Efficiency dividends

Clever cash management offers a new competitive edge in today's tough market, says *Roger Brookes* at Citigroup Global Transaction Services. Here, he shows how streamlining relationships and cash flows can provide the efficiency improvements the market is demanding.

AS INVESTMENT performance becomes harder to predict, investors are increasingly looking at other factors to help them differentiate between mutual funds. Administrative efficiency is one of those factors, with funds coming under pressure to justify, or reduce, management fees. In response to this market sentiment, the investment industry is re-thinking business models and re-designing processes to drive down costs.

A good place to start the quest for efficiency is by analyzing the value chain for securities services (see Diagram 1 over). Meeting business and regulatory requirements for mutual funds involves a complex set of transactional and reporting tasks, right down to the details of fund units within individual accounts.

The administrative value chain involves three key players: the transfer agent (handling information services and retail record keeping); the cash manager (subscriptions and redemptions); and securities services (custodial services and fund accounting). Good technical integration and strong relationships between these three areas will help the drive for efficiency by speeding up the flow of data and minimizing the disjoints which lead to operational delays and errors.

Many mutual fund providers manage their securities services' relationships actively, as a strategic resource, but this is not always the case for cash management, which is sometimes seen purely as a must-have utility.

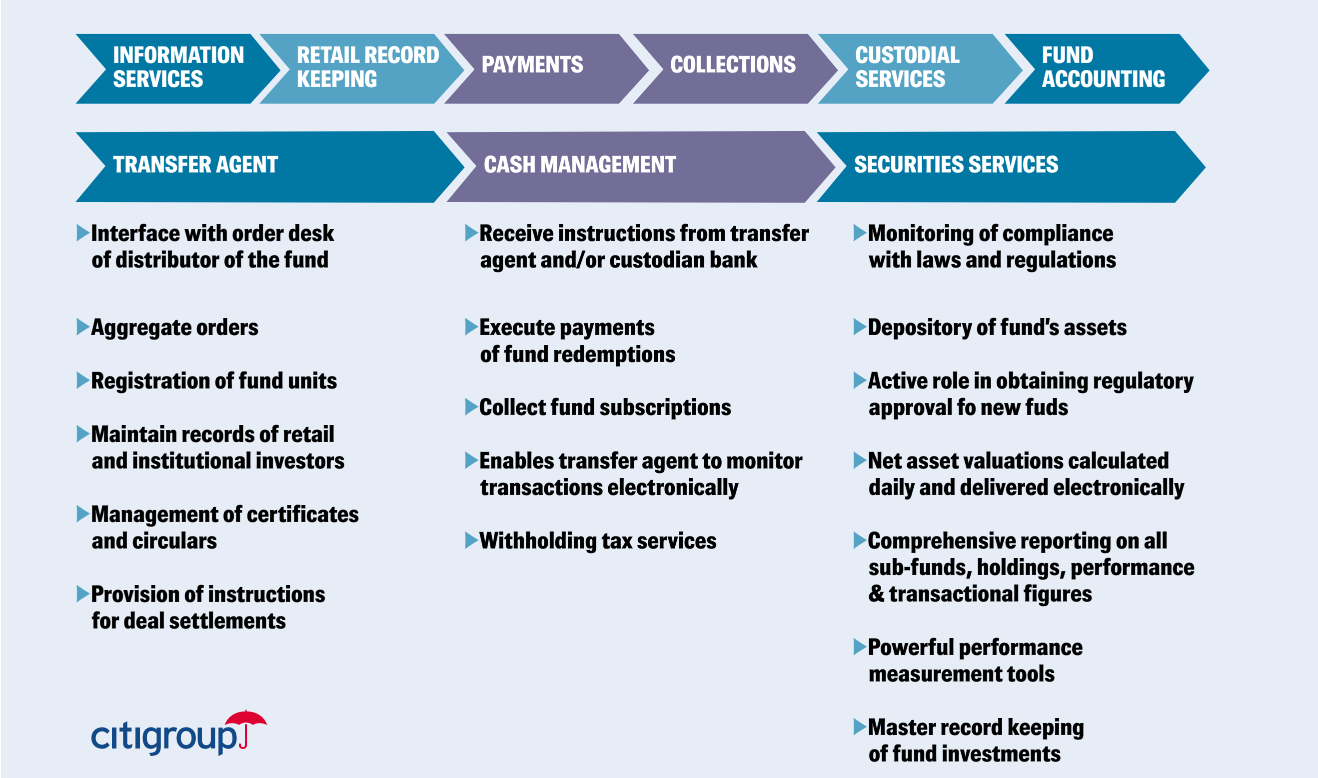
But well-structured cash management will deliver efficiency dividends in two areas, which together add up to substantial savings for the business. Actively managing banking relationships can significantly reduce the costs of collection and payment (transaction charges and banking fees), by exploiting scale benefits and better ways of working. Best-practice cash management will ensure that incoming cash is received, reconciled and applied to accounts at lowest cost and as quickly as possible. Reducing *cash-in-transit* in this way can have a real impact on the cost of working capital needed for the business.

