Scarcity versus plenty

AT A SUPERFICIAL LEVEL, THERE IS AN OBVIOUS DISTINCTION BETWEEN CORPORATIONS THAT HAVE AMPLE LIQUIDITY AND THOSE THAT DO NOT. HOWEVER, AS JENNIFER DOHERTY EXPLAINS, WHEN IT COMES TO LIQUIDITY MANAGEMENT, BOTH GROUPS ARE CURRENTLY CONFRONTING SIMILAR CHALLENGES

The most recent Kyriba/ACT survey[1] underlines the continuing importance of cash and liquidity management, with most respondents citing it as one of their top three priorities for the year ahead. Furthermore, the environment in which they need to deliver on this priority is demanding. Regulatory changes, such as Basel III, have impacted certain liquidity management techniques and changed the way in which bank deposits are compensated, while negative central bank deposit rates in certain locations[2] are pressurising returns more generally.

In addition, changes in technology are driving a shift towards real-time liquidity management, while corporate investment policies have continued to grow in complexity. Fortunately, some solution providers have anticipated these challenges and already have the capabilities in place to help corporate treasuries address them.

Scarcity: maximising cash accessibility

Corporations that are not cash-rich require solutions that help them to improve the visibility of their cash and then to consolidate and optimise it. This is an area where notional pooling has been a popular and effective tool, but this is becoming less available as a result of Basel III.

The reduced availability of notional pooling has driven increased interest in cash concentration, but the underlying challenges of managing the resulting intercompany loans still need to be addressed. This is particularly germane to jurisdictions such as China, where efficient intercompany loan management is critical for effective renminbi cash concentration.

Therefore, intercompany loan management solutions have needed more sophisticated capabilities, such as automated loan limit management. This needs to allow visibility and control both bilaterally between accounts, as well as multilaterally across the entire structure if it is to help avoid any issues relating to thin capitalisation rules.

Plenty: risk, return and efficiency

Regulation also has liquidity management implications for cash-rich companies. Under Basel III, banks have a preference for more stable funding, which is prompting them to offer products that incentivise the placing of longer-term cash, subject to advance notice of withdrawal. As a result, some treasuries are making their 'bucketing' of cash by timeline more granular to reflect the notice they need to give on these deposits. Those treasuries

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seeking liquidity as well as security need to consider whether leaving cash in an operating or instant access savings account satisfies those requirements. Those that have yield as a priority may opt for an evergreen-style notice account or money market funds.

This range of possibilities, coupled with a changing environment and treasuries' typically low headcount, is driving the emergence of solutions that can automate the investment side of the liquidity management process. Treasuries can use these to define the allocation rules for liquidity in accordance with corporate investment policy based upon balance trigger levels. Cash above a user-defined account balance trigger level is automatically allocated across appropriate investment instruments and is automatically redeemed from those instruments, should the client operating account drop below client-defined cash levels.

This gives treasuries far more granularity and control in distributing cash in accordance with investment policy, as well as significantly improving efficiency through automation. It also confers the important additional benefits of enhanced risk management and transparency. Operational risk in treasury is to some extent mitigated, but so also is overall risk management from an exposure perspective. In addition, associated reporting capabilities make it straightforward to demonstrate to the CFO and board that all activity is in accordance with corporate investment policy. This is particularly pertinent given the increasing complexity of such policies (and the associated monitoring requirements) in the wake of the events of 2008.

Technology

Technology-related liquidity challenges currently come from several directions. Certain markets and payment platforms are already migrating their infrastructure from batch-based processing to a real-time environment. This means that treasury increasingly needs to manage cash and liquidity dynamically, rather than on an end-of-day basis. In addition, given the growing number of payment methods now available to corporates' end customers, there is also the need to consolidate and deploy information and cash across a growing number of channels.

While the technology solutions to achieve this may be available, many corporate treasuries do not have the resources to deploy and integrate these with existing enterprise resource planning systems or treasury management technology. This often means that they look to their banks for assistance with integrating solutions for new payment and information channels, which has led to the evolution of bank integration teams that include qualified technology specialists.

Integration and centralisation

In the current environment, there is growing appreciation within treasuries of the value that can be added by combining cash management and liquidity with one provider. For instance, the definition of an operational deposit under Basel III means that there must be operational activity against the cash on deposit for it to be valid (and valued) as an operational deposit. Therefore, if a treasury gives transaction business to one bank and only excess liquidity to another, the second bank will not receive the funding benefit of the operational account – with consequences for the interest rate it can offer.

In addition, there has been a growing tendency for treasuries to purchase services on a more centralised basis in the interests of efficiency. This reduces the management overhead from the treasury's perspective, but also means that any prospective bank has to be able to deliver in a regionally or globally homogenous manner. This requires an extensive physical bank network, plus the ability to on-board business both efficiently and consistently, irrespective of location.

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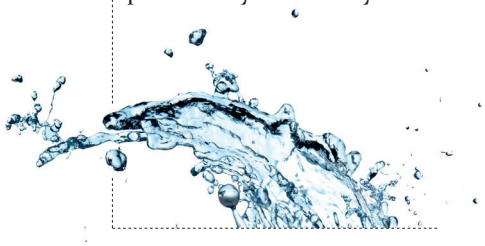
Action, opportunity and the future

While the combination of regulation, low interest rates, technology changes and more complex investment policies poses significant liquidity management challenges, suitable solutions to address these are available. Nevertheless, the solutions chosen will depend on specific corporate circumstances, which necessitates an understanding of how corporate cash is distributed and its perceived market value across the various available instruments. Companies that are not cash-rich face a similar need to understand their current position, which will inform any decisions, such as whether to (re)visit cash concentration.

Future-proofing is another important consideration. The liquidity management environment has changed substantially in the past five years and may change as much, or more, over the next five. Therefore, it is vital to ensure that solutions and strategies adopted today will remain relevant in the future. That necessitates closely examining each solution offered. Is it future-proof? Is the solution provider already planning the next iteration? And is their solution structured to ensure a smooth transition? If the answer to these questions is yes, then you may have just found the right liquidity management partner for your treasury.



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1. Kyriba/ACT 2016 Treasury Survey: *Prioritise Technology to Support the Treasurer's Expanding Role*; www.treasurers.org/kyriba/2016
2. https://www.bloomberg.com/quicktake/negative-interest-rates