

# TIME TO GET REAL

ARE YOU STILL STRUGGLING WITH DATA THAT'S 24 HOURS OLD, WHEN WHAT YOU'D REALLY LIKE IS UP TO DATE INFORMATION? NOW **ALAN MACFARLANE** AND **BOB DANT** OF CENTRIC STRATEGIES HAVE THE ANSWER.

**T**he pressure on treasurers regarding the liquidity position of their company is relentless. They need to make continuous cash transactions and security trades to maximise financial performance and to accomplish this with minimal risk, even though they have only one- to two-day-old reconciled information available to them. They have to try to gain this information from their bank, with telephone calls, faxes and an occasional visit to a website. But how can they move from this time-lag information to a position where their hourly transactions are based on reconciled hourly, or, better still, seconds' old information? In today's business environment it's crucial to have up to date information available immediately and, now, fortunately, this is possible. Here, we will explore the complexities of getting there.

**DEFINING TIME.** The term 'real-time' information has been adopted somewhat loosely by many organisations in attempting to describe the timing of their data processing. 'Real-time' is often used to refer to the practice of obtaining transaction information as soon as it is available from processing mechanisms ie when transaction data has been processed rather than when the underlying transaction actually took place. Accordingly, many companies describe their processing capabilities as 'real-time' even though the information was actually transacted 24-48 hours earlier. To counter this, the information processing industry is starting to explore more rigorous interpretations of the definition of 'real-time' processing. The new thinking is that a revised benchmark for real-time information processing will be the ability to immediately distribute transaction information as an activity or event occurs (when value is given or received) through each stage in an information chain, rather than when relevant processed information becomes accessible. In the new real-time environment each transaction will be immediately processed through additional straight through processing (STP) functions, such as real-time reconciliation, to achieve highly automated rates, and to give management more time to make critical decisions that will reduce risk, lower costs and improve customer service.

Before discussing how to reach this new eWorld, an understanding of the current transaction process needs to be reviewed to ensure a common understanding of how today's banking transactions are completed. *Figure 1* represents the current flow for one side of a foreign exchange settlement. You'll see that the chain of payments from one company to another can be long, incur significant costs, and can result in time-lag delays receiving notification of the arrival of funds.

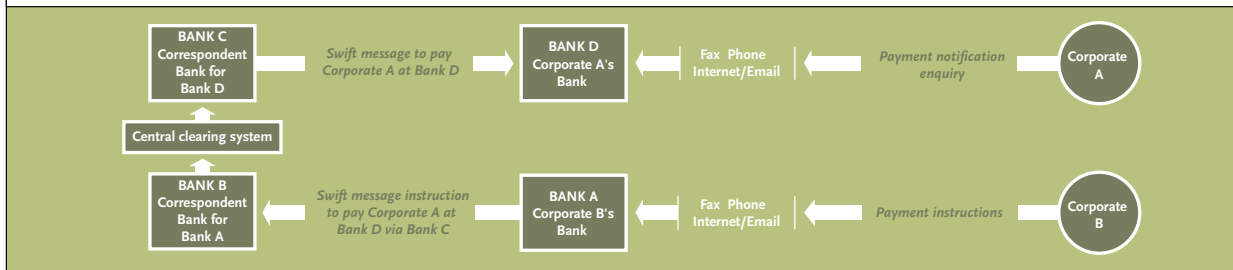
A company must instruct its bank to make a payment, this bank, in turn, must instruct its correspondent bank for the particular currency to pay the correspondent bank of the beneficiary's bank. Then the second correspondent bank must notify the bank of the beneficiary, and this bank must, in turn, notify the beneficiary organisation. With potentially so many players involved, and many with 24-plus-hour time-lag batch systems, the beneficiary company may have to complete certain cash management without all transaction information being available. Educated guesses and telephone contact to banks may enable reasonable cash management in normal circumstances. However, unsettled large amounts will throw out end-of-day funding, and, unfortunately, the cost of this will fall back on the company. Although banks sometimes send 'advice to receive' messages they are only advices and do not guarantee the actual payment or the actual time the funds will be received. Other complications from today's transaction information flow include:

- the multiplicity of non-standard payment systems formats;
- information from banks can be inaccurate as a result of information truncation on bank and payment systems;
- information may be missing altogether or corrupted because of the various links in the chain a payment may have to go through;
- bank charges may be incurred along the way and deducted from the payment amount without any detail attached to the final transaction notification to the company; and
- another aggravating issue is that it is almost impossible to have bank payment charges allocated to a subsidiary's bank account while the full transaction amount is sent to the company's centralised treasury account.

