How to Optimize the Benefits of In-House Banking

In-house banking plays a crucial role in helping corporates to achieve operational efficiency, financial optimization and effective risk management. Tools such as Virtual Accounts can deliver these benefits quicker and easier than ever, writes Carolina Prieto, Core Cash Global Market Manager, Citi Treasury and Trade Solutions.

Carolina Prieto
Core Cash Global Market Manager, Treasury and Trade Solutions, Citi

Companies around the world face increasing headwinds to growth, heightened volatility and growing uncertainty over a potential trade war between some of the world's most important economies. In response, many corporates are seeking to improve efficiency by centralizing core treasury functions and aggregating subsidiary transaction flows and risks. An In-House Bank (IHB) is a key construct in achieving such benefits.

IHBs are structured as a separate legal entity and are usually managed by a multinational group's regional or global treasury. They operate across a range of functions, such as cash concentration, foreign exchange and funding. IHBs manage their own profitability and financial position and act in a similar way to a bank for group entities – subsidiaries transact with the IHB at arm's-length and the IHB and group subsidiaries maintain intercompany loans and accounts.

By sitting between the group's various financial service providers, financial markets and group entities, IHBs can concentrate treasury activities, reducing the volume of external FX and cash transactions and the number of bank accounts and relationships, helping to lower costs. Aggregation of transactions also reduces reconciliation volumes, improving operational efficiency, and can optimize negotiation positions with financial service providers.

Many companies have surplus liquidity in one location but need to borrow in another; an IHB makes it easier to optimize liquidity group wide, lowering overall borrowing levels and maximizing returns from investing surplus cash. As well as generating efficiency and financial benefits, IHBs provide an opportunity to adopt standardized and automated financial processes and tighter controls, improving visibility, control and risk management across liquidity, FX, interest and counterparty risk.

A step-by-step approach

Putting an IHB in place takes time. The results of Citi Treasury Diagnostics, a benchmarking survey based on inputs from over 800 large corporates, shows corporations tend to build out their IHBs in stages. These stages typically include:

1. Establishing a finance company focused on segregated liquidity management (with no co-mingling) and intercompany netting;

2. Centralizing liquidity management across entities and currencies, external investments, and cash forecasting and risk management;

3. Integrating with legal entities for intercompany netting and on-behalf-of (OBO) structures, such as payments-on-behalf-of (POBO) and receivables-on-behalf-of (ROBO). OBO structures allow corporations to leverage their infrastructure to achieve an even greater level of centralization by concentrating operating flows at treasury level. An in-house bank manages payments and collections from a master account on behalf of subsidiaries in a region or globally.

Stage 1	Stage 2	Stage 3
Finance company: focused on intercompany netting	Centralizing liquidity, investment and risk management	Integrated with legal entities having on-behalf-of (OBO) structures

