CASHFAC
TECHNOLOGIES

Virtual Accounts

Turning Adversity into Advantage

How the latest technology helps banks adhere to Basel III and empowers corporates

The Calm Before the Storm

Is the banking sector ignoring, or bracing itself in preparation for the latest regulatory changes, and what opportunities exist to turn compliance challenges into advantages?

There is real apprehension about what might happen to the banking sector in 2017/18. Many expect a raft of game-changing legislation to have a long-lasting impact on the industry. Whether opening up payment APIs to third party providers with PSD2, simplifying the payments process across Europe through SEPA or reducing the risk of system-wide shocks with Basel III, all are likely to challenge the dominance of traditional banks.

> Banks have to think like a fintech. Only by using the latest technology and casting away the shackles of legacy technology and processes, will banks secure their future.

Alongside the legislative change, and contributing to a perfect storm of challenges, new and innovative businesses are finding it easier to enter the market and introduce a highly competitive element to banking. Challenger banks have made a big impact in retail banking, and many predict this scenario could be played out again in the corporate or business banking space. Already there are packs of hungry fintech companies poised to snap up business customers when the opportunity arises, taking advantage of their agility and flexibility to quickly roll out products and services that can deal more effectively with the regulatory changes.

There is also a "glass half full" scenario of course, with opportunities to take advantage of the need for change to strengthen relationships with corporate clients. Introducing new and innovative products for businesses - self-service, greater visibility of funds, easy segmenting of accounts to fit in with business workflows.

Undeniably we can expect the banking sector to look very different in the coming years. Some argue there is a serious existential threat for large traditional banks. Are they able to maintain relevance in the market when their solidity and traditions are being challenged and they are confronted by newcomers that focus on delivering precisely what customers want?

Business customers want change. Not only do they feel they are spending valuable time finding ways for their treasury function to operate more efficiently in spite of, rather than with the help of, their banks.

But as retail banking customers they have seen the potential of what can be offered - useful apps, a culture of self-service, an innovative approach to products and genuine competition for their business - and want to see this level of customer experience reflected in their corporate banking.

As this paper finds, some of the most forward thinking banks are ahead of the curve in this respect. They appreciate they need to be responsive to the ever-changing day-to-day demands of a company CFO or Treasurer.

This highlights the key issue faced by business banking today - the strength of focus on the customer, perhaps the weakest link in business banking.

Any solution to the challenges of legislation and agile competition should:

- Be centred on the customer first and foremost
- Respond to their needs and support them in becoming better businesses
- Comply with new regulation
- Respect the tradition and pedigree of the banking sector

This white paper looks at some of these issues and gathers opinions of bankers, corporates, advisors and independent journalists. It focuses on the imminent impact of Basel III, and shows that by using the latest technology, such as virtual accounts, banks can prepare for and overcome future challenges from legislation and fintechs.

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Jeremy Light
Managing Director Accenture Payments, Europe, Africa and Latin America

Anupam Majumdar
Management Consulting Manager, Accenture Payments

Graham Buck
Editor, GT News

Business customers want change... as retail banking customers they have seen the potential of what can be offered and want to see this reflected in their corporate experience

CASHFAC TECHNOLOGIES

A Snapshot of the Latest Thinking

Regulatory changes such as Basel III mean that banks need to address core areas of their governance and compliance activities. Whether it is strengthening banks' transparency and disclosure processes by reporting on each individual bank account, or by improving their ability to absorb shocks arising from financial and economic stress by increasing regulatory capital, it poses a challenge for banks providing services for corporates.

But regulation is also an opportunity. A chance for banks to refocus products and services to respond to what business customers want - greater control, better visibility and processes that are more efficient and cost effective.

In this paper we have interviewed some of the people at the sharp end of business banking, from corporates to banks, consultants to journalists. Together they paint a picture of the challenges, but also opportunities to embrace change at a customer service as well as an operational level.

