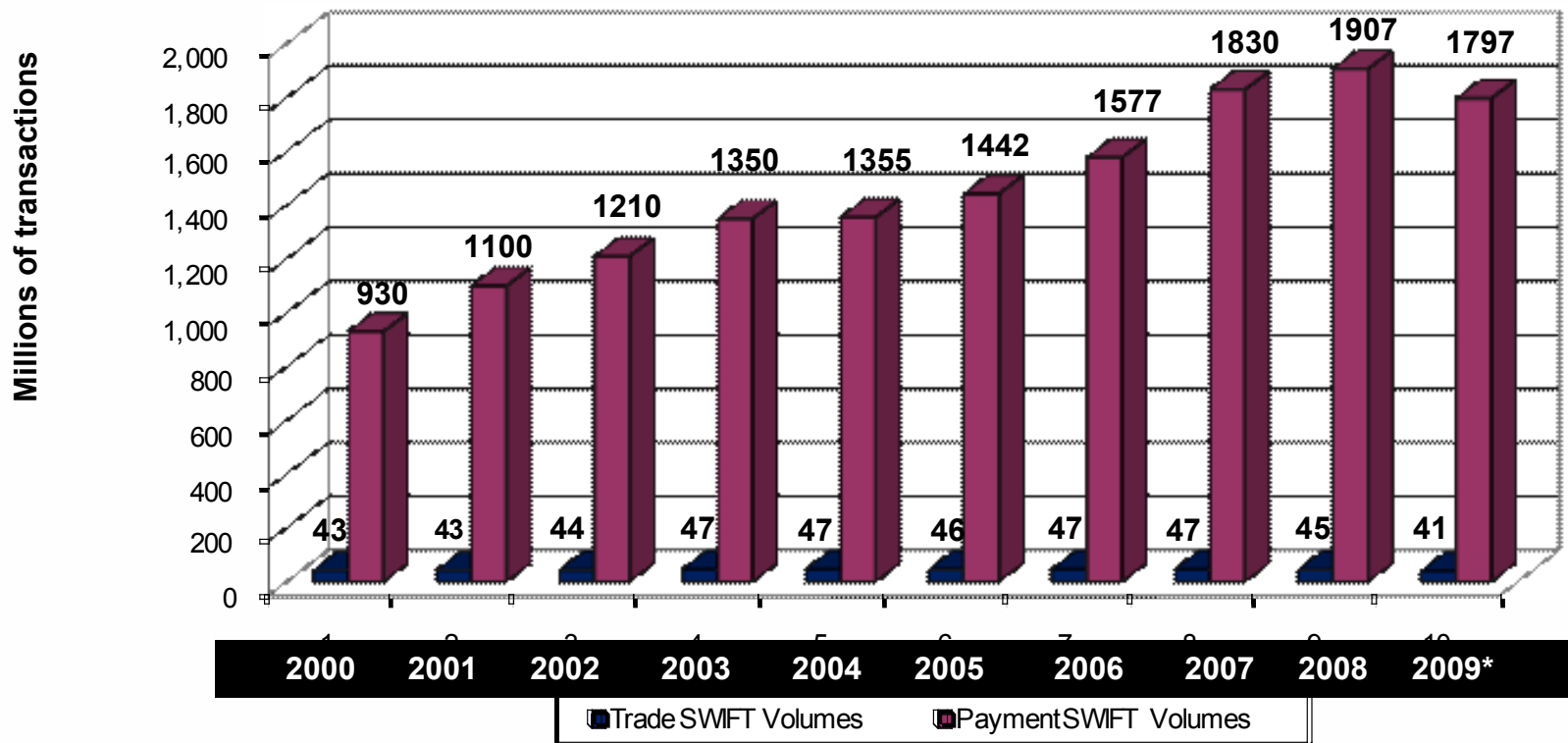


Source: U.S. Commercial Service – export.gov

Shift to Open Account

- The global trade business is in full transformation mode.
- Corporate mandate
 - Reduce costs
 - Leverage technology
- Banks have to choose how to satisfy existing, emerging, and evolving corporate client needs.