Relationship management

Cash management plays an important role in the fund administration value chain enabling relationships to be strategically managed

For funds with an international distribution, the chances are that cash management arrangements have been established piecemeal, based on historic relationships with fund distributors and correspon-

DIAGRAM 1: INTEGRATED SECURITIES ADMINISTRATION VALUE CHAIN



dent banks. As a result, transfer agencies (whether in-house or outsourcing partners), may have to interface with multiple banks to receive subscriptions from retail or institutional investors and pay out redemptions for each fund under management.

Such organically grown cash management relationships are likely to have built-in inefficiencies and hidden costs at every level.

Each relationship will be subject to a separate price and service negotiation; cross-border banking fees, extended clearing delays and lifting charges may be incurred on transactions; data may be received in different file formats requiring separate interfaces to accounting systems; additional banking charges may be levied for unnecessary repairs and returns; lack of standardization may result in heavy exception processing during reconciliation of transactions against subscription accounts.

All these inefficiencies and associated costs can be avoided by de-coupling cash management from the distribution network and establishing a strategic cash management relationship with a single bank, able to deliver local banking services in each country of operation, through one delivery channel.

We will look in more detail later at how this might work at a country of distribution level. The important point to make here is that this should be achievable without significant disruption to the distribution network. In fact, it may even help to simplify those relationships as well.

After moving its cash management to Citigroup, Alliance Capital is convinced of the benefits of a centralized approach to managing their cash. "The most obvious savings are in the time it takes to reconcile incoming data and prepare outgoing payments" says Chris Bricker, managing director at ACM Global Investor Services[1]. "But because we now have a standardized process, we're also handling far fewer errors and queries, which adds up to happier clients as well as lower administration costs for us."

