

# The treasury function at asset managers – Evolving to a more centralized model

Economic trends and regulatory reforms are creating pressures on asset managers to provide greater control, reduced cost and increased performance in the firm-wide management of cash and risk. Companies are also striving to increase profitability in mature markets and are exploring new markets to grow revenues.

Against this backdrop, managing global cash positions and risk exposures has taken on an increased significance and complexity, and the treasury function has an increasingly central and strategic role to play. To achieve their objectives, the treasury function is evolving towards a more centralized model, supported by advances in technology and the services of global banks.

Treasurers need to select the centralization strategies which deliver the greatest benefits, set against the costs and time required to implement. This article discusses where to focus and the key factors in a successful implementation.

## TABLE OF CONTENTS

What's on your mind?.....	2
The way we were (and some still are).....	2
What "world-class" does .....	2
Why centralize? .....	3
How to get there .....	4
Setting the vision .....	4
Treasury front and center.....	4

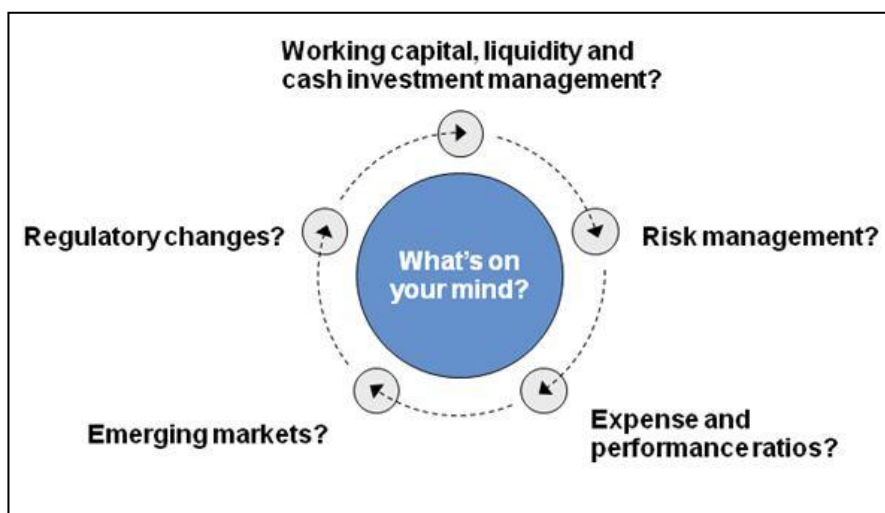
## What's on your mind?

Asset managers in Europe are facing a confluence of short term and longer term environmental challenges – the proverbial “perfect storm”? Regulatory reforms such as MiFID II, AIFMD and FATCA require increasing amounts of capital to be set aside and are driving up the costs of compliance. At the same time, economic and political uncertainties are impacting both market returns and investors’ appetite for risk assets. The longer term compression of fees and margins is making smaller funds uneconomic and accentuating the need to bring in more assets. Against this backdrop, as asset managers strive to sustain profits in mature markets and to grow profitably in new markets – while controlling risks – the treasury function has an increasingly central and strategic role to play.

## The way we were (and some still are)

In many asset managers, Treasury has not always been a discrete department and instead its core functions were run as an unconnected collection of activities within Finance. Typically, these functions had little access to purpose-built technology, no oversight of the firm’s global activities and positions, and incomplete, inaccurate and delayed exposure reporting capabilities. The 2008-9 financial crisis highlighted the threat to corporate survival posed by this lack of sophistication.

At J.P. Morgan Treasury Services’ Asset Managers Forum Roger Turner, Group Treasurer at Schroders PLC, described the situation at Schroders when he took over in 2009. “Reporting and analysis were almost entirely conducted on spreadsheets and we had limited real-time information. Counterparty analysis was cumbersome to collate and there was no overall treasury strategy which directed the activities of our overseas offices. Our information systems relied upon manual input and the lack of a single source for data led to duplication of effort.”<sup>1</sup>



Roger has transformed Schroders’ treasury function since then and many asset managers have also made progress. However, in several respects the treasury functions at asset managers still have some way to go before they can be judged world-class.

## What “world-class” does

To achieve improved returns and reduce both costs and risks for the firm, the treasury function at an asset manager needs to address a range of cash and risk management objectives. This section further develops the five key themes discussed at J.P. Morgan’s Asset Managers Forum.

### 1. Visibility and control over cash in all legal entities

A well-planned approach to liquidity management is an essential part of ‘future-proofing’ the firm’s short term assets. Timely reporting on firm-wide cash positions, leading to a consolidated view of all bank accounts globally, is the starting point. The treasury function should have oversight of all sources of cash, not just working capital and strategic balances. Oversight should also encompass cash awaiting investment or redemption, residual cash as a result of securities clearing and settling, unencumbered cash collateral for derivatives, segregated cash

and portfolio cash.