Migration to open account as seen at SWIFT



* Aug YTD Annualized

Source: SWIFT Traffic Watch

Pre-Financial Crisis

- World Trade USD 14 trillion*:
 - 20% involves secured documentation
 - 80% open account
- Trend of the last 10-15 years importers and exporters moving to open account
- Migration to open account limits bank involvement in trade to settlement

*Source: Global Business Intelligence (GBI)

Current Environment

- First time since 1982, we seen a contraction in world trade – expected 6 % for 2009*
- Suppliers finding pre- and post- shipment financing hard to obtain
- Even large buyers have a riskier profile as trading partners
- Less confidence in buyers, buyer's country and its import regulations
- Unstable markets are a threat
- Contraction in trade – risk issue or liquidity issue?

*Source: International Chamber of Commerce

...As a result

- Shift back to bank intermediated trade finance and cash in advance
- “Renaissance of the Letter of Credit” – maybe?
- Increase in demand of documentary collections
- However, banks facing liquidity squeeze and more stringent review of creditworthiness

Going forward...

- Current global recession slows the movement to open account
- Open account transactions will continue
- Companies will focus on their supply chains to maximize working capital
- Treasurer's perspective:
 - Increasing emphasis on integrating trade finance solutions with cash, payments, & forecasting for optimal working capital management
- Less paper, more information
 - Visibility and control of cash now translates also to visibility and control of trade flows

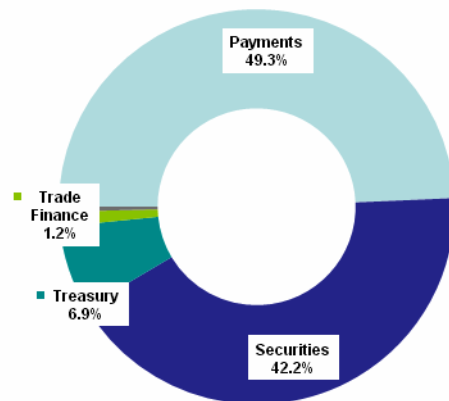
SWIFT TSU Perspective

What is SWIFT?

A
co-operative
organization
serving the
financial
industry

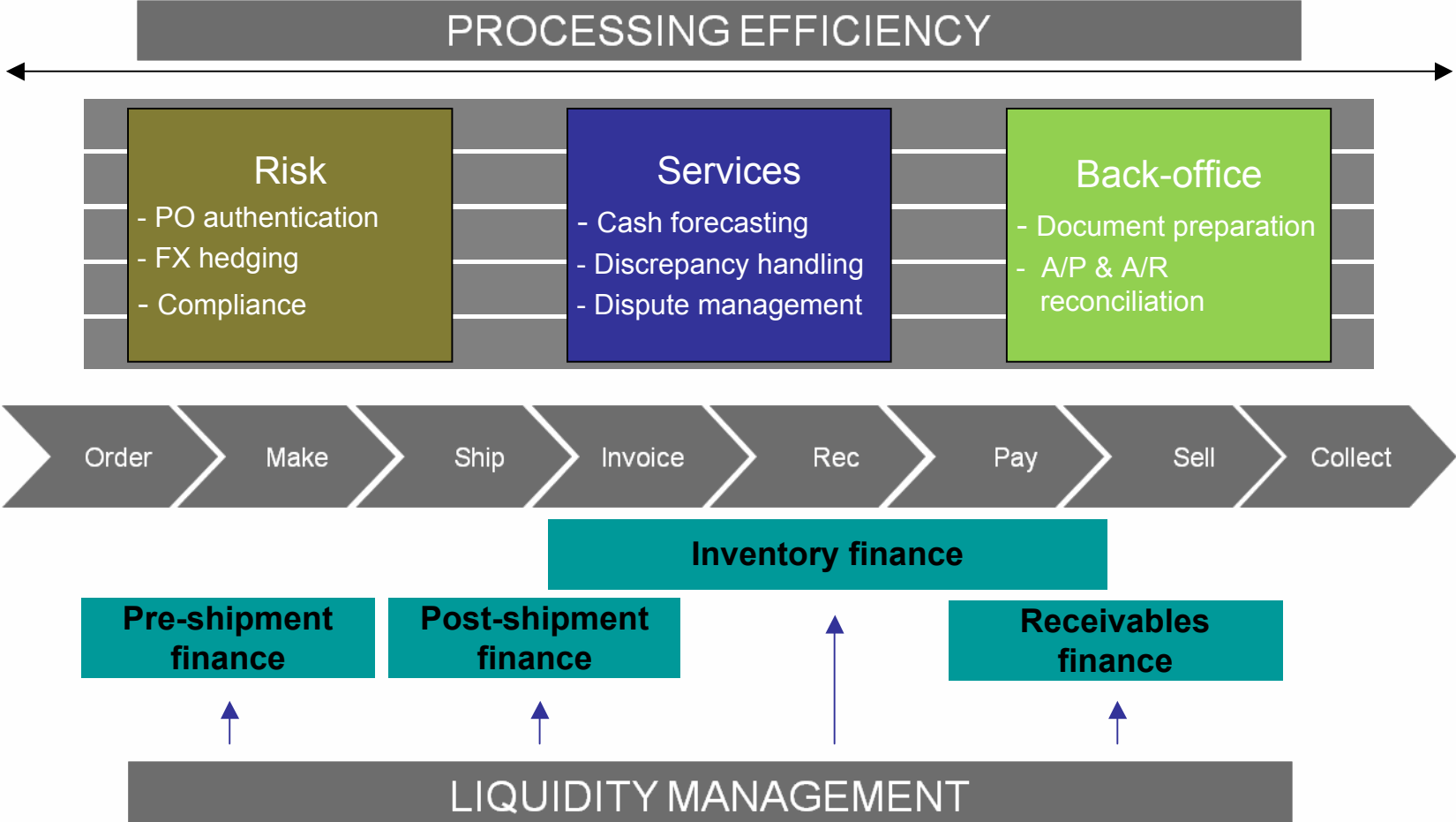
A
provider of
highly secure
financial
messaging
services

