

Funds Managers

Global Finance brings together a group of experts to discuss recent developments in the industry.

GLOBAL FINANCE: SEPA credit transfers went live on January 28 of this year. What has been the experience of banks and companies so far? Some think the real challenge lies ahead with the introduction of SEPA direct debits. How do you see this developing?

DAVID MANSON, *head of international cash management, Global Transaction Services, Royal Bank of Scotland*: Both parts of the business I'm representing—on the ABN AMRO side and Royal Bank of Scotland—have had a successful month, with over 50,000 transactions in each of those two businesses. We're very pleased with that. We have one major multinational who has kindly agreed to pilot the whole process with us, and given the experience on both sides, it's very positive. There are challenges, inevitably, most of those from a big bank perspective. This is a volume economy: You're either in this game big time or you're not. The challenge for a lot of banks is, are they going to make the necessary investments themselves or, rather, work through a partner who has the necessary scale and processing power? There are also issues around the public sector in terms of convincing them it's the right time to change.

RAJESH MEHTA, *managing director, head of treasury and trade solutions EMEA, Global Transaction Services, Citi*: It got off to a healthy start with some early take-up, quite a few multinationals jumping in. There's still a bit of a wait-and-see approach, though, around which corporates in the current environment really want to fund serious projects moving up to SEPA that encompass other areas of

internal efficiency. But there is a lot of interest, particularly from some of the Central European countries, which have really come to the forefront to gain cheaper and more efficient access to euro trade flows.

ALAN VERSCHOYLE-KING, *managing director, head of treasury services EMEA, The Bank of New York Mellon Treasury Services*: The CEE banks are very thoughtful about what SEPA means for them and aren't lumbered with the infrastructure. It's been interesting working with US-based corporates who want advice on SEPA, because we haven't necessarily had the guidance and support we expected from some of the larger Western European banks. We've received much more from some of the CEE banks.

MEHTA: As we see the emergence of new business models in the FI space, we

are seeing a much more convivial relationship develop between the banks. Now there's a lot of experimenting, which has more interesting implications than just the short-term tactical shifts.

VERSCHOYLE-KING: The larger organizations that have expanded eastward—UniCredit, for example—are able to offer the expertise and infrastructure to support the scale of the transactions. It is scale that is leading to this more pragmatic approach. We can't all be building infrastructure and in-sourcing or white-labeling. There will come a point where there isn't the scale in the market to support all of us, and that is where collaboration comes in, even to the extent of sharing infrastructure.

MEHTA: Collaboration will solve part of the issue, but the bigger question when you get either consolidation or collaboration is, what are we going to be competing on? Competition is no longer grounded in the settlement/clearing space; smaller banks are recognizing they can let go of this without impacting their client proposition. They would rather invest their increasingly scarce resources on enhancing their client proposition and building value-added services to meet the needs of their specific client segment.

GF: Regulation and competition have created a need for infrastructure change that is expected to place an investment strain on many banks now in the market. How will this affect the competitive banking alignment in Europe? How will companies benefit from this?



Mehta: "We will have three or four large, serious, credible players"

MEHTA: It depends on whether you see it as an asset or a liability. The demand on the investment euros to meet mandated infrastructure or regulatory or industry changes is extremely high. If banks fail to manage this in the context of longer-term strategy, then they will find that their product enhancements and client-visible projects will always get pushed out. Banks also need to take advantage of the new pan-European processors and CSM's to offer a more efficient, variable cost model for accessing market infrastructure. Building scale through insourcing is also key to creating a workable business model for the SEPA environment.

MANSON: The customers will follow that model as well. They will want to have greater consistency in how they approach the regulations, but the decisions may be based not on whether they can afford them but rather on what they have to have. The industry is estimating that about one-third of the equivalent IT spend is going into regulation and compliance right now—astronomical amounts of investment, but the price of entry for serious players to be fully accredited.

MEHTA: The scale also plays to the next level. With scale you have consistency of delivery, service and product regionally and globally. The lack of consistency caused by multiple connectivity will go away.

VERSCOYLE-KING: What's interesting is how quickly that's changed. Not long ago we were saying there's really only space for two types of organizations in this market: global players and niche providers. The pendulum has swung dramatically, and the cost of delivering regulation and compliance is a key part of that. Clients expect us to meet our requirements, but they're not willing to pay for it. It's effectively a written-off cost. A collaborative approach—a number of organizations working together across regional bases to create an infrastructure that effectively meets the clients' require-



Verschoyle-King: "It has become extremely important for us to know where our funds are"

ments—that may be the only option for most banking organizations now.