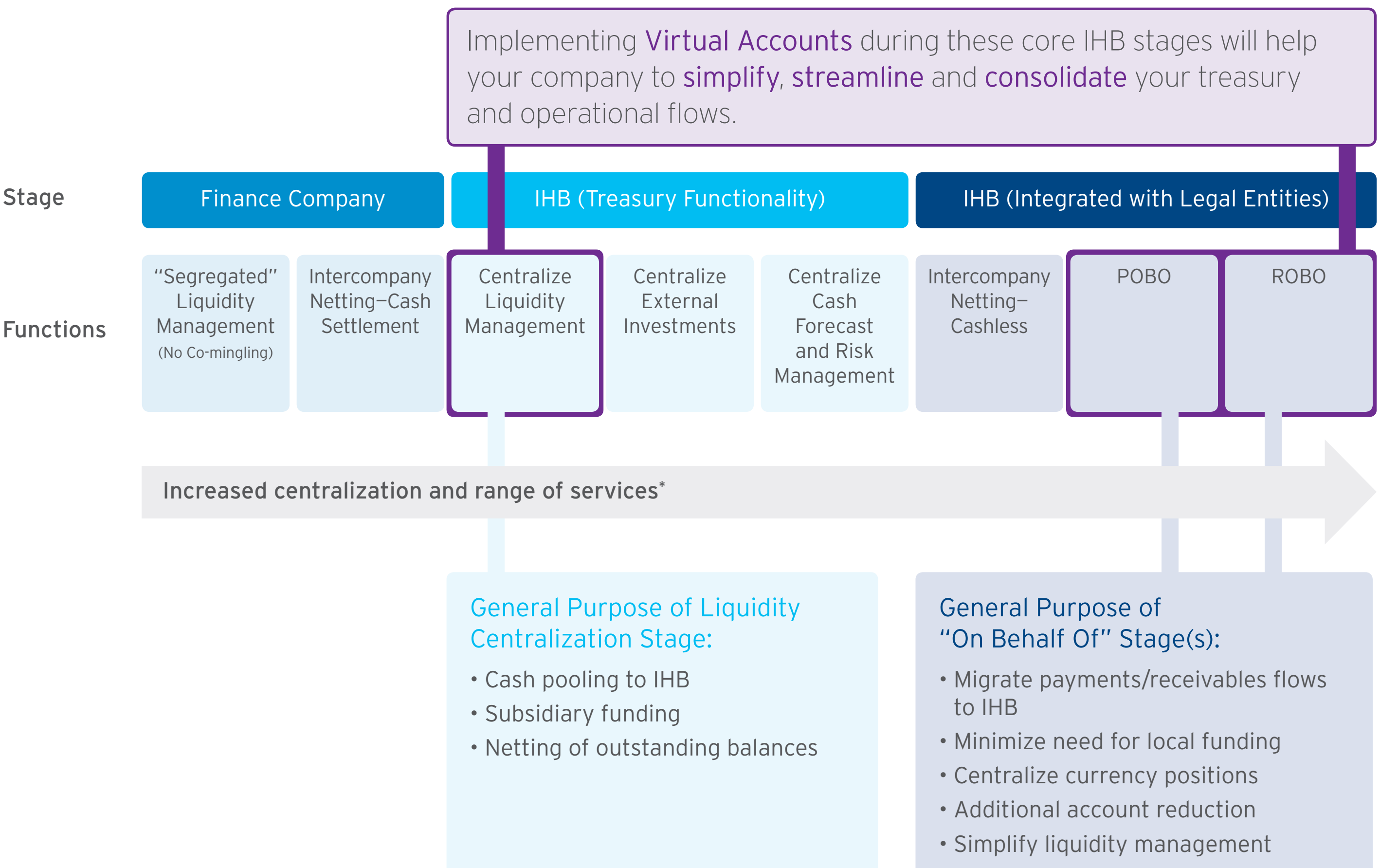
Accelerating the benefits of IHBs

The stages described above remain logical steps for companies to realize the operational efficiency, financial optimization and risk management benefits of an IHB. However, sophisticated banking and integration tools, such as Virtual Accounts, are making it easier and faster for corporations to simplify, streamline and consolidate their treasury and operational flows.

Virtual Accounts resemble traditional bank accounts, with a specific number designating a specific account. However, rather than being individual physical accounts, these numbers are instead simply used to segregate flows relating to a single physical account. This physical account is in the name of the IHB; Virtual Accounts are established in the name of various operating legal entities.

Virtual Accounts are valuable in IHB stages 2 (treasury functionality) and 3 (integrated with legal entities) as outlined in the graphic below.

Application of Virtual Accounts in IHB Stages



*While IHB functions are set out here sequentially, these stages can be re-ordered based on your company's own strategic objectives of IHB set up. The above depicts a visual of a more common IHB progression based on Citi Treasury Diagnostics results.

Implementation of Virtual Accounts reduces the number of physical accounts needed and the number of physical sweeps between accounts.

Stage 2: Liquidity centralization

Virtual Accounts can help with liquidity centralization by minimizing the number of sweeps needed to centralize liquidity in a cash pooling structure. Companies often have multiple bank accounts for the same legal entity in order to differentiate between Accounts Payable or Accounts Receivable flows, or indeed flows related to different projects or business lines. Virtual Accounts can be leveraged to segregate these flows under the same legal entity without the need to open separate physical bank accounts. Even if multiple physical accounts are already open, Virtual Accounts can support with bank account rationalization and the minimization of sweeps.