Best practice is to segment corporate cash into operational positions, discretionary cash and balances held for strategic purposes. Funds should be invested to achieve the maturity and risk requirements of each pot.

Cash flow forecasting is essential for position management as it enables treasury to proactively manage cash and counterparty positions and it underpins rules-based investment solutions for optimizing returns on excess cash.

### 2. Maximum use of internal cash

A primary method for increasing funding efficiency is to maximize self-sufficiency, using sweeping and pooling to offset the cash balances of some entities against the funding needs of others. In addition, pockets of cash should be aggregated into market-size amounts so as to achieve market yields.

Where exchange controls, tax, legal or regulatory requirements prevent the movement of funds or the commingling of fiduciary and non-fiduciary funds, returns on cash balances can be enhanced through banks’ interest optimisation programs, which offer improved rates by taking a portfolio view of cash held in multiple currencies and jurisdictions.

<sup>1</sup> J.P. Morgan Treasury Services, Asset Managers Forum, Edinburgh, November 2011

### 3. Effective risk management

Among asset managers, the trend to a wider spread of international activities amplifies the need for reporting systems that offer visibility and control of risk exposures. Volatility in the financial environment has increased the need for accurate reporting with minimal time lags, combined with the ability to act quickly.

Counterparty risk management was a key theme at J.P. Morgan's Asset Managers Forum, where speakers identified key elements in managing counterparty risk. Chief among these were the establishment of a governance model, aggregating exposures by counterparty arising from all sources, developing a top 10 watch list, limiting the number of acceptable counterparties and close cooperation with the compliance department.

### 4. Bank relationship rationalization

Counterparty risk mitigation through diversification tends to drive up the number of a firm's bank relationships, as does a need for local bank services and expertise across many markets. In the latter case, costs can be contained by implementing global structures supported by the networks and value-added services of regional and global banks.

However many bank relationships maintained by treasury, the number and structure of accounts should be rationalized. The Hackett Group estimated in 2009 that Global 1000 companies with world class treasuries operate with 44% fewer accounts per \$US 1 billion revenue than their peers (20 vs. 36 accounts), saving on average more than \$US 5 million per year in the process<sup>2</sup>. At Schroders, Roger Turner has focused upon building global relationships with a core group of banks and therefore rationalizing both the number of banks with whom he deals and the number of bank accounts that are maintained.

### 5. Operational effectiveness

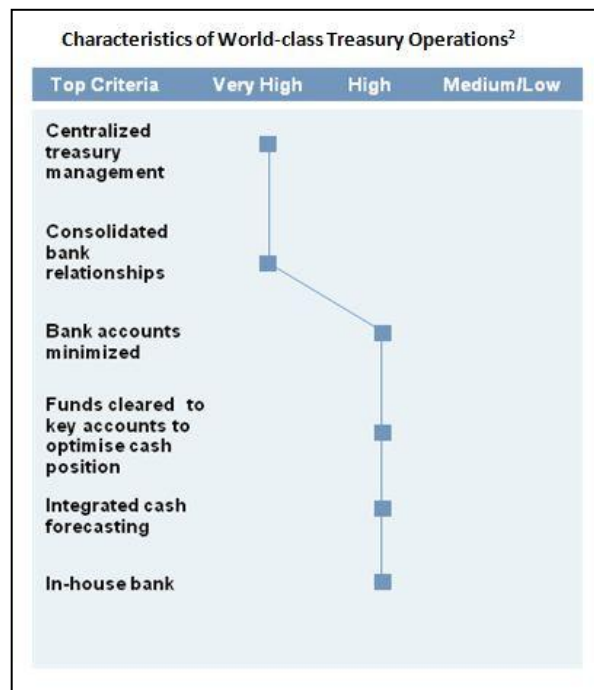
While a few asset managers are somewhat vertically integrated, more typically major parts

of the investment and investor management chain are outsourced, from wealth advisors and funds supermarkets, though third-party asset managers, to transfer agencies, fund administrators and custodians. This creates frictional costs and reduces asset managers' direct influence on overall cost levels. The firm should negotiate fees with third parties through a centralized buying function, to which Treasury should contribute with a view to optimizing resource allocation and ensuring good

governance. In addition, the treasury function is an area that can directly contribute to firm-wide cost control by driving both efficiency and low error rates in its own processes.

The importance of the interoperability of treasury systems with other internal and external systems was highlighted at J.P. Morgan's Asset Managers Forum. Automation is a key step towards these goals: Hackett estimates that best-in-class practices can reduce treasury processing costs by a third<sup>2</sup>. Manual, paper-based and disconnected processes are not only costly but are also prone to error and fraud. Approvals for fund transfers, segregation of duties, data encryption, bank reconciliation and accounting entries can all be embedded into automated workflows which integrate bank interfaces, treasury functionality and accounting systems. Such integration reduces both cost and operational risk.

