

Global Cash Custody - Thinking Outside the Silos

Does your bank think outside product silos? Do you already have an integrated view along your product value chains? If you were working in payment services or in the cash business stream in general, your answer would most probably be “No”. Now that new banking initiatives such as Continuous Linked Settlement (CLS) have been introduced, more countries are joining Euroland and the overall regulatory requirements are - at a high pace - becoming more and more demanding; the dynamics of the payments business have changed dramatically. It is time for a new vision: the Global Cash Custody Concept. What, though, does this buzzword mean? What are the drivers and implications on the demand- and the supply-side? What does it signify for the banking industry?

New drivers increase the pace of change in the cash business

The Euro has, so far, replaced twelve national currencies, and transformed the way banks manage their nostro network. It triggered the first wave of nostro-consolidation. Banks began balancing the positive effects of reciprocity with the cost advantages of a lean correspondent network. The next push in this direction came with the introduction of CLS in Fall 2002. Because the vast majority of the financial community participates indirectly in CLS as Third-Parties of Settlement Members, the door to consolidating cash streams with one provider has been pushed wide open. In addition to these developments arising from within the commercial banking industry, rules and regulations have become the driving force

for change. Basel II (introducing the measuring of and provisioning for operational risk) and the OFAC compliance rules force banks to invest in new systems and processes. On top of this, new initiatives like SEPA (Single European Payments Area) and the European Union rules and regulations for cross-border payments increase competition and decrease margins in the payments area.

The cash stream receives increased management attention

Driven by the above-mentioned developments, the payments area has started to pop-up more prominently on the screen of management sensitive to cost/income ratio. The challenge is to find a balance between focusing on core competencies, cutting costs and at the same time improving reliability and service quality. For small-to medium-sized banks this means to either optimize and maintain existing infrastructure, merge or share infrastructure with other banks, or completely outsource non-core activities. Potential partners must cover a broad part of the value chain in order to maximize the effects of economies of scale and use of know-how. The partner of choice has to become a custodian for cash.

What is Global Cash Custody?

The Global Cash Custody concept includes the administration of worldwide cash streams and the management of the resulting currency positions. As its name implies, it is the adaptation of the Global Custody model, however the underlying instrument is cash instead of securities. This covers more than the processing of

payment orders and goes on to connect the areas of Foreign Exchange, CLS, Cash Clearing, Treasury, and Liquidity & Collateral Management. Global Cash Custody, being a relatively new business model, has implications on the demand- as well as on the supply-side.

What does it mean for the demand-side?

The main drivers on the demand-side are economies of scope, in this case defining and concentrating on the core competencies of the bank and getting rid of the “noise”. Connecting with a strong provider and its buying power allows the client to participate in economies of scale and the positive effects of economies of speed, i.e. the lead-time to keep abreast of the latest developments in the industry. Global Cash Custody, however, is not only a matter of internal and external cost reduction, rather it also forces new thinking on the demand side. There is growing evidence that neither the back nor the front office is purchasing independently anymore. This does not mean standard services will be purchased; instead a balance must be struck between the benefits of best of breed solutions and the high cost of their integration along the very same value chain. The selection of a Global Cash Custodian involves several departments and cultures within a buying bank. A case in point is CLS: classical investment banking streams like Foreign Exchange must co-ordinate their approach with wholesale cash, taking into consideration the needs from the retail and corporate side. Old structures have to be torn down, and new information channels established. Only if all stakeholders along



Connecting with a strong provider and its buying power allows the client to participate in economies of scale

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the value-chain can agree on a provider, is successful outsourcing guaranteed. The decision-making process is a chance to form within the bank a common understanding of its core competencies, value proposition and positioning in the market.

What does it mean for the supply-side?

The striking arguments for offering Global Cash Custody on the supplier's side are benefiting from economies of scale and making optimal use of existing capacity and processes. In the future, market-leading providers of wholesale cash products and solutions will have to further align and bundle their Foreign Exchange and payment activities to increase client retention through offerings along the entire value chain.

To prove successful, providers must ensure that the integration of their offering forms a critical element of the product development process. This is in contrast to the widely spread focus on back-

ward integration. It requires thinking beyond boundaries, and senior management focusing on removing product silos and beginning to measure and monitor the cross product interactions and revenue linkages. Offering Global Cash Custody means combining the classical products in the way it best suits the customer and ensuring smooth interaction along the value chain. Significant human investments have to be made to change the sales spin. The sales force must possess an inherent awareness of the drivers for integration and need to understand a product offering that is likely outside of their "comfort zone". In short, the sales force must expand their classical role to encompass an advisory role. Leaving this "comfort zone" not only applies to the sales force but also to Credit Risk Management, operations and customer service.

What does it mean for the industry?

Breaking out of the existing structures and "silos thinking" on both the demand

and supply side, is a challenging but rewarding exercise. Thinking outside the silos catalyses speeding up the transition processes which other industries have already undergone. Carmakers produce only about 25% of their parts in-house. Delivery models such as "just in time" have evolved. Small to medium-sized banks can be considered as premium brand carmakers: they have the core competence to service their clients best; they buy the high quality components to build a premium product and outsource the costly development of generic parts. Although the Global Cash Custody Concept requires new thinking on the demand- as well as the supply side, the way business is done does not change - it continually remains a people's business. In the Cash Custody world it just becomes even more about partnership.

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