Stage 3: The role of Virtual Accounts in OBO transactions

Virtual Accounts also facilitate process and create benefits within the third IHB stage, where an IHB is integrated with legal entities using an OBO structure — payments are made from, or received into, Virtual Accounts and can therefore be easily differentiated. By supporting the migration of payments and receivables flows to an IHB, Virtual Accounts minimize the need for local funding to support payments, centralize currency positions into IHB, allow for a reduction in the number of accounts held, and simplify liquidity management.

When POBO payments are made from a Virtual Account, they go to the beneficiary in the name of the underlying entity and therefore provide the beneficiary with full payer details. Similarly, when payments are received into a Virtual Account (ROBO), the IHB has absolute clarity of the entity these payments are destined for.

Implementation of Virtual Accounts reduces the number of physical accounts needed and the number of physical sweeps between accounts. Virtual Accounts also instantly reflect changes in balances of IHB accounts, which results in improved liquidity efficiency for the corporation.

The use of an IHB structure and OBO payments without bank-provided Virtual Account structures potentially limits the amount of information available, which makes reconciliation difficult both for payments (for beneficiaries) and receivables (for the IHB).

Without the use of a bank's Virtual Accounts, ROBO payments go directly into the IHB account and may not have the details that make it clear where payments are directed. Similarly, although POBO is supported by internal IHB accounts within an Enterprise Resource Planning (ERP) platform, the specific payment beneficiary details are usually entered in the Transaction Reference Details, which may not always be forwarded to the beneficiary. Consequently, reconciliation can be time consuming and complex for the beneficiary.

Integrating Virtual Accounts into ERP and TMS platforms

Accounting principles have historically allowed for accounts to have sub-accounts, traditionally to manage internal accounting structures for inventory, payables or receivables. This principle is leveraged to aid reconciliation by having Virtual Accounts linked to the physical account structure of the IHB through ERP and Treasury Management Systems (TMS), many of which now support Virtual Accounts. The account structure hierarchy is essentially the same across the bank platform and the ERP or TMS, making one-to-one reconciliation straightforward.

By linking Virtual Accounts with the physical account structure of the IHB through ERP and TMS, it is possible to automate reconciliation of receipts and payments, in turn improving days sales outstanding and increasing the working capital of a company. It is critical to ensure the configuration of Virtual Accounts in the ERP or TMS platforms match the set up at the financial service provider. Any mismatch may jeopardize automated reconciliation.

It is critical to ensure the configuration of Virtual Accounts in the ERP or TMS platforms match the set up at the financial service provider. Any mismatch may jeopardize automated reconciliation.

