Virtual Accounts: Corporate Cash Management

FINEGAN SOLUTIONS

Virtual Accounts is a hot topic, filling page after page in specialised magazines and at Cash Management conventions around the world. They enable corporates to sub-divide a single physical bank account into an almost unlimited number of 'virtual' accounts. They offer corporates the same advantages as extensive physical bank account structures, while eliminating the costs of opening and managing accounts. This offers companies the means to rationalise their existing account structure, in theory, into one single 'real' bank account.

Companies have been aiming to centralise their cash and transaction management for several years now, both to optimise their working capital and to decrease the administrative burden. The most obvious move is to centralise treasury functions and reduce the number of bank accounts held. With this goal in mind, companies have been looking to adopt Payments On Behalf Of (POBO) and Collections On Behalf Of (COBO) structures, which see a central account issue and receive payments for a number of subsidiary accounts. Solutions are available but can be a heavy exercise from an implementation and maintenance point of view. Virtual accounts can now offer an alternative solution to these challenges, combining a simple implementation effort with the immediate benefits of efficiency and control. As such, banks are also picking up on the trend and have started to answer their clients' needs, with both Virtual IBAN and Virtual Account Management propositions.

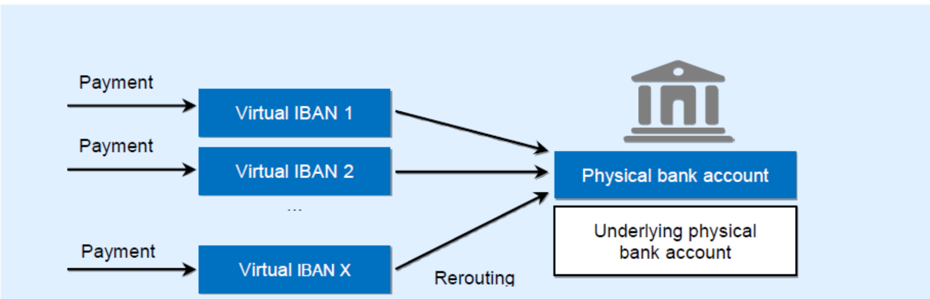

Image 1: Virtual IBANs as a reconciliation support tool

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Virtual IBANs are bank-issued IBAN references that are used to reroute incoming payments to another, physical bank account. From a company's client point of view, a Virtual IBAN looks and operates exactly the same as a real IBAN. Whenever a debtor pays to a Virtual IBAN however, the funds will immediately end up in the corporate's physical bank account to which the Virtual IBAN is associated. A corporate can hold numerous Virtual IBANs which reroute all incoming payments to the same physical bank account. Moreover, Virtual IBANs can be used to identify the purpose of the payment made. To this end, a corporate can go as far as to allocate a Virtual IBAN to each client, so that client X is the only one paying to Virtual IBAN X. This facilitates straight-through reconciliation and greatly reduces administrative costs.

Virtual IBANs are a sound value proposition to help corporates increase their reconciliation rates, which improves the Days Sales Outstanding and increases the available working capital. It also eliminates manual reconciliation effort needed, and allows companies to rationalise the number of accounts receivable (A/R) bank accounts held. In addition to the obvious reconciliation benefits, Virtual IBANs are already serious step towards centralisation.

Virtual Accounts as a centralisation support tool

Virtual Accounts in the true sense of the word, are sub-ledgers of one and the same physical bank account, which is often called the 'Master Account'. The Master Account is maintained in the account management system of the bank, and all the corporate's cash resides in this account. While all incoming and outgoing payments take place on the Master Account, they can be tagged as belonging to a specific Virtual Account, so that corporates can allocate funds internally without segregating them physically. A corporate could choose to open Virtual Accounts per business unit, per client, or for incoming and outgoing transactions – but also at different levels for all of these purposes. This gives treasurers control through increased visibility on their accounts. Since all funds are held in a central location, treasurers have a real-time view of cash flows across the company. This makes it easy to map out counterparty exposures and determine areas where action is required to mitigate risk. Yet despite this perspective, the Virtual Accounts are also a source of highly granular information. This combination of transparency and granularity is highly advantageous in today's rapidly changing world. Not only does it provide treasurers with a comprehensive overview of account activity, it also enables customer queries to be met quickly and efficiently. Hence helping the company to win the trust and respect of their clients.