Graham Buck, Editor of GT News:

"The task of banks to convince their corporate clients that they are robust enough to withstand the impact of a further global financial crisis has become increasingly tough. The biggest hope being pinned on virtual accounts and virtual cash management is that it offers treasurers a viable alternative to notional pooling, the cost of which is being pushed up by Basel III to the point where it is no longer an attractive option."

Anupam Majumdar, Management Consulting Manager, Accenture Payments:

"The most pressing result of Basel III is that banks must shore up extra regulatory capital, especially on liquidity coverage ratios, which will require reporting on the account level. This makes the critically important notional pooling an expensive proposition for banks."

Nick Morrissey, Director, Client Integration, Digital Client Access, Barclays Corporate:

"While virtual accounts help to overcome many of the problems arising from Basel III, the real issue is far wider than client money management. For us it's more about combining this with other payment, reporting and receipt management. This is where there is then an opportunity for banks to build interesting propositions."

The Key to Unlocking Virtual Bank Accounts

What is a Virtual Bank Account and what benefits can they offer banks and corporates?

According to our interviewees, the choice for banks is clear. Either deliver a better customer experience that adds value to their customers' business whilst at the same time controlling costs or lose a very important part of their business. One of the most effective solutions to this very serious challenge, which is also aligned to customer service, is the introduction of virtual accounts.

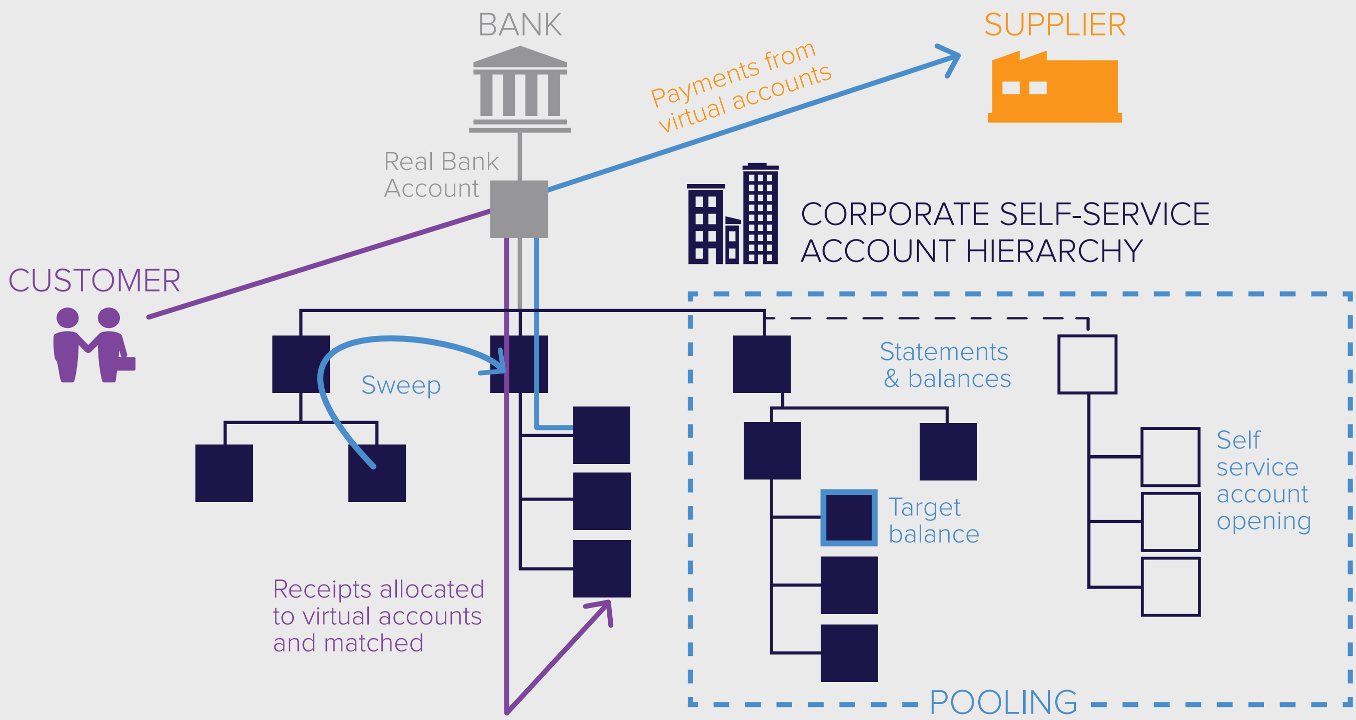
By allowing customers greater control, banks can reduce the amount of administration to service corporate clients whilst delivering a more expedient service. More importantly it can also offer a range of solutions such as an alternative to netting or notional pooling - solutions that Basel III now heavily penalises. This allows banks to reduce costs and their reporting requirements and, as a result, eliminate the need to increase the liquidity reserves they have set aside for Basel III in the future.

