SunTec®

It Is Time for Account Analysis to Become Intelligent

eBook

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Introduction

A question for all you corporate bankers and your customers: what looks and feels like a bill but is not treated like a bill? The answer: Account Analysis. Think about it- the monthly Account Analysis statement is a list of itemized charges for the various services used during the previous month, just like any bill from a vendor. What makes that bill an Account Analysis statement is the application of pseudo-interest to the balances held in the account known as Earnings Credit.

Neither Account Analysis nor Earnings Credit have changed much since they came into existence many decades ago although in this time, our world- and the banking industry- have seen many disruptive changes and paradigm shifts. Every part of banking is now exponentially faster, yet Account Analysis remains the same, old thing. We at SunTec believe that both corporate banks and their customers would be better off if Account Analysis (and Earnings Credit) were transformed. This eBook provides a brief historical perspective on earnings credit and account analysis and explains our view that it is time for Intelligent Account Analysis.

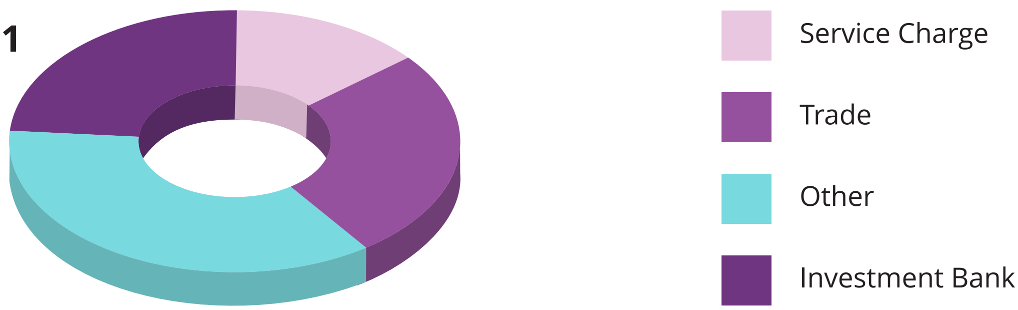
A Walk Down US Banking Memory Lane

For centuries, the main source of revenue for banks was the "buying and selling money." They would attract money in the form of checking/savings/time deposit accounts from retail and business customers and from this pool of funds, lend to both retail and corporate customers. The difference in the interest rates banks charged their borrowers and what they paid their depositors constituted their revenue; this is known in industry parlance as the "net interest rate spread." It is estimated that even now, the average bank earns almost two-thirds of its revenue from net interest rate spreads. Nearly one-third of banks' revenues today come from the services they provide to their customers.

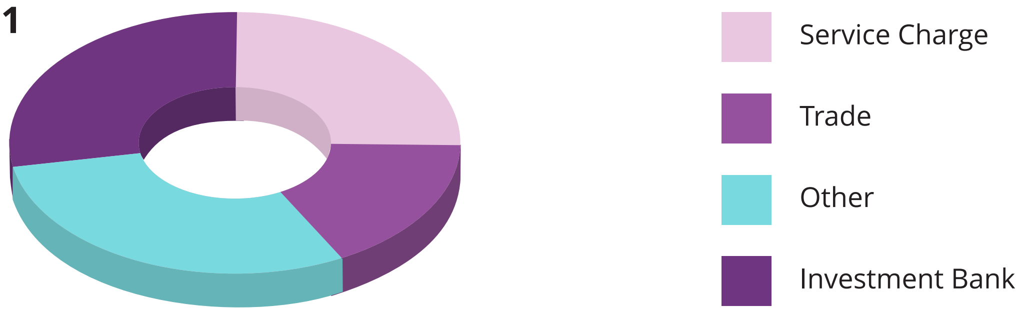
In the 1950s, US banks started providing corporate clients additional services such as merchant cards, trade finance, cash/treasury management, lines of credit, custody, forex etc. Not all of these were provided at the same time or by all banks; indeed, the evolution was driven by the needs of local communities and larger corporate customers. This was also the time when early mainframe computers began to be used in banking, to make record-keeping faster, easier, more accurate, and hence, more convenient. Each new product or line of business a bank added needed a separate module that became part of a core that, over time, became more and more complex and unwieldy.