MANSON: The clients are getting huge value out of this. For example, the Payment Services Directive aims to increase competition and transparency and provide harmonized, guaranteed service levels, all of which are customer friendly and also will be delivered to them in an accelerated manner. Banks need to take that sort of investment into account to stay in the game.

MEHTA: The challenge is that compliance takes such a big proportion of the IT spend, there is very little left for discretionary innovation. The mind-set of many banks has shifted to the point where they clearly recognize that in-house processing and infrastructure is not fundamental to being a payments bank; partnering and outsourcing are very relevant alternatives.

GF: Does the investment you're making to satisfy regulatory requirements in Europe benefit you elsewhere in the world?

MEHTA: It's global. We're a global bank with global customers. While they see value in the consolidation and standardization in Europe, they are hungry for their banks to take a global approach to their

infrastructure and services. The challenge is creating global consistency while accommodating regional variations in regulatory requirements and market practice.

MANSON: These are global initiatives that have benefit to the whole global organization.

VERSCOYLE-KING: We need to consider the client perspective as well. If we couldn't demonstrate to our clients that we are investing to address the issues, region by region, they would be concerned. We're almost obliged to take that approach whether we think it's the right one or not.

GF: What might the landscape look like in the future in this market?

MEHTA: I believe we probably will have three or four large, serious, credible players. It won't be just SEPA and cash management that drive the consolidation; there's going to be consolidation among the processors, too. And when Direct Debit is launched, that's when you're going to really see some new business models. Customer relationships and price points will extend beyond just payments/collections into adjacent areas of other industries—logistics, supply chain, invoicing—and have multiple price points, effectively servicing more of the value chain. Banks will be forced to look along the value chain to find the revenue opportunities for the future.

VERSCOYLE-KING: There are a number of things going on simultaneously. For the first time we're seeing consolidation driven by processing. Transaction processing used to be an afterthought. Now consolidation is driven by the focus on infrastructure that two organizations can bring. Second, there is a question about cash management, whether it's profitable or not on a stand-alone basis. Some organizations say it's processing; others broaden it out to include true working capital. Some ally cash management with custody or asset management. Clients are looking at

processing on a bundled basis. Processing is the core, but their buying decision is based on what else a bank provides.

MANSON: It's become a completely different level altogether—a focus on the “services” part of the financial service industry. It's become its own specialist discipline that underwrites the two broader businesses—cash and trade—that we look at within the transaction world. There is evidence now that it may not even be a bank that does this in the long term, unless banks demonstrate strong innovation and continuing commitment to long-term leadership or similar.

GF: We are in the midst of a global credit crunch. The US is entering a recession and may pull parts of the world along with it. With corporate treasurers' liquidity being at a premium, how can banks offer effective cash management solutions that meet their needs?

MEHTA: The large global corporates want consistency, they want globality, they want scale. Critical criteria in their evaluation will be liquidity, visibility, mobilization and optimization. If you're well positioned in those areas over the next 18 to 24 months, it will be quite a big advantage. If we can offer a corporate the ability to pull out surplus liquidity every night and follow the sun—to Asia, to Europe and then North America—that's going to really be the ace in the hand for the next couple of years. It could almost be worth subsidizing your transaction processing capability for the next couple of years.

MANSON: Recent events have focused corporate treasuries on the counterparties they're dealing with. We offer a visibility control and optimization model that can really help companies to make the most of their working capital and so manage down their overall cost of capital—a powerful proposition in the current climate. You first need to see where the money is so you can bring it in, save

fund overdrafts and idle balances to maximize excess liquidity. We're seeing this through regional as well as cross-regional concentration programs—also via cross-currency notional funding solutions becoming increasingly common for both large and mid-size corporates. You get the real value of all the internal working capital of the entire company before we go to the market.

VERSCOYLE-KING: The credit crunch and the liquidity challenges present the banks with enormous challenges. It has become extremely important for us to know where our funds are. It changes the nature of the dialogue with the client—corporate, institutional—because we've become very reliant upon each other. For 10 years we've heard talk about partnership. Suddenly it's real. Clients need to know they can trust us to manage their funds effectively, to process and to invest. We need to know what those funds are, where they are, and how much more or how little more of them we're about to get. Because we're managing our own liquidity as well, on almost a minute-by-minute basis.

MEHTA: These kinds of crises bring out new criteria for evaluating your operating models because a lot of these things are

okay for growth, but when you're in risk mode, do the same models work?

GF: How concerned are your corporate clients about the current situation?

MEHTA: Our clients are fairly well informed and are really being prudent in their approach to the industry; they're not panicking. They're looking at diversifying, and they're looking at compound risk a little differently.