The
financial
standardisation
body

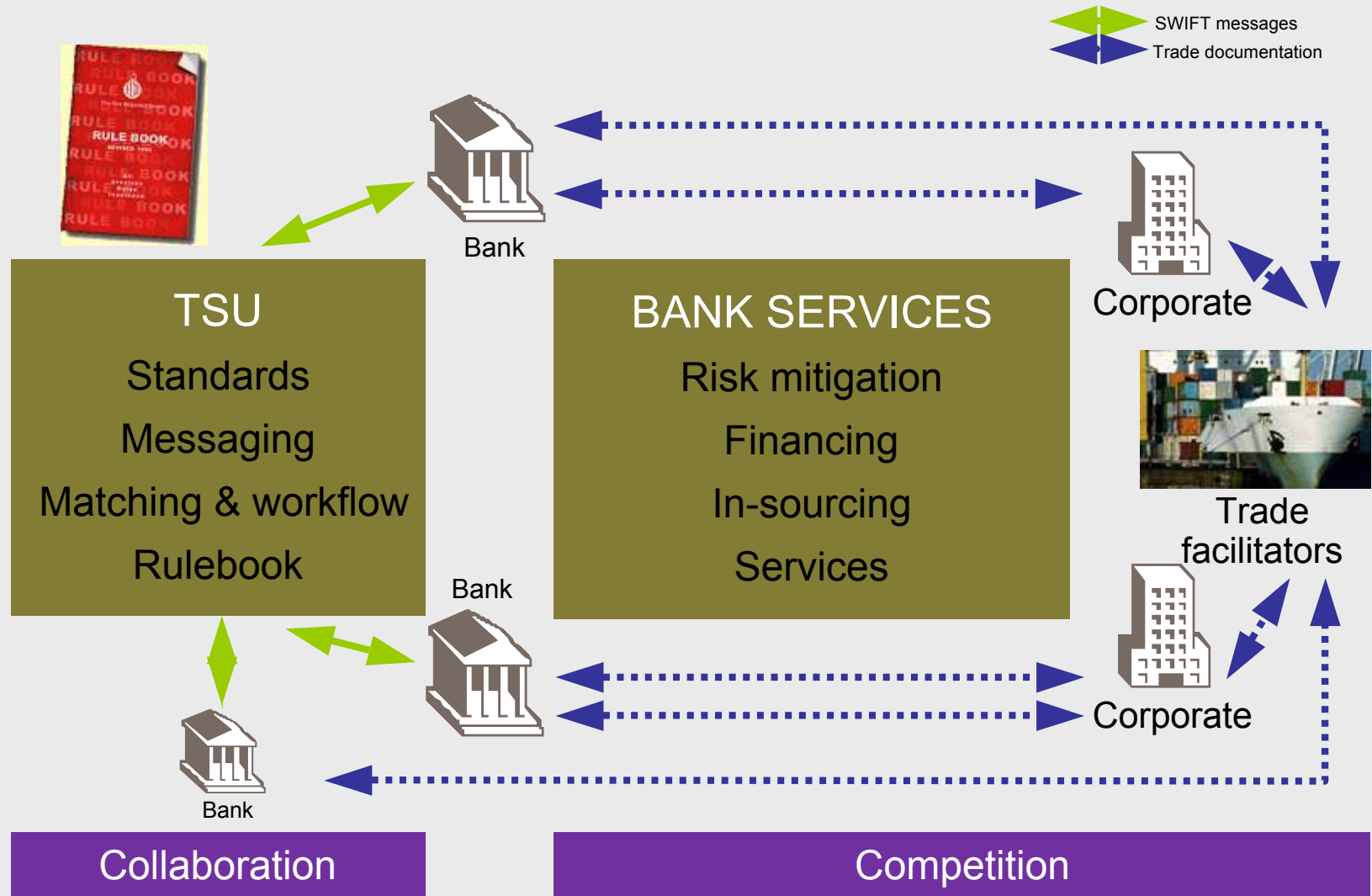


- 3.5 billion messages/year
- 8,740 customers
- 209 countries
- Latest Peak day:
17.8 million messages

Financial Supply Chain Management

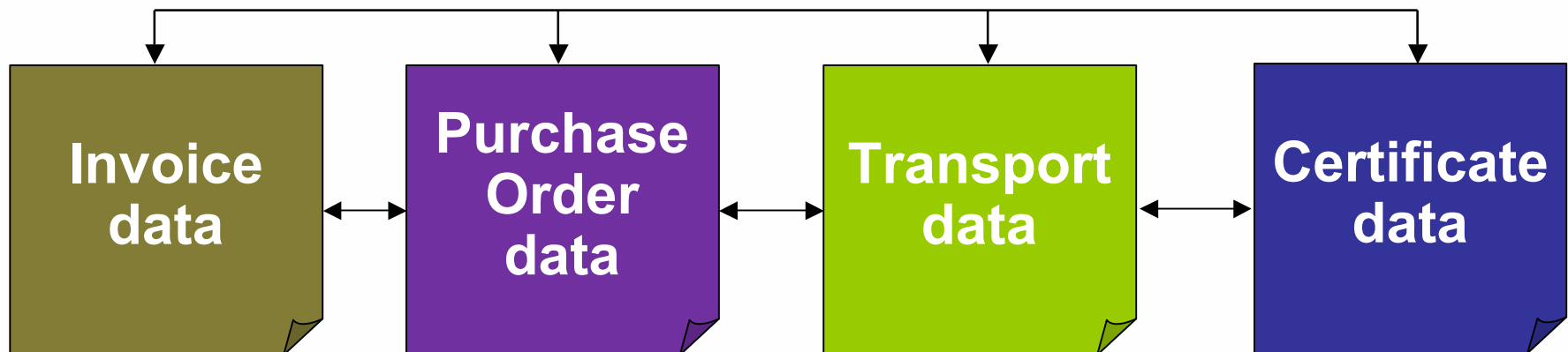


SWIFT's Trade Services Utility (TSU)



TSU key features

- Supports the exchange of standardized information between banks – bank to bank only
- Matches data elements extracted from trade documents (Purchase Order, Invoice, Transport & Certificates)
- Enables banks to:
 - enhance existing services
 - develop new services



