

PERSPECTIVE

Cross Border Liquidity Management – A Key Differentiator



Ensuring smooth functioning of business houses by managing and maintaining adequate liquidity is one of the KRA's of a corporate treasurer. Cash flow management, appropriate investment of excess cash and borrowing cash when it is required are the three basic aspects of liquidity management which demand considerable focus from a corporate treasurer.

While liquidity management is a panoptic term representing a gamut of functions performed by corporate treasury / liquidity managers, this article considers cash concentration and notional pooling as the predominant techniques of cross border liquidity management. The task of managing liquidity would have been much simpler for a treasury manager had it been a case of 'uni-banking relationship' with a single account to monitor and manage. However, a global corporate cannot completely do away with multiple local banking relationships for a variety of reasons, often resulting in chunks of idle cash left in various accounts. It's imperative for corporations to take a global view of their banking relationships to optimize return on the most liquid asset on their balance sheets.

Cash Concentration Beyond Boundaries – The Logical Choice?

A decentralized liquidity management structure demands time and effort of corporate treasury managers across operational units and is less effective due to certain inherent drawbacks like subsidiaries borrowing funds when excess funds are available with other group companies, idle cash resulting in opportunity cost and, less informed and risky local investment decisions. On the other hand the underlying advantages of convergence are stimulating corporations to realign their strategies towards centralized treasury / liquidity management structures.

In a utopian world, movement of funds between different legal entities / across borders is a simple task. But cross border cash concentration in practice is subject to currency fluctuations, settlement risks, regulatory restrictions and tax implications arising out of intercompany lending / borrowing. However, with cash concentration techniques inching towards complete automation

and increasing regulatory pressure for centralized monitoring, cash concentration beyond boundaries could be the logical choice of a corporate treasurer to gain centralized control over dispersed cash balances.

Notional Pooling – The Perfect Alternative?

Notional pooling involves notionally aggregating balances across accounts without initiating physical transfer of funds. As notional pooling does not involve co-mingling of funds, for corporate treasurers who want to avoid time consuming inter-company loan administration, FX swaps and settlement risks, notional pooling could be a viable alternative.

It should not be misconstrued that notional pooling arrangements are free from operational hindrances and regulatory restrictions. Notional pooling arrangements are also required to pass through the regulators, tax administrator's scanners, particularly when it comes to allocation of pool benefits. While notional pooling is a viable alternative to cash concentration the practical way of achieving liquidity objectives in a cross border scenario seems to be following a 'Mix N Match' approach involving both cash concentration and notional pooling techniques to suit the specific requirements of corporations.

Bank's Role – The Four I's Of Cross Border Liquidity Management:

While banks may not be able to completely assume the role of a treasury / liquidity manager, they can help treasury managers streamline and simplify their role in cross border liquidity management by addressing some of the crucial issues confronted by treasury managers, referred here as the 4 I's of cross border liquidity management.

- Identify balances and initiate fund movement
- Intercompany loan administration
- Investment management
- Information assimilation and reporting

Identify balances and initiate fund movement – 'the focal point of automation'

Business vagaries, underlying liquidity requirements, the structure of account overlay in the group, easy availability of local borrowings, regulatory restrictions, and tax implications are some of the factors which have a direct bearing on any cross border cash concentration structure. It is also important to give due consideration to the cost benefit trade off and the objectives of cash concentration before structuring a cross border liquidity management solution.

Once a cash concentration structure is put in place, the immediate step is identifying balances in the structure and initiating movement of funds from where the excess funds are, to where they are required. In the absence of an automated solution the treasury managers have to rely on a time consuming process of manually checking the balances of multiple local bank accounts and locally initiate transfer of funds. The objectives of liquidity management can seldom be achieved with manual processes. Identification of balances in the subsidiary accounts and initiating fund movement in accordance with the liquidity objectives is the focal point of automation to eliminate time consuming manual processes and possible operational slippages.

Leveraging on the innovations in payment systems banks can identify balances of dispersed local accounts through automatic account updates sent by local banks or by sending automatic requests for account updates. Banks can also eliminate the tedious tasks of determining the quantum of sweeps and initiating fund transfers by providing automated rule based solutions. Some of the rules can be - minimum balances above which funds could be moved to concentrating accounts, over all limits on the quantum of fund movement, trigger / threshold limits for initiating sweeps, intraday or end of day, with sun or against sun, one way or two way sweeps.

Intercompany loan administration – 'a vital determinant'

The next time-consuming activity of a corporate treasurer is administration of intercompany loans arising out of fund movement among legal entities. Administration of inter-company loans is a relatively simple task when cash concentration is within one jurisdiction, but the challenges faced by a corporate treasurer are multifaceted when it comes to intercompany loan administration in a cross border scenario. Careful consideration need to be given to the regulations governing intercompany borrowings like thin capitalization rules, underlying home tax rules, bilateral tax implications and transfer pricing rules with respect to allocation of interest benefit to the member entities. The consequences of not complying with such rules could prove to be costlier for the corporations than the benefits accrued through cross border liquidity management. Automation in the area of tracking of fund movement among group companies, accurate and rule based interest allocation and tax administration could be a vital determinant of a bank's cross border liquidity management.

Integrated Investment management – 'a value-add'

While traditionally corporate treasurers have been investing excess funds in various investment avenues available locally, cross border cash concentration can open up new avenues of investments for them by facilitating movement of funds to places best suited for investments. Centralized investments would also help corporations reap the benefits of more informed and less risky investment options. Bank's liquidity management offering with integrated and automatic rule based investment sweeps whether overnight or otherwise, with or without automatic redemption options would be a definite value-add to the treasury managers.

Information assimilation and reporting – 'sine-qua-non'

Without a consolidated view of the account balances, inter-entity transactions, limit utilizations, costs involved vs. benefits accrued

the objective of centralized monitoring / control is a mirage for liquidity managers. Consolidated, accurate and up to date information would enable treasury managers take informed decisions. The other crucial aspect of information management is regulatory reporting. Movement of funds across entities / across borders, notionally offsetting debit and credit balances is subject to scrutiny by the regulators even in the most liberalized economies. Thus, information assimilation and reporting is a prerequisite of cross border liquidity management. Banks can eliminate treasury manager's tedious task of compiling information for internal monitoring or regulatory reporting by providing flexible and automated reporting options.

Cross-border Liquidity Management System – A Key Differentiator

Today's global corporations face multiple challenges with respect to maintaining and managing liquidity positions across multiple bank accounts / subsidiaries. Relying on an automated, end to end cross border liquidity management offering by banks could be the panacea for corporate treasurers. On the other hand with stiffening competition and product offerings becoming commonplace more rapidly, the very specialized nature of a cross border liquidity management offering has all the potential to be a key differentiator for banks in the market place.

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