So what exactly is a virtual bank account and how can introducing them help banks prepare for Basel III and beyond? But more importantly what are the benefits to corporates, their customers, of shifting to a virtual platform?

With the long list of benefits highlighted on page 7 it is not surprising that virtual banking technology is increasingly being actively demanded by corporates and encouraged by banks. The slow evolution of business banking to incorporate digital channels is accelerating, moving quickly from offering simple statement and transaction data to a broad array of sophisticated integrated payment and receipt services that are now capable of accommodating virtual banking technology.

The best people to ask about the benefits are of course the banks themselves and their corporate customers. In the next sections we hear directly from the banks and businesses that have implemented the technology. They explain how virtual bank accounts are helping banks adhere to the latest Basel III regulations, cut costs and deliver higher levels of customer satisfaction. We also hear how their customers use them to integrate business workflows, increase efficiency and become empowered with new and valuable insight. They share their experience and give real life examples of how virtual bank accounts are transforming corporate banking.

Example of Virtual Accounts in action



Benefits for Banks

Transforms customers' cash management processes and relationships with bank

Dashboards to help better serve clients by monitoring cash operations and offering tailored services

Effective response to notional pooling and reporting challenges of Basel III

Liberates through self-service:

- No longer setting up multiple bank accounts
- Greater efficiency

Fewer real accounts which means:

- Lower costs
- Faster and more flexible service

A platform to offer businesses multiple cash & liquidity services:

- Payments & receivables
- Client money management
- Cash flow forecasting
- Liquidity management
- In-house banking

Capture anticipated payments & receipts and provides a workflow that integrates with specific business processes

Offers unique propositions that can be tailored to meet the cash management needs of a wide range of sectors

Benefits for Corporates

Accounting entries and audit trails generated through virtual account structure for:

- Authorisation requests
- Balance checks

A single account virtualised into thousands of accounts, each mapped to customer definable hierarchies, with:

- Individual account attributes
- Work flows
- Relationship rules

Treasury policies enforced with corporates controlling treasury and cash management tools that feed directly into ERP:

- Interest rate management
- Notional pooling
- Aggregation
- Sweeping
- Target balancing

Primary transactions that can be fully managed:

- Invoices
- Investment instructions
- Contribution schedules
- Payroll deduction
- Rent demands

Delivers “Bank in a Box” concept providing customers with greater control over cash and liquidity:

- Flexible reporting and analytics
- Make smarter decisions more quickly

Able to take into account the value of transactions in the pipeline and proactively eliminate redundant bank balances

Automated systems from payment collection and reconciliation to receipt allocation and matching:

- Saving time and money
- Reducing risk

Dashboards configured to specific industries, bringing together complex data sets from a multitude of sources for an enhanced user experience

A Banking Opportunity

Improving efficiency and regulatory compliance while maintaining relevance in an increasingly innovative environment

The billion pound question for banks is how to deliver what customers demand while at the same time complying with Basel III and future legislation in a cost-efficient environment. Traditional bank accounts have for years forced business clients and banks to come up with a range of techniques to set up structures and systems that provide the capabilities they need to operate effectively as businesses. The practise of notional pooling is one example. But some of these strategies that have become so essential to modern businesses will become a very expensive problem for banks after Basel III.