TSU benefits to banks & industry

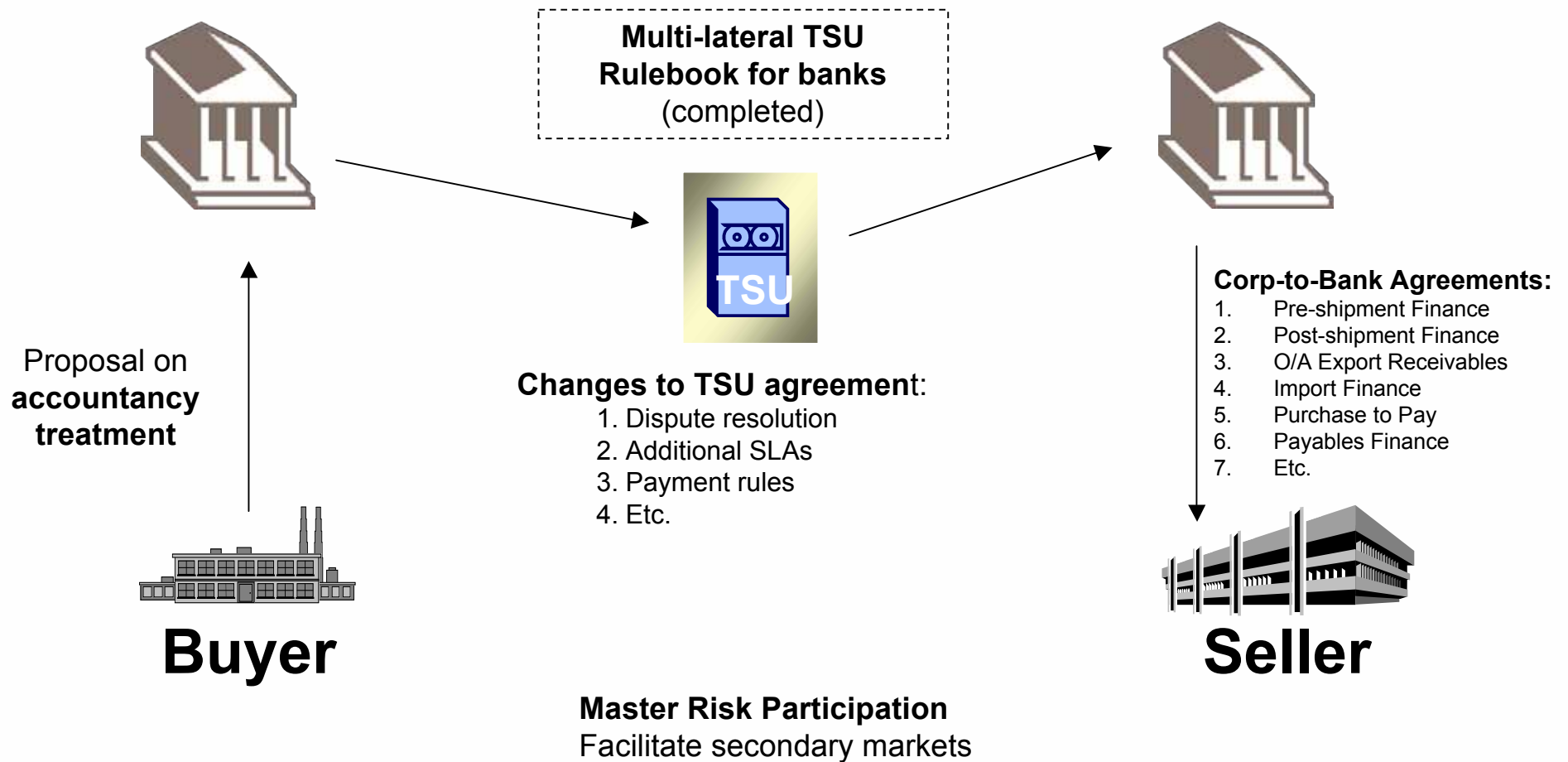
Bank

- Enhance existing or build new products for corporates
- Build products **in stages**, according to needs of their customers
- Enables **trigger points** by monitoring of transactions
- **Lowers cost** of investment in a shared infrastructure
- Increases **automation** of data checking
- **Reduces risks** with dual party transaction authentication
- Matching baseline purchase orders results in **fewer discrepancies**
- Creates reusable computer readable **data elements**

Industry

- Helps the industry move toward a **standard approach** to business
- **Common (XML) standards** facilitate STP and handling efficiencies
- Provides **interoperability** between banks
- Separates **collaborative** space and competitive space
- Bank neutral service provider; **trusted delivery and resilience**
- **Respects** existing corporate business practices

