GLOBAL THIS, GLOBAL THAT – IT SEEMS TO BE THE MOST OVER-USED ADJECTIVE IN THE ENGLISH LANGUAGE WHEN BANKS DESCRIBE THEIR CAPABILITIES, SAYS **ST JOHN POTTER** OF JPMORGAN TREASURY SERVICES. BUT WHEN IT COMES TO BEING A TRUE GLOBAL LIQUIDITY PROVIDER, ARE THE BANKS UP TO SCRATCH?

ALL THINGS GLOBAL

Everything these days is 'global' – global business, global communications, global entertainment, global news. It is perhaps the most exhausted adjective in the English language, tacked on to virtually any word to make it that much more trail-blazing, innovative or powerful. This is particularly true in the world of financial services, where terms such as global infrastructure, global connectivity and global reach are kicked around as often as a kid's football.

But what does it truly mean to be a 'global liquidity provider'? Can all the banks that make such a claim substantiate it with a liquidity solution that extends the returns, cost and integration benefits, credit rating, geographic coverage and liquidity management expertise that market-leading global corporations demand?

It is doubtful. In fact, as the latest liquidity buzz words, 'Big Four', so aptly suggest, there are only about four banks with the requisite dominance in dollars and euros that can truly offer the highly integrated, automated and geographically-broad liquidity management solution deserving of the 'global' label.

Each of these banks has an extensive global remit, intra-day liquidity management capability and a sophisticated core infrastructure that can accommodate more advanced strategies – many of which involve multi-currency options. However, not all of them can offer the level of integration with cash management services, clearing and electronic client access platforms, strong credit rating and liquidity management expertise that market-leaders need for a competitive edge. While the tools these Big Four use may be similar, the strategy and subsequent benefits they extend to their customers clearly vary.

Global liquidity management services have only recently become high profile for the leading banks. A growing range of solutions, new technologies that make intra-day liquidity management possible, and new infrastructures that link subsidiaries across the world to central cash pools for optimal investment and returns, all mean that global liquidity management has achieved an unprecedented level of interest.

This article will examine the convergence between cash management strategy and global liquidity management, the increasingly lucrative world of money market investment, and the benefits today's treasurers can anticipate from going global with liquidity management.

INSEPARABLE

Cash management and liquidity management strategies are inextricably linked. In order to achieve the two key objectives of a corporate treasurer – to maximise the returns on investments and minimise risk – treasury must have a solid core account structure and a liquidity management strategy that complements its overriding cash management strategy.

Mobilising cash into a single position is essential in today's corporate landscape. To achieve this, treasurers must have a solid overlay structure in place with a banking provider that has the geographic coverage and infrastructure required to either physically move the funds into the central cash pool with sweeps, or establish a notional pooling structure to achieve the same end. Traditionally, banks have different approaches for integrating these pooling structures: adopted vertically or horizontally. The vertical approach is generally focused on interfacing with the treasury's electronic client access systems, enterprise resource planning (ERP) facility or treasury management system (TMS), while the horizontal approach involves the integration between all of the services the treasury uses from that particular bank.

Regardless of the approach, the integration between cash management strategy and liquidity management solutions remains paramount. This is further evidenced by the fact that banks are now

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viewing liquidity management as an integral part of financial value chain management. The current trend is for banks to seek new ways to achieve higher levels of horizontal integration and establish a closer link between liquidity management solutions and overall cash management strategy. This is clearly where the Big Four differentiate themselves. Once you have established a global solution, the logical next step is to integrate it horizontally in order to achieve the Holy Grail of a one-stop-shop solution that links the entire value chain to a single, highly-integrated portal. Again, while all banks are striving for this, there are only one or two that have actually demonstrated real leadership on this concept and begun to engineer the actual technology to make this vision a reality.

INTRA-DAY AUTOMATION

To realise a flexible and cost-effective liquidity solution that adheres to best practice, banks rely heavily on investment in automation. Historically, treasurers had to shuffle funds between bank accounts and manually secure investments – a task that was time-consuming, inefficient and potentially risky. Today, however, as long as a firm has sufficient liquidity and a solid core account structure in place, automated sweeps allow it to concentrate cash and zero balance the net position into funds on a daily basis. In turn, this can automatically deliver optimal returns on the market's most lucrative investment opportunities. Similarly, two-way sweeps allow the funds to be automatically swept back into a deposit account from a money market fund (MMF) before it falls below target balance or into deficit.

Intra-day cash sweeps are providing unprecedented opportunities for intra-day cash concentration and enhanced returns on surplus liquidity. The sweeps are based on real-time account balances at a particular time of day, and can be scheduled and completed before important cut-off times. Treasurers, therefore, have a much higher degree of flexibility to meet deadlines applicable at concentration account locations as well as more time to contemplate future investment opportunities. Intra-day capability can also mean that companies no longer need to maintain large credit lines for their concentration accounts in order to support intra-day payments and investments.

While sweeps are not restricted to MMFs, they do offer several critical advantages over other investment vehicles, therefore warranting further discussion. MMFs can improve yield and credit rating, yet match the same-day liquidity offered by demand deposits. A number of MMFs carry a AAA-credit rating (the highest rating possible), so, in combination with an automated sweep, they represent a secure alternative for end-of-day cash. In addition, they hold securities from a broad range of different issuers, extending an unprecedented level of depositor diversification.

