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Cash management survey 2011: Cash gets central billing

by [Laurence Neville](#)

As corporate executives make cash management an increasingly important part of their treasury function, so transaction banks are realigning their businesses. Now it is increasingly part of the overall corporate relationship. Laurence Neville looks at the models the leading banks are adopting.

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TRANSACTION BANKING, THE process of facilitating buying and selling for companies and financial institutions, has never been the most glamorous of activities. To be sure, parts of the business might be able to claim romantic origins serving the merchants of Renaissance Italy while, at the same time, the contemporary industry is driven by the type of kit that is inevitably accompanied by hyperbole about bleeding-edge technology.

Nevertheless, the reality of transaction banking has been prosaic. Contract periods are long (for corporates anyway) resulting in a business cycle that seems positively lethargic compared with the cut and thrust of capital markets, for example. Moreover, despite liberal use of sophisticated widgets, much of transaction banking is broadly the same as it was five, 10 or 20 years ago – after all, the broad goals of companies and investors scarcely change.

As a result, although most large banks have always had big transaction banking businesses, what they actually did was seldom understood by the rest of the bank. Furthermore, while those banks valued transaction banking, there was little rationale to direct the brightest of their graduate hires towards such a sedate business – not given the potential thrills and rewards of collateralized debt obligations, for example.

Then Lehman Brothers imploded and the banking business changed for ever. Suddenly, a dull business became a safe business and the sticky, recurring revenues produced by transaction banking became among the most desirable in financial services. In next to no time, the flash suits of capital markets began circling transaction banking to find ways to share its growth and exploit its privileged access to C-level decision makers.

Meanwhile, financial regulators have worked to try to put in place structures that would make the banking business more stable and prevent a recurrence of the nightmare it has inflicted on the world since 2008. Despite creating some problems – most obviously uncertainty over the capital treatment of trade assets under Basle III – most of these measures strengthen the importance of transaction banking still further.

Consequently, the world's leading banks are engaged in an unparalleled retooling and restructuring of their transaction banking units to position them for increasingly tough competition. Indeed, we are entering the decade of transaction banking, according to Karen Fawcett, group head of transaction banking at Standard Chartered, which came **ninth globally for corporates** in *Euromoney's 2011 Survey*. "Its importance has been recognized by all banks; top talent is being attracted to the business and, as a result, innovation and competition will accelerate."

As stable as retail banking

While for many people in banking groups 2008 was the first time they ever noticed the transaction banking unit down the hall, unsurprisingly most of the big banks claim to have begun boosting the business long before the financial crisis. "Citi's global transaction services (GTS) business [which was ranked **first globally for corporates** in *Euromoney's* survey but **second for financial institutions**] has been a core business unit of Citi since before the financial crisis," says Francesco Vanni d'Archirafi, chief executive of GTS.

Fawcett at Standard Chartered says that "recognition of the importance of transaction banking came earlier [than the crisis] in 2005" while Luc Caulier, deputy head of global cash management at BNP Paribas, ranked **fifth globally for corporates** in *Euromoney's* survey, says that transaction banking has been an important focus for BNP Paribas for the past 10 years.

"When clients identify their top-five priorities you can address them all rather than having to refer them to another part of the bank"



Paul Simpson,
Bank of
America Merrill
Lynch

Nevertheless, as Vanni d'Archirafi concedes, the events of the past three years have served to underscore transaction banking's operational importance to clients. "GTS enabled Citi to respond immediately at the onset of the financial crisis, in close coordination with regulators and clients, to help ensure the financial system continued to operate with market confidence and our clients had greater visibility into their cash position," he says. "We also worked with our clients to preserve critical supply-chain ecosystems by extending finance to their key suppliers and distributors." The centrality of transaction banking to clients is also emphasized by Paul Simpson, head of global transaction services at Bank of America Merrill Lynch (ranked **fourth globally for corporates** in *Euromoney's* survey), who describes the business as "intertwined in the overall corporate relationship". He explains: "It is seen as part of clients' nervous systems: without payments to employees or suppliers a company cannot function."