Graham Buck, Editor of GT News, feels banks have a difficult job ahead of them:

"The task of banks to convince their corporate clients that they are robust enough to withstand the impact of a further global financial crisis has become increasingly tough. The latest stress test by the Bank of England did little to reassure about the health of the UK banking sector as a whole."

> One of the issues banks have to address after Basel III is the need for bank account rationalisation... if they ignore this they will have to deal with large penalties

Anupam Majumdar, Management Consulting Manager, Accenture Payments, explains in more detail how banks are facing up to the new regulatory framework:

"The most pressing result of Basel III is that banks must shore up extra regulatory capital, especially on liquidity coverage ratios, which will require reporting on the account level. This makes the critically important notional pooling an expensive proposition for banks.

"In the short term the impact on the balance sheet needs to be reduced. Many banks are suggesting a range of alternative propositions to their clients. Target balancing, for example, could help them solve this problem, but there are benefits and disadvantages to these alternatives. Target balancing, as an example, does not provide a viable alternative primarily due to the increasing number of sweeps that are required, which if you are a corporate with 6,000 accounts across a subsidiary network, means a big increase in the time and administration needed to get the visibility modern businesses require. Most are at best temporary fixes, so banks are looking for innovation to deliver long-term solutions."

So one of the issues banks have to address after the introduction of Basel III is the need for bank account rationalisation. If banks ignore the problem and seek to maintain the status quo, they will have to deal with large penalties. Typically a medium level bank will be handed a £10-£15 million bill if the numbers of bank accounts they have on their books are not reduced. The cost across the banking sector would run into billions.

But what can banks realistically do to encourage clients with hundreds, or in some cases thousands, of bank accounts to change the way they work and reduce that to a few header accounts? By increasing the use of virtual accounts, both banks and their clients could have better visibility of funds and comply with Basel III regulations for managing liquidity.

Graham Buck, Editor of GT News, feels virtual accounts offers advantages:

"The biggest hope being pinned on virtual accounts and virtual cash management is that it offers treasurers a viable alternative to notional pooling, the cost of which is being pushed up by Basel III to the point where it is no longer an attractive option. Many banks are likely to withdraw their notional pooling services entirely once the regulation is fully implemented in 2018. Digitised banking services enable treasurers to do more with their limited resources and gain greater cash concentration and visibility across the organisation."

To understand how this approach could transform the banking environment, consider the step change experienced by banking in the last ten years. Up until very recently larger corporate customers that wanted more control over their business banking would get an on-premise solution involving installing and maintaining servers at their offices. This was not only difficult to manage and maintain by banks, but in most cases available only to larger customers that justified such an investment. Other smaller clients would have more rudimentary online tools to work with.

A virtual account approach allows banks to tick all of the boxes above, offering customers the control, visibility and workflow integration benefits of the on-premise solution and a lot more besides, while also allowing banks to reduce costs by removing the need for businesses to set up multiple real bank accounts.

Nick Morrissey, Director, Client Integration, Digital Client Access, Barclays Corporate, explains how and why he decided to shift to virtual accounts:

"We have offered a simplified version of virtual accounts to our clients for some time. They are considered equally alongside more traditional online and electronic banking in our stable of products for corporate and smaller customers.

"They have proved valuable in helping our clients take a more holistic approach to cash management. At Barclays we focus heavily on providing the functions to better integrate our customer's workflow with the data produced by the bank. Ultimately our clients want a seamless experience. The more we eradicate the need for a customer to deal with different file formats, uploads and downloads etc. the better that experience."

> Virtual accounts have proved valuable in helping our clients take a more holistic approach to cash management

The impact of Basel III will be felt directly by customers, especially in relation to the bank's customers' client's money - the funds typically held by solicitors and property managers as deposits or bonds. Traditionally these are held in separate bank accounts to create a clear distinction between client and company money. The fact that Basel III penalises banks for holding large amounts of these deposits threatens this practice. These funds are no longer considered part of the bank's working capital, in fact quite the opposite. Banks are expected to hold a liquidity buffer for every pound taken as a client managed deposit. Virtual accounts allow these very different accounts to be consolidated into one account that is split virtually by the client.

