

yield, liquidity, risk

Which Is Your Top Priority?

When formulating a cash investment strategy that fits your specific needs, is yield more important than liquidity? When focusing on risk, what's the trade-off on return? Is ready access to assets the primary objective? In light of a new regulatory landscape and market demands, many financial institutions (FIs) are examining the relative importance of yield, risk and liquidity to their organizations.

From Basel II to UCITS III, ever-changing regulations are a primary factor driving the way FIs manage cash assets now and into the future. The demands are a bit different with each — while Basel II, for instance, renews an emphasis on operational risk and regulatory capital, UCITS III calls for tightened controls around diversification.

These regulations have added a new dimension to a process that is already undergoing extensive reevaluation. Unprecedented levels of cash, increasingly complex cash investment portfolios and a focus on how corporate policy is driving controls and choice of investments have led treasurers of FIs to cast cash assets in a different light. Often considered simply a consequence of doing business, cash is now increasingly viewed — and treated — as a strategic asset that both hedges against market volatility and opens the door to business opportunities such as mergers and acquisitions.

Now more than ever, bank treasurers are engaged in a balancing act of *enhancing yield, optimizing liquidity* and *controlling risk* in their cash portfolios, while looking to enhance efficiency in the overall investment process. And increasingly, chief operating officers are involved in cash strategies, focusing on the issues of operating, settlement and liquidity risks. To ensure a solid investment strategy that truly meets the needs of the organization, FIs should consider which of these priorities is of utmost importance and make decisions about the other two in that context.

The objective is a multidimensional approach for managing cash strategically and efficiently, both for the overall portfolio and for the different types of cash within: operating cash, cyclical cash and long-term cash.

Regardless of whether the top priority is yield, liquidity or risk, the FI's banking partner should be able to meet that primary need while fulfilling the requirements for the other two. An integrated solution that addresses all these issues may encompass:

- ▶ Information reporting that provides a single consolidated view of the global cash position to facilitate decision-making, as well as appropriate cash concentration tools to optimize liquidity and improve efficiency across the client's network of branches and subsidiaries.
- ▶ Solutions that provide risk management capabilities relating to operating, credit/counterparty, liquidity and settlement risk. To diversify risk, and at the same time gain efficiency, and FI should look to its banking partner to provide highly configurable, automated investment capabilities. For added risk control and efficiency, FIs are increasingly opting for investment solutions that enable them to establish the parameters for investing — including risk tolerance, duration, counterparty selection and types of vehicles — while leaving the execution to their partner.
- ▶ Selection of investments, enabling the FI to customize investments according to its guidelines for yield, liquidity and risk. The banking partner should offer investment options for each of the three key building blocks of a cash portfolio: for operating cash, liquid investments such as money market funds (which are likely to become increasingly attractive to FIs under Basel II); for cyclical cash flows, time deposits, enhanced yield funds and fixed income instruments; and for long-term cash, fixed income securities and separately managed accounts.

At the end of the day, a financial institution and its banking partner should be able to turn strategy into solution — satisfying both regulators and its own priorities. ○○○