Necessarily, as CEOs and CFOs at corporates have increasingly recognized that transaction banking is crucial to their business, it has become more important for banks. Moreover, given the volatility of recent years, transaction banking's ability to contribute steady earnings and liquidity has

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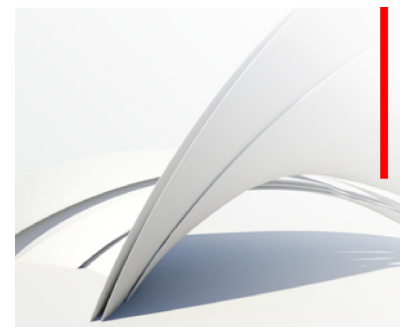


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further enhanced its attractiveness to banks. As Fawcett notes: "In 2008, transaction banking was the only business that kept moving. People realized that it is the bedrock of client relationships. Even in a recession, while the pace may slow, buying and selling continues." She adds: "During the financial crisis, market conditions proved problematic for those banks reliant on wholesale liquidity. Those reliant on transaction banking didn't have liquidity problems."

Only two banks break out transaction banking but anecdotal evidence indicates that it is not as lucrative as it was before the crisis. For the first six months of 2007, Deutsche Bank's global transaction banking had a pre-tax return on equity of 85%. "Now it has fallen to 65%, due to the acquisition of parts of the ABN Amro franchise in the Netherlands," explains Werner Steinmüller, head of global transaction banking and member of the group executive committee at Deutsche Bank, ranked **third globally for corporates** in Euromoney's survey. Nevertheless, it is still well above the 40% to 50% range that analysts expect from successful transaction banking franchises (and also well above the 18.9% pre-tax return on average active equity Deutsche posted overall at June 30 2011 or the 21% return corporate banking and securities earned over the same period).

Similarly, at Citi – where transaction services made a phenomenal 125% return on risk capital in the second quarter of 2007 – performance is thought to have declined (although Citi no longer puts out a return on risk capital figure for the business). Vanni d'Archirafi will say only that "transaction services makes very effective use of risk capital and holds over \$360 billion in core deposits for the company". Despite declining revenues – much of which can be attributed to falling interest rates – the return characteristics of transaction banking "remain very sticky," according to Simpson, making it ever more attractive given volatile earnings from other businesses.

As important as the operational benefits to clients and earnings benefits to banks of transaction banking is the broader appreciation of its characteristics by financial markets – a change that has been a spur to improving the visibility of the business within banks.

"All banks have recognized that analysts see transaction banking as at least as stable as retail banking, and as generating much-needed liquidity," says Steinmüller. Another leading transaction banker agrees: "It has always been essential to get payments and trade services right – otherwise you can't be in business. What has changed is the marketing." He explains: "When we talk to analysts we need to be able to explain that we do ordinary banking and are not just reliant on volatile markets."

Reshuffling the deck

Whether the change started before the financial crisis or after, it is clear that many leading banks active in transaction banking have undergone wide-ranging organizational change in recent years. Over the past 10 years, there has been an evolution with big banks bringing together various elements of transaction banking to gain economies of scale and enable the infrastructure spending required to compete in the top flight of the business.

The organization of transaction banking within each bank is necessarily determined by the relative importance of its commercial and investment banking units and its client split between corporates and financial institutions. The product grouping within transaction banking differs from bank to bank – some banks include investor services such as custody while some deliver cash and trade services jointly.

One distinction between banks is whether corporates and financial institutions are served from a single business unit. Most leading banks operate a single transaction banking business in to leverage the crossover benefits of platforms between client groups. Citi, Deutsche Bank, Standard Chartered and Bank of America Merrill Lynch are structured this way. Other banks – most notably HSBC – do not have a single transaction banking unit but instead exist to support corporates and financial institutions through other business units.