Morrissey continues:

"While virtual accounts help to overcome many of the problems arising from Basel III, the real issue is far wider than client money management. For us it's more about combining this with other payment, reporting and receipt management. This is where there is then an opportunity for banks to build interesting propositions. When we use our experience to combine this with a technology platform that is easy to use. This is then an attractive business proposition that clients want to use.

"Over the last ten years there were two main options for Barclays clients. Either interact through a browser using an Account Management Solution (AMS) to make simple cash management activities - make a payment, manage incoming receipts and allocate these in individual accounts. Larger corporates used an Integrated Funds Solution (IFS), these bespoke on-premise solutions that took a lot of time to implement."

The latest generation of virtual account technology has allowed these two very different offerings to be combined into one, more sophisticated product that at the same time is easier and more economic for the bank and customer to deploy.

Barclays are convinced of the benefits from both a legislative and operational perspective and are excited about the opportunity offered by virtual accounts technology.

Morrissey explains:

We see it as a kind of "Bank in a Box" solution. We provide corporates and financial institutions with a banking platform; they can take that and do whatever they want with it.

"We have so many clients in different sectors with such a variety of needs - property management clients that operate in the social housing space, for example, have specific business problems to solve around welfare reform, changes to Universal Credit and how they collect rent from their social housing tenants. We can provide a solution for them.

"At the other end of the scale we have very large multinational corporates that want to set up collection or payment factories and 'payments on behalf of' structures. Again, this meets their needs, it's just how you configure it for these clients.

"We even think we can help fintechs that are looking for a core banking solution - literally a 'Bank in a Box'. Ultimately the capability to create an almost unlimited number of bank accounts that are under the control of our customer is revolutionary. It allows them to make payments from each of those virtual bank accounts, manage incoming receipts or incoming payments, automatically allocating them to the underlying virtual account. They could, if they wished, produce bank account statements on each of those virtual accounts.

"With these three elements you have the underlying structure of a core banking system, which can then be deployed to each customer. They can then act as their own bank, opening and closing virtual accounts as necessary, create a structure of hierarchy of virtual accounts that fits your business needs - however your subsidiaries look, whoever they report into a parent company or sub-entities, you can create a structure that reflects and feeds into that. This gives corporates unprecedented control over their finances."

Delivering Corporate Benefits

Customer driven innovation, visibility and efficiency

While account rationalisation has clear financial benefits for banks, and helps build a stronger relationship with their customers, the direct benefit to those customers promises to be even greater. After years of having to change the way they operate to fit in with a legacy banking structure, the dynamics of this relationship has shifted. The catalyst for this change is increased competition. Business banking customers have for too long not received the level of attention and service their retail counterparts have become accustomed to. But with the increasing success of challenger banks, peer-to-peer lenders and the burgeoning fintech sector competing for their custom, their power is increasing.

Graham Buck, Editor of GT News, highlights how this regulation might benefit business by forcing them to concentrate on services for corporate customers:

“It has been clear for some time that the impact of Basel III has convinced large banks with a presence in many countries to give up their global ambitions, or to become all things to all clients and focus on the business lines where they are strongest.”

Corporates have built complex systems to deal with the idiosyncrasies of the banking system, but in reality they don’t want the hundreds of real accounts they have created. They just want to view their cash position effectively and efficiently, simplifying the process as much as possible. They want to centralise their payment or collection operations in one place and ideally operate one technical platform to achieve this. As a result, virtual accounts are very attractive.

Anupam Majumdar, Management Consulting Manager, Accenture Payments, explains:

“Imagine the scenario of a collections factory of a multinational company with ten subsidiaries, each of these managing their own collections. Every subsidiary is likely to have their own way of doing things. Ten different pieces of software, some using Excel, some using a treasury system or ERP, this complicates the life of the overall group treasurer.