According to Barry Wright, formerly Head of Treasury at Coates: "It's not just the cost of penalties caused by delayed and inadequate nostro information that is a big issue, but more importantly the continuing cost of staff time to find out the complete and correct information."

Given this current industry model, it is no wonder that firms find getting genuinely real-time information from banks is so difficult. There are now new technologies and methods to allow banks to provide this information on a truly real-time basis. However, it is not just the banks, it is the internal corporate systems that need to accommodate STP and to have the ability to initiate follow-on processes such as real-time reconciliation.

**FIGURE 1**  
FLOW FOR ONE SIDE OF A FOREIGN EXCHANGE SETTLEMENT.



**FIRST THINGS FIRST.** The first step will require a change in banking systems to allow the individual transaction information to be automatically 'sent' to the corporate customer as the transaction occurs, versus current time-lag statements, telephone calls, faxes, or an internet browser. This information should be relayed as soon as the bank receives funds, and in addition should indicate the time 'good value' will be given to the company. Once it receives this information from the bank in a usable format, the firm can then immediately process the information through its reconciliation system or other internal processes. Once the transaction is reconciled, then the treasury is not dealing with speculative payments, they are dealing with data meeting the new standard for real time information flows.

The IBIX nostro standard was recently developed to overcome the problems of existing account information messages. The standard is XML based, improves data content to enable higher STP rates and added-value processing beyond that which can be achieved through SWIFT or other current nostro messages.

What does this simple change mean to a treasurer? Suppose you have a £50m payment that is due in today and you are expected to pay out £40m for a transaction. If you pay too early and your funds do not arrive, you are short and then you are borrowing the funds overnight from the bank. Now, if you get your information on a payment from the bank at 9:20am, when your account was credited, you could make your payment, and not run the risk of being overdrawn through part of the day. Taking it one step further, if the treasury systems had STP processing, a trigger could be established to automatically release the payment when the first payment value has been received. Finally, you could be at lunch when this happens and the corporate payment transaction application can page, email or call your mobile phone to let you know the payment has been received. This process improvement will be further reinforced with the new continuous linked settlement (CLS) banking initiative that will drive intraday money markets and lead to charging interest for intraday overdrafts. When all large payments are automatically processed in real 'real-time' the benefit will be significant cost savings and risk reduction.

**GETTING THERE.** Before any company moves towards a real-time transaction processing environment, one thing above all must be ensured – the leadership and commitment of senior management to obtain performance in its banking relationships that reflects today's high value, high speed and high risk environment. This is essential if the project is to succeed and meet business objectives as banks are notoriously slow to change their current operating procedures.

Second, demand that your banks utilise the new technologies now available to automatically send real-time transaction information as a needed service. Banks must use technology to send this information

into your company's business systems, where you can then process the payment in real-time and make your decisions based on up-to-the-minute information. If your company wants to be aggressive, it can also implement STP and a real-time reconciliation system that automatically reconciles the payment to ensure the payment actually belongs to your company and it has been applied to the correct account. Once you have accomplished this automatic real-time process level you will then be able to realise the maximum benefits of timely information and mobilise each last cent.

The argument for adopting a real-time environment is persuasive on many levels. Cost savings is just one of them. If data is truly current, discrepancies can be identified and resolved faster, saving both time and money. Early error detection and rectification in this way reduces treasury penalty charges. It will also be possible to detect delays to incoming funds and give time to chase the payer, so avoiding penalty charges and reducing risk. For example, FX settlements for two or more currencies, unlike payments for commercial sales, are expected on the agreed settlement date. However, some companies have been known to deliberately delay settlement on their side of the FX deal in order to fund other FX trades. Continuous real-time reconciliation with alerts for exceptions is needed to monitor this risk.

A real-time environment facilitates giving maximum ability to manage liquidity by optimising the use of funding and collateral. By moving towards real-time, rather than daily time-lag reconciliation, firms are automatically aware of the status of their funds by each second, so they can maximise the time-sensitive use of funds and improve liquidity management. This means funds can be immediately reinvested at better rates and revenue can be increased through these new opportunities.

**RESPOND TO THE CHALLENGE.** The move towards real-time transaction processing within companies and the banking/financial services industry is in its early days. However, one thing is clear, the current manually intensive controls, time-lag batch systems and unclear checkpoints must be replaced. As a result, communication between bank providers and companies will increase enormously, processing will be faster, and of a higher quality, and the management of liquidity risk will be significantly improved. Firms do require improved services from banks, but this will only come when the banks are required by businesses to change their current time-lag information processes. Therefore, the next time you are discussing payments with your bank, ask them "when are they going to Get real – information?"

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