A fund should ideally be large enough that no single investor accounts for more than 10% of the total assets under management, which provides still further diversity and minimises volatility to both the fund manager and investor base. The sheer range and flexibility of automated liquidity management structures available today, coupled with the high degree of automation between bank accounts and MMFs, clearly catalysed the market's fervour for money market investment.

GEOGRAPHY MATTERS

The issue of geographic or global coverage is a contentious one. Some treasurers are quick to only consider partnering with banks that have a physical presence in all of the countries where they operate. While the name on the branch door may be a psychological comfort, these companies may be at a disadvantage because their lead bank cannot compete with the regional banks' local knowledge and country-specific expertise.

Similarly, cross-border liquidity concentration within the same bank is not quite as simple as people may think. In fact, most banks are still unable to offer true cross-border notional pooling with real balance sheet offset. Furthermore, some international banks offer cross-border sweeping only on a next-day basis, leaving issues with reconciliation, cash forecasting and loss of value.

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A few of the larger banks have adopted a different approach that leverages the expertise and local knowledge of market-leading in-country banks, yet allows the global bank to maintain control over the liquidity structure. This 'partnership approach' allows the global bank to transfer liquidity seamlessly between the partner banks and itself without loss of value or deterioration in the quality of the service. Generally, with this structure the global bank provides a single overriding technology platform, which consolidates position and information flows, creating a more centralised and flexible technology environment.

SPEAKING OF BENEFITS

Closely aligned to the responsibilities of treasurers, today's global liquidity management solutions are focused on maximising value and minimising risk. The greater the cash concentration, the greater the treasurer's ability to reduce credit exposure to banks. By offsetting overdrafts and long positions, the treasurer is not exposing as much cash to the banks and subsequently limits his or her exposure to credit risk.

Similarly, few banks have a credit rating that is higher than AA, so, by investing in MMFs, which are AAA-rated, the treasurer is actually gaining an upgrade, in terms of credit quality. Last, as more treasurers look for means to minimise depositor risk, the ability to sweep surplus cash balances into highly diversified MMFs on a daily basis also provides a means for managing counterparty risk.

In addition to the risk management benefits, yield enhancement is another key benefit derived from global liquidity management solutions. By matching global debit and credit balances against each other on a daily basis, the treasurer is able to concentrate cash for future investment and subsequent yield enhancement. Furthermore, by zero balancing that net balance into an investment product, such as a MMF, they are able to enhance yields still further.

Efficiency and cost reduction are obvious benefits of high levels of automation and cash concentration. Automation frees up valuable resources by eliminating the need for time-consuming cash forecasts, investment ordering procedures, and fund transfer, settlement and reporting tasks. Treasurers have the option of selecting the type and amount of investment themselves, or outsourcing this to their bank. The latter option essentially mitigates operational risk by placing the responsibility in the hands of an experienced banking provider. Regardless of whether the treasurer chooses an active or passive role, they still realise cost and efficiency gains by adopting global liquidity management strategies.

INNOVATION AHEAD

Unlocking global liquidity management's potential is simply a matter of finding a structure and banking partner that most closely complements the treasury's overall cash management strategy. While there is clearly no shortage of liquidity management solutions, banks are working hard to enhance them to provide ever greater sophistication and integration. Horizontal integration, particularly where it draws the financial value chain closer together, will remain a primary focus for banks going forward.

Global liquidity management services will continue to evolve at a rapid pace because of a variety of factors, including:

- Countries are queuing up for euro membership, opening up new markets that will narrow the gap against the dollar;
- Increased automation of foreign exchange (FX) services will drive down costs, creating more opportunities to integrate other currencies into an efficient single liquidity solution; and
- De-regulation means that cross-border sweeping is now commonplace across much of Europe and North America, while Asia has already liberalised considerably in the past decade and will continue to do so.

Demand for notional pooling, often driven by tax and inter-company considerations, may start to diminish in popularity as more sophisticated and integrated TMSs come onto the market. Ultimately, regulatory and tax harmonisation directives will contribute to a more even landscape so that, in Europe, countries such as the UK or The Netherlands will not always be such an automatic choice for liquidity concentration in the future.

The range and flexibility of automated liquidity management structures, coupled with the high returns and security offered by MMFs, should perpetuate the trend towards intra-day money market sweeps.

MMFs, particularly those that are AAA-rated with proven returns, will continue to be the investment vehicle of choice for most forward-thinking treasurers.

Another area of future interest is multi-currency liquidity management solutions. To date, the majority of notional pooling and sweeping structures have only offered single currency techniques, but the leading players will undoubtedly be introducing more sophisticated multi-currency options in the very near future.

While the word 'global' will continue to attach itself to virtually all financial services going forward, it is important that treasurers look beyond the label to uncover the real benefits of global liquidity management – optimal returns, minimum risk, extensive coverage and flexibility through integrated market-leading services – all of which cannot be delivered simply on the back of a six-letter word.

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