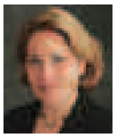
cash management
LIQUIDITY

Liquidity management to the fore



NEVER BEFORE HAS THE TREASURY FUNCTION TAKEN SUCH A PROMINENT ROLE. **LISA ROSSI** EXPLAINS.

Executive summary

On top of the financial crisis treasurers have had to deal with changing standards, the burden of regulation and compliance. As a result of these issues and others, automation has increased in treasury departments across the globe, freeing up some time for the treasurer while allowing greater visibility and reduced risk.

The current crisis has placed treasurers in the spotlight in many organisations, with effective liquidity management becoming more pertinent than ever. Recent developments in financial markets and the global economy have shifted the focus among many corporates' treasury operations. Indeed, never before has the treasury function taken such a prominent role. Making more efficient use of cash and ensuring the security of short-term investment vehicles have become top priorities for corporate treasuries around the world. Coupled with the ongoing crisis, treasurers have also had to deal with changing standards and the ever more onerous burden of regulation and compliance.

Extended periods of favourable economic and market conditions may lead to some relaxed structures developing, while on the other hand during periods of market stress there will be renewed management attention on areas that could yield efficiencies. That said, key themes will likely inform any action taken within corporate treasuries looking to increase efficiency. For instance, the centralisation, standardisation and consolidation of accounts and processes in order to increase visibility, reduce risk and take steps towards full automation have been ongoing for several years. This has been supported by increasing levels of automation within corporate treasuries, allowing treasurers to expand their business scope. Certainly, automation has freed up time for many treasurers, allowing them to take a more strategic view within the company and focus on the bigger changes that will yield cost savings and other benefits in the medium and long-term. This is particularly pertinent in the context of the current economic difficulties; guaranteeing the availability of funds and using them to their maximum potential will be vital to riding out the crisis.

Another theme concerns investment strategies for treasurers seeking to maximise cash efficiencies. Due to current uncertainty regarding the integrity of many short-term investment vehicles, together with interest rates reaching record lows in many jurisdictions, re-evaluating account structures has taken on a new level of importance for many corporate treasuries. And, in terms of liquidity management, physical cash concentration is a commonly-used technique to improve treasury efficiency. The roll out of the euro and the Single Euro Payments Area (SEPA) has made such structures potentially easier to implement, especially from the perspective of those corporates with operations across Europe.

SEPA Aside from the ongoing turbulence in financial markets, the other main factors currently affecting best-practice in liquidity management are changes in standards and regulation, with SEPA having the most significant impact.

SEPA will help corporates streamline operations through reducing the number of bank accounts they need to hold and

the number of banking relationships they need to maintain. However, more significant benefits will accrue when the Payment Services Directive (PSD) is adopted into the domestic law of EU member states; the current deadline for this is 1 November 2009. The PSD will affect liquidity management and pooling structures thanks to the proposed tightening of the rules on execution times and value dating. And the implementation of the PSD will also herald the introduction of the next stage of the SEPA project, the SEPA Direct Debit (SDD). This will allow for pan-European collections and initiate the next stage in treasury consolidation and efficiencies.

CASH CONCENTRATION In terms of techniques, cash concentration refers to the physical movement of funds in order to produce a single liquidity position across a number of accounts. As well as providing obvious liquidity and visibility benefits, cash concentration also supports a high level of treasury centralisation that can pave the way for further efficiencies through consolidating and automating processes.

Concentration can work in both directions – either upwards to a target account (a “sweep”) or through “covering” a debit position from the target account. Meanwhile, a “zero-balancing structure” will see the entire debit or credit balance of a participating account put to zero at the end of the day.

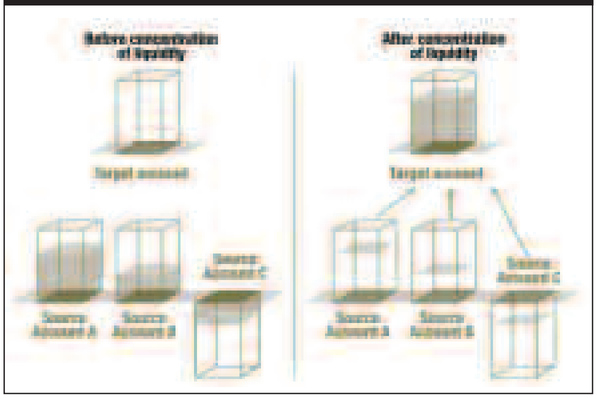
A variation on zero-balancing is where certain parameters can be applied to achieve a target balance (not zero) to remain on the account. It is also possible to establish a system where cash concentration transfers take place on fixed dates in order to limit inter-company loans resulting from cash concentration between different entities.

While cash concentration at a domestic and regional level is quite common practice, it is only recently that the possibilities for applying these techniques globally have been fully implemented. Indeed, there are only a few transaction banks that have the reach and platform required to be able to offer a truly global cash concentration product. Deutsche Bank's solution, for example, enables the management of these global treasury functions from a single location, as well as offering value-added services such as automated reporting and clear visibility of a global cash position.

While the legal and regulatory challenges to establishing cash pooling may be daunting, cash concentration represents one of the most efficient tools available for controlling corporate liquidity. And many of the obstacles to establishing such a solution will be best overcome by taking a phased approach towards implementation while combining cash concentration with other steps towards globalising and centralising working capital management.

NOTIONAL POOLING Notional pooling is another technique for effective liquidity management. Similar to cash concentration, notional pooling involves accounts being offset on a “virtual” basis, rather than requiring funds to be actually placed together in a target account. Much like cash concentration, efficient use of this technique will result in

Figure 1: Global cash concentration



better credit and debit interest being applied to balances. The ideal scenario involves bank interest being paid (or charged) on a single position after balances have been notionally aggregated. By using an interest compensation scheme, credit balances can be used to cover short positions. Record keeping and account autonomy is maintained.

EVALUATING LIQUIDITY TECHNIQUES Both types of arrangements – physical cash concentration and notional pooling – can reduce the need to seek credit outside of the organisation’s balance sheet. However, while pooling may seem like a more simple and attractive choice, the regulatory and tax environment may make this more complex than straightforward cash concentration. Indeed, depending on the limitations, corporates may seek a combination of both approaches within a single structure. For example, treasurers could move funds through cash concentration into a centrally-held account that is attractive from a regulatory perspective then, subsequently, employ notional pooling across the accounts. Additionally, certain accounts must be located in the operating accounts’ legal jurisdiction. In all cases, tax and regulatory advice is recommended.

INVESTMENT APPROACH Treasurers are also increasing the use of automated investment sweeps to ensure full coverage of excess funds. Investment sweeps take end of day balances and invest funds overnight while returning the designated balance back into the account for full availability. Deutsche Bank has recently launched an automated investment sweep into a one month term deposit for euro accounts. This “Special Investment Account” offers more attractive yields with slightly reduced availability. Treasurers can more effectively manage longer-term positions with less operational maintenance but with increased control and reporting. The power of automated global processing visibility and control is paramount for treasurers during these challenging times.

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