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Increasing Rates Brings Account Analysis to the Forefront, Again

By Dan Gill,
Vice President – Client Facing Group,
SunTec Business Solutions

Now is the Time for Banks to Introduce Intelligent Account Analysis

The Federal Reserve has begun to increase short term rates and is expected to continue to push them up faster than ever before in an effort to push back inflation. This will have a cascading effect across other short-term rates including earnings credit in account analysis. Savvy banks now have even more options to use account analysis to provide value to their corporate customers. With rates sitting near zero for most of the past decade, the traditional account analysis statement has been little more than a bill for services. As rates climb, let's revisit account analysis and some of the opportunities it affords in the corporate banking market.

Where Did Account Analysis Come From?

Account Analysis in the US has its roots in the Great Depression. Among the many government responses to the crisis was the passage of the Glass-Steagall act. One component of Glass-Steagall was the prohibition of paying interest on corporate demand-deposit accounts (DDA).

Corporations continued to maintain large amounts of their liquidity in these DDAs even though those balances didn't offer any yield. Banks offered a variety of basic services to corporations at no charge simply because their large (no-interest) balances provided sufficient value to the bank. As the 20th century marched forward and the sophistication of corporate cash management and banking systems increased, banks began to offer innovative new "services" to their corporate clients. These services often required significant investment in technology and operational expenses for banks. And in the 1960s, banks began to charge their corporate client's transaction-related charges.

While corporate treasuries maintained millions in balances that offered no yield, they now found themselves being charged fees for check clearing and balance reporting. As technology improved and new services like lockboxes, wire transfers, reporting, controlled disbursements, ACH, and anti-fraud services emerged, banks now had a significant catalog of services that they could offer their corporate customers. This began a subtle but significant transformation of the banking world from the business of buying and selling money to provider of financial services.

While corporate treasury groups were happy to have these new products that increased the speed of cash management, the value of their deposits continued to be diluted. Banks then offered their corporate customers the option of paying for the services used either with a monthly fee, or by maintaining a sufficient average daily balance to offset their fees. This was made possible through a pretend interest on balances known as Earnings Credit Rate (ECR). Each month, the bank would aggregate the volumes of each service used on a corporate account and generate a charge. The average daily balances for the account would be calculated and a pretend interest, the ECR, would be applied. The account would then be "analyzed" to determine if the balances were sufficient to offset all the fees. And thus, Account Analysis was born!

Growth of Account Analysis

Earnings Credit was a completely made up thing. Since banks were not allowed to pay interest on DDA accounts, it could only be used to offset service charges. But it looked like interest and acted like interest and over time began to follow the trends in other short-term interest rates like the Fed Funds rate or 90-day T-Bill. The account analysis statement grew to be an important reporting tool for corporate treasury as well.

Typically delivered at the end of each month, it provides a valuable summary of how a company's cash management engine is operating. Over time, the account analysis statements from various banks became relatively standardized which helped treasurers get the broader view. In 1984, a fully electronic version of the account analysis statement known as the EDI 822 was released. Account Analysis remained a staple part of corporate cash management all the way up until the financial crisis that started in 2008.

The reserve reduction was a part of the traditional account analysis calculation whereby the balances that received earnings credit were reduced by the amount that the bank was required to hold in reserves. Typically, this meant that earnings credit received an automatic 10% cut reducing the value of earnings credit as compared to other yield opportunities. That all changed after the 2008 financial crisis.

Reserve Reduction

One of the core functions of corporate treasury is to maximize the yield on the cash assets of the company. Earnings credit was a way to get some value out of balances that could not be deployed for better returns. As an earnings mechanism, it was handicapped from its inception. While earnings credit looks like interest, it is available on only part of the average daily balance of the account and can only be used to offset service charges. In classic account analysis, the ledger balance was reduced by the amount of float, and something called the reserve requirement and increased by the number of covered overdrafts to arrive at a net investable funds (NIF) in the account. The NIF balance is where the ECR was applied.

Chasing Yield

2008 Financial Crisis

Just like the Great Depression led to the creation of Account Analysis, the 2008 financial crisis led to a situation that promised to turn it upside down.

- Dodd-Frank repealed the prohibition on hard interest on demand deposit accounts, and it seemed that earnings credit might be destined for the history books.
- Almost simultaneously, the Fed Funds rate dropped to near zero making both ECR and hard interest less interesting.
- The Fed began paying banks interest on their reserve balances and eventually dropped the reserve requirement to zero.

Considered independently, these factors could have resulted in a new age of bank fee billing in the US. Together, however, they have led to a decade of stagnation in account analysis. When your balances can only earn 15-20 bps in earnings credit, the account analysis statement is just another bill for services leaving corporate treasury struggling and bankers unable to differentiate themselves in a commoditized product market.

In traditional account analysis, many banks charged a fee for the insurance coverage provided by the FDIC. After the 2008 financial crisis, these fees increased greatly, while ECR was extremely low. This led to a situation where the cost to insure the balances in an account could be more than the balances earned.

The FDIC Fee

Time for Intelligent Account Analysis

As rates rise at a record pace in the coming months, the chase for yield will once again be a focus of corporate cash managers. Earnings credit will never be the best return on excess liquidity, but it can be a viable solution for companies that need to maintain readily available funds. Most banks will simply return to their old playbook for offering earnings credit. Smart banks will understand that we find ourselves in an entirely different situation than we have been in the past and offer corporate customers a more intelligent Account Analysis solution.

- Take a customer-centric view rather than a product-centric view
- Get visibility into the totality of the company's relationship with your bank
- Develop earnings and interest offerings that are a custom fit to each company Earnings Credit Only – Hard Interest Only – Hybrid
- Eliminate unnecessary reductions of earnings credit from reserve reductions and maybe even float
- Offer ECR and/ or Interest that are pegged to a standard rate
- Bring transparency to the fees and value that your corporate customers are receiving through intelligent statements, analytics, and open banking
- Implement strategic Deal Management processes and systems to shine on RFPs and negotiations that allow you to win and retain profitable business
- Get your product catalog, pricing, and Account Analysis out of the core without waiting to replace the core

While Account Analysis has been around for a long time, we have a significant new opportunity to apply modern technology to implement a much broader solution for our corporate customers.