Standardizing Financial Supply Chain Management Globally

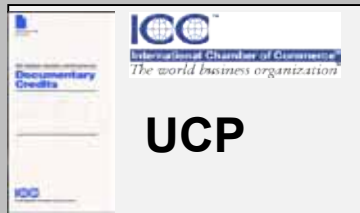


TSU - Filling the void for Open Account

Letters of Credit

Open Account

Rules &
Market
Practices



- TSU Rulebook
- Standardized Agreements

Shared
Infrastructure



Message
Standards



TSU - Growing Community of Banks



SWIFT – greater coverage across the risk spectrum

PO **
Finance

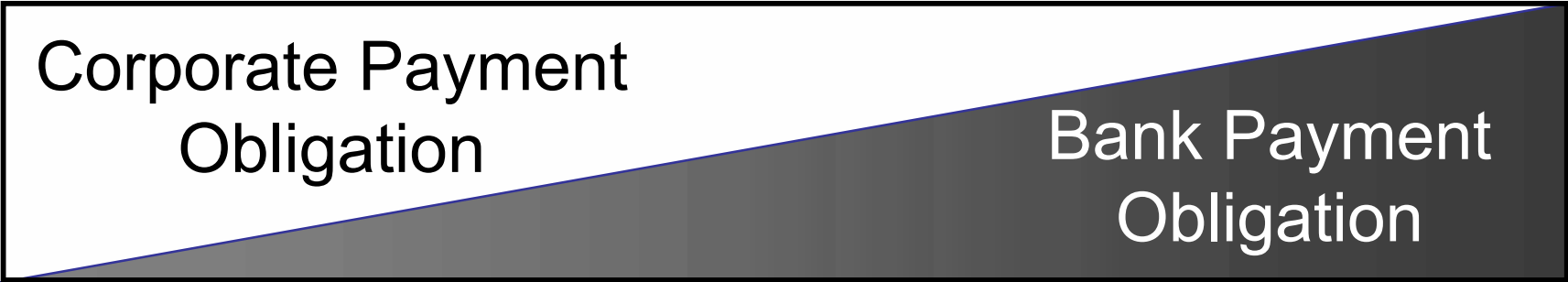
Conditional
Payment **

Structured
Finance ***

Payments *

Collections *

Letters of
Credit *



Open account trading

(-) Bank engagement in corporate trade (+)

Bank facilitated trading

* Available

** Introduced

** Not addressed

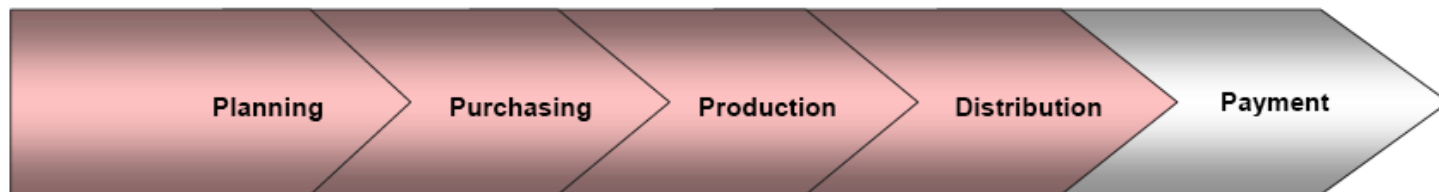
The corporate / bank perspective

Challenges of globalization

- Complexity of managing a business across multiple borders:
 - Cross-border payments and collections
 - Local payables, receivables, currency exposure associated with daily operating expenses and payroll
 - Tax strategies and payments
 - Access to working capital and managing different interest rates
 - Cross border funding and repatriating money
 - Improved cash forecasting
 - Linking physical, information and financial supply chain and increasing visibility in supply chain events
 - Risk Management

3 Supply Chains underlying B2B eCommerce

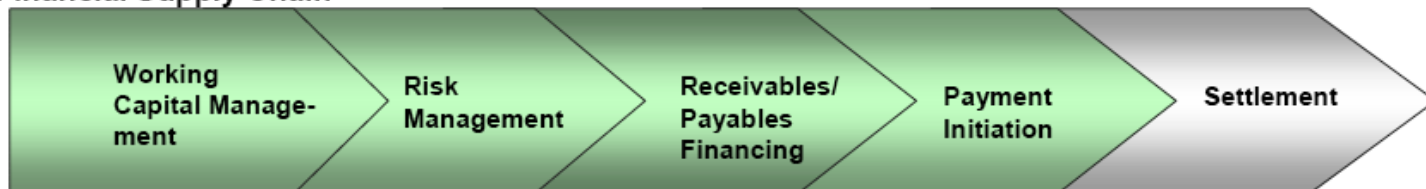
Physical Supply Chain



Information Supply Chain



Financial Supply Chain

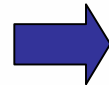


Source: Financial Insights 2008

Counter parties are driven by different needs

Importer (Buyer)

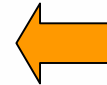
- P.O. Issuance
- Accounts Receivable
- Increase Days Payable Outstanding (DPO)
- Looking for credit terms
- Buy in own currency
- Trade Payables Financing
- Reducing costs including banking fees



Supply Chains

Exporter (Supplier)