MANSON: Corporates are focusing both on liquidity maximization as well as on outsourcing their own treasury functions. They see that if we have an effective global sweeping solution, then they don't need 15 people looking at spreadsheets to manage their liquidity. There's actually substantial potential cost savings in that. We're also seeing clients who already have regional solutions looking one step above—to consider building a global cash mandate.

VERSCOYLE-KING: We're developing true partnerships in client relationships. Clients—including large banks—are, in some cases, all but asking us to do an analysis of our competitor organizations. That's not appropriate for us to do, but the fact that they're asking for that input says it's at the forefront of their minds.

GF: How is supply chain finance developing for the banks and their customers? How different will it look in the future?

MANSON: There are many promoters of supply chain finance, and there are as many definitions of the whole concept as there are promoters of it. All offer a variety of benefits and blessings and work with a range of successes. Where I see the real value in supply chain financing coming in the next six to 12 months would be in the pre-shipment element. Traditionally, a supplier wants to see a bank name on the top of a letter of credit. Increasingly we're saying our corporates can be a strong primary counterparty in their own right given their track record and proven ability to pay. You know this



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order is as good as an L/C, but how do we collectively make that leap of faith? The obvious model increasingly focuses on a variety of banks, particularly in Asia, where there's actually a system in place to share risk around the suppliers to allow them to get credit, which wouldn't be done on a traditional model of pre-ship and credit. You're actually looking to capture the whole end-to-end chain right through from the pre-shipment or from the actual procurement, not just the transaction where you're basically saying, "Yes, we know our buyer and will advance funds to their suppliers on their say-so." We'll actually look to underwrite that risk. It's a fundamental change in how the supply chain is assessed.

MEHTA: There are so many other examples. I look at it as the extension of the ERP of the company or as the coming together of logistics finance and trading counterparties. The key in the trade space—domestic and cross-border—is how to scale up. It's a great approach for a bank, but can you say all the clients want to arbitrage the credit rating of buyer and seller? And if, say, there's a big buyer with seven suppliers, it's still seven fields.

MANSON: And you're creating enormous exposure on that one buyer, which will need some form of distribution of risk.

VERSCHOYLE-KING: What distinguishes the supply chain is that, instead of trying to play across the entire space, banks have come in the other way around, saying, "Here's where we think we can add value. Now who is out there who can add value to the rest of it?" Then we reach out to them and collaborate from the beginning. That's the approach we've taken. We've reached out to other organizations in the relevant geographies and said we don't wish to be risk exposed here; we need to work on a collaborative basis.

MEHTA: There's also a shift happening in that the direction of flow is changing pretty interestingly. The cash flow is com-



Giarraputo: "Regulation and competition have created a need for infrastructure change"

ing out of places like India and China because, say, the sovereign wealth funds are showing interest in buying paper.

VERSCHOYLE-KING: That's a very good example. You can expand that concept to the supply chain, then take what you gain in terms of assets to your hedge fund clients, to your broker-dealer clients, and say, Look at what we bring with us. We'd like you to invest in this paper.

MANSON: Customers also have such a variety of needs—or in some cases they're becoming aware of needs that they didn't even know they had. The key is enabling companies to realize the opportunities that are available. For most companies, there are at minimum three or four ways of defining the value of that supply chain.

GF: Current market conditions have placed an even greater emphasis on risk management. Banks and their customers often have different perspectives of risk. How is the view of each accommodated?

VERSCHOYLE-KING: I work for an extremely risk-averse organization. Sometimes that works to our advantage, and sometimes that works to our disadvantage. But with all that's happening now, we've become much more willing to be direct with prospective clients,

saying, Here's where we perceive risks in working with you, and here's how you can make us comfortable. There's also a client perspective on bank risk, and we're finding that, at the moment, it's working to our advantage. We've had a net inflow of business over the past three months that has far, far exceeded our expectations. It's been driven by the flight to what is perceived to be effective risk management.

MANSON: The flight to quality is very evident in the market now. We have seen a few clients migrating even into the triple-A-rated funding from double-A-rated investments. Risk and security is much more important at the moment.

MEHTA: More recently, it's normalized. It's just a question of diversifying—across instruments, across institutions, across markets. Everybody understands better now the risk/reward relationship—the correlation. In the past few years people became a little gung-ho. What happened in the compliance and governance space a few years ago is likely to happen now from a risk point of view, where corporates only deal with banks that have decent risk management.

VERSCHOYLE-KING: The challenge is, can you turn that selling point into a pricing point, too? That's what we're all focused on.

GF: White-labeling and outsourcing are becoming increasingly important in this market—particularly outside of the United States. How are these offerings developing?