FIGURE 1 - BREAKDOWN OF NONINTEREST INCOME

2001 Q1



2018 Q1



Source: Reports of condition and income (Call Reports)

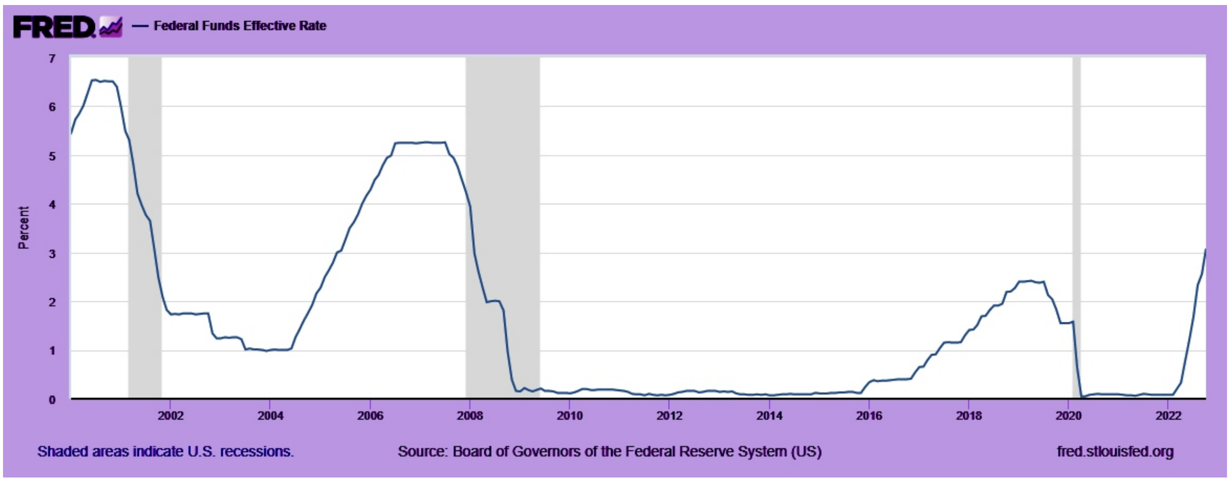
Until the early years of this millennium, the way banks operated was by and large stable; change was largely limited to hardware upgrades, addition of software to support new lines of business and/or changing business rules for existing products. Throughout the 20th Century both corporate and retail customers of banks largely relied on physical (paper-based) checks and other such instruments to send/receive funds. Wire transfers were an option but were much more expensive.

The process of making/receiving check-based payments required significant manual effort and took several days, or even weeks, to complete. During this time, the funds remained in the account of the customer issuing the check. The time between when a check was issued and when it was debited to the issuer's account was called "float." The float was an important factor that treasury teams in corporates kept track of as part of their overall cash management efforts because if they could smartly manage float over the many payments they made/received, they could minimize the need for short-term borrowings. In the processing of checks, banks added new products such as controlled disbursement and positive pay to make float management easier while also controlling fraud risk.

Although there was a lot of fear around Y2K, the transition to the current millennium was smooth. However, that was when the world changed forever because of two huge disruptions. The first was the rapid maturing of the internet and related technologies. The second was the tragedy of 9/11. The abrupt stoppage of all flights for a week meant that checks could not be quickly transported from one city to another leading to large-scale disruptions in payment processing. This led to innovation that greatly sped up payment processing including check scanning and the use of ACH and other electronic payment methods. This reduced the use of float as a cash management tool and gave banks a variety of new products that they could sell.

While payments were getting faster and new banking products were being added, a decade of relatively low interest rates in the US meant that net interest income for banks was reduced significantly. The emergence of digital payment platforms and treasury management systems has put further pressure on the revenue and margins of banks. This, coupled with significant regulatory activity after the 2008 financial crisis have reduced many of the reliable revenue streams of banks.