Choosing the right partner

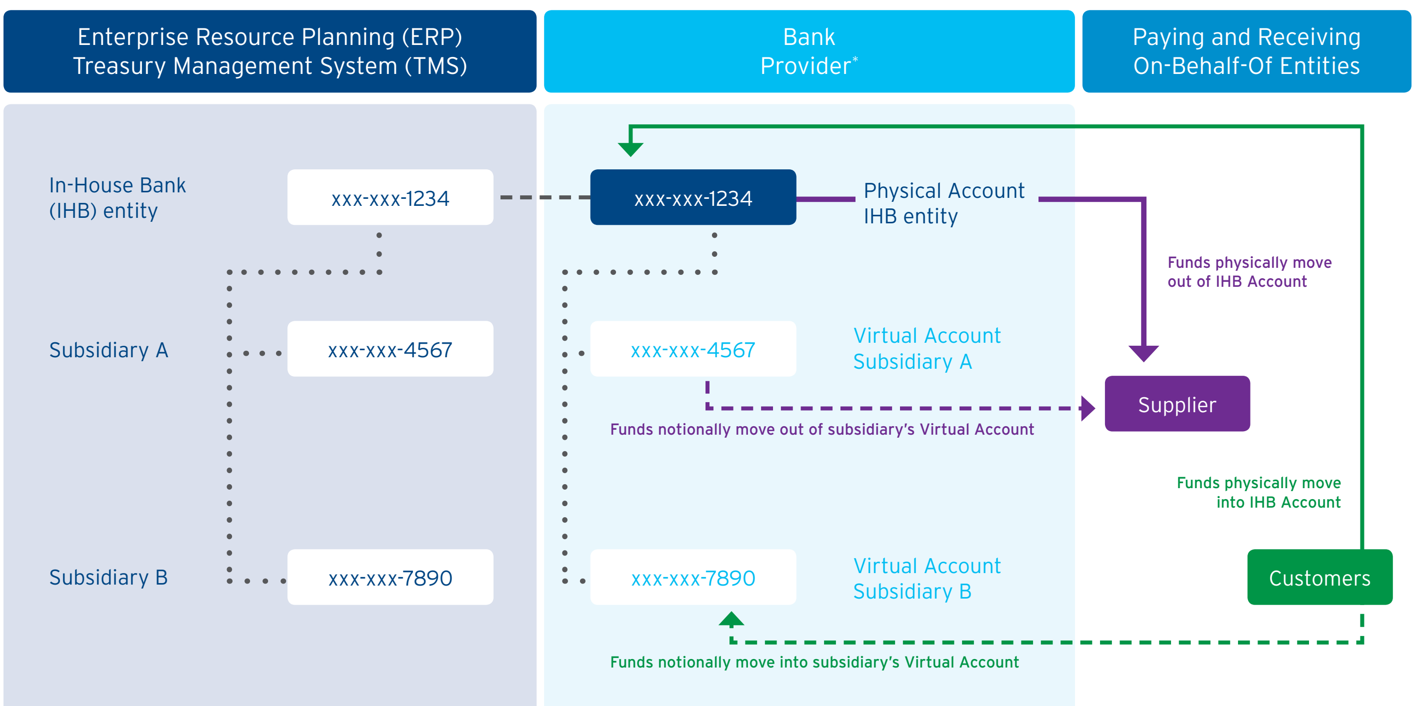
Virtual Accounts and supporting services have the potential to transform how companies manage payables and receivables through IHB solutions. Benefits include reduced costs and improved working capital as a result of account rationalization, easier reconciliation and instant access to liquidity. Visibility, information sharing and reporting are also enhanced as all debits and credits from multiple subsidiaries are visible in a single entity (the IHB). As ERP and TMS providers continue to partner with financial service providers to develop and expand these solutions, companies will be able to achieve further benefits.

Corporates seeking to gain the advantages of Virtual Accounts for POBO and ROBO through an IHB structure need to ensure they work with the right banking partner. While a number of global and regional banks now have Virtual Account capabilities, their functionality and potential for integration into ERP and TMS, which is essential to optimize visibility, control and efficiency, differs widely between banks.

Citi Virtual Accounts leverages the strength of Citi's on-the-ground presence while delivering a globally consistent offering; the solution is live with clients in Western Europe covering 37 currencies, with the U.S. and Asia to follow. The flexibility offered by Citi's solution allows clients to individually view transaction activity, manage online banking entitlements and generate Virtual Account statements. Virtual Account structures can be configured for a single entity or to support the OBO model of an IHB. Clients can harness additional transparency for accounts receivables by using Citi Virtual Accounts in conjunction with Citi Payer ID Accounts to further automate the reconciliation process. In addition to servicing treasury needs, the capabilities can also be used as a business enabler for emerging client segments including digital marketplaces and the sharing economy to segregate payment flows.

Virtual Accounts have multiple use cases, including liquidity optimization, segregation of flows and OBO payments; they support automation, reduce costs and enable companies to leverage a scalable framework across their ERP and banking infrastructure. Virtual Accounts address multiple pain points and support the creation of more efficient treasuries.

Virtual Accounts Infographic



*Credits and Debits take place at IHB Physical Account, flows are segregated by Virtual Accounts


BLOCK 01

Treasury and Trade Solutions
citi.com/treasuryandtradesolutions

1858652 06/19