Within these two groups there are endless permutations with myriad reporting lines and often seemingly overlapping responsibilities and alignments: no one-size-fits-all model has been devised for transaction banking and there is no neat way to generalize about how banks are structured. Of importance – especially as transaction banking assumes a greater role within the broader banking world – is how transaction banking is represented at the top table within a bank's hierarchy.

Direct representation

Citi and Deutsche are the only banks that not only operate transaction banking as a line of business but also as a publicly reported entity. "Not all of the major banks in the industry have their transaction services division structured as a line of business, or operate as a globally managed business," says Vanni d'Archirafi at Citi. Unsurprisingly, he believes GTS's independence as a line of business is a contributory factor in its success.

At Citi, transaction services sits within the institutional clients group, which also includes securities and banking. Vanni d'Archirafi, as chief executive for global transaction services, reports to the president and chief operating officer of Citi (and CEO of the institutional clients group), John Havens. Vanni d'Archirafi also sits on Citi's operating committee, giving the business representation at the highest level.

Transaction banking at Deutsche Bank is run by Steinmüller as head of global transaction banking. As at Citi, transaction banking is part of the corporate and investment bank group, which is led by Anshu Jain (the future co-CEO of Deutsche Bank). However, transaction banking is represented by Steinmüller (who joined Deutsche from Citi in 1991) on the group executive committee.

Jain's fellow future co-CEO, Jürgen Fitschen (currently head of regional management worldwide), created the global transaction banking platform at Deutsche by bringing together the cash trade, trust and securities services businesses under one organizational roof. "So you can see that transaction banking is very much at the heart of Deutsche Bank," notes Steinmüller.

At BNP Paribas, transaction banking also has a place at the top table – although through a very different route. Caulier describes the business as having "the genetic footprint of a retail bank: we operate a daily banking business for customers and lend to them and work with them for a long time in areas that are essential to their business". As such, cash management is part of the corporate and investment bank but it also reports directly to the executive committee of the group. "It is managed by a governance board of BNP Paribas' top executives and the heads of various divisions at the commercial [and] back end," says Caulier. "That means that big decisions regarding cash management, such as infrastructure spending, require the whole group to focus on the business."

Broader representation

Other banks active in transaction banking are harder to categorize. BAML, Standard Chartered and some other banks operate transaction banking as business lines (rather than support services to other units) and are part of a broader group. However, each operates transaction banking as part of a different type of entity.

At BAML, transaction banking is part of corporate and investment banking and is, according to Simpson, more fully integrated with other product areas within its group than other banks. "The transaction services business sits alongside leasing, loans, capital markets, and mergers and acquisitions, and reports into global corporate and investment banking," he says. "It helps enormously in talking to clients because when they identify their top-five priorities you can address them all rather than having to refer them to another part of the bank." Simpson reports to Paul Donofrio, co-head of global corporate and investment banking.

Barclays has undergone a thorough shake-up of transaction banking – and strengthened its links with investment banking – in recent years.

"Previously, corporate and retail banking was run as a combined business," explains John Kelting, head of product, Barclays Corporate. In December 2009, corporate, which includes transaction banking, was realigned with investment banking. "The change greatly improved our ability to serve clients across the bank," he says.

Barclays Corporate, which has a core focus on lending, cash management, trade, FX and interest rate hedging, is divided into coverage and product on a global basis. "The head of client coverage [Kevin Wall] and I report to the CEO of Barclays Corporate [John Winter], who in turn reports to the co-CEOs of corporate and investment banking



"We need to be able to explain that we do ordinary banking and are not just reliant on volatile markets"

Werner Steinmüller, Deutsche Bank

"Remuneration for the product people is structured so they are indifferent to the type of client a product is sold to"

John Kelting,
Barclays
Corporate



[Jerry del Missier and Rich Ricci]," says Kelting. "The close cooperation between coverage and product is important: it ensures that our capabilities remain aligned with clients and that we efficiently allocate capital."