“By implementing a virtual account system they can operate from one account, have instant visibility of collections, and everything is automatically reconciled. Potentially more than 90% straight through reconciliation could be achieved without a team of people manually allocating each incoming receipt to specific bank accounts. The efficiencies that can be achieved when making this change are dramatic and game changing for many businesses.

“With clear and timely visibility of where cash is landing and where cash is pooling it is immediately apparent which subsidiary has an excess of cash and which has a shortfall. Using this instant information treasurers and can develop more advanced strategies. In this case for example the best course of action might be to make an intra-company loan and charge interest, but without this insight, this business decision wouldn’t have even been an option. All this can be achieved from within a virtual bank account by thinking smart and without even touching a bank.”

Standardisation that is being introduced as a result of other legislation is also influencing the services and products corporates are demanding.

Majumdar continues:

“The Single European Payments Area (SEPA), implemented in 2015, has brought increasing standardisation to European business and has been a stepping stone to towards a more centralised treasury function for these businesses.

“The cost efficiencies brought about by SEPA have been driven by standardising formats for payments and recording. Many corporates are now keen to take the next step and are demanding the means to rationalise their treasury to move to a centralised model. They are looking to their banks to provide them with the answers to help meet greater efficiency targets.

“The number one demand from corporates today is to be in control of their cash management. They want a single view of all their cash positions and they want to reduce the effort of reconciling account statements across multiple accounts.

“The wave of digitisation that is happening in banking today, with retail banking being at the forefront, corporate customers are realising they need to be empowered and be in control of their treasury functions. Self-service, popularised through personal banking, is highly attractive to many corporate customers. A streamlined and efficient working capital proposition is what customers want and virtual accounts hit many of these points.”

The number one demand from corporates today is to be in control of their cash management. They want a single view of all their cash positions and they want to reduce the effort of reconciling account statements across multiple accounts.

With virtual account technology we have 35,000 virtualised accounts linking to one main ‘real’ client account and removed the 35,000 accounts we held previously. We are now able to transfer all our money for each of the clients making payments without touching the banking system

How LV= Made the Change

A real example of how Virtual Accounts Transforms Business

One of the UK's biggest Insurers, LV=, has already switched to virtual accounts to simplify their bank account structures and processes. The result has been big operational and financial benefits for their business, reducing banking costs and making their business processes far more efficient.

Andy Young, Head of Finance, LVFS, reveals:

"Before adopting virtual account technology LV= used to operate individual client money bank accounts for every one of our customers, which meant we had opened and managed more than 35,000 individual real accounts with our bank. Logistically this was a problem for us and our bank; not only in dealing with the paperwork to ensure regulatory compliance, the time taken to manage these accounts, but also in routing all the transactions that occurred through the bank systems.

"There was a significant number of transactions that would flow from clients or between our main client account and all the individual client accounts - the latter being effectively internal transactions that would have to go through the banking system on a daily basis and attract associated charges.

"With virtual account technology we have 35,000 virtualised accounts linking to one main 'real' client account and removed the 35,000 accounts we held previously. We are now able to transfer all our money for each of the clients making payments without touching the banking system. We don't need additional bank accounts with the bank, we now have one account which we split using virtual accounts.

"This has freed up a lot of transactional processing from the bank, removed a large element of administration that we had to do with the bank and it has also enabled us to take the overall pot of money and diversify the risk across our bank relationships, reducing the exposure of our clients. On top of this we have minimised a large amount of IT resource in our company.

"Originally we were planning to gradually introduce the system, keeping some accounts while testing and migrating others. But the systems were robust so our view was that the 'big bang' approach, moving all 35,000 accounts overnight, was just as easy. More than 35,000 bank accounts with in excess of £100 million of funds were transferred on a Friday night, with all glitches ironed out and checks and balances completed by Monday morning.

"Virtual accounts have transformed the way we do business and shows that banks can't stand still when faced with innovation. It mimics the low cost airline industry. Things will inevitably change, it's just whether that change will be too quick or slow enough for you to keep up. Fintech companies are generating new ideas all the time. When someone has that great idea an entire industry can be wiped out overnight unless it adapts."

