Complexity increases as the company grows

As the company grows, the need for additional bank accounts becomes a necessity. The accounts are opened for a variety of reasons, but the need to make the most out of the money is still there. It is here that the complexity of cash management begins to increase and banks begin to specialise. The first step is to bring the accounts of the company together. In the simplest form it is the mailing-out of the bank accounts to the same address, or showing the accounts on e-banking as separate accounts. The bank does not try to work with the accounts as if they belonged to one company.

Technology and processes

It is here the technology and processes being applied by certain banks within a particular country that start to earn them a name for cash management. In addition, the availability of inexpensive software to assist companies in reconciling their bank accounts has made companies keener to have the banks develop more sophisticated techniques. This has lead to competition from banks outside the domestic country for the larger companies’ banking business. The key technique is the automated movement of funds between all the accounts so that no one account generates overdraft charges should one of the accounts become overdrawn when another has more than enough to cover the shortage. It is similar on the investment side when consolidating the money enables the company to generate a greater level of interest payment.

Figure 1.5: More than one company bank account (single currency) – simple

Sweeping:

Account 1
Zero balance

Account 2
Target balance set at 10

Account 3
Target balance set at 15

INVESTMENT ACCOUNT

Surplus balances above zero swept into an investment account.
Above example uses zero balances and ‘target’ balance per account.
Bank system automatically moves the money.
Usually, monthly fees are charged for sweeping.

Source: IBS Publishing
Figure 1.9: Bi-lateral netting

**Country A**

- Bank Account ‘A’
- Payments to B:
  - 50
  - 100
  - 150

**Country B**

- Bank Account ‘B’
- Payments to A:
  - 200
  - 300

---

**Before Netting:**
Total number of payments = 5

**After Netting:**
Total number of payments = 1 (200 to A)

**Benefits:**
Fees saved on fewer transactions
Easier reconciliation
Where FX, less FX margins paid

**Used by:**
Any company with extensive payments between two parties

Source: IBS Publishing

Figure 1.10: Multi-lateral netting

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>E</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>+50</td>
<td>-160</td>
<td>-10</td>
<td>+10</td>
<td></td>
</tr>
<tr>
<td>B</td>
<td>-50</td>
<td>-200</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>C</td>
<td>+160</td>
<td>+200</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>D</td>
<td>+10</td>
<td>0</td>
<td>0</td>
<td>+60</td>
<td></td>
</tr>
<tr>
<td>E</td>
<td>-10</td>
<td>0</td>
<td>0</td>
<td>-60</td>
<td></td>
</tr>
<tr>
<td><strong>End positions</strong></td>
<td><strong>+110</strong></td>
<td><strong>+250</strong></td>
<td><strong>-360</strong></td>
<td><strong>-70</strong></td>
<td><strong>+70</strong></td>
</tr>
</tbody>
</table>

**Transactions:** A+B pays C, E pays D
Total transactions = 3

**Benefits:**
Fees saved on fewer transactions
Easier reconciliation
Where FX, less FX margins paid

Much greater return over bi-lateral netting but need a ‘lender of last resort’, usually head office.

**Used by:**
Large, multinational companies – highly sophisticated

Source: IBS Publishing
High risk criteria

The following circumstances should be considered high risk criteria:

- When data on the customer’s identity is insufficient or not deemed to be reliable or accurate;
- When ambiguities for basic due diligence remain;
- When suspicions of money laundering or terrorism financing exist;
- When the business relationship includes transactions, services or products that may favour anonymity (e.g. use of cash);
- When the client is domiciled in, or transactions are carried out in, a country with a known record of encouraging terrorism.

In addition, extra due care is needed with a PEP who is resident abroad.

Documentation

The banks have found the easiest and quickest way to obtain information about the customer’s identity and ownership structure is to ask the customer for the required information and documentation. The documents routinely requested are:

- A certified copy of registration certificate not older than three months;
- A certified copy of the share register – majority owners to undergo CDD/KYC – see below;
- A copy of the adopted business plan;
Liquidity management

The need to stay liquid is paramount. During these financially difficult times, banks are selling non-core assets to meet their regulatory obligations. Banks also need to manage intraday liquidity as they are receiving and paying out large amounts of money throughout the day.

A report by SWIFT in 2011 showed the priority requirements for banks today were:

- A view on intraday cash positions (93%);
- Ready-made liquidity risk analytics and business intelligence (91%);
- Advanced interactive cash and collateral management functions within payment infrastructures (88%);
- Ability to build predictive positions (88%).

While the trading floor often knows its actual cash position across assets within seconds, because of their size and complexity, banks often do not know. The best example of this was the Board of Royal Bank of Scotland, which when asked what its capital position was, noted that it ranged from 4% to 8% – a spread of billions of dollars, reflecting the complex nature of the business and a lack of internal coordination resulting in the inability to give an accurate figure to which it could be professionally managed.