Meanwhile, at Standard Chartered transaction banking is one of four product groups (the others being financial markets, corporate finance and principal finance) in wholesale, which is headed by Mike Rees. He reports directly to Peter Sands, CEO of Standard Chartered. "There is a high-level allocation of resources between consumer and wholesale and then each division determines further allocation," explains Fawcett at Standard Chartered.

Transaction banking contributes 40% of client income in Standard Chartered's wholesale business and Fawcett says that there is a recognition that it is the bedrock of client relationships. "There is always balanced investment in financial markets [rates, FX, commodities and derivatives] and transaction banking," she says.

"Transaction banking can be tremendously affected by rates while financial markets are impacted by volatility. We take a holistic view when investing because each tends to balance the other out."

RBS stands out among a swathe of competitors that operate transaction banking within a broader group that includes investment banking. Instead, new global transaction services (GTS) chief executive Scott Barton reports to Chris Sullivan, who heads the RBS corporate banking division. Barton is a member of the group management committee but GTS is represented on the group executive committee by Sullivan. Although GTS is not part of the same business unit as investment banking, Barton is quick to add that it "has a close working relationship with global banking and markets and there is considerable internal focus to ensure that the two areas of the bank are aligned and have common goals".



"There is considerable internal focus to ensure that the two areas of the bank are aligned and have common goals"

Scott Barton,
RBS

HSBC's shake-up

HSBC, ranked **second globally for corporates** in *Euromoney's* survey and **first for financial institutions**, has perhaps the most idiosyncratic model in transaction banking.

It was refined further at the end of September in a shock move that abolished the global transaction banking business and precipitated the departure of its GTB head, John Coverdale, who had only been in place since March.

HSBC's GTB unit historically supported global banking and markets, which services large corporates and financial institutions; commercial banking, which services mid-caps and SMEs; and – to a lesser extent – private banking and retail banking. Relationship managers were responsible for lending, and other services, such as transaction banking, were positioned as support. As Coverdale told *Euromoney* shortly before his retirement: "A good analogy is of the relationship manager as a general practitioner doctor, who understands your requirements and has sufficient knowledge to point you to the right specialist."

The surprise structural changes at the end of September retain the same relationship between the constituent elements of what was HSBC GTB and the businesses they served – they will still operate as a support business to relationship managers. However, in line with CEO Stuart Gulliver's goal of stripping out layers of management at HSBC and improving operational efficiency, GTB itself has been disbanded. Instead, securities services will be managed by global banking and markets, trade will be part of commercial banking, and payments and cash management will be jointly managed by both those businesses.

Detractors have long claimed that HSBC suffers because of the absence of transaction banking representation at the top table, unlike at Citi. This latest reorganization will do nothing to change that: the head of securities services will report to Samir Assaf, chief executive of global banking and markets, while the head of trade will report to Alan Keir, global head of commercial banking and the head of payments and cash management to both men.

What will change, however, is that no one individual will be there to press the case for investment across transaction banking (despite the overlapping use of platform technology by corporate and financial institution clients).

Effective selling

While the organizational structure and reporting lines of transaction banking may be important, equally critical to the success of the broader banking group is motivating relationship managers and sales forces to promote transaction banking products. At HSBC, where transaction banking is a support service to other businesses, this is less of a consideration: transaction banking is not in competition with other businesses – the relationship manager simply pulls in expertise where it is needed and all businesses exist to support that relationship manager.

However, at most banks one of the most important challenges facing the transaction banking business is to ensure the relationship manager is given the correct incentives to sell appropriate products – rather than simply those that will generate the highest and fastest returns (and likely benefit them most financially).

"Our sales managers obviously sell a wide range of services and something like a bond mandate is clearly a more attractive immediate sales prospect than a transaction banking product," explains Fawcett at Standard Chartered. At the bank, relationship managers do the majority of selling for mid-market and local corporates while for larger clients the relationship manager brings in product specialists.