MEHTA: One model is the processing outsourcing model. The second is broader: Every bank is looking at every single business initiative, saying, "Do I build, do I buy, do I ally?" That usually provokes a discussion about what is necessary spend, what they tend to be more amendable to sharing or buying or allying, and what is my true valued differentiated element? Banks today would

look seriously at allying or buying something that was not pricing or a value-add. Model three is dictated by speed and differentiation: Banks look at time to market, the investment spend required, the risk of success, the geographical footprint of new products.

MANSON: Often what drives it more is just the absolute efficiencies of processing. It has to be instant delivery. If I can white-label, I can get instant benefits. To be in the market in five years' time, banks would be processing 5 billion-plus transactions to be even in the top 20. A lot of institutions have to say we simply cannot be in that game; they are recognizing that to stay competitive they have to shift away from a proprietary business model and align with one of the top-20 players.

VERSCHOYLE-KING: The dialogue we have with our clients and prospects has changed in the past year or two. Most of what I talk to my clients about now is in-sourcing back offices. Our model is built around processing: It's a processing, in-sourcing model. The quality of processing is key. Many clients start by giving us some of their business and very quickly want to give us the entire back office. Mindsets have changed. A while back we were pushing this concept. Now it's a pull. It's all about scale and profitability.

MEHTA: There is a business emerging in being a bank servicing company. It's a different breed, a different sales process, a different model.

MANSON: It is important to be selective on the outsourcing relationships one builds. There are a few names that you would not wish to white-label for. They are there to build market share, and we would not want that to be at our expense. We want to capture market share.

GF: Some clients are requiring the integration of treasury and cash management services with other services like custody in a bundled approach. What are the latest developments in this area?

VERSCHOYLE-KING: Clients who traditionally have done either their asset management or their asset servicing with us, but not their cash or trade, are coming back and saying, "Can you offer an integrated, standardized approach? Can you commit to offering the same service levels around cash as you're offering around custody?" If the answer is yes and we can make the pricing work, then our instinct is to put it in one location. We're certainly seeing that on a global basis, with no distinction between the developed and the developing markets.

MEHTA: On the corporate side, we're not seeing it because the buying centers within a corporate tend to be separate for the two lots of services. I am not seeing it as much from FI customers, either. Where I am seeing it, the demand is to have the same servicing model at the account and transactor level, which makes it a little difficult to service the cash business with its margins using the same model. The bigger linkage that clients—corporates and FI alike—are making is between the cash management and trade businesses.

MANSON: Custody apart, we are seeing customers looking for a bundling in general, certainly in terms of access. Clients don't want to look at 25 different PCs, all with different proprietary systems from the banks. They want us to consolidate things on a single platform, building more and more functionality onto a single portal. It's a lot of work to get interlinked with Wall Street and SAP and so on, but if the client can do more on fewer systems with more assurance and security, then that's ideal.

VERSCHOYLE-KING: Absolutely. The client is typically saying, "We'll bundle, provided you're willing to guarantee in return a standardized level of servicing: single points of contact and the same portal to access all information."

GF: How does globalization affect the treasury function today?

MEHTA: We're a business that interm-

diates flows of cash, financial assets and goods. In a globalized world, the size and scale and velocity of those flows are rising tremendously. Second, the direction and nature of those flows is changing all the time, as exporters change direction, for example. The sovereign wealth funds are also generating greater flows.

MANSON: Global treasurers are studying it in two ways. It's not just finance, which is the traditional way of looking at it, but very much a service flow. We're making payments and servicing customer needs in receivables and then actually moving the money around. A lot of global treasurers are being asked to do an awful lot more for less, and banks have to deliver that to them. It's very automated, there's a lot of STP [straight-through processing] in it. It has saved a lot of time and energy for corporate global treasurers and given great efficiencies on liquidity. It's driven up the value of their own internal liquidity, enabling real-time automated self-funding and consolidating cash pools for more efficient and easier investing.

VERSCHOYLE-KING: I think treasurers face the same challenges they faced 10 years ago: access to information, effective risk management, understanding the markets. But the currencies and markets have changed, so the focus is different. People can sit wherever they like, but they have to have access to local market information, and they need to consolidate that information at a global level.

MEHTA: Treasury models at corporates are changing as well. After the wave of centralization, we're seeing a second wave of functional specialization. Let's send the low-value, high-volume work to India, keep risk management in London, and send customer service somewhere else.

MANSON: That's lowering the distinction between what's decentralized and what's outsourced. The central part is where the strategy is—the 12 employees who manage this blur of outsourced, decentralized treasury and operational processes.