- Invoicing
- Accounts Payable
- Reduce Days Sales Outstanding (DSO)
- Minimize credit risks
- Sell in own currency
- Pre- and post-export financing
- Reducing costs including banking fees



Procure to Pay Cycle

Order to Cash Cycle

Heightened Sensitivity to Risk Management

- More companies are managing cash more prudently due to downturn
 - Heightened sensitivity to the risks associated with the solvency of their customers and suppliers
 - More are actively collecting receivables, and imposing stricter credit policies
 - Country risk and settlement practices
 - Constricted liquidity
 - Reduction in access to external funding
 - Lower sales demand

Buyer Risk Assessment

High Risk Buyer

- Cash in Advance
- Confirmed Letter of Credit
- Letter of Credit

Medium Risk Buyer

- Open Account Terms with Standby L/C or Export Credit Insurance
- Documentary Collections

Low Risk Buyer

- Open Account Terms
- Documentary Collections (Acceptance)

Increasing Risk



Shift of Risk from Bank to Corporate in Open Account

- Banks no longer provide the financial guarantee or third-party review of documents
- Lower costs, but the buyer assumes additional risks and administrative burdens:
 - Trade Document (P.O.s, invoices, bills of lading...) checking to ensure compliance with trade terms
 - Compliance shift (AML)
 - May require staff to handle functions that were previously handled by the bank

Best Practice: Buyers and Sellers need to ensure they understand what the additional costs and risks are to their transactions and what (if anything) a bank may or may not support under open account terms.

Shift of Risk—a closer look

- The change in settlement method from the traditional Letter of Credit and Documentary Collections where either documents are...
 - fully examined:
 - LC terms - banks examine for both Documentary Compliance to the credit under the provisions / guidelines of UCP600 and ISBP - International Standard Banking Practices and ISP 98 - International Standby LC Practices and banks also review for Regulatory Compliance - OFAC, BSA/AML
 - or partially examined:
 - Documentary Collection terms - where a bank performs a quantitative examination of documents to the Collection Cover Letter and performs a level of Regulatory Compliance check

Best practice: Understanding the Credit/Payment and Risk Reporting decisions that were previously undertaken by the bank.

Bank Services Used to Assist with Open Account Transactions

Information Supply Chain

- Trade document compliance checking
- Bank reference checking
- Outsourcing payables management
- Trade counterparty information
- Logistics support
- Documentation preparation
- payment systems
- Trade Outsourcing accounts receivable management
- Purchase order transaction information & management report status

Financial Supply Chain

- Import/purchaser financing against confirmed purchase orders
- Financing vendor receivables
- Import/purchaser financing against approved invoices
- Credit insurance
- FX hedging
- Pre-export finance against purchase orders
- Post-export finance against approved invoices
- Post-export finance against guaranteed invoices
- Ability to finance inventory in transit
- Supplier Finance Program
- Factoring
- Payment guarantees

Source: Flmetrix and PNC Data and Client Analysis

Value Adds to Supply Chain from your Bank

- SWIFT TSU
 - Banks at various stages of assessing the applicability and integration capability of the TSU with TM product offerings (payments and information management) as well as lending area
- Purchase Order and Invoice Processing Management
 - Issuance, Matching and Settlement
- Mostly post-acceptance financing today based on approved invoice
 - Example: Trade Payables Finance (i.e. discounting trade payables to vendors allowing the trading partners to maximize the management of working capital)
- Earlier stages of financing emerging
 - Risks, complexities, and benefits of pre-export, in-transit inventory, and event-triggered financing models

Conclusions

- Cross border trade is alive and well!
- The Letter of Credit is here to stay, though open account will continue to gain momentum
- Increasing reliance on automation
- Innovation in information flows
 - Enhances working capital management
- Innovation in solution structuring
 - Solutions reaching into pre-shipment
- Convergence of cash, payables, forecasting and trade finance

Q&A



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Exhibits

More Information

- Trade Finance Services: Current Environment and Recommendations: Wave 2: “A survey among banks assessing the current trade finance environment– sponsored by The International Monetary Fund and the Bankers’ Association for Finance & Trade (August 2009)
- “Rethink Trade Finance 2009: An ICC Global Survey” – International Chamber of Commerce (March 2009)
- “Adoption of SWIFTNet Trade Services Utility to Meet Supply Chain Challenges,” Connie Leung, SWIFT Asia Pacific (2008/2009)
- “Open-Account Transactions: Open or Closed Door for Banks?”, AITE (February 2009)
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