This is an example of how corporate customers are demanding the level of service innovation previously offered only in their personal bank accounts. The banks that are offering this already are not only taking great strides in preparing for Basel III, but also galvanising relationships with customers and demonstrating a compelling balance of traditional reliability, experience and understand that comes with being an established bank, with the innovation and customer focus more often associated with challenger fintech companies.

Seizing Opportunity Through Innovation

Respond to the regulatory challenge by putting customers at the heart of the business

While solidity and consistency is a trait that is highly valued in normal circumstances, flexibility and adaptability are perhaps the most valuable qualities during a storm. Most people and organisations don't respond well to change, especially organisations that operate in an industry where traditions and history are held in such high regard. While Basel III is a current challenge, there is a big opportunity to address wider issues and create a solid foundation that will also enable banks to weather future storms.

For large traditional established banks to navigate the obstacles that lie ahead they will need to embrace change more than ever before. Innovation and the ability to adapt quickly must be built into the fabric of every organisation that wants to survive in the digital environment and banking is not excluded from this. Industries that have sat behind high barriers to entry are seeing those defences against newcomers eroded by digital innovation, and none more so than the financial sector. The most effective technological innovations being implemented today are those aimed at customers. To survive, the customer will need to be at the heart of any strategy by large established banks.

This is only the start of the process for business banking and the appetite for innovation developed at this formative stage will set firm foundations for the future of the banking industry. Whether banks hold back from offering the dizzying array of services to such a wide range of people or organisations, choosing instead perhaps to retreat to the areas of business where they have most competence or experience, to consolidate their position is yet to be seen.

We can be certain that the future will bring opportunities that would have been unimaginable a short time ago. Banks that aren't already preparing for these new opportunities will find it difficult to exist in this new reality, while those that have embraced this change will have a competitive advantage. Virtual bank accounts represent the solution banks can use to seize the initiative. They offer a unique proposition that helps both banks and their business clients benefit financially and operationally.

The real challenge for larger banks is to maintain the best of their traditions while championing change for the customer. Tradition is a quality only they can portray with authenticity and is a critical unique selling point that can't be surrendered. But they must also act and react like the very fintech companies that threaten their dominance. Paradoxically perhaps, the only way for the traditional banks to maintain their position is to innovate and implement radical change with a laser focus on customers.

The most effective and efficient way to achieve this is by introducing virtual bank accounts. They respond to each of these challenges, and more. Banks can retain their authenticity, their traditions of security and safety, while also responding to constantly evolving customer expectations. They allow innovation in products and services, while also reducing cost for banks and customers alike through efficiency savings and responding to regulatory requirements.

If you want your business to experience the benefits of this new approach to banking please contact Cashfac to find out if your bank offers a virtual account service for their corporate customers.

The question you should be asking is not whether to adopt virtual accounts… but if any bank or business can afford not to.

About Cashfac Technologies

Cashfac has more than 600 users that implement virtual accounts in very different ways, whether to separate client money from company funds, to distinguish between subsidiaries, or to reduce thousands of accounts to one underlying account to drive efficiency and cost control. The platform is highly flexible and Cashfac can advise on how you can offer a compelling solution for your customers. For more information, please contact Cashfac's Head Office on **+44 (0)207 920 0617** or visit **www.cashfac.com**.

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Cashfac Technologies is a market leader in Bank-to-Corporate Cash Management solutions. Banks around the world white-label Cashfac Virtual Bank Technology® (VBT) to acquire and retain customers; securing loyalty, increasing deposits and driving transaction revenues. A wide range of cash management solutions are delivered through Cashfac's VBT platform including; Receivables Management, Cash Flow Forecasting and Client Money Management. Corporates that utilise Cashfac's technology achieve greater transparency, control and compliance over their operational cash.

For more information on Cashfac
contact info@cashfac.com or visit www.cashfac.com

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