While regulators have focused a great deal on the fees charged to consumers, corporate bank fees charged through account analysis have continued to be reliable revenue streams.



Through all this, account analysis has largely remained unchanged. Increasingly, however, smart bankers and visionary CFOs are wondering why this element has not kept pace in an increasingly digital world where almost everything is "on-demand" and transactions can be completed in near real-time. It is in this context that we believe that account analysis has the potential to be a game-changer.


Series 2
5.60
8.52
8.74
1.08
5.54
3.03
6.00
5.78
4.32
7.56
5.90

Earnings Credit: The Backstory

To understand the concept of Earnings Credit, it is helpful to go back to the Great Depression that hit the US in 1929 and lasted till 1939. To stabilize the economy, the government of the day enacted various legislations. Regulation Q, and the Glass Steagall Act of 1933 made it illegal for banks to pay interest on demand/transactional deposit accounts. A ceiling was also placed on interest rates payable on time/savings deposits. The overall objective of these restrictions was to prevent more bank runs, while also encouraging corporates to invest money in avenues other than bank deposits, so that these funds could be used to goose the economy and create jobs.

Just as the US started to see the end of the Great Depression, World War II began. There was thus a prolonged period of global uncertainty, followed by a period of rapid economic expansion in the 1950s. In the 1960s, corporates started to realize that they were not getting any value even for the multi-million balances in their bank accounts. This led to the invention of pseudo-interest known as "Earnings Credit." This basically mimicked interest, in that it was calculated by applying a percentage rate to the customer's average daily collected balances. However, earnings credit rates were not regulated or set by the Federal Reserve. The key point about earnings credit is that it is not paid out; it can only be offset against bank charges. Banks followed a variety of schemes in how they calculated earnings credit. The customer's ledger balance would often be reduced by the amount of deposited items still in float and further reduced by the amount of balances the bank was required to hold in reserve. In addition, the fee for federal insurance on the customer's balances would also be charged causing a further reduction in the real earnings credit that was granted to offset service charges.

Banks realized that they could not provide the ever more complex services for free and started charging corporate customers for the services consumed. Every bank charged services in a slightly different way, and there was very little standardization across banks which made the Treasurer's job more difficult in trying to decipher what they were being charged for. Most banks levied charges based on criteria such as how many checks were processed, what route they took (i.e., where they were deposited), how many in-person bank teller transactions occurred in the month etc. Over time, banks expanded their services (trade finance, custody, forex, lockbox, etc.) and charged fees for providing those as well. Banks had one distinct advantage in collecting their fees in that they could simply debit the payment directly from the customers' accounts.

The 1970s saw the advent of account analysis statements, which was essentially itemized monthly bills with details of what services the customer had consumed, the applicable earnings credit for the month and the net amount payable based on offsetting the earnings credit against the charges. This gave corporate treasurers an important tool in managing their excess cash in that they could choose to pay the account analysis fees outright or maintain sufficient average balances to offset a portion or all of their fees.

Corporates often have multiple banking relationships. This situation, combined with the lack of account analysis standards meant that each bank's statement not only had its own rates/rules for service fees and earnings credit, but also differed in terms of formats and nomenclature for services and associated charges. For treasury teams, this made the task of cash management and reconciling bank charges and EC complex. The introduction of standard industry-wide codes helped simplify the job of treasury teams.


