

# New perils to face



**PATRICK COLEMAN** DESCRIBES NEW AND TRADITIONAL ISSUES FACING CORPORATE CASH MANAGEMENT, AND EXAMINES HOW TREASURY TECHNOLOGY CAN HELP.



## Executive summary

This article identifies familiar and not-so-familiar aspects of cash management for which corporate treasurers are using (or seeking) effective technology solutions in today's exceptionally demanding environment. Modern technology – when effectively deployed – can substantially help the treasurer both by automating non-productive, repetitive processes, and by providing the entire set of dependable and accurate information needed to make critical decisions.

system at a pre-defined frequency, enhancing the accuracy of the cash position from intra-day updates.

In addition to direct communications with banks, TMS may now offer corporates the benefits of SWIFT connectivity, for the processing of payments and electronic confirmations, as well as MT940 bank statements. For companies with operations in the developing world, there are likely to be accounts with banks that are not SWIFT members and do not report electronically; in such cases, the balances are ideally communicated via a TMS web module that can capture this information via spreadsheet or manual entry on a 24/7 basis, so that the system can derive an enterprise-wide picture of all bank accounts.

In addition the TMS can perform an essential cash management role wherever corporates employ pooling and sweeping arrangements to optimise interest income/expense. The TMS calculates the interest income/expense relating to each member of a cash pool, so that the amounts can be properly allocated internally.

Within the TMS, the cash position is determined by consolidating the global bank positions with treasury flows. These relate to the opening and maturing of such operations as FX hedge deals, money market loans and deposits, money market fund investments and withdrawals, facility draw-downs and repayments, and the proceeds of issuance of debt instruments such as commercial paper, MTNs and bonds. For a best practice solution, the TMS presents this information with automatic real time updates, so that the cash manager does not have to refresh data to view an up-to-date position. The cash manager can therefore focus on professional duties, rather than having to divert into data processing.

Effective cash and liquidity management depends on more

than accurate cash positioning: it needs to be able to see into the future via effective forecasting. The relevant forecast composition and time horizon depends on a number of factors, including company structure and the predictability of commercial flows over time. Contemporary TMS today use web-based modules to collect forecast information from global networks of subsidiaries. This approach has the advantage of operating on a 24/7 basis, and if customised templates are available, local language and business specific tailoring can make the forecast submission process very user friendly – and thus more likely to be accurate.

Many companies additionally (or alternatively) use their ERP and accounting systems to import accounts payable and receivable information into their TMS so that these committed flows can be integrated into the cash forecast. Technically, these interfaces have tended to be file based, but some ERPs today support more efficient integration using middleware.

The overall perspective for cash and liquidity management is that robust TMS provide efficient solutions in which all the required information is collected, consolidated, analysed and reported giving accurate, up-to-date and complete pictures of the current and forecasted cash position. The data may be analysed in any required perspective, for example by currency, by business unit, by manufacturing line, by geographic area and by sales team.

**OPERATIONAL RISK – THE NEW PERIL** Recent turbulent events have provoked treasurers to analyse financial risk exposures in new ways. The shock suffered by the changed financial landscape is still being assessed – and there are clearly new, emerging areas of risk which were once seen as negligible, but are now judged to be legitimate areas of concern for corporate treasurers. These are grouped generically as "Operational Risk"; I will now define and explain the various elements of operational risk that have been identified – so far. These I will call Investment Counterparty Risk, Bank Risk, and, the most elusive concept, Settlement Risk. There are (fortunately!) some ways in which treasury management systems can help to measure and manage the various kinds of operational risk.

■ **Investment counterparty risk** is the best known component of operational risk, as its foundations have long been established among fund managers, and proprietary traders. The assignment of risk ratings has of course been the preserve of the rating agencies; we have seen some investors adding their own risk rating assessment to the process. Most companies now assign some specific investment limit value to each counterparty in which they are permitted to invest; and this may be complicated by maturity and instrument parameters. The role of the TMS is to record the treasury policy and document and manage the limits and policy with regard to permitted (and forbidden) investments. Policy documentation should be integrated with treasury processing to facilitate efficient decision making and work flow; and it can only make sense to manage and monitor counterparty limits in real time. If there is a significant

level of investment activity in a treasury, overnight limit breach reporting may be too late!

- **Bank risk** relates to time deposits placed with banks. Who would have imagined that this would be an area of concern? In the context of this article it is relevant to recommend applying limit functionality to the use of depository banks in the same way as described for investment counterparties.
- **Settlement risk** relates to exposures to banks that are involved in settlement execution chains. As an example, suppose that a business pays away an amount owed against a commercial invoice, and that the receiving bank fails – what happens next? The key service that a TMS can offer is that issues – and potential issues – such as this can be fully measured, making it much easier to evaluate the situation, and to take any remedial action. The problem may be broadened to assessing the risk of a bank that is the victim of a bear raid – or worse – and where the level of exposure may suddenly be perceived as a major risk.

So, what answers can technology supply that can help in such a situation? First, the settlement exposure may be treated as another exposure that should be subjected to strict credit assessment and limit assignment, and subsequent limit management via the TMS. Then, it is extremely valuable administratively if the TMS integrates all relevant bank information (such as account locations and purposes, mandate documents and details of the authorised signatories) with exposure information. This has the benefit that if an executive decision is taken to migrate accounts to another bank, the necessary information is immediately available. The risk – and occurrence – of settlement bank failure can have a significant negative impact on liquidity unless the TMS can present all the required information – reliably and rapidly. A TMS can help the treasurer preserve – and document – financial control in testing circumstances.

**FUNDING LIQUIDITY RISK** A new area of risk that has only recently concerned corporate treasurers is funding liquidity – or what can be done if a traditional source of funding dries up? One example has been the difficulty of raising funds in the commercial paper market, which has caused some corporations to fall back on bank facilities. In such cases, the TMS can support efficient facility utilisation management and monitoring, including the tracking and verification of the various related fees. In terms of reporting, future funding requirement management reports should integrate both commercial paper roll-over risks and facility monitoring, to support strategic liquidity management.

**CONCLUSION** The more rapidly and accurately the treasurer can respond to internal and management questions requiring the instant quantification of risk exposures, the more effective the treasury operation will be.

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