[1] *Wholly owned subsidiary of Alliance Capital Management LP.*

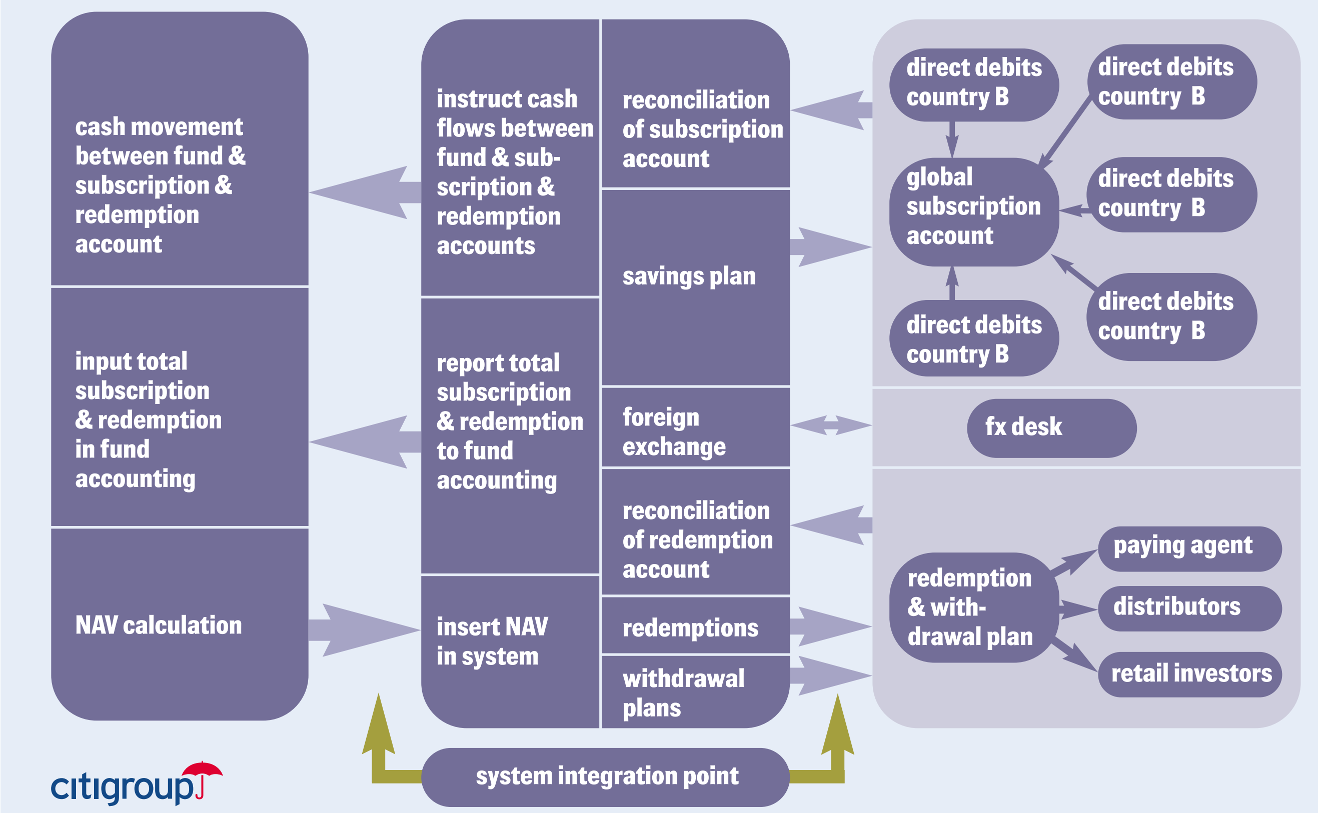
"WITH 44 FUNDS, OVER 500 SHARE CLASSES AND €33 BILLION IN ASSETS, WE HAVE HIGH VOLUMES AND VALUES OF TRANSACTIONS EACH DAY TO SETTLE WITH OUR BROKERS. WE HAVE ACHIEVED A VERY HIGH LEVEL OF STRAIGHT-THROUGH PROCESSING ON OUR TRADES, WHICH COMBINED WITH AUTOMATED RECONCILIATION AND A LOWER LEVEL OF QUERIES, DEFINITELY CONTRIBUTES TO OUR EFFICIENCY, AND THEREFORE TO OUR COMPETITIVENESS."

Angus Stening, Pioneer Investments

Key ingredients for success

The choice of a single banking partner will be based in large part on the strength of the solution offered. A best-practice cash management solution should provide a high level of technical integration at the country of domicile of fund level and ideally also at the country of distribution level, since thorough technical integration will enable the mutual fund provider to get the full efficiency benefits of standardised interfaces and uniform processes.

DIAGRAM 2: FULLY INTEGRATED SYSTEM



In addition, fund managers should look for the four fundamental capabilities from any prospective single banking partner, since these are the critical success features for a cash management solution suited to their needs:

1. An extensive branch network, which the mutual fund provider can leverage to receive incoming subscriptions and pay out redemptions across borders at minimum cost and loss of float.
2. Segregated accounts in the name of each individual fund are more efficient than bank Nostro accounts. They allow for items to be associated with the correct fund at every stage, simplifying reconciliation and leading to cleared funds available for investment earlier in the value chain.
3. A single-window electronic delivery platform for transaction initiation and reporting. It must be capable of integration with the transfer agency's back office systems and flexible enough to be accessed from other locations for ad hoc reporting requirements.
4. Access to Continuous Linked Settlement services (CLS). CLS offers risk-free settlement of foreign exchange transactions, leading to lower operational processing costs, optimization of daylight overdraft lines and enhanced liquidity management. CLS will become the settlement system of choice for volume users of FX.

Diagram 2 above illustrates the fully integrated solution that Citigroup Global Transaction Services has implemented successfully for a number of mutual fund providers, including the Luxembourg funds of Pioneer Investments.

It shows how the integration in each area of activity allows for an automated hand-off of single data files from the transfer agent's systems to the bank, or from the bank's systems to the transfer agent, as well as between transfer agent and securities services.