Increased flexibility is perhaps the most appealing feature of Virtual Accounts. Digital innovation has made a significant contribution in this respect, with online self-service banking portals now enabling a company to manage their accounts independently of the bank. Thanks to this, new Virtual Accounts can be opened, closed or modified within seconds and without involvement from the bank. This is a drastic improvement that removes huge amounts of administration from the process. Virtual Accounts can be mapped out to exactly replicate a company's existing account structure, so that treasurers don't need to be concerned with structural changes, even as processes are adjusted and refined.

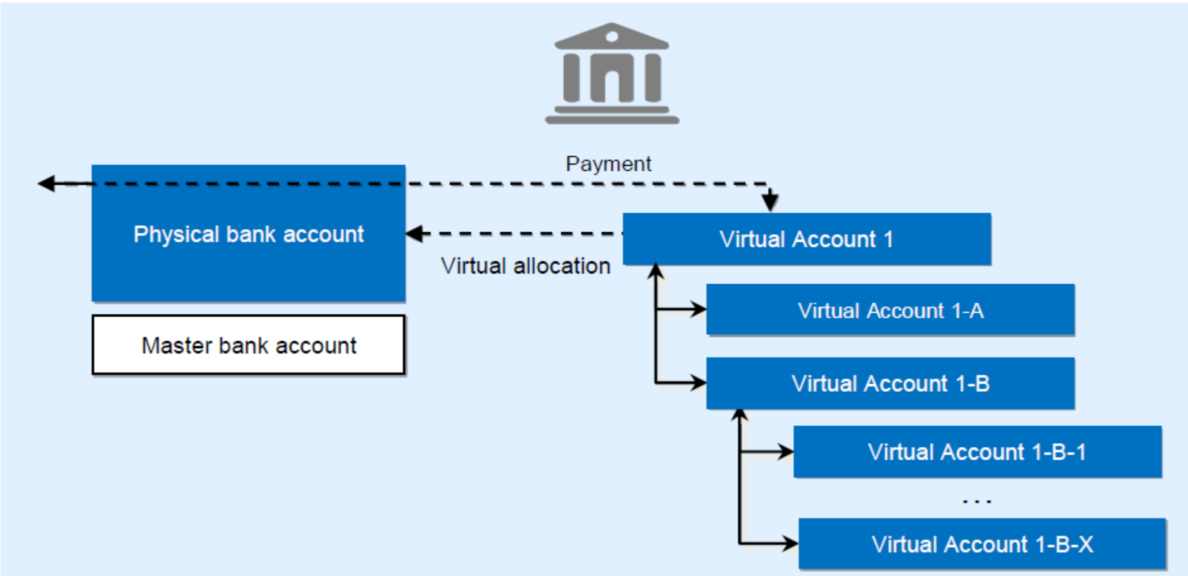

Image 2: Virtual Accounts as centralisation support tool

While Virtual Accounts are potentially beneficial to any corporate that uses physical bank account structures for its financial administration, the potential benefits of Virtual Accounts are higher for corporate groups. If a corporate group can centralise its cash, liquidity that is otherwise trapped in complex local bank account structures can be freed, improving available working capital substantially. Moreover, because all transactions take place on the Master Account, multi-entity Virtual Account hierarchies will enable the Master Account-holding entity to Pay On Behalf Of (POBO) and Collect On Behalf Of (COBO) Virtual Account-holding entities. Thus supporting corporate groups in centralising their cash management. With the addition of an Intercompany Loan Administration (ICLA) to calculate internal interests, the offer can even transform into a complete In-House Banking (IHB) proposition, fully delivered on-demand by the corporate's banking partner. Which is useful in order to avoid the many pitfalls associated with the internal implementation of such a complex system.

Clearing the path

Several legal and tax related challenges still need to be answered before banks can fully offer their own Virtual Account-based in-house banking propositions. For example, banks will need to decide whether Know Your Customer (KYC) procedures are required at a Virtual Account-holding entity level, and how extensive these procedures need to be. Banks are facing a new situation where Master Account-holding clients now have the ability to open accounts for entities that are not necessarily clients of the account-servicing bank. However, even without these issues tackled, banks have already started offering single-entity Virtual Account propositions. These combine reconciliation with corporate group centralisation through the integration of Virtual IBANs with the in-house banking software that advanced corporate treasuries already own.

By leveraging Virtual Accounts in the correct way, the benefits of reconciliation automation, POBO, COBO, and digitalisation are all within the grasp of corporate treasuries. With minimal implementation problems barring the way to get there. In light of these perspectives, Virtual Accounts in its different forms will be a guaranteed feature of the cash management landscape of the future.