Market
Portfolio
Quote
Click
Bids Offers
Ticker
Technical
Info
DCA
Condition
More
1,535.98
-11.33
High
Low
1,552.78
1,533.52
+5.47
-13.79
Value
97,201.58 MB
Load indicator
Load Chart
1D
Credit Limit
Price:
Vol:
Limit
Cond.
BUY
SELL
Portfolio
Symbol
Start Vol
8,000
6,900
Avail Vol
8,000
6,900
Actual Vol
8,000
6,900
Avg Cost
58.00
64.03
Mkt Price
65.75
69.00
Amount (Cost)
464,000.00
441,807.00
Market Value
526,000.00
476,100.00

Why Both Banks and Corporate Customers Need Account Analysis to Be Transformed

In 2007-08, the global financial crisis was precipitated by investor greed, senseless risk-taking, anachronistic legislation, inadequate governance, and structural changes in the US and global economy. Recognizing the need for reform, the US introduced sweeping changes to domestic policies and legislations. The Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”) was a major component of this change. From the perspective of account analysis and earnings credit, perhaps the most important change ushered in by the new regulatory framework was the repeal of Regulation Q. 80 years after the Depression-era law was enacted to prohibit banks from paying interest on demand deposits, this restriction has been removed. In the current environment, this shift has two important implications:

- With hard interest now a possibility, we probably should have seen a reduction in the use of earnings credit. However, while hard interest was added to the bank’s toolbox, the Federal Reserve reduced short-term rates to near zero, where they remained until very recently.

- Today, we see the Fed rapidly reversing course on low rates, interest rates continue to rise and will likely remain elevated for some time. This gives innovative banks an opportunity to win new business through better treatment of their customer’s balances.

Two major structural shifts are occurring because of this digital transformation are:

- Fintech and bigtech players are changing the way customers send/receive money. These digital payment apps ride on banking infrastructure without having to incur the associated costs of real estate, people, and technology. For banks, this shift has led to a reduction in the number and nature of touchpoints between banks and their customers.

- Business ecosystems comprising various non-competing business enterprises are gaining momentum because they are inherently able to target customers more effectively and address a greater chunk of their needs- at a lower cost. Banks too are joining such ecosystems because they enable banks to acquire new customers and sell various services to them. Such models also enable banks to add a new and steadily growing revenue stream in the form of BaaS (Banking-as-a-service).

About SunTec Account Analysis and Its Features

- **An intelligent approach to Account Analysis that gives the smart banks a way to replenish the balances and look for new avenues to generate income.**
- **Faster account analysis help corporate treasury teams, given that these teams are responsible for cash management and work with multiple banks across different jurisdictions.**
- **Quicker data extraction from disparate product-specific siloed systems and different customer accounts without modifying the core banking system.**
- **By adding an intelligent layer to the existing core banking platform, customer and transaction data can be captured, analyzed, and used to generate not only reports but also actionable insights that can help banks negotiate better deals with customers and make better pricing decisions.**
- **Flexible pricing can be offered based on criteria such as relationship size, potential for growth, profitability, range of products consumed, and so on.**
- **Pro-rata account analysis can even be offered "on-demand" so that treasury teams can make better-informed decisions especially during times when interest rates change frequently.**

All these actions will not only help banks exhibit the agility that their customers expect, but also forge stronger ties with customers because banks can position themselves as "partners" to their corporate customers, and not just be a service provider.

It is in this broader context of becoming nimbler and more responsive to customers that we believe it is important for banks to transform the account analysis function. Doing so can enhance the ability of banks to diversify their revenue streams, something that will be especially critical in the current environment of high economic uncertainty and high interest rates.

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If you would like to know more about how SunTec can assist your bank in honing its competitive edge in these turbulent times, write to us on contactus@suntecgroup.com. If you have any feedback on this ebook, we would love to hear from you. Write your views to contactus@suntecgroup.com.

About SunTec

SunTec is the world's No. 1 pricing and billing company that creates value for enterprises through its Cloud-based products. More than 150 clients in 45+ countries rely on SunTec to provide hyper-personalized products, offers, pricing, loyalty programs, and billing for over 400 million end-customers. SunTec products are based on our cloud-native and cloud-agnostic, API first, micro-services-based proprietary platform, Xelerate and are delivered on-premise, on private cloud and as SaaS. SunTec has global operations including the USA, UK, Germany, UAE, Singapore, Canada, Australia and India. For more information, please visit us at www.suntecgroup.com or email us at marketing@suntecgroup.com