To give incentives to the bank's teams, Standard Chartered has a system that sets volume targets. "We devise strategies to take highly variable pricing out of the reward system for transaction banking so that a target might for example be set for relationship managers to increase cash deposits by 20% for a client – clearly if they were only measured on revenue, relationship managers would not get too excited about deposits in a declining rate environment," says Fawcett. "We are considering increasing the weightage towards transaction banking products – so they are rewarded more fully for every dollar of a transaction banking product than they might be for another."

At Barclays, under its new structure, clients are assigned a relationship manager in either the corporate business or the investment bank (Barclays Capital) depending on the size and nature of the client. "Products across corporate and investment banking are not ranked in order of importance so coverage bankers, either in the corporate or the investment bank, gain the same revenue benefits regardless of whether they sell an investment banking or a corporate product to their client," says Kelting. "Our job is to ensure that both our own and BarCap's relationship managers understand our products. Similarly, remuneration for the product people is structured so they are indifferent to the type of client a product is sold to."

Kelting says the new structure has proved extremely effective: "Since it was put in place, cross-selling has increased significantly for both corporate and BarCap. An important aspect of this was education about product capabilities internally so that bankers understood our full product capabilities, and which clients they are appropriate for."

The way in which clients receive coverage underwent a major change at Deutsche Bank in September 2010, when a new group within the corporate and investment bank group called capital markets and treasury solutions (CMTS) was established to provide debt capital markets, FX and transaction banking services to clients in an integrated way. "When the idea was first suggested I was somewhat sceptical because transaction banking ticket sizes are smaller than investment banking products, for example, and I was concerned that the sales force would therefore concentrate more on investment banking," says Steinmüller.

However, Steinmüller says that the new structure has proved highly successful because the long-term nature of transaction banking makes revenue recognition attractive to the sales force – a point echoed by Simpson at BAML: "The coverage people, who are part of our fully integrated [investment and transaction banking] model, are very supportive of GTS products because of their long-term, annuity-based characteristics". Steinmüller also stresses that his role on Deutsche's corporate and investment bank executive committee allows him to have a direct influence on the sales force. "CMTS has made for an easier conversation with corporates' treasury teams, and undoubtedly we have won mandates because of the structure that we would have otherwise lost," he says. "Fifty

percent of the incremental increase in revenue since CMTS was established can be attributed to the reorganization."

Boost for the top tier

All the main banks in transaction banking are seemingly steeling themselves to pursue the opportunities on offer. "The future for transaction banking is rosier than for many other parts of the banking world," says Fawcett at Standard Chartered. "In financial markets, for example, the move from OTC to exchanges as a result of Dodd-Frank will have significant economic implications. It is true that Basle III will increase capital requirements and that will affect transaction banking but at the same time, transaction banking will be boosted for being recognized as a critical generator of liquidity." She adds: "There will be challenges but the opportunities in transaction banking will become more attractive."

Simpson at BAML says that as markets evolve some areas of profitability will be enhanced. "There are new fee lines in supply-chain finance and risk management, for example," he says, "and while the final shape of Basle III is still evolving it will offer opportunities for scale players. Certainly, it will prompt some players to partner with another bank or withdraw from the market altogether. Basle III – and the broader focus on transparency – mean that the value of certain services will become clearer to clients and therefore the ability to price those services realistically will improve."

Indeed, while no one doubts that competition in transaction banking will become more intense in the coming years it seems inevitable that many of the challenges facing the business will be most easily surmounted by those already in the top tier of transaction banking. "It is a tough business to enter: you need not only a network, systems and people but also linkages with the rest of the bank – otherwise it can prove to be an expensive disaster," says Steinmüller. "What is certain is that Basle III, Target2Securities, Dodd-Frank, Emir, Sepa and other regulatory changes will lead to greater consolidation: even large regional banks could face challenges given the investment requirements," says Steinmüller.

Caulier at BNP Paribas agrees: "This business requires material investments in infrastructure. If you haven't got everything in place, then you won't be able to offer the quality of services that clients want."

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