Figure 4.1: Liquidity management for a bank

Source: Author

Liquidity management is the ability to pay bills when they become due over an acceptable time horizon, usually 12 months. Often companies have a three-month time detailed cash horizon and then a 12-month rolling average. Liquidity is now a
LIQUIDITY STRATEGIES FOR FINANCIAL INSTITUTIONS AND CORPORATES

Figure 5.2: Outside investments

Source: Author

Forecasting cash flows

Over time the pattern of money flowing into the bank account becomes predictable. Often a company has peaks and ebbs in its accounts. The account can be reviewed to see which monies can be invested for a longer period. Banks often pay more interest on monies put on deposit for longer times. Hence, corporates with established balances can earn more money by moving day-to-day savings into longer-term commitment – seven or 30 days or three or six months.

Figure 5.3: Company balance over time

Source: Author

The area of forecasting money both into and out of the account has received little attention to date. Most banks do not offer any services around this area of cash management. Corporates are also guilty of not forecasting cash flow for accuracy.
CHAPTER 8 • THE INVESTMENT PYRAMID VERSUS THE CREDIT LADDER

Figure 8.1: The investment pyramid vs the credit ladder (1)

**Company / Individual**
Investment pyramid value liquidity exceeds credit outstanding. Corporate / individual potential in good financial condition.

- Appreciating cash
  - currency
  - gold

- Base cash / Term deposit

Value = A highly liquid

Interest rate

- 10%
- 5%
- 0%

Loans
Revolving credit
Credit cards

Credit = B
- -15%
- -25%

Source: Author

Figure 8.2: The investment pyramid vs the credit ladder (2)

**Company / Individual**
Investment pyramid value is less liquid and meets the level of credit outstanding. Corporate / individual at a potential tipping point.

- Appreciating cash
  - currency
  - gold

- Base cash / Term deposit

Value A but lower liquidity

Interest rate

- 50%
- 15%
- 10%
- 5%
- 0%

Private company investments
Property

Bonds / Equities

Loans
Revolving credit
Credit cards
Invoice financing

Value B use of pure credit through credit cards and invoice financing
- -15%
- -25%

Source: Author
liquidity strategies for financial institutions and corporates

entry to that system is by physical POS devices and a prepaid NFC-compliant card created by the carrier. An open system is one in which the NFC-compliant prepaid, debit or credit card or mobile phone can be used anywhere. One example of this is 2012 Olympics, where Visa, LloydsTSB and Samsung are provided preloaded credit for the athletes and officials. The Visa contactless payment option is called Payway; MasterCard’s is called PayPass.

Reconciliation

It is well understood by financial professionals that profitable businesses fail every day if cash flow is negative and the 2008 credit crunch brought this home to even the largest conglomerates such as GE that had borrowed short and was unable to roll over credit lines. Most corporate Treasurers and CFOs don’t have the luxury that GE had of tapping into emergency funding programs such as TARP and have to rely on their bank.

In the UK, after bailing out the banks, the government insisted the banks lent money to the SME market under ‘Project Merlin.’ The Bank of England’s official assessment of Project Merlin found that lending to small businesses was £74.9 billion, £1.1 billion short of the target. Credit lines are being squeezed and overdraft rates are up, so understanding the numbers has never been more important. Bank of England Governor Sir Mervyn King in February 2012 spoke against the “harsh treatment” of small and medium companies being starved of the funds they need to grow, create jobs and drive the economic recovery. Bank of England figures show that net lending fell by £10.7 billion in 2011 – in other words, the banks received £10.7 billion more in loan repayments than they gave out in new loans. That took the total fall in credit outstanding since the end of 2008 to £82.7 billion.

Reconciliations are the end of a long process which may have been strung out over a number of months and include winning an order, receiving a purchase order, delivering of the goods/services, issuing an invoice and receiving a payment without having to chase for payment. The final step often gets less focus, as payment has now been received and typically staff that carry out reconciliations have many other duties which are more visible to their colleagues and are often prioritised as more urgent.

Timely, accurate reconciliations are vital part of the process because:

- Business decisions lean heavily on accurate financial decisions;
- Credit control processes can only be activated with confidence once unrecognised items have been accounted for;
- Fraud (in-house or by customers) can be identified (and deterred) by timely reconciliation of ledgers and bank accounts;
- Incorrect bank charges, fees, interest or FX conversions can be identified and addressed early – it can be a significant amount of work to recalibrate the books if there is a long-standing error that has not been identified;
- Regulations are obligations that if left undiscovered can lead to significant fines –
  - PwC failed to notice that JP Morgan Securities Ltd had not properly
The complexity of the landscape creates difficulties in achieving standard workflow control, introduces manual dependencies and hampers the entire chain, resulting in an ineffective cash management position. From a cash management perspective, establishing open standards can facilitate improvements in operational efficiencies, achievement of STP and the optimisation of corporate cash.

The introduction of the XML-based payment initiation message, combined with the associated advices and bank statements, addresses one of the three core components of the client-to-bank interface (the other two being the underlying file security and the communication interfaces). As the banking community supports this new standard, this will enable the corporate to use more than one bank. In simple terms, the corporate now has the required portability and is no longer locked into a bank through proprietary standards. However, banks’ legacy internal infrastructure technologies make disconnecting from proprietary standards a slow process.