



Cashing in on cash management

The impending liquidity regulation's demand for greater transparency and reporting, combined with the need to more fully optimise available funds, has led to an increased focus on risk across the inter-bank market. Here, Les Gosling, head of EMEA at TwoFour, discusses how banks can best meet their obligations and the benefits that can be gleaned from effective management of nostro accounts.

With regulators across the globe turning their attention to liquidity and the forthcoming FSA regime sending many banks into frenzy, cash – as the most liquid asset – has literally become more valuable. To satisfy the regulators, financial institutions need to not only have enough cash and liquidity to continue trading, but must also be able to prove that they have enough to meet their ongoing obligations. While the degree of regulation will vary across institutions, it is proposed that some firms will need to provide the regulators with sufficient data to allow for various stress and scenario tests. Furthermore, as a result of the credit crisis, 'back to basics' transaction banking is once again a favourable area for banks to make money. This in turn is likely to continue to drive increases in transaction volumes. As a result, banks will have to ensure that they are putting their cash to good use, which has led to more focus on counterparty and nostro account management.

For most tier one and two banks, throughout the trading day literally hundreds of thousands or millions of transactions from multitudes of sources flow across their nostro accounts. Subsequently, the balances of these can change hundreds of times a second at peak times. The volume of cash flows has also been steadily rising and, with greater increases in electronic and algorithmic trading, this trend is set to continue. This makes it even harder to maintain target balances and meet regulatory demands, adding more pressure to nostro balance netting, reconciliation and forecasting processes. If banks can conquer this, however, they can significantly reduce the potential for loss of confidence in the market. They can also increase their opportunity to maximise the efficient use of valuable cash in the money markets and foreign exchange markets, both regionally and globally.

Poor nostro account management, on the other hand, can represent an area where banks have potential to lose money. If an institution does not have sufficient funds in its nostro account at the time of closing, it will incur penalty interest and charges. And because this is short-term and unexpected, the interest rates – which are based on the current Libor rate – are high. All too often, these nostro account balances fall so short that banks are severely penalised, potentially resulting in them losing hundreds of thousands of dollars on individual trades. This can also impact their liquidity buffers, which will soon be specified

by the regulators. If banks in the UK fall below their threshold, they will need to submit daily liquidity reports to the FSA and may also be issued heavy fines.

Inefficiencies in nostro account operations are highly common, which often comes at the expense of productivity. It could therefore be argued that the methods banks use to manage their nostro accounts today are wholly inadequate compared to the planned new regulatory requirements. For example, many banks hold complex hierarchies and nostro accounts structures, while using a multitude of manual processes and systems to maintain target balances, sweep funds, make cash flow projections, execute trades and manage risk. These complexities and disparities are multiplied for global banks trading a broad mix of asset classes across time zones. Not only does this make accurate and timely information harder to come by, but it also increases both liquidity and operational risk. As a result, the challenge of determining what the institution's cash requirements are to meet day-to-day counterparty obligations only gets tougher. However, with the impending liquidity regime and the return to transaction banking, banks are now recognising that this is a challenge they need to overcome.

In order to accurately maintain target balances and meet their cash requirements, the bank's treasury department needs real-time intra-day information about its positions and cash movement. Furthermore, the data needs to be readily available on a 24x7 basis. With more business than ever relying on cash-based settlement, this has to be fundamental – without it the entire trading operation is in jeopardy. To rebuild counterparty trust and confidence in the inter-bank market, as well as appease the regulators, financial institutions across the globe now need to take a more proactive approach to their cash and liquidity management.

Such an approach requires seamless, automated operations, which provide the necessary controls, transparency and data access. For example, systems should be in place that not only process the transactions and manage account balances, but also provide intuition through data that helps improve decision-making processes. This includes the valuation of assets against benchmarks and determining how and when to turn liquid assets into cash. Furthermore, institutions that use operational infrastructure to the fullest potential should also have the capability to conduct 'what if' scenario analysis and stress testing, as well as execute trades. This should all be centralised within a single, integrated solution that spans the front, middle and back offices. Not only will this reduce costs by significantly streamlining and simplifying processes, but it is key for stabilising the institution.

This strategy will certainly drive efficiencies, but errors will still occur, such as when trades are mis-booked. It's therefore important to ensure that a level of flexibility and intuitive exception handling capability is integral to the process. This should allow for errors to be identified and alerted and corrections to be made quickly and efficiently.

Another important consideration is volume. By 2012 large institutions will need to be equipped to handle in excess of five billion transactions per year, which will place substantial strain on existing systems. STP, speed and scale – on a global and continuous basis – are subsequently paramount.

Ultimately, the consequences of having precious cash funds in the wrong place are more severe than ever, so a smarter approach to cash management must be instigated. This relies on centralising cash flows into a single point, processing these and working out how best to make the most of the available funds. By effectively and actively managing the entire transaction lifecycle, the treasury will know what its cash positions are in real-time, giving the necessary control and foresight to make this work in their favour.

About TwoFour

TwoFour is a provider of 24X7 global technology and consultancy solutions for treasury and capital markets. Its management team has more than 22 years of experience in financial services technology, serving the world's leading institutions. Established in 2002 and headquartered in New York, TwoFour is privately held with more than 150 employees across two continents. The company has achieved year-on-year growth since its inception and its client portfolio comprises large banks, brokerage firms and financial institutions that operate on a global scale. For further information visit: www.twofour.com.

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