Treasury Management Systems (TMSs) can cost several million dollars and take several years to implement, but when well-executed they pay for themselves in a short time frame. Roger Turner estimates a payback period of nine months for Schroders' TMS but his main driver for change was to improve the transparency and control over day-to-day operations. However, not every



firm can afford the up-front cost and as an alternative, banks' internet portals offer value-added services for automating many functions, including cash flow forecasting, payment file management, intercompany payment netting, account reconciliation, and liquidity and FX management.

## Why centralize?

The Hackett Group assessed the characteristics that explain world-class treasury performance. They found that operating as a centralized function is one of two key characteristics of world-class treasuries<sup>2</sup>. Moreover, centralization is a pre-requisite for the achievement of other characteristics identified by Hackett as being "very high" or "high" in importance (see chart).

To consolidate global cash positions, both current and forecast, and to take firm-wide action on the opportunities and threats that become apparent, requires at the very least co-ordination from the center, but more likely centralized ownership of reporting, forecasting and the resulting actions. However, as the audience at J.P. Morgan's Forum heard, local knowledge should still

<sup>2</sup> "Best Practices Enable Phillips Treasury to Minimize Risk, Maximize Value During Tough Economic Times and Beyond".  
The Hackett Group, June 8, 2009

play an important role: Schroders relies on local management forecasts, while at another major fund manager International Treasury depends on local staff to recognize abnormal flows.

Treasury needs to build a centralized view of exposures to each type of risk, even at firms where portfolio managers run their own FX strategies. Moreover in risk management as in other areas, the scale of a centralized treasury enables specialization through investment in expertise and tools and technology that would be uneconomic in local operating companies. Similar considerations apply to liquidity management, where maximizing self-funding requires centrally-designed and operated account structures. Schroders use automated sweeps to bring in-country balances as close to zero as local regulations allow.

UCITS IV and SEPA (Single European Payments Area) regulations combine to create significant opportunities for achieving efficiencies in Europe. Asset managers utilizing Management Company Passport and Master/Feeder structures under UCITS IV can minimize the number of local management companies and achieve increased economies of scale and lower operational costs, although the lack of tax harmonization remains a hurdle.

In parallel with UCITS, the integrated euro payments market under SEPA will make all euro payments domestic within 32 European countries. In February 2012, the European Parliament passed into law the End-date Regulation for the migration to SEPA payment services of all euro credit and debit payments by 1st Feb 2014.

By taking advantage of consistent payment and collection methods within the legal framework of the PSD (Payment Services Directive), asset managers can rationalize their account structures and introduce pan-European centralized payment and collection functions to boost efficiency. For example Group Treasury at one European asset manager operates a Shared Services Center in Dublin which centralizes corporate payables in selected jurisdictions.

## How to get there

An outdated treasury management function cannot achieve sophistication overnight. The new structure and systems at Schroders, for example, are the result of two and a half years' work, including one year to install the TMS. To evaluate the relative priority of functions to centralize, asset managers should balance the benefits of centralizing each function against the complexity of centralizing the function.

Following this evaluation, liquidity management is usually the initial priority. The returns to centralized management - in the form of lower funding costs and increased yield, as well as the ability to limit the impact of capital controls and other impediments by moving money quickly between jurisdictions - are relatively high. On the cost side of the equation, the implementation of liquidity solutions can be facilitated using banks' advisory services and internet portals, which offer cash flow forecasting, multi-bank reporting, assistance with establishing and maintaining complex liquidity structures and intercompany loan management.

FX management is another candidate for early adoption of centralization, since rapid risk identification and mitigation offer vital benefits in times of financial turmoil and treasuries can take advantage of proprietary systems and bank modules to implement relatively quickly and inexpensively.

Setting up payment factories and centralized collections may be more complex and therefore left until later in the process, unless the firm has already organized its business in Europe on a hub and spoke basis.

## Setting the vision

Whichever functions are being centralized, best practice is to first set the vision and get buy-in from the board. Implementation should begin by re-engineering, automating and standardizing processes, procedures and policies in the existing decentralized model before they are transferred into a centralized treasury environment. To gain local

management's acceptance to changes, it pays to prove the concept and demonstrate the benefits in a single country or region before replicating or scaling the solution in other markets or regions.

## Treasury front and center

The treasury function has an increasingly strategic role to play in helping the European asset management industry to sustain its profits and move into new markets. By implementing centralized solutions and structures which provide group-wide efficiencies, visibility and control, the treasury function will provide substantial benefits to asset managers at a critical time.