As a result, subscription funds and data for reconciliation flow from the investor in a country of distribution to accounting entries in the country of domicile, or from redemption instruction through paying agent back to the investor, with minimal manual intervention and maximum straight-through processing.

According to Angus Stening, executive vice president of operations for Pioneer Investments: "With 44 funds, over 500 share classes and €33 billion in assets, we have high volumes and values of transactions each day to settle with our brokers. We have achieved a very high level of straight-through processing on our trades, which combined with automated reconciliation and a lower level of queries, definitely contributes to our efficiency, and therefore to our competitiveness." At Citigroup we believe that, given the repetitive nature of transaction types within the mutual funds business, a straight-through processing rate of close to 100% should be the target.

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Chris Bricker, ACM Global Investor Services

BEST-PRACTICE CASH MANAGEMENT OFFERS

- **Fully integrated, automated process resulting in high straight-through processing rates;**
- **One-stop shop for subscriptions and redemptions processes, regardless of type and origin/destination;**
- **Bulk process allowing for more competitive transaction pricing;**
- **Centrally-initiated transactions executed as domestic transactions (with domestic pricing) wherever appropriate;**
- **Complete control over value dates;**
- **Paper transactions fully accommodated within a streamlined electronic process.**

Together, these advantages add up to a real competitive edge, which is fully achievable, even in today's difficult climate. There has never been a better time to take a closer look at cash management.

Home country support

To take advantage of the full efficiency benefits on offer from a single-provider cash management solution, it is highly advisable to take the streamlining of relationships, interfaces and processes to country-of-distribution level.

This is because the costs and delays that occur when data and funds are passed between different banks in different countries can be considerable. They can also be hard to control, due to a continuing lack of transparency in European banking practices such as hidden value dating and float. And, as we saw earlier, reconciling accounts with different reporting formats also adds costs.

By using a single bank with an extensive branch network it is possible to achieve the best of centralized and local cash management: initiating and controlling subscriptions and redemptions centrally from the country of domicile of the fund, but collecting into local accounts and using local payment mechanisms familiar to investors, with charges at domestic transaction pricing levels.

More efficient collections

The first step is to set up subscription accounts with the selected cash management bank in each country of distribution. These accounts will be segregated to keep subscriptions to each fund separate. Balances on the subscription accounts can be swept to a concentration centre of choice (such as Luxembourg, Dublin or London) on a daily basis or as required, for rapid investment.

Investors pay their subscriptions to these local accounts by their chosen method: electronic wire transfer, domestic transfer, cheque or direct debit. Many mutual fund providers prefer to collect subscriptions for regular savings plans and repeat subscriptions from retail investors via direct debit.

International Direct Debits are the ideal mechanism here: the transfer agent can send the bank one file containing direct debit instructions to debit investors' accounts in any of eleven countries in Europe. Notification of rejected direct debits will also be returned in one file to the transfer agent for reconciliation and follow up.

Processing of subscriptions paid by cheque can also be successfully centralized by means of a lockbox service provided by the cash management bank.

A major benefit is that it is not necessary to have staff located in each country to physically process the cheques. The investor sends his or her cheque to a local PO box (the lockbox). Cheques are collected from there daily and couriered to the bank's processing centre for scanning and data capture. Information about the cheques received in all the countries of distribution is then sent electronically to the transfer agent for reconciliation, while the cheques themselves are delivered back into the local clearing in the country of origin.

Cost-effective redemptions

As for subscriptions, so redemptions and other payments can also be cost-effectively centralized. The transfer agent can prepare a single file of redemption instructions and send it to the bank for sorting into payment types (electronic wire transfers, domestic credits or cheques) and destinations. The bank will then execute the redemptions.

Wire transfers will be made cross-border, via SWIFT. Domestic credits will be re-formatted into the standard required for each local clearinghouse and distributed via the bank's branch network into the local clearing. Cheques will be printed (with a remittance advice) at the bank and mailed to the individual investor or to the distributor as appropriate. Transaction data will be reported back electronically, for easy reconciliation of the redemption accounts.

Net gains

We have argued that re-structuring and streamlining cash management will pay an efficiency dividend in the form of reduced banking fees and lower costs of capital - as well as improved internal processes. We have presented a potential solution, analyzed its critical success features and described the services that make it achievable. Calculating the bottom-line savings that might be achieved from such a re-structuring requires careful analysis of the specifics of the particular business, but the elements